

SPENDING REDUCTION PROPOSALS

HEARINGS
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
NINETY-SEVENTH CONGRESS
FIRST SESSION

—————
MARCH 17, 18, 19, 24, 25, 1981
—————

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CONTENTS

ADMINISTRATION WITNESSES

	Page
Berrington, Craig A., Deputy Assistant Secretary for Employment Standards, U.S. Department of Labor	356, 373
Donovan, Hon. Raymond J., Secretary of Labor	349, 351
Lewis, William B., Administrator, Unemployment Insurance Service, Employment and Training Administration, U.S. Department of Labor	354
Schweiker, Hon. Richard S., Secretary, Health and Human Services	11, 28
Stockman, Hon. David A., Director, Office of Management and Budget	94, 101

PUBLIC WITNESSES

American Association of Colleges and Universities, John P. Mallan, vice president for governmental relations	343
American Enterprise Institute, Dr. William J. Fellner, resident scholar	152, 155
American Federation of State, County, and Municipal Employees, Robert E. McGarrah, Jr., director, health and institutions	276
Angoff, Jay, Public Citizen's Congress Watch	326, 329
Ash, Roy L., on behalf of the Business Roundtable	374
Association of State and Territorial Health Officials, James Kenley, M.D.	336
Barber, Michael E., legislative representative for the California District Attorney's Association Family Support Council	305, 309
Business Roundtable, Roy L. Ash	384
Calhoun, John A., director, Center for Governmental Affairs, Child Welfare League	243, 247
California District Attorney's Association Family Support Council, Michael E. Barber, legislative representative	309, 310
Chamber of Commerce of the United States, Richard W. Rahn, vice president and chief economist	390
Child Welfare League, John A. Calhoun, director, Center for Governmental Affairs	247
Children's Defense Fund, Ms. Marian Wright Edelman, president	223
Edelman, Ms. Marian Wright, president, Children's Defense Fund	216, 223
Fellner, Dr. William J., resident scholar, American Enterprise Institute	152, 155
Heinemann, H. Erich, vice president, Morgan Stanley & Co., Inc.	168, 171
Houthakker, Dr. Hendrik S., Henry Lee professor of economics, Harvard University	158, 162
Kenley, James B., M.D., Commissioner, Virginia State Health Department	332, 336
Mallan, John P., vice president for governmental relations, American Association of State Colleges and Universities	341, 343
Marshall, Hon. Mary, delegate, House of Delegates, Commonwealth of Virginia, on behalf of the National Conference of State Legislatures	289, 293
McGarrah, Robert E., Jr., director, health and institutions, American Federation of State, County, and Municipal Employees	272, 276
Morgan Stanley & Co., Inc., Erich H. Heinemann, vice president	171
National Association of Counties, Robert Orth, Ramsey County Commissioner, St. Paul, Minn.	319
National Conference of State Legislatures, Hon. Mary Marshall, delegate, House of Delegates, Commonwealth of Virginia	293
Orth, Robert, Ramsey County Commissioner, St. Paul, Minn., on behalf of the National Association of Counties	314, 319
Public Citizen's Congress Watch, Jay Angoff	329

	Page
Rahn, Richard W., vice president and chief economist, Chamber of Commerce of the United States, accompanied by Eric J. Oxfield, employee benefits attorney, and Kenneth D. Simonson, tax economist, tax policy center.....	387
Virginia State Health Department, James B. Kenley, M.D., commissioner	386

ADDITIONAL INFORMATION

Committee on finance press releases	1, 349
Opening statement of Senator Max Baucus	2
Senator Baucus' questions to Secretary Schweiker and his responses	3, 8
Senator Dole's questions to Secretary Schweiker and his responses	6
Charts:	
HHS percentage of Federal budget.....	12
Growth in all Federal social programs	13
Social services block grant consolidates 12 programs	20-23
Shift in budget priorities	24
FY 1982 HHS budget changes	25
Prepared statement of Hon. Richard S. Schweiker, Secretary of Health and Human Services.....	28
Responses by Secretary Schweiker to additional questions raised by Senators Baucus, Bradley, Dole, and Long	58
Characteristics of General Assistance in the United States.....	67
Prepared statement of Hon. David A. Stockman, Director, Office of Management and Budget.....	94
Responses by Mr. Stockman to questions submitted by Senator Baucus.....	117
Letter to Senator Dave Durenberger from Janet Smith, legislative representative, National Association of Counties	324
Statement of Hon. Raymond J. Donovan, Secretary of Labor	351
Responses by Secretary of Labor Donovan to questions asked by Senator Moynihan.....	353
Response by Bert Lewis, Administrator, Employment and Training Administration, U.S. Department of Labor, to questions by Senator Charles Grassley.....	370

SPENDING REDUCTION PROPOSALS

TUESDAY, MARCH 17, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:10 a.m., in room 2221, Everett McKinley Dirksen Office Building, Hon. Robert J. Dole (chairman of the committee) presiding.

Present: Senators Baucus, Bradley, Byrd, Chafee, Dole, Durenberger, Long, Mitchell, Moynihan, and Roth.

[The committee press release announcing these hearings follows:]

[Press Release No. 81-111]

FINANCE COMMITTEE ANNOUNCES HEARINGS ON ADMINISTRATION'S SPENDING REDUCTION PROPOSALS

The Honorable Robert J. Dole (R., Kans.), Chairman of the Committee on Finance, today announced that on March 17, 18, 19, 24, 25, and 26 the Committee will hold hearings on the spending reduction proposals in the Administration's Program for Economic Recovery.

Health and Human Services Secretary Richard S. Schweiker will testify on March 17. Office of Management and Budget Director David A. Stockman and Labor Secretary Raymond J. Donovan will testify on March 18. The Committee will hear from public witnesses on March 19, 24, 25, and 26.

The hearings will begin at 10:00 a.m. in Room 2221 of the Dirksen Senate Office Building each day.

Requests to testify.—The Committee requested that persons desiring to testify during these hearings make their requests to testify in writing to Robert E. Lightizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, *not later than* Monday, March 16, 1981. Persons so requesting will be notified as soon as possible after this date whether they will be scheduled to appear. If for some reason a witness is unable to appear at the time scheduled, he may file a written statement for the record in lieu of the personal appearance.

Consolidated testimony.—The Committee urges all witnesses who have a common position or with the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Committee. This procedure will enable the Committee to receive a wider expression of views than it might otherwise obtain. The Committee urges very strongly that all witnesses exert a maximum effort to consolidate and coordinate their statements.

Legislative Reorganization Act.—The Committee observed that the Legislative Reorganization Act of 1946, as amended, and the rules of the Committee require witnesses appearing before the Committees of Congress to file in advance written statements of their proposed testimony and to limit oral presentations to brief summaries of their arguments.

The Committee stated that all witnesses who are scheduled to testify must comply with the following rules:

(1) All witnesses must include with their written statements a *one-page summary of the principal points included in the statement.*

(2) The written statements must be typed on letter-size (not legal size) paper and at least *100 copies* must be delivered to Room 2227, Dirksen Senate Office Building, *not later than noon of the last business day before the witness is scheduled to appear.*

(3) *Witnesses are not to read their written statements to the Committee, but are to confine their oral presentations to a summary of the points included in the statement.*

(4) *Not more than 10 minutes will be allowed for the oral summary.*

Witnesses who fail to comply with these rules will forfeit their privilege to testify.

Written statements.—Persons requesting to testify who are not scheduled to make an oral presentation, and others who desire to present their views to the Committee, are urged to prepare a written statement for submission and inclusion in the printed record of the hearing. Statements submitted for inclusion in the record should be typewritten, not more than 25 double spaced pages in length and mailed with five (5) copies to Robert E. Lighthizer, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building, Washington, D.C. 20510, *not later than* Thursday, April 9, 1981.

Senator DOLE. The committee will come to order.

Mr. Secretary, we are happy to have you here this morning. There will be other members. In fact, I think most members will be here within the next few minutes and we will proceed.

I think it is well to point out and I ask that the statement I have made be a part of the record.

Without objection, it will be made a part of the record.

[The statements follow:]

OPENING STATEMENT BY SENATOR MAX BAUCUS

Thank you Mr. Chairman.

Today the Finance Committee begins six days of hearings on President Reagan's proposed budget cuts for next year. But, before I ask any questions, I would like to make a few general comments about the President's proposals.

I agree with the President that spending must be cut, and I support reducing the budget by \$50 billion. I also intend to support a tax cut. These measures are necessary to help us fight inflation and to get the economy moving again. The President recognizes this, and has offered a bold and courageous program that he believes will result in lower inflation and higher productivity.

Now, the Finance Committee must decide whether to endorse the President's proposals, or to come up with its own. Like many of us, I have not made a final decision on that question. But, whatever we adopt, I hope will be fair and even-handed.

I am concerned that the Reagan proposals do not meet that criteria. Inflation affects all Americans—and an anti-inflation plan should make each of us give a little.

But more than that, I am concerned that we just don't understand the consequences of enacting the Reagan plan. The fact of the matter is that we don't have enough hard economic data to answer that question. The administration's forecasts are being disputed.

We don't know how long it will take for these proposals to have any effect. We have no way of determining how much these proposals would affect the poor, the middle-income or the rich.

For example, on the surface at least, the Reagan plan would appear to present several glaring inequities. But this committee, and Congress as a whole, is a long way from knowing whether that is true.

The Reagan program proposes eliminating 400,000 poor families from food stamp benefits while giving 546,000 affluent families tax reductions averaging \$27,000 a piece.

The program proposes to reduce by one-third to one-half the funds going to poor mothers and their unborn or very young children to provide them with adequate nutrition during this critical developmental period. At the same time, it provides over \$8 billion in tax reduction to families earning between \$80,000 and \$100,000 a year.

The administration also proposes to eliminate unemployment benefits to those out of work more than three months unless they are willing to take jobs far below the level of their job skills and employment history. At the same time, the administration would give a \$10 billion tax cut to families making \$50,000 a year.

I am not saying that each of these programs should be spared from any cuts. What I am saying, though, is that these cuts should affect all Americans—not just one segment.

Finally, for the past few weeks I have been discussing tax expenditures—the tax deductions, exemptions and credits that dot the tax code.

Tax expenditures will cost the Federal Treasury \$267 billion this year—yet, incredibly, no one knows whether they are accomplishing what Congress intended when it created them.

These tax provisions have a place in our tax code. Often, using tax expenditures is the best way to accomplish a goal that we believe is desirable. But, that should not exempt them from the same kind of congressional review that we give spending programs.

We will not complete that review in the short amount of time we have to work on the President's plan. But we can begin, and that is what I hope we will do.

Mr. Chairman, in closing, I would like to insert in the record a column from last night's Washington Star written by Eileen Shanahan entitled, "Reagan Is Offering More Questions Than Answers." This is a thoughtful piece, which I strongly commend to my colleagues on the committee.

SENATOR BAUCUS' QUESTIONS TO SECRETARY SCHWEIKER AND HIS RESPONSES

Question. On page 61 of your testimony, you propose that Federal funding for PSRO's should be eliminated at the end of 1983 to allow time for implementation of "health care financing reforms that promote competition."

What assurance will we have that your as yet undefined "health care financing reforms" will be more effective than PSRO's? Should we eliminate the PSRO's that are doing a good job before we can be sure?

Answer. It is not the concept of PSRO's which the Administration opposes but rather mandating of PSRO's nationwide when they have proven to be of highly variable quality and providing total Federal funding of such organizations when the private sector could absorb some of the costs. The PSRO's which have proved to be effective in controlling the quality and efficiency of health care will be funded through fiscal year 1983 and thus will continue to impact positively on Medicare utilization. During this phasing out stage, we expect the cost effective PSRO's to obtain private funding enabling them to continue to function. By the time the funding phase out is completed, we will have instituted our health care reforms to reduce any incentives for excessive Medicare utilization and costs.

Question. On page 60 of your testimony, you say that PSRO's are effective in some areas and not in others. Rather than eliminate all PSRO's, as you suggest, wouldn't it be better to retain the good performers and either upgrade or eliminate the ineffective PSRO's?

Answer. Requiring PSRO review as the national approach to controlling Medicare and Medicaid utilization has not worked and it should be replaced by other competitive approaches. However, we do intend to fund the most effective PSRO's during the two-year period in which Federal funding of the program is phased-out. After Federal funding expires in 1983, we expect effective PSRO's will become a component of the competitive market by contracting their services to private health care systems.

Question. You are proposing that Federal spending for Medicaid be reduced by \$15 billion over the next five years. Cuts of this magnitude could affect States very differently depending on a State's relative economic and fiscal strengths, the restrictiveness of its existing program, and the degree to which it has already adopted cost control measures. Such factors could combine to force some States to adopt unacceptable program cutbacks. Will you be able to tailor your proposal to fit the needs of the various States?

Answer. The proposed cap on Medicaid does not reduce the level of Federal spending below actual fiscal year 1980 expenditures. It does reduce projected Federal expenditures for fiscal year 1981 by \$100 million. Federal Medicaid expenditures in fiscal year 1982 would be allowed to grow by 5 percent over fiscal year 1981 outlays. Thereafter, until permanent reforms can be enacted, the rate of Federal Medicaid spending would rise with the rate of inflation, as measured by the GNP deflator.

Under the proposal, Federal expenditures would be allocated among States so that each State will maintain its current relative share of Medicaid spending. The neediest Medicaid beneficiaries would also be protected against loss of basic Medicaid benefits.

The proposal gives States great authority which they do not currently have to take steps to make their programs more cost effective without hurting beneficiaries. Examples of such alternatives which States could pursue under the proposal include hospital reimbursement rates set on other than a reasonable cost basis, including prospective reimbursement; competitive bid and bulk purchase arrangements; tar-

getting optional services for specific populations; and promotion of non-institutional long-term care arrangements. The Administration believes the degree of restraint required under the proposal can be achieved by most States through the additional flexibility provided in the legislation.

We recognize, of course, that a prolonged imposition of a cap on Medicaid expenditures without relieving the pressures contributing to the inflation of health care costs could indeed result in shifting a significant cost burden disproportionately onto State and local governments. That is why we have proposed the cap on Medicaid as an interim measure only. The Administration intends to propose legislation this year that will reestablish competitive market incentives for the delivery of health care.

Question. Can you explain to me how the Administration expects these (public) clinics to survive if Medicaid is capped if and other public health funds are cut by 25 percent?

Answer. The Administration's proposals give the States the authority and responsibility for decisions as to which health services (other than required services under Medicaid) will be funded. If the citizens of Montana agree that clinic services should be supported then they will be. The changes we are proposing will allow continued funding of the services the citizens of each State consider most worthwhile.

Question. What details can you give us with respect to the formula which will be used to determine the effect of the cap on a State-by-State basis?

Answer. We are presently refining the methodology for determining the amount each State will receive. We would be pleased to furnish this information to the committee as soon as it is available.

Question. On what basis will the 5 percent increase be formulated? Will it be on 1981 expenditures, 1982 expenditures? Or on a combination of years?

Answer. The base for the 5 percent increase will be the amount allocated to each State for fiscal year 1981 under the cap proposal.

Question. Mr. Secretary can you tell me how much more money Montana will lose under the cap, and can you give me any idea about how my State is going to be able to save any additional funds after these enormous cuts go into effect? Do you have figures on the loss of Medicaid funds for all States, and more importantly, have you determined what services will be lost nationwide?

Answer. I do not have State-by-State figures at this time because we are refining the method for setting each State's ceiling. I would be pleased to submit this information to the Committee when it is available.

The limits we are suggesting will constrain the excessive growth which has been occurring in the costs of the Medicaid program so that program expenditures are more in line with the overall economy. These are not enormous cuts. In fiscal year 1982, for example, the reduction under the cap will amount to only 3 percent of the projected Medicaid program spending which would otherwise occur.

There are many ways in which States will be able to save funds by making their programs more cost-effective, especially utilizing the flexibility which our proposal will provide. We believe each State will make adjustments according to its own needs and there is no reason to believe that effective services will be eliminated. Some examples of activities which have been suggested include targeting of optional services, replacing retroactive reasonable cost reimbursement with reimbursement methods which encourage efficiency, and competitive bid and bulk purchasing of certain items and services (such as durable medical equipment and laboratory services).

Question. In an attempt to reduce hospital costs, some States have created hospital cost review commissions. Results of this effort appear favorable in comparison to States where there are not authorized commissions. What will be the Department's role in cost-sharing with States in regard to demonstration projects which will test the efficiency of various types of State options for containing hospital costs?

Answer. The Department of Health and Human Services (DHHS) has been very active in supporting State initiated hospital cost containment demonstration projects. Over the last several years, DHHS has financially supported the development efforts of most State rate setting programs and cost review commissions including Connecticut, Maryland, Massachusetts, New Jersey, New York, Rhode Island, and Washington.

DHHS also granted Medicare and or Medicaid waivers to test the Maryland, New Jersey, Rhode Island, and Washington demonstrations and supported part of the operating costs of these State systems during the demonstration period.

The Department is now reviewing Federal strategies to control health care costs in the context of a pro-competitive initiative and support for State rate-setting commissions will be part of that review.

Question. Claims have been made that large numbers of people will be removed from the AFDC program and the Medicaid program because of the proposed cuts. How many people do you expect to see dropped from the rolls?

Answer. The net effect of the mandatory AFDC eligibility changes proposed by the Administration is projected to be a 400,800 family reduction in AFDC recipients.

Translated into Medicaid terms, this means that States will not be required to cover those 400,800 families for Medicaid.

However, it should be noted that many of these individuals would be those who have opportunity for employment or who may be already employed intermittently or at low income levels and would likely have medical coverage under employer plans. These would include individuals over 18 years of age, strikers, students, and those with limited incomes and large families.

In addition, States have the option to provide coverage to individuals who have income above the cash assistance limits—the “medically needy.” Thus, individuals who lose AFDC coverage under the Administration’s proposal may continue to receive Medicaid if the State chooses to cover them as “medically needy” people.

Most of the AFDC changes proposed affect how income will be calculated, e.g., standardizing disregards (in counting income), permitting States to consider receipt of other benefits, counting income of stepparents, requiring retrospective accounting. The Administration also proposes to limit AFDC eligibility to people whose gross income is less than 150 percent of the State’s “need standard.”

Question. Secretary Schweiker, you indicated in your statement the elimination of Federal involvement will allow State and private insurers to make their own decisions regarding the most appropriate form of utilization. Inasmuch as the Administration is proposing to also eliminate PSRO and utilization review for our Federal Medicare program, what does the Department have in mind as the most appropriate form of review for Medicare expenditures?

Answer. We believe that certain review mechanisms already in place will encourage the private sector to assure that utilization is controlled. For example, private accrediting organizations such as the Joint Committee on Accreditation of Hospitals (JCAH) and the American Osteopathic Association (AOA) require performance of utilization review and other types of quality control activities. Continued expansion of alternative delivery systems such as financially viable Health Maintenance Organizations (HMOs) and other health care systems with incentives to control utilization should encourage more self-discipline in the more traditional systems.

Most important, we expect to have pro-competitive health care financing reforms in place by 1983, prior to elimination of the PSRO program in 1984. These reforms will provide strong incentives to providers to deliver care cost-effectively and will thus encourage them to carry out aggressive utilization review where it is useful.

Of course, we are not proposing to totally eliminate the responsibility of HCFA and its agents to take actions to assure that program payments are made only for services that are medically necessary and appropriate. Medicare carriers and intermediaries, as part of their claims processing functions, will have the basic responsibility for these activities. We will continue to monitor trends in utilization and, should significant problems arise, consider alternative review trends.

Question. The Administration proposes to collapse and consolidate a number of HHS programs into four block grants. Each block would be cut by 25 percent.

(a) What has the Administration decided about reallocation of funds from one block grant to another?

(b) What about redistribution of funds from block grants to cover anticipated deficits in the Medicaid program?

Answer. (a) Up to 10 percent of the funds under any block grant could be used for the purposes specified under the other block grants.

(b) Many of the current programs which will be included in the block grant serve medically underserved and poor individuals. Many of these individuals are currently covered by Medicaid. While the block grant funds cannot be directly redistributed to the Medicaid program, they can be used to provide services to individuals not eligible for Medicaid. Thus, block grant funding can complement Medicaid.

I would point out, however, that our proposed legislation will afford the States additional flexibility in the operation of their Medicaid programs which will enable them to maximize the impact of Medicaid.

Question. The Administration proposes to block grant a series of health programs, including the Title V Maternal and Child Health and Crippled Children’s programs and to then reduce the amount of funds to States by 25 percent. I am especially concerned about this issue since Federal statistics show that the cost to the States of administering Medicaid is only about 5 percent. Unless the cost of administering other health programs is 5 times higher, the Administration’s proposed reduction

will make substantial incursions into the amount of money States spend to actually deliver health services.

Answer. The Administration does not assume that there is a 25 percent element of administrative waste in the programs to be included in the block grants. However, we do believe that there will be reductions in administrative costs and other savings as a result of transferring administration of these programs to the States. There will be no need for elaborate annual applications for a whole series of individual projects. Funds not needed for one purpose will be able to be shifted to other purposes, rather than being spent in low priority areas just because the categorical grant requires it. There will be few Federal program requirements, permitting States to make judgments about program expenditures. All of these factors will serve to reduce administrative costs.

SENATOR DOLE'S QUESTIONS TO SECRETARY SCHWEIKER AND HIS RESPONSES

Question. There has been a distinct Federal commitment to Maternal and Child Health (MCH) since 1912, and since 1935 with the Title V legislation, States have designated Agencies responsible for MCH and Crippled Children's Programs.

Do you feel that this Federal commitment should continue? In light of the proposed changes, how do you think the Department will manifest its commitment to MCH?

Answer. There continues to be a Federal commitment to maternal and child health, as well as to the interests represented to date by the other categorical programs included in the block grant. But the manifestation of that commitment will no longer consist of a Federal agency making choices about where, when and how services are delivered.

Under the current Title V authority, States do have flexibility in the use of funds to improve the health of mothers and children. Some, like Alabama, have had considerable success in using this flexibility to attack those areas of the State with very high infant mortality rates.

With the block grant, States will have the flexibility to coordinate primary care, family planning and maternal and child health services, so that all pregnant women and children in need will be served.

Question. As the Social Security law currently stands, a small segment of the SSI program is administered by Title V Crippled Children's Agencies. In view of the repeal of Title V with the block grant proposal, where will this program be administered?

Answer. The SSI Disabled Children Program is included in the Health Services Block Grant along with Title V. Funds will be provided to the States, which may choose their own way of providing those services they see as necessary for disabled children.

Question. In what specific areas do you expect to provide the States with flexibility?

Answer. We expect to provide broad authority for extending flexibility to States, rather than flexibility in only a few specific areas. We can, however, give you some examples of the kinds of activities in which States have indicated an interest and for which flexibility would be provided:

- targeting optional services to specific populations;
- competitive procurement and bulk purchase arrangements for durable medical equipment and laboratory services;
- reimbursing hospitals on a basis which encourages efficient delivery of care;
- removal of impediments to contracting with HMOs in medically underserved areas; and
- eliminating impediments to developing cost-effective community-based care to the mentally retarded, the mentally ill, and the elderly.

Question. What is your response to those who would suggest giving the States flexibility and waiting for the results prior to implementing a cap on the program?

Answer. Providing flexibility to the States, without a cap, will not assure that the necessary steps are taken to restrain the program's excessive growth. The Medicaid program has increased in cost an average of over 15 percent a year for the last five years. The projected Federal expenditure for the program this year, without a cap on spending, is almost \$17 billion. The economic condition of the country requires that the growth of the program be more in line with the general economy.

The cap increases the incentives for States to control costs.

It provides States Medicaid programs with a budgeting device that encourages the hard tradeoffs that tend to be ignored in an uncapped program.

It changes the expectations of providers by signalling to them that the money is limited, encouraging cost-efficient behavior.

It provides a brake on increases in expenditures.

It eliminates the incentive to maximize Federal reimbursement even where it means higher total costs.

Question. The Administration has indicated a desire to return to the States the design and administration of the Medicaid program. You describe the cap as an interim program. What do you anticipate long term?

Answer. In the long term we expect to have a program which takes advantage of the efficiencies provided by a competitive market place. We are currently developing our proposals for reform of the health financing system and Medicaid to accomplish this. We anticipate providing specific proposals to the Congress within the next year.

Question. Aside from reducing Federal expenditures, what do you hope to accomplish by the inclusion of Title XX, social services, Child Welfare, and the like, into a single block grant?

Answer. We believe the block grant will allow a more rational, streamlined structure of social services to those who need them.

The current categorical structure requires specific amounts of funding in specific categories. These national requirements may or may not match the needs in any particular state. In addition, the multiple requirements for eligibility and separate program requirements make it extremely difficult for State and local officials to coordinate programs and eliminate gaps or overlaps in services delivery.

Under the block grant, the States will be in a position to allocate program resources, based on their knowledge of the needs of their particular populations. They will also be able to coordinate programs for a more efficient use of funds and more effective delivery of services.

Question. A controversial element of the Administration's proposals relates to foster care and adoption assistance, two programs that were newly created last year. Since you now propose to consolidate these programs into a social services block grant, I would be interested to hear how you justify their inclusion.

Answer. As in the other programs included in the block grant, we think the States are in a better position to allocate resources to meet the specific needs for foster care, adoption assistance, and other child welfare programs in their states.

We are aware of the concerns about foster care services that were expressed in Public Law 96-272, the Child Welfare and Adoption Assistance Act of 1980, and the need for change in the current systems. We believe that changes can and will be carried out effectively by the States.

Categorical funding did much to create the problem in the first place, through unlimited payment for foster care as opposed to adoption assistance. The block grant will allow funds for all these services, without creating an incentive for one type of service over another.

In addition, the public debate surrounding Public Law 96-272 has done a great deal to arouse public awareness of the problem, and we think the states will act responsibly to carry forward the necessary solutions. States such as New York, California, and Illinois were at the forefront in dealing with problems of foster care and pushed for Federal legislation. They will continue their commitment. States currently and in the past have contributed many more funds for child welfare services than has the Federal government. (It is estimated that in 1979, combined State and Federal expenditures were \$800 million, with State spending about 93 percent of that.)

Finally, the Department will continue to support the States in improving foster care and adoption practices by researching best practices, providing technical assistance, and assisting in exchange of information among the States where this would be most useful.

Question. What is the total impact of the administration's cutbacks on student benefits such as Social Security, BEOG, GSL, etc?

Answer. The Administration's proposals regarding Federal assistance for post-secondary education are designed to improve the target efficiency of the allocation of Federal assistance by focussing it on students who demonstrate a need for assistance in order to pursue a course of higher education.

SSA estimates of the size of the reductions in Title II student benefits and OMB estimates of the additional costs to the Pell Grant (BEOG) program due to people who would be newly eligible or who would receive higher benefits because of the proposal to phase out social security student's benefits are presented below (in millions of dollars).

	Fiscal year—				
	1981	1982	1983	1984	1985
Title II	-\$35	-\$1,030	-\$1,675	-\$2,075	-\$2,225
Pell		(+ 30)	(+ 50)	(+ 75)	(+ 100)

Social security paid about \$1.6 billion in benefits to post-secondary school students in fiscal year 1980. By comparison, post-secondary educational assistance for fiscal year 1982 under the President's economic program demonstrates that the grant and loan programs will continue to be the main source of assistance to post-secondary students and will be available to low-income students whose benefits under social security will be reduced or eliminated.

More than \$5.6 billion in direct budget authority for the Pell grant, work-study, direct loan, supplemental grant, and guaranteed student loan program will be available.

More than \$500 million in State and institutional matching funds and collections of prior loans will also be available for student assistance.

In addition, it is estimated that about \$5.7 billion in loans from banks and other lending institutions will be available as part of the guaranteed student loan program.

A more detailed breakout of these amounts for fiscal year 1982 follows.

Fiscal year 1982 Student Assistance for Higher Education

	<i>Millions</i>
Pell grants.....	\$2,486
College work study.....	550
(Institutional match).....	(40)
SEOG	370
State student incentive grants.....	78
(State match).....	(78)
Direct student loans.....	286
(Institutional match).....	(32)
(Collections).....	(380)
Guaranteed student loans.....	¹ 1,865
(Lending institution loans).....	(5,700)
(Families).....	(2,300)
(Students).....	(3,400)
Federal BA.....	5,635
Matching and other	530
Bank loans	5,700
Total	11,865

¹ Covers subsidies.

It should be noted that the President's program is intended in part to stop the skyrocketing increases in educational costs. This will benefit all students.

ANSWERS TO SENATOR BAUCUS' QUESTIONS ON WORKFARE AND WIN

Question. 1. The Administration's proposed work provisions appear to closely resemble than (sic) Governor Reagan's Community Work Experience Program and the old Community Work and Training Program under the Social Security Act. Both were abandoned after several years. A number of other similar work programs also had very little success. Why will this proposal be any more successful?

Answer. This is the first time that Community Work Experience Programs will be required in all States. The original Community Work and Training Program enacted by Congress in 1962 and phased out in 1967, was voluntary. Those States not interested in workfare ignored it. The subsequent California program from 1971-74 was only a demonstration program. While its success can be debated, it is clear that many California counties took little if any interest in administering it.

In contrast, the current CWEP proposal has the full backing of the Administration. Both the White House and the Department of Health and Human Services are committed to its success. Furthermore, much stronger interest has developed in the States for establishment of CWEP programs.

Question 2. Will the states and local governments be able to create enough jobs for all those mothers who are required to participate and who cannot find private sector work? Do you know how many people will be eligible? Do you have any estimates by state or local jurisdiction?

Answer. We do not expect creation of CWEP jobs to be a major problem. Of course, the number of jobs States create will to a great extent depend on how each State designs its program to fit its specific needs. States and local governments will have considerable flexibility in the types of jobs they create. Several States have come up with a variety of creative jobs for workfare programs involving general assistance recipients. Many involve services formerly provided by volunteers—work in schools, libraries and senior citizen centers. Day care and home repairs for the elderly are other examples of possible CWEP jobs.

We estimate about 1.5 million individuals will be potentially eligible for the Community Work Experience Program. That includes the number of recipients in the WIN unassigned pool plus the number of AFDC parents with children between the ages of three and six, and recipients excluded from WIN because of remoteness.

We do not yet have available an estimate of potentially eligible individuals by State or locality. This will depend to a large extent on demographic characteristics of the AFDC population. A rough estimate can be computed for each State by multiplying the 1.5 million potential CWEP eligibles by the percentage obtained from dividing a State's AFDC population by the national AFDC population.

Question 3. The evidence gathered from past work experience programs suggest that work programs such as this can be very complex (because only part-time work is required) and costly to run. Who will pay for running the program?

Answer. Costs for the program should be limited. The proposed legislation specifies that participants are not entitled to a salary or other work and training expenses provided by other laws. Transportation and other expenses will be limited to \$25 per month. Federal financial participation will be available at the present 50/50 matching rate for all administrative costs associated with CWEP. Furthermore, we expect CWEP to achieve overall savings for the following reasons:

Some recipients will secure employment and become self-supporting;

Some savings will result from the elimination of fraud (e.g., some recipients have unreported earned income); and

Some recipients with other potential sources of support (e.g., parents) will not apply.

Recent welfare-reform demonstration projects have shown that when individuals are required to report daily for structured job search, many drop out of the AFDC program. In Lowell Massachusetts, 7.9 percent of the participants requested that their cases be closed. In Weld County, Colorado, the AFDC unemployed parent caseload immediately dropped by approximately 25 percent when the job-search requirement was introduced. The benefits from this program will far outweigh the costs.

Question 4. What provisions will be made for child care for working mothers in the face of proposed cuts in the AFDC child care deduction and in the Title XX program?

Answer. States may develop day care CWEP projects and have participants care for children of other AFDC parents who are working or participating in CWEP. This will alleviate potential problems caused by program cuts.

Question 5. At what wage rates will recipients have to work off their benefits? At the minimum or prevailing wage rate? Will the program follow the principle of equal pay for equal work?

Answer. The CWEP program is not intended as a means for recipients to work off their benefits. The proposed legislation makes it clear that welfare benefits will not be considered as compensation for work performed under CWEP. The CWEP program is intended to enhance the employability of participants through actual work experience and training. However, the maximum number of hours that a State can require a participant to work will be based on the Federal or State minimum wage (whichever is greater).

Question 6. What guarantees will you have that welfare workers will not displace low-skilled employed workers?

Answer. The proposed legislation provides that a State CWEP program shall not ". . . result in displacement of persons currently employed, or the filling of established unfilled position vacancies."

Question 7. Will the same services now provided to AFDC mothers under WIN be provided?

Answer. The proposed Community Work Experience Program will complement rather than displace the existing WIN program. The services provided under CWEP will not duplicate those provided under WIN. It will enable States to provide work

experience to recipients who are actually receiving employment services under the WIN program. Although States may utilize the State public employment office to find employment opportunities, CWEP will not engage in extensive counseling, training, or subsidized employment as currently authorized under the Work Incentive program.

Question 8. Why establish another program when the WIN program is available?

Answer. Under the current WIN program, the majority of employable AFDC recipients do little more than register with WIN. Furthermore, it is impossible for WIN to find employment or training for every employable recipient. Approximately 800,000 individuals are now in the WIN unassigned recipient pool. CWEP would fill in these gaps and participate in WIN.

Question 9. Will you provide for the latest available fiscal year the following information about WIN: (Note: States are required to submit this information monthly to DOL.)

(a) How many AFDC mothers participated in WIN?

Answer. During fiscal year 1980 DOL reports that 2,189,792 adult recipients were registered with the WIN program. Of these 1,624,857 were female and 564,935 were male. This figure includes a small number of teenage youths not attending school as well as heads of households.

(b) How many AFDC mothers moved off AFDC completely because they found jobs through WIN?

Answer. DOE reports 140,302 as leaving AFDC due to employment. (Not necessarily through WIN).

(c) How many AFDC mothers saw their AFDC grant reduced because they found jobs through WIN?

Answer. DOL reports that 207,150 entered employment but continued to receive AFDC supplemental benefits in fiscal year 1980.

(d) What was the total amount of AFDC grant savings because of mothers into employment through WIN?

Answer. DOL reports an annualized AFDC grant savings figure of \$632,352,438 for individuals entering employment. (assuming all are attributable to the WIN program).

ADDITIONAL AFDC QUESTIONS

Question 1. The Administration proposes to cut back substantially on the earnings disregards that determine initial eligibility for AFDC as well as on the work incentive deductions considered in computing AFDC grant supplements. This will make many people ineligible for AFDC if they have jobs and substantially reduce the AFDC supplement grants of many others. Won't this approach force many mothers ruled ineligible for an AFDC grant to abandon work in favor of full dependence on AFDC in order to preserve their Medicaid eligibility? Won't substantially reduced AFDC grants for working mothers who do qualify make it uneconomical to work and force them to leave work in favor of full dependence on AFDC?

Answer. Anyone receiving AFDC benefits who voluntarily leaves a WIN job without good cause can be subject to sanctions and removal from the grant if he/she refuses to participate. The same sanctions will apply to persons refusing to participate in CWEP. Further, in the 33 States that provide Medicaid to individuals not eligible for a federal cash assistance program, AFDC ineligibility does not automatically result in Medicaid ineligibility.

Question 2. The Administration proposes to end a working mother's supplemental grant after four months of work. Won't many mothers find that they cannot afford to continue working because of work related expenses including child care? What assurance can you provide that they will not leave work in favor of full dependence on AFDC?

Answer. The premise upon which this question is based needs clarification. Only the \$30 and one-third disregard is terminated after four consecutive months; recipients would remain eligible for work expense and child care deductions. As discussed in the previous question, leaving work is not a guarantee that one may avoid the work requirement or even remain eligible for assistance.

Senator DOLE. This is the first of a number of days of hearings on the spending cut part of the administration's economic recovery program.

Yesterday, the committee, by unanimous vote, did adopt the numbers as suggested by the administration, \$9.3 billion in spending reductions, and also the figure for tax reduction.

I would hope that we can begin consideration of the revenue part of the proposal in the very near future.

I might say that I was very impressed with the Secretary's appearance on Sunday. I had a chance to watch Secretary Schweiker do an excellent job on "Issues and Answers."

I think he touched on a number of things that I have outlined in my statement. Of note is the fact that during the 10-year period from 1971 to 1980, the Federal Government outlays grew from \$211 billion to almost \$580 billion.

In 1981, spending is estimated to reach \$655 billion. And, even in the Reagan budget, it is estimated to be \$695 billion next year.

So, I would just suggest that spending is going to continue—is going to be increased. We are trying to slow down the growth of spending in some areas and I would just hope that we can—I think we can in this committee in broad nonpartisan, or bipartisan manner support efforts to get a handle on inflation and spending—at least for myself I pledge to the Secretary cooperation in an effort to find ways that we can reduce the spending in the areas that we have jurisdiction.

And again, without impacting on the needy and others. The so-called safety net as outlined by the President.

So, we welcome you here this morning.

Senator Long, do you have any comments?

Senator LONG. Let me make just one addendum to that. I am inclined to think, Mr. Chairman, when we talk about these levels of spending, that we might do well to discuss them in terms of constant dollars, because the cost of everything has increased. No matter how you figure it, I think you will have a more accurate basis if you cite numbers in terms of what those dollars will buy at that point.

President Reagan made that point in his fireside chat and he was correct. I think the very same point ought to carry over in the figures we use from time to time when we see how much we are doing in terms of spending.

For example, whatever figures you used to show growth in social welfare spending would be somewhat lower if you take out the inflation. Social welfare spending has been going up and we do want to bring it under control, and the areas you mention are ones where we want to do it.

I agree with what you want to achieve.

STATEMENT OF RICHARD S. SCHWEIKER, SECRETARY OF HEALTH AND HUMAN SERVICES

Secretary SCHWEIKER. Thank you, Mr. Chairman and Senator Long.

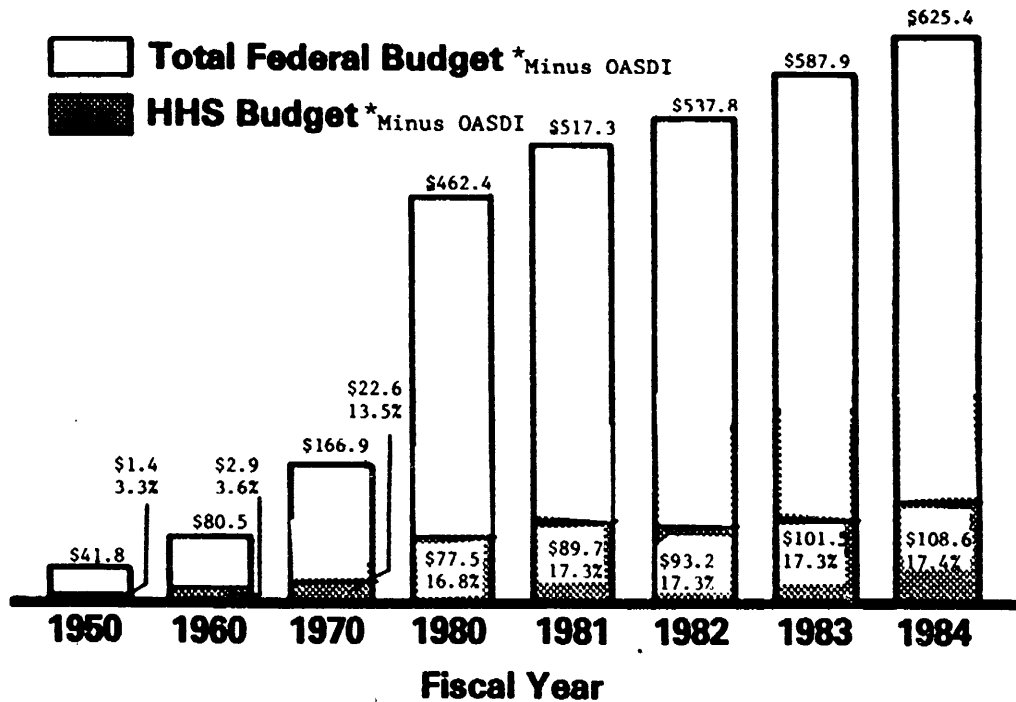
First, let me thank you for your indulgence. I had a meeting with the President this morning. I'm sorry I'm a little bit late. I apologize for that.

I'd just like to take a few minutes to show a few figures that I think tie into both the points that you are making here this morning, if the committee will indulge me.

Mr. Chairman, Senator Long, I think this is really the key chart in terms of why the Reagan administration has put forth the budget cutting program that it has, why our country is in trouble today, and what we must do to correct it.

HHS Percentage of Federal Budget *

Outlays in Billions of Dollars

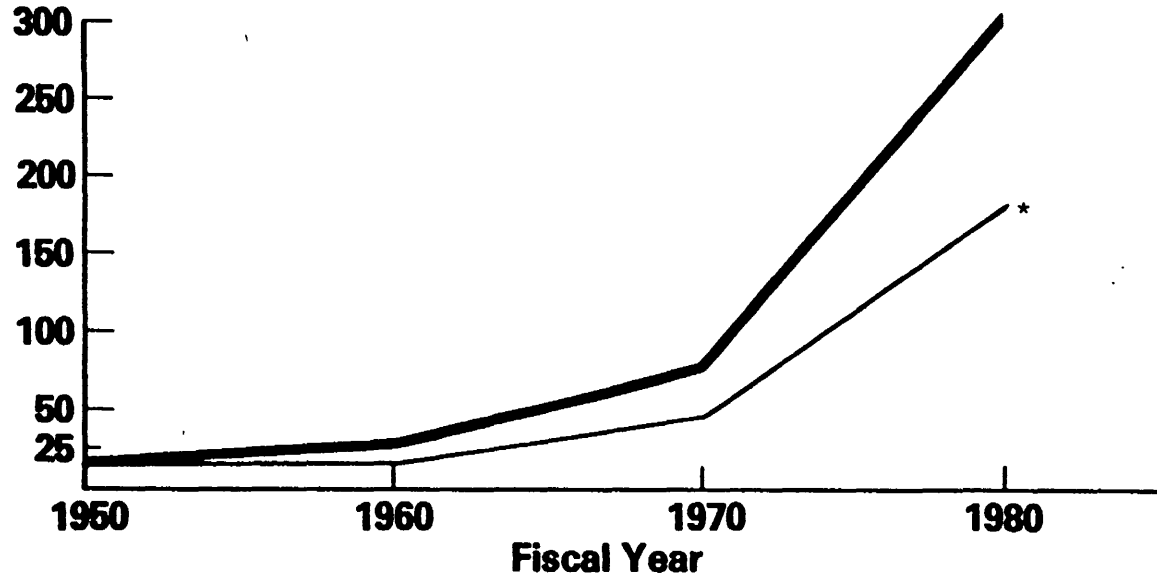


*Minus Old Age Insurance and Disability Insurance (OASDI)

Growth in All Federal Social Programs (Outlays in Billions of Dollars)

(Includes Programs in HHS, Labor, VA, Education, Agriculture,
HUD, and Other Domestic Agencies)

Outlays in Billions of Dollars



*Growth in All Federal Social Programs Minus Old Age & Survivors Insurance and Disability Insurance (OASDI)

Secretary SCHWEIKER. This basically shows the Federal social program outlays from 1950 up to 1980. As you can see from the chart, they were something less than \$20 billion back in 1950. Today, they are \$300 billion.

As you can see from the escalating geometric progression of the chart, there has been a rapid acceleration rate.

From 1950 to 1960, these social programs went up something like 82 percent. From the 1960's to the 1970's, they went up 188 percent. In the last decade, they went up 313 percent. So, that is really the problem. We are beginning to take off like a rocket and that is why we have to get the programs under control.

Now, Senator Long mentioned constant dollars and I think that is a valid point.

If I were to interpolate that without putting the same figures in, you can look at it this way. The cost of living from 1950 to 1980 went up about 250 percent, measured by the consumer price index.

During the same period, social programs went up about 1500 percent. So, in essence, the social program growth has been about 6 times the rate of the cost of living. I think that is a very valid point. We should discount as much as we can the cost of living or inflation index.

Actually, our social programs went up about 6 times faster than the CPI did during that period.

The next chart shows where the cuts come from. Back in 1962, the Defense Department was getting 44 percent of the total budget.

Now, the figures are almost reversed. In 1981, the Defense Department has dropped down to only 24 percent of the budget. The safety net social programs are up to 37 percent of the budget.

The important point here is that even after the cuts that we are discussing today, some \$48 billion, we will still have 41 percent of the Federal budget in safety net programs. Defense will still be lower, at 32 percent, despite all the hullabaloo in the media today. We would still be some 9 percentage points ahead of Defense in terms of people programs over Defense after you implement the Reagan cuts.

That is for all the programs in the Departments that are affecting people.

Just look at my Department, and I think you will see almost the same story. Back in 1970, we were 24.8 percent of the total budget. Now, of course, in 1981 we are up to 35 percent. As you know, we spend more money than every country in the world except the Soviet Union.

Even with all the cuts, the Department will still go from 35 percent of the budget up to 36.6 percent of the budget and so, in just our Department, we will still escalate our pro rata share of the Federal budget.

The next chart shows some interesting statistics about these cuts. For example, my Department, HHS, was cut 3½ percent. All the other Departments, excluding our Department and Defense, were cut 13.4 percent.

So, the people programs were only cut basically 3½ percent compared to the other Department cuts of about 13.4 percent.

Another way of looking at it is that we have 36 percent of the Federal budget today, yet we only got 20 percent of the reduction.

So, we took 20 percent of the reductions even though our pro rata share of the whole budget was 36 percent.

We were cut less than our pro rata share.

Another way of looking at it is in the increases in the budget. We are going to get, in my Department alone, 54 percent of the increase. \$21 billion will come to my Department. So, I think, with all the concerns about the cuts, we should just look at a few of those figures.

I think the others will wait until I come to them in the testimony regarding the block grant programs.

I appreciate the indulgence of the committee.

Mr. Chairman, members of the committee, it is a pleasure for me to be here today to discuss those aspects of the President's program for economic recovery that concern the Department of Health and Human Services and that are within the purview of this committee.

I also want to commend you, Mr. Chairman and members of this committee, for moving quickly to address the President's program.

I look forward to working with you in shaping the necessary legislation to implement the President's program.

I will be discussing today the specific issues and proposals relating to the social security program of old-age, survivors and disability insurance; the program of aid to families with dependent children; medicare; medicaid; child support enforcement; the social services programs; and other related programs that we administer.

We believe that these proposals are meritorious in and of themselves. Yet, they are also part of the larger program that I have just outlined.

As we discuss the specific proposals, we must keep in mind the importance of the President's economic recovery plan—the total package of initiatives designed to restore the health and vigor of the national economy.

We must not lose sight of the benefits that will accrue to all citizens with enactment of the President's program for economic recovery.

At the same time, I want to assure you that as President Reagan stated so forcefully in his address to the Nation,

None of these proposals represent in any sense a turning away from our commitment to those most in need, to the aged, or to others who must depend for support from existing public programs. The safety net of social programs upon which these Americans must rely will remain intact.

Mr. Chairman, I would like to begin by reviewing briefly the financing of the OASDI program.

In the past few years this huge and vital program has suffered continual financial difficulties, which have sapped public confidence and the security of the commitments.

Those who rely on Social Security benefits fear that the funds will run out and that their checks will stop. The workers who pay the taxes that finance these benefits see an ever larger bite being taken from their paychecks at a time when they have serious doubts that they will ever collect benefits themselves.

You and I know these fears will not be realized. We also know that to place the program on a sound financial basis will require

hard work and tough choices on the part of the administration and the Congress in the months to come.

The administration has already moved forcefully to address the first of these tasks through President Reagan's economic program of budget and tax reductions.

I am addressing the second of these tasks through a working group chaired by the Under Secretary-designate, which is dealing explicitly with the Social Security financing issues.

Let me review briefly our most recent projections of the status of the social security trust funds based on these new economic assumptions.

First, we continue to project that the OASI trust fund will experience cash flow problems in mid-1982. Its assets at the beginning of 1982 will amount to only about 13 percent of the projected 1982 expenditures, and they would continue to decline over the course of the year until the fund is exhausted. However, the combined balances in the old-age, survivors, disability and hospital insurance trust funds over the next 5 years appear to be substantially healthier than previous estimates showed. Both the DI and the HI trust funds would grow in absolute dollars as a percentage of annual expenditures after 1981. The assets of all three programs combined would decline as a percent of annual expenditures from 23 percent at the beginning of this year to 14 percent by 1985, and 16 percent by 1986.

These projections assume the continuation of present law expenditures. If we assume the adoption of the proposals recommended in the present fiscal year 1982 budget, the financial status of the trust fund is improved. The projections taking these proposals into account show a decline in the ratio for the three funds combined from 23 percent this year to 22 percent by 1985, but increasing to 30 percent by 1986. Although this would represent a very substantial improvement for the three funds combined, action will still be needed to strengthen the OASI trust fund by the early part of 1982 or 1983.

I would like now to turn to a brief review of each of the President's OASDI budget proposals.

First, the minimum benefit. Under social security, the regular benefit formula does not apply to people with very low average earnings. Instead, they get a minimum benefit—\$122 for people who would start getting benefits in the future. Our proposal for eliminating the minimum benefit will not take the entire social security benefit away from anyone now receiving it, or from anyone who, under today's law, will become entitled to receive it in the future. However, it will mean that these people will get only the amount to which they are entitled based on the actual covered earnings that they had under social security.

Second, social security student benefits. Under our proposal, beginning with August of this year, benefits for a student who is over age 18 and is attending a postsecondary school would begin to be phased out. No new students beyond the secondary school level could become entitled to benefits.

Third, the lump sum death benefit. When an insured worker dies, a lump sum death payment of \$255 generally is paid to the deceased worker's surviving spouse. If there is no qualified spouse,

the lump sum death benefit is paid to any person who paid the burial expenses. Our proposal would not eliminate this benefit, but would limit payments to cases where there is either a surviving spouse or surviving child beneficiaries. With this change, the payment would, again, fulfill the original purpose.

Fourth, currently insured status for disability. Under present law, a worker can qualify for disability insurance benefits if he has credit for 5 years of work in the 10 years preceding his disability and is fully insured. For a younger worker, the requirement is one-half of the time since he reached age 21. We believe that in a contributory work-related disability insurance program like social security, it is appropriate for benefits to be paid only where the worker was recently employed under the program and where the disability itself can be presumed to be the reason covered earnings ceased.

Such a requirement of recent covered work—referred to as currently insured status—was included in the social security disability program initially, but it was repealed in 1958. We believe that it should be reinstated now. Adding a requirement of recent work means the worker will have to have credit for one and a half years of work under social security at some time during the 3-year period preceding disability.

Fifth, disability megacap. We are also recommending that social security disability benefits to workers and their families be reduced if the sum of all the benefits payable to them under Federal, State, and local disability programs exceeds the worker's predisability net earnings.

Sixth, review of the continuing eligibility of those now getting disability benefits. While this change will not require legislation, I nevertheless want to bring it to the attention of the committee. Specifically, we propose to intensify the review of the continuing eligibility of people who are now getting disability benefits so that we can assure that only those people who are, in fact, disabled receive them.

Mr. Chairman, while they are not sufficient to assure adequate social security reserves in and of themselves, the President's proposals, if promptly enacted by the Congress, constitute an important \$22½ billion step over the next 5 years toward placing social security on a sound financial basis.

I would like now to discuss another area of great concern to all Americans, our public assistance program, for which my department and your committee share responsibility.

The American people strongly oppose assistance going to those who can work, those who have other sources of income, and those who get as much—or more—on welfare as others get from working.

In AFDC, the proposals are designed to improve the problem by limiting eligibility to those most in need, strengthening work requirements, making AFDC a temporary safety net for those who are not economically independent, emphasizing the individual responsibilities, and improving administration.

I will now discuss the major provisions in each of these areas.

Our proposal contains a number of provisions designed to limit eligibility and to better target limited funds to those most in need.

We propose to change the earned income disregard. To determine basic eligibility for the AFDC program, we would deduct from an applicant's monthly earnings \$75 for work expenses and up to \$50 per child for child care. For those found eligible for AFDC, we would then, in calculating the benefit amount, deduct an additional \$30 and one-third of the remainder of the earnings. This additional disregard would be limited to 4 months to provide a transition period to acclimate a recipient to employment. We also propose a set of changes which will strengthen the work requirements in the AFDC program.

The American public is not willing to bear the burden of supporting people who can work. We believe that everyone receiving assistance who is capable of working should be involved in a work program. To this end, in addition to continuing the current requirement that an employable recipient seek and accept employment, we would require States to establish community work-experience programs. Employable recipients who are unable to find a job in the regular economy would be required to accept work in this program.

Our next set of proposals is aimed at assuring that the AFDC program is available only as a temporary program to assist families with children who have no other means of support. Before the first dollar of aid is paid, all other sources of income should be pursued and all available income counted.

It is interesting to note that the most prevalent and substantial sources of income not counted for AFDC purposes are provided by the Federal Government. Nearly all AFDC recipients receive Federal food stamps. Yet, the States include an amount for food as part of the AFDC payment. We believe it is now time to halt this overlap of Federal assistance. Our proposal is to allow States to reduce the amount of AFDC paid for food and shelter to the extent it duplicates these other programs.

We also require that income of stepparents, or those assuming the role of stepparents, be counted as available to children living in the same household. The proposal will prevent those situations in which the children receive AFDC even while they are an integral part of a family grouping with substantial income.

We are also introducing proposals to insure that people assume more personal responsibility for planning the use of income to meet their needs. When a large amount of money is received as a lump sum—for example, an inheritance—we will consider it as income available for support not only in the month it is received, but to meet future needs.

The final set of AFDC proposals is in the area of administration. We propose systematic, business-like methods of securing and processing information about applicants and recipients. This will not only result in greater accuracy and efficiency, but will also help States ferret out fraud, waste, and abuse.

The first change in this area is to require retrospective accounting combined with prospective accounting for those coming on or leaving the rolls. This would be combined with monthly reporting of income and other family circumstances.

Next, we propose to establish a national recipient information system. Because a central information system does not now exist,

the same individual may now file for and receive multiple benefits, even in nearby communities. This national system will enable States to gain access to a common file containing information on benefits received by individuals from various welfare programs. This will enable States to verify that an individual is not already receiving welfare benefits, thus preventing fraud and abuse. In addition, we propose to provide full access to information in Federal, State, and local files to those public officials who need the information to fulfill their responsibilities under this program. Together, these two proposals will allow State officials to fulfill the basic statutory requirement that all income be considered in determining AFDC eligibility, as well as to prevent duplicate payments.

Let me turn now and discuss a program that is closely related to AFDC—child support enforcement. The Child Support Enforcement program is a Federal, State, and local effort to collect child support from absent parents. The failure of absent parents to meet their child support obligations is of large scale proportions, and has devastating consequences for children and the taxpayers.

We are offering legislative proposals which, if enacted, will increase collections, reduce administrative costs and spread the benefits of the program more equitably between the State and Federal Governments.

First, we propose to establish a Federal tax intercept to collect delinquent child support payments in AFDC cases.

Second, we propose to authorize enforcement of existing alimony obligations owed by absent parents.

Third, we propose to charge a fee for non-AFDC child support collection services.

Fourth, we propose to finance incentive payments from both the State and Federal share of AFDC collections.

Finally, in the child support enforcement area, some absent parents have used bankruptcy as a means of permanently avoiding child support. We propose to no longer allow child support obligations to be discharged in bankruptcy.

The consolidation of many of the social service grant-in-aid programs administered by the Department into a block grant is an important element in the President's program.

The social services block grant—and I think we should have a chart here in a moment—consolidates 12 social service authorities into a single block grant authority covering the purposes of the consolidated program. We believe that this approach to social services will resolve several problems caused by the multiplicity and categorical nature of the present Federal-State social service programs.

Block Grant Benefits

- **Improves Services Delivery Effectiveness:**
 - Assigns Responsibility to States
 - Provides States with Resource Control and Flexibility
- **Allows States to Meet Particular Needs and Priorities of Their Citizens**
- **Makes More Efficient Use of Resources:**
 - Eliminates Duplicative Administrative Overhead
 - Removes Unnecessary Federal Requirements

Social Services Block Grant

Consolidates 12 Programs:

- **Social Services**
- **Day Care**
- **State and Local Training**
- **Child Welfare Services**
- **Child Welfare Training**
- **Foster Care**
- **Child Abuse Prevention and Treatment**
- **Adoption Assistance**
- **Developmental Disabilities**
- **Runaway and Homeless Youth**
- **Community Services Administration (economic development not included)**
- **Rehabilitation Services**

Appropriation Authorization: \$3.8 Billion

Health Service Block Grant

Consolidates 15 Programs:

- **Community Health Centers**
 - Primary Health Care Centers
 - Black Lung Clinics
 - Primary Health Care Research and Demonstrations
- **Migrant Health**
- **Home Health Services**
- **Maternal and Child Health**
 - Grants to States
 - SSI Payments to Disabled Children
- **Hemophilia**
- **Sudden Infant Death Syndrome**
- **Emergency Medical Services**
- **Mental Health and Substance Abuse Services**
 - Mental Health Services
 - Drug Abuse Project Grants and Contracts
 - Drug Abuse Formula Grants to States
 - Alcoholism Project Grants and Contracts
 - Alcoholism Formula Grants to States

Appropriation Authorization: \$1,138 Million

Energy and Emergency Assistance Block Grant

■ Consolidates Two Major Programs:

- Emergency Assistance Under the Social Security Act
- Low-Income Energy Assistance -- both HHS and CSA Components

■ Funds Can Be Provided for:

- Home Energy Costs
- Low-Cost Weatherization
- Temporary Financial Assistance, Food, Clothing, Shelter
- Emergency Medical Care
- Emergency Social Services

Appropriation Authorization: \$1.4 Billion

Shift in Budget Priorities (Percent Composition of Outlays)

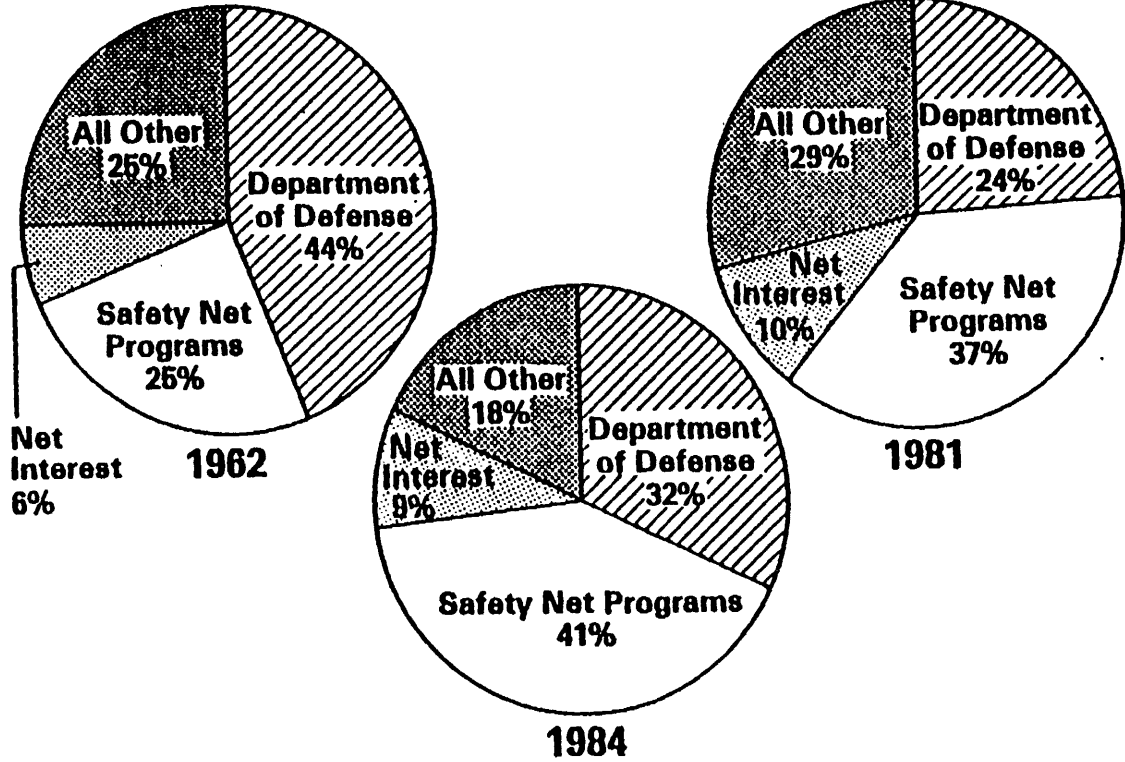


CHART 3

FY 1982 HHS Budget Changes

All Other Departments Excluding HHS and Defense Were Reduced 13.4% but the HHS Budget Was Reduced 3.5% from the Carter Budget.

With 36% of the Federal Budget, HHS Share of Reductions Was Only 20.5%.

Increase in HHS Budget from FY81 to FY82 Equals \$21.5 Billion — 54% of Increase in Total Federal Outlays.

Secretary SCHWEIKER. First, it allows States and localities the flexibility they need to distribute social service funds and to give priority to services which best meet the needs of the residents of the State.

Second, by eliminating many burdensome Federal administrative requirements, standards and the like, the block grant will permit more efficient State and local administration, thus freeing resources for the provision of services.

The social services block grant to States consolidates 10 major authorities from the Department of Health and Human Services.

You can see those listed on the chart there, Mr. Chairman. I won't read them, but they are listed there.

Our budget request for this consolidated block grant authority represents 75 percent of current funding levels, or \$3.8 billion for fiscal year 1982.

Under the block grant, States and localities will be in a much better position to take action where previously mandated conflicting program requirements and overlapping services have resulted in the waste of service dollars.

Overall, these proposals embody our philosophy that assistance funds can be most effectively used when States have the flexibility to respond to State and local conditions, and that the most effective Federal role is to serve the States and localities in this effort through research and other support activities.

I would like now to focus briefly on our block grant proposal for health services. The administration proposes to replace 15 categorical health service programs with a health services block.

The States would receive a percentage of the funds now available under the existing categorical programs and would make decisions based on their own assessments of health service needs within their own boundaries.

As with the social services block grant, we believe that the State can better administer these funds, given added flexibility, and can make better judgments about the allocation of funds and services.

The authorities included in this health services block grant are, again, listed on the chart, and I won't read them.

We are also proposing to establish a block grant authority to the States for providing energy and emergency assistance for needy households. Under our proposal, the funds would be used to assist households in meeting home energy needs to provide cash or in-kind assistance for emergency medical situations, for emergency medical care or social services, and other similar uses as the States deem appropriate. The States will have broad discretion in all aspects of the program including the use of funds, the population eligible for coverage, the types and forms of assistance provided, and levels of payment. Thus, each State will be able to design a program which can best respond to its own particular needs.

The block grant consolidates two major programs. Of these, the low-income energy assistance program provides grants to the States to help low-income households meet their home heating and medically necessary cooling needs.

The other program being consolidated is emergency assistance authorized by title IV-A of the Social Security Act.

Provisions of emergency assistance, which all States can provide under the proposed block grant, can make the difference between a one-time payment to cope with an emergency and a long-term stay on welfare.

As with the social service block grant, the only restriction is that the funds are used to meet the purpose of the program. Reporting requirements will be simple.

I would like to turn now to the President's proposals to increase the cost-effectiveness of the medicaid program. In 1970, the cost of the medicaid program to the States and the Federal Government was \$5.2 billion. This year the program will cost approximately \$29 billion. Medicaid expenditures have increased more than 15 percent per year for the last 5 years.

Under the hospital reimbursement approaches generally used today, the higher a provider's costs or charges, the higher the reimbursement. Close observers of the health care scene point to the cost-increasing biases in the program's requirements and in the health care system overall as the sources of the difficulty. Consequently, there is no incentive for price competition. At the same time, health care consumers are not always cognizant of the cost of the services they use.

This situation can be remedied only by reestablishing market incentives for the delivery of health care. The administration, therefore, will be proposing comprehensive health financing and medicaid reforms which promote competition.

It will, of course, take time to develop and fully implement these comprehensive changes.

In the interim, we are proposing that a ceiling be placed on medicaid funding to limit the program's growth.

Additionally, we are proposing that title XIX of the Social Security Act be modified to provide greater flexibility to States so that they may reorganize their medicaid programs to deliver care more effectively and at a lower cost.

For 1981, the limit would be established by reducing the current base estimate by \$100 million. This ceiling would be increased 5 percent for fiscal year 1982. After 1982, Federal spending would be increased based on the rate of inflation as measured by the GNP deflator. We believe that this degree of restraint can be achieved by States without reducing necessary services for the needy.

The combination of an interim ceiling on the Federal contribution to each State's medicaid program and enactment of our proposals to provide greater latitude to improve program effectiveness will stimulate States to improve their programs while adjusting program spending to a more acceptable level.

We also propose to phase-out Federal support of the Professional Standards Review Organization program. The PSRO legislation was passed in 1972 to replace an ineffective system of utilization review.

We are recommending, therefore, that Federal funding be continued through 1983 only for those PSRO's judged effective in controlling health-care costs. This will allow time for implementation of health-care financing reforms that promote competition.

After 1983, we expect that the most efficient PSRO's will be supported by private systems of health care which contract for their services.

Finally, we are proposing a number of other changes to improve medicare program efficiency and effectiveness. These include elimination of the current automatic reimbursement bonus paid to hospitals for routine nursing services to medicare beneficiaries, elimination of the one-time deferral of PIP reimbursements, movement to a competitive bid system for medicare contractors, and institution of an administrative hearing procedure to more effectively combat fraud and abuse in the medicare program.

In conclusion, Mr. Chairman, Senator Long, Senator Byrd, and the others, I want to reemphasize the importance of these programs. They address a wide area of concerns, but have common goals:

Guaranteeing that the basic social security program upon which millions of Americans currently depend and to which many millions more will look in the future, is fiscally sound and will remain the primary means to insure income to those who can no longer work.

Insuring that public assistance is focused on those who cannot, through no fault of their own, provide their basic needs; and making certain that those who are able to provide for themselves will have the opportunity and responsibility of doing so.

Providing flexibility and funding to States to enable them to more directly design and control their programs to better serve the needs of their residents.

Increasing the cost-effectiveness of medicare and medicaid.

To meet these goals, the President's program for economic recovery—of which these proposals are an important part—should be given prompt consideration and action.

That concludes my testimony, Mr. Chairman. I read only part of it so I ask that the rest be put in the record, and I would now be happy to submit to any questions that you or the committee may have.

Senator DOLE. Without objection, the entire statement will be made a part of the record.

[The prepared statement of Hon. Richard S. Schweiker follows:]

STATEMENT BY RICHARD S. SCHWEIKER, SECRETARY OF HEALTH AND HUMAN SERVICES

Mr. Chairman and members of the committee, it is a pleasure to be here today to discuss those aspects of the President's program for economic recovery that concern the Department of Health and Human Services and that are within the purview of this Committee. I also want to commend you, Mr. Chairman, and the members of this Committee, for moving quickly to address the President's program. I look forward to working with you in shaping the necessary legislation to implement the President's program.

I will be discussing today the specific issues and proposals relating to the social security program of old-age, survivors, and disability insurance (OASDI), the program of aid to families with dependent children (AFDC), Medicare, Medicaid, Child Support Enforcement (CSE), the social services programs, and other related programs that we administer. We believe that these proposals are meritorious in and of themselves.

Yet they are also a part of the larger program the President has outlined. As we discuss the specific proposals, we must keep in mind the importance of the President's economic recovery plan—the total package of initiatives designed to restore the health and vigor of the national economy. We must not lose sight of the benefits

that will accrue to all citizens with enactment of the President's program for economic recovery.

At the same time, I want to assure you that—as President Reagan stated so forcefully in his address to the Nation—none of these proposals represents in any sense a turning away from our commitment to those most in need, to the aged, or to others who must depend for support upon existing public programs. The safety net of social programs upon which these Americans must rely will remain intact. Mr. Chairman, I would like to begin by reviewing briefly the financing of the OASDI program.

Social security—old-age, survivors, and disability insurance

In the past few years, this huge and vital program has suffered continual financing difficulties which have sapped public confidence in the security of its commitments. Those who rely on social security benefits fear that the funds will run out and that their checks will stop; the workers who pay the taxes that finance these benefits see an ever larger bite being taken from their paychecks at a time when they have serious doubts that they will ever collect benefits themselves. You and I know that these fears will not be realized. We also know that to place the program on a sound financial basis will require hard work and tough choices on the part of the Administration and the Congress in the months to come.

In order for us to restore confidence in the social security program we must place social security on a sound financial basis.

First, we must restore the health of our national economy. We must reduce inflation and unemployment and restore productivity growth to this country.

Second we must insure that the package of basic protection offered by social security is soundly financed in the next few years and in the decades to come. Moreover, we must assure that the financing arrangements do not overburden the workers of the Nation and do not injure the economy. Social security financing arrangements must not only serve well the interests of the social security program, but also the interests of the Nation as a whole.

The Administration has already moved forcefully to address the first of these tasks through President Reagan's economic program of budget and tax reductions. I am addressing the second of these tasks through a working group chaired by the Under Secretary which is dealing explicitly with social security financing issues.

We believe that with the adoption of the initiatives taken in the President's Budget, we will be able to restore the health of our economy in the next few years. This is reflected in this Administration's revised economic projections which feature lower inflation, lower unemployment, and greater improvements in real wage growth than do the projections released in January by the previous Administration.

Let me review briefly our most recent projections of the status of the social security trust funds based on these new economic assumptions. First, we continue to project that the OASI trust fund will experience cash-flow problems in mid-1982. Its assets at the beginning of 1982 will amount to only about 13 percent of projected 1982 expenditures, and they would continue to decline over the course of the year until the fund is exhausted. However, the combined balances in the old-age, survivors, disability, and hospital insurance trust funds over the next 5 years appear to be substantially healthier than previous estimates showed. Both the DI and HI trust funds would grow in absolute dollars and as a percentage of annual expenditures after 1981. The assets of all three programs combined would decline as a percent of annual expenditures from 23 percent at the beginning of this year to 14 percent by 1985 and 16 percent by 1986.

These projections assume the continuation of present-law expenditures. If we assume adoption of the proposals recommended in the President's fiscal year 1982 budget the financial status of the trust funds is improved. The projections taking these proposals into account show a decline in the ratio for the 3 funds combined from 23 percent this year to 22 percent by 1985, but increasing to 30 percent by 1986. Although this would represent a very substantial improvement for the 3 funds combined, action will still be needed to strengthen the OASI trust fund by the early part of 1982 or 1983. Even with the proposed legislation, the OASI fund is expected to experience cash flow difficulties by the end of 1982 or early 1983.

As the Members of this Committee know, there are also serious longer-range financing problems in social security. The 1980 report of the Boards of Trustees of the Social Security trust funds shown that over the next 25 years (1980-2004) the old-age, survivors, and disability programs will run a surplus averaging 1.19 percent of payroll. For the second 25 years (2005-2029), we have a roughly equal deficit (1.17 percent of payroll). This is followed by a very significant deficit of 4.58 percent for 2029 to 2054. The average of these three figures is a 1.52 percent deficit for the full 75-year period.

Another way of looking at the longer range picture is to trace the projected trust fund balances. The 1980 Trustees Report showed the combined assets of the OASDI trust funds rising from 23 percent of annual outlays in 1990 to 335 percent of outlays in 2010 and declining thereafter until the funds would be unable to pay benefits in 2030 or so. The trust funds surplus builds over the years when tax receipts exceed benefit expenditures, after which the funds are drawn down by the growing ratio of beneficiaries to workers when the "baby boom" generation retires. As you know, the deficits projected in the 21st century are largely the result of projected demographic changes. The combination of projected lower mortality rates, especially among the aged, and of continued lower fertility rates causes the ratio of workers to beneficiaries to shift from about 3 to 1 today to about 2 to 1 in the year 2035.

The working group I mentioned earlier is addressing both short-term and long-term financing issues. I am not in a position to comment about where this review may ultimately lead us. It would be premature for me to speculate on that today. What I can say is that we are open to suggestions, and that we are conducting as thorough and as painstaking review as time allows—recognizing that the sooner we are able to put our recommendations before you, the sooner we can begin working out a comprehensive future strategy together.

I would now like to turn to a brief review of each of the President's OASDI budget proposals.

First, the Minimum Benefit: Under social security, the regular benefit formula does not apply to people with very low average earnings; instead, they get a "minimum" benefit—\$122 for people who would start getting benefits in the future. Our proposal for eliminating the minimum benefit will not take the entire social security benefit away from anyone now receiving it or from anyone who, under today's law, will become entitled to receive it in the future. However, it will mean that these people will get only the amount to which they are entitled based on the actual covered earnings they had under social security.

Relatively few people who qualify for the minimum benefit were, in fact, self-sufficient on the basis of their own covered earnings during their working years. A majority of the people who qualify for the minimum benefit and would be affected by its elimination have additional resources in the form of pensions from non-covered work, social security benefits as dependents or survivors of covered workers, or SSI payments. To the extent that the minimum benefit is paid as a "windfall" to people who have other sources of income, that windfall will be eliminated. To the extent the minimum now goes to aged and disabled people who are in real financial need, the supplemental security income (SSI) program is available to meet that need with payments financed by general revenues.

I should note that we are *not* proposing any changes in the separate "special minimum" benefits for people who have worked under social security at low wages for many years.

Second, Social Security Student Benefits: Under our proposal, beginning with August of this year, benefits for a student who is over age 18 and is attending a post secondary school would begin to be phased out; no new students beyond the secondary school level could become entitled to benefits. Social security benefits are currently provided for the child of a retired, disabled, or deceased worker if the child is aged 18-22 and a full-time student. Serious questions have been posed regarding this benefit, particularly whether, considering the other forms of educational assistance now available, it is necessary for a wage replacement program to help finance post secondary education.

There were few other financial aid programs available when students benefits were enacted in 1965. Since then, however, other public programs have been established or substantially expanded to provide financial assistance for students. These programs more appropriately relate student assistance directly to family income and educational cost and target the benefits toward those who are in need.

Our proposal will not affect benefits paid to children in high school. However, it will phase out the benefits paid to young adults pursuing a higher education. The needs of this latter group can be met more appropriately through students' own initiatives, through private means or through other public programs.

Third, the Lump-Sum Death Benefits: When an insured worker dies, a lump-sum death benefit of \$255 generally is paid to the deceased worker's surviving spouse. If there is no qualified spouse, the lump-sum death benefit is paid to any person who paid the burial expenses. The lump-sum death benefit was originally intended to help the worker's family with the costs associated with his illness and death. However, today almost half of the lump-sum payments are in cases where there is neither a surviving spouse nor surviving minor children.

Our proposal would not eliminate this benefit, but would limit payments to cases where there is either a surviving spouse or surviving child beneficiaries. With this change, the payment would again fulfill the original purpose. Also, a significant administrative simplification would result, since complex and time-consuming determinations of who paid the funeral expenses, now required in cases where there is no surviving spouse, would be eliminated.

Fourth, Currently Insured Status for Disability: Under present law, a worker can qualify for disability insurance benefits if he has credit for 5 years of work in the 10 years preceding his disability (or, for a younger worker, one-half of the time since he reached age 21). Thus, a person can qualify for social security disability benefits even though he has not worked under social security for up to 5 years preceding the onset of his disability. We believe that, in a contributory work-related disability insurance program like social security, it is appropriate for benefits to be paid only where the worker was recently employed under the program and where the disability itself can be presumed to be the reason covered earnings ceased.

Such a requirement of recent covered work—referred to as “currently insured status”—was included in the social security disability program initially, but was repealed in 1958. We believe it should be reinstated now. Adding a requirement of recent work will have to have credit for 1½ years of work under social security at sometime during the 3-year period preceding disability. The vast majority of regular workers will be able to meet this requirement. Moreover, all of those disabled workers who cannot meet it and are in financial need will qualify for SSI payments.

Fifth, A Disability Megacap: We are also recommending that social security disability benefits to workers (and their families) be reduced if the sum of all benefits payable to them under other Federal, State and local disability programs exceeds the worker's predisability net earnings. Limiting the amount of social security benefits for people who receive multiple benefits payable on the basis of disability will reduce or eliminate the instances of overinsurance and duplication of benefits. It will also address a significant disincentive for people to return to productive activity. The proposal would not reduce social security disability benefits on account of the receipt of needs-based benefits public pensions based in whole or in part on social security covered earnings, veterans compensation, or private insurance.

Sixth, Review of the Continuing Eligibility of Those Now Getting Disability Benefits: While this change will not require legislation, I nevertheless want to bring it to the attention of the Committee. Specifically, we propose to intensify the review of the continuing eligibility of people who are now getting disability benefits so that we can assure that only those people who are, in fact, disabled receive them. This initiative will be in addition to the implementation of a provision enacted in 1980 which mandated periodic review of the disability rolls.

Finally, Eliminate the Special Vocational Rehabilitation Funding for Disabled Beneficiaries: Under the present law, the total cost of providing vocational rehabilitation (VR) services to disabled social security beneficiaries is paid for out of the social security trust funds, and out of the SSI appropriation for SSI recipients. The proposal would eliminate these special funding mechanisms, and place responsibility for all rehabilitation services under the Social Services block grant, which I will be discussing later.

Mr. Chairman, while they are not sufficient to assure adequate social security reserves in and of themselves, the President's proposals—if promptly enacted by the Congress—constitute an important \$22½ billion step over the next five years toward placing social security on a sound financial basis.

This concludes my remarks on the social security program. I would now like to discuss another area of great concern to all Americans—our public assistance programs—for which my Department and your Committee share responsibility.

The necessity of revitalizing our national economy is of critical importance, yet the conscience and compassion of the country and of the Administration will not allow the burden to fall on the backs of those most in need: we must insure that help is provided to those who cannot otherwise provide for themselves.

I will be discussing with you today those areas of public assistance in which changes can and should be made. I believe that many of the proposals are highly desirable by themselves; however, together, they will help in meeting the goals of insuring that limited funds go only to those most in need, encouraging individual efforts towards economic independence and reducing unnecessary administrative costs.

The American people strongly oppose assistance going to those who can work, those who have other sources of income, and those who get as much—or more—on welfare as others get from working.

They believe, and this Administration believes, that people who can take personal responsibility for themselves ought to do so.

But the American people are compassionate and generous toward those who, through no fault of their own, have no other choice but to rely on public programs to meet their basic needs. The kinds of changes I will be describing today need to be made to bring the public assistance programs in line with our country's concerns.

AFDC

In AFDC, the proposals are designed to improve the problems by:

- Limiting eligibility to those most in need;
- Strengthening work requirements;
- Making AFDC a temporary safety net for those who are not economically independent;
- Emphasizing individual responsibilities; and
- Improving administration.

I will now discuss the major provisions in each of these areas.

Limiting eligibility to those most in need

Our proposal contains a number of provisions designed to limit eligibility and to better target limited funds to those most in need.

The generous disregards applied to earned income under current law, for example, have allowed AFDC recipients who join the workforce to continue to receive public assistance, even after they are working full time. Furthermore, the present policy on treatment of work expenses, which does not define or limit what types of expenses may be disregarded, prevents the use of reasonable controls which contribute to the administrative burden. We propose to change the earned income disregard. To determine basic eligibility for the AFDC program, we would deduct from an applicant's monthly earnings: \$75 for work expenses; and up to \$50 per child for child care.

For those found eligible for AFDC, we would then, in calculating the benefit amount, deduct an additional; \$30, and one-third of the remainder of the earnings.

This additional disregard would be limited to four months to provide a transition period to acclimate a recipient to employment. We believe four months is a sufficient transition period to acclimate a recipient to employment. Indefinitely prolonging this "incentive", which was intended to encourage independence, is counter-productive.

The new formula will reduce or eliminate benefits to those earning at higher levels and should simplify administration, reduce error, and provide an incentive for AFDC recipients to find the most economical ways to meet their work expenses.

In addition, we propose to limit eligibility to families with income not in excess of 150 percent of the State needs standards as another means of insuring that funds are targeted to those most in need.

Present law permits some people to receive AFDC who voluntarily choose not to work. We propose to tighten this area by removing eligibility for those age 18 unless they are completing their senior year in high school. For all practical purposes these people are voluntarily unemployed.

Finally, in tightening eligibility, we would like to correct another problem in current law. In States which cover two-parent families, either parent can qualify as the unemployed parent. Consequently, even if one parent is employed, the family can still be eligible for AFDC based on the unemployment of the other parent. We propose to define the unemployed parent as the parent who is the principal wage-earner in the family.

Encouraging work

We also propose a set of changes which will strengthen the work requirements in the AFDC program. The American public is not willing to bear the burden of supporting people who can work. We believe that everyone receiving assistance who is capable of working should be involved in a work program. To this end, in addition to continuing the current requirement that employable recipients seek and accept employment, we would require States to establish community work experience programs. Employable recipients who are unable to find a job in the regular economy would be required to accept work in these programs. This work would be performed in return for the AFDC benefits.

These community work programs will encourage recipient identification with the labor market, provide recipients with a work history and develop the disciplines necessary for accepting employment in the regular economy.

In addition, we would require AFDC parents who attend college to register for work and meet all other work requirements under AFDC. The purposes of the AFDC program is not to enable individuals to attend college at taxpayers' expense

as an alternative to supporting their children. It is unfair to allow able-bodied adults to avoid work and attend school while the taxpayers who are supporting them through welfare may be unable to afford college for themselves or their children.

These proposals will involve those recipients who are able to work in work activities. They will increase the self-esteem and work experience of many recipients and will promote self-support through jobs in the regular economy. They will eliminate current abuses in the program and, more importantly lessen the burden of providing public assistance to those in need.

AFDC as a temporary safety-net

Our next set of proposals is aimed at assuring that the AFDC program is available only as a temporary program to assist families with children who have no other means of support. Before the first dollar of aid is paid, all other sources of income should be pursued and all available income counted. However, under current law, many actual and potential sources of income to AFDC recipients are ignored. We propose to close these loopholes.

It is interesting to note that the most prevalent and substantial sources of income not counted for AFDC purposes are provided by the Federal Government. Nearly all AFDC recipients receive Federal food stamps, yet the States include an amount for food as part of the AFDC payment. As a result, some families may receive more for food than they spend for food. The same situation can occur with housing subsidies; the amount of the subsidy does not reduce the portion of the AFDC grant designed to meet shelter costs. This problem has been mounting steadily with the growth of Federal in-kind assistance programs and has received close congressional study in recent years. We believe it is now time to halt this overlap of Federal assistance. Our proposal is to allow States to reduce the amount of AFDC paid for food and shelter to the extent it duplicates these other programs.

Another source of public income available to working AFDC recipients is the earned income tax credit. The law permits eligible workers to receive an advance on this credit throughout the tax year. We will require that the EITC be counted as income for AFDC on a monthly basis—in other words, we will assume that the recipient has elected the option of receiving the EITC in monthly payments throughout the year.

We will also require that income of stepparents or those assuming the role of stepparents be counted as available to children living in the same household. The proposal will prevent those situations in which the children receive AFDC even while they are an integral part of a family situation with substantial income. This provision will not require that a person neglect his or her natural children to support other children in the household. Income which is used to pay support or alimony would be disregarded.

Next, we will permit States to recover assistance paid to recipients living in homes whose value exceeds the average home value in the State. In this way, those with an above average resource will be allowed to remain in their homes, but will be held responsible for repayments of assistance provided at public expense when the home is sold or transferred to another person.

Finally, to insure that families make use of available resources before applying for AFDC, we propose to amend the AFDC law to place a limit of \$1,000 per family on allowable resources, and to exclude from this limit only the home and one vehicle. Since the new limit will be equity value rather than market value, it will still permit recipient families to retain reasonable amounts of personal property.

Emphasizing individual responsibility

We are also introducing proposals to ensure that people assume more personal responsibility for planning the use of income to meet their needs. When a large amount of money is received as a lump sum (for example, an inheritance), we will consider it as income available for support not only in the month it is received but to meet future needs. This would be accomplished by requiring that the lump-sum payment be divided by the State's standard of need. The recipient would be ineligible for assistance for the number of months that result from that computation.

As another matter of personal responsibility, we will require that AFDC overpayments be repaid. At the same time, of course, we will require States to make good on underpayments.

Improving administration

The final set of AFDC proposals is in the area of administration. We propose systematic, business-like methods of securing and processing information about applicants and recipients. This will not only result in greater accuracy and efficiency but will also help States ferret out fraud and avoid waste and abuse.

The first change in this area is to require retrospective accounting combined with prospective accounting for those coming on or leaving the rolls. This would be combined with monthly reporting of income and other family circumstances.

Each State may now choose whether to pay AFDC benefits based on actual, prior month circumstances (that is, use retrospective accounting) or expected current month circumstances (that is, use prospective accounting). In fact, 12 States and the City of Denver now use some form of retrospective accounting. However, most States use the prospective method with no systematic means, other than directly contacting the recipient every 6 months, to find if any changes have actually occurred. Moreover, few of the present systems respond adequately to the frequent or irregular changes in circumstances even if reported. Our proposal is to require retrospective accounting along with monthly reporting in all States. Together, these will provide a rational, business-like method of securing and processing accurate, up-to-date information on each recipient family. This change will reduce program costs without altering the benefit levels. Prospective budgeting will be used in the first month to prevent hardship and in the final month to prevent payment of benefits to those who are no longer needy.

Next, we propose to establish a national recipient information system. Because a central information system does not now exist, the same individual may now file for and receive multiple benefits, even in nearby communities. This national system will enable States access to a common file containing information on benefits received by individuals from the various welfare programs. This will enable States to verify that an individual is not already receiving welfare benefits, thus preventing fraud and abuse. In addition, we propose to provide full access to information in Federal, State and local files to those public officials who need the information to fulfill their responsibilities under this program. Together, these two proposals will allow State officials to fulfill the basic statutory requirement that all income be considered in determining AFDC eligibility as well as to prevent duplicate payments.

Other changes which will result in simpler, more effective administration include:

Removal of the current 20 percent limit on vendor payments which has prevented recipients in some States from securing housing and utilities from vendors who are fearful of late payments—or even no payment at all;

Elimination of payments of less than \$10 a month where the administrative cost can often exceed the payment made. However, persons who would have been eligible may receive food stamps, Medicaid and other benefits as though they were AFDC recipients; and

Reduction of the Federal share for training expenses from 75 percent to 50 percent to be consistent with the normal 50 percent matching rate for administrative expenses.

We also are proposing to change the accounting period and method under the SSI program from a quarterly prospective system, which is highly error prone, to a monthly retrospective system similar to the one we are proposing for AFDC.

Let me turn now and discuss a program that is closely related to AFDC—Child Support Enforcement.

Child support enforcement

The child support enforcement program is a Federal, State and local effort to collect child support from absent parents. The failure of absent parents to meet their child support obligations is of large scale proportions, and has devastating consequences for children and the taxpayers. Eighty-two percent of the children receiving welfare under the AFDC program are on the rolls because there is a parent absent from the home who is either paying an inadequate level of support, or, in most cases, no support at all.

State and local child support enforcement agencies are responsible for locating absent parents, establishing paternity of children born out of wedlock and establishing and enforcing support obligations. These services are provided automatically to AFDC families and are available upon request to families who are not on public assistance. The Federal government pays for 75 percent of the administrative costs of the program and provides a wide range of services and technical assistance to the States.

The Child Support Enforcement program is making inroads into this problem. Fiscal year 1980 collections of almost \$1.5 billion represent a near tripling of collections since the inception of the program in fiscal year 1976. Nationwide, every dollar of expenditure to administer the program yields over \$3.25 in collections.

Yet, even with this record, we believe that more can be done. We are offering legislative proposals which, if enacted, will increase collections, reduce administrative costs and spread the benefits of the program more equitably between the State and Federal governments.

First, we propose to establish a Federal tax intercept to collect delinquent child support in AFDC cases. Patterned after State procedures to intercept State income tax refunds, this will increase collections substantially. The procedure will apply only to delinquent payments pursuant to legal support obligation. The States will send a report of the delinquent amount to IRS which will deduct the delinquency from any refund otherwise due the absent parent and send it to the State.

The States will pay a small fee set by IRS to cover the costs of the procedure.

Second, we propose to authorize enforcement of existing alimony obligations owed by absent parents. This will correct two problems. Currently, even when there is an existing court order for alimony in a case being handled by a child support agency, the agency is not authorized to collect the alimony. In addition, some courts order a single amount for alimony and child support without specifying separate amounts. This creates difficulties in determining how to account for and distribute the collection. Our proposal will allow both child support and alimony obligations to be enforced, and both to be used to reduce State and Federal welfare expenditures.

Third, we propose to charge a fee for non-AFDC child support collection services. Non-AFDC collection costs currently result in a loss to the Federal government of millions of dollars. Charging a fee of 10 percent of the collections would approximate the national average costs of the non-AFDC program, and would virtually eliminate State and Federal costs for this activity. We feel this would not be an undue burden to the families who receive from the program a substantial benefit that is not available to them from any other source at a comparable cost.

Fourth, we propose to finance incentive payments from both the State and Federal share of AFDC collections. There is currently an incentive payment of approximately 15 percent of AFDC collections, paid to a collecting State or county, and financed entirely from the Federal share of the collections. Our proposal would deduct the incentive payment from the collection before determining the State and Federal share, thereby helping to correct the inequity that currently exists in the program between the State and Federal governments.

Finally, in the child support enforcement area, some absent parents have used bankruptcy as a means of permanently avoiding child support. We propose to no longer allow child support obligations to be discharged in bankruptcy.

Social service block grants

The consolidation of many of the social services grant-in-aid programs administered by the Department into a block grant is an important element in the President's program. The social services block grant consolidates 12 social service authorities into a single block grant authority covering the purposes of the consolidated programs. We believe that this approach to social services will resolve several problems caused by the multiplicity and categorical nature of the present Federal-State social services programs. First, it allows States and localities the flexibility they need to distribute social services funds, and to give priority to services which best meet the needs of the residents of the State. Second, by eliminating many burdensome Federal administrative requirements, standards and the like, the block grant will permit more efficient State and local administration, thus freeing resources for the provisions of services.

The social services block grant to States consolidates ten major authorities from the Department of Health and Human Services:

Social Services; Day Care; State and Local Training; Child Welfare Services; Child Welfare Training; Foster Care; Child Abuse Prevention and Treatment; Adoption Assistance; Developmental Disabilities; and Runaway and Homeless Youth.

Two authorities currently administered by other Federal agencies also are included:

Community Services Administration, except for community economic development; and Vocational Rehabilitation Services.

Our budget request for this consolidated block grant authority represents 75 percent of current funding levels, or \$3.8 billion for fiscal year 1982. Under the block grant, States and localities will be in a much better position to take action where previously mandated conflicting program requirements and overlapping services have resulted in the waste of service dollars. State and local officials will also have the flexibility to respond to new and changing conditions, or to adjust to local conditions where, in the past, nationwide requirements have limited their options, particularly in rural areas. Associated with the block grant, but not part of it, we plan to consolidate the funds for maintaining the necessary Federal support activities where they can be of most assistance to States and localities. Many of the statutory categorical authorities proposed for the block grant include authorities for research, training, and demonstration projects to improve the administration and effectiveness of these programs. Consolidating the funds related to these authorities will give the Federal Government the ability to respond flexibly to State needs for

information and assistance, particularly where interchange of information among States is concerned, such as the national adoption information exchange and the national runaway youth switchboard.

Overall, both of these proposals embody our philosophy that assistance funds can be most effectively used when States have the flexibility to respond to State and local conditions, and that the most effective federal role is to serve the States and localities in this effort through research and other support activities.

Health services block grant

I would now like to focus briefly on our block grant proposal for health services. The Administration proposes to replace 15 categorical health service programs with a Health Services Block Grant. The States would receive a percentage of the funds now available under the existing categorical programs and would make decisions based on their own assessments of health services needs within their own boundaries.

As with the Social Services Block Grant, we believe that the States can better administer these funds, given added flexibility, and can make better judgments about the allocation of funds and services.

The authorities included in this Health Services Block Grant are:

- Community Health Centers:
 - Primary Health Care Centers—Black Lung Clinics
 - Primary Health Care Research and Demonstration
- Migrant Health;
- Home Health Services;
- Maternal and Child Health; Grants to States—SSI Payments to Disabled Children;
- Hemophilia;
- Sudden Infant Death Syndrome;
- Emergency Medical Services;
- Mental Health and Substance Abuse Services:
 - Mental Health Services;
 - Drug Abuse Project Grants and Contracts;
 - Drug Abuse Formula Grants to States;
 - Alcoholism Project Grants and Contracts; and
 - Alcoholism Formula Grants to States.

Energy and emergency assistance block grant

We are also proposing to establish a block grant authority to the States for providing energy and emergency assistance for needy households. Under our proposal, the fund could be used to assist households in meeting home energy needs, to provide cash or in-kind assistance for emergency situations, for emergency medical care or social services, and other similar uses as the State deems appropriate. The States will have broad discretion in all aspects of the program including the use of funds, the population eligible for coverage, the types and forms of assistance provided, and levels of payment. Thus, each State will be able to design a program which can best respond to its own particular needs. The block grant consolidate two major programs. One of these—the low-income energy assistance program—provides grants to States to help low-income households meet their home heating and medically necessary cooling needs. This program, which is totally federally financed, has evolved in five years from a \$200 million crisis intervention program administered by the Community Services Administration to a \$1.85 billion grant program which subsidizes energy costs in all States.

Although States do have flexibility in many program areas, there is still a myriad of Federal restrictions and requirements to which the State must adhere. For example, States must use the bulk of their funds for general energy assistance to the low-income population and are not allowed to use more than a small portion for energy crisis situations. Due to the unpredictability of the weather in certain States, this may not be efficient and could be downright wasteful.

States also must submit highly detailed and extensive reports as to how they determined payment levels and on expenditures and uses of the funds which add significantly to the expense of administering the program while resulting in nonproductive uses of scarce program funds.

The other program being consolidated, emergency assistance authorized by Title IV-A of the Social Security Act, also has some serious shortcomings:

First, it has both burdensome Federal requirements and limitations which constrain its utility. For example, it can only be used to assist needy families with children and States are not allowed to specify what type of emergencies will be covered.

Second, it provides Federal funds for energy needs which are also covered under the energy assistance program.

Third, coverage is uneven throughout the country. Twenty-five States do not participate, many because they do not agree with the Federal requirements imposed on the use of the funds. As a result, in States which have not elected to participate, some families have been forced to join welfare rolls when denied temporary relief during crisis situations or when faced with an unpredictable need.

Provision of emergency assistance, which all States can provide under the proposed block grant, can make the difference between a one-time payment to cope with an emergency and a long-term stay on welfare.

As with the social service block grant, the only restriction is that the funds are used to meet the purpose of the program. Reporting requirements will be simple.

Our proposal will ensure that funds are available to all States for whatever emergencies they see fit to cover. It will consolidate the functions now provided under the separate programs and at the same time give States the opportunity to efficiently and at the same time give States the opportunity to efficiently direct the funds to where they are most needed. By eliminating the cost of the States of Federal red tape and complications that now accompany the programs, and the layers of Federal personnel now needed to direct, approve and oversee the State programs, a significant amount of money can be saved.

Medicare and medicaid proposals

I would like to turn now to the President's proposals to increase the cost-effectiveness of the Medicaid program. In 1970 the cost of the Medicaid program to the States and the Federal Government was \$5.2 billion. This year the program will cost approximately \$29 billion. Medicaid expenditures have increased more than 15 percent per year for the last five years.

Under the hospital reimbursement approaches generally used today, the higher a provider's costs or charges the higher the reimbursement. Close observers of the health care scene point to the cost-increasing biases in the program's requirements and in the health care system overall as the source of difficulty. Consequently, there is no incentive for price competition. At the same time, health care consumers are not always cognizant of the costs of the services they use. They are generally insulated from the financial consequences of using services inappropriately or excessively.

This situation can be remedied only by re-establishing market incentives for the delivery of health care. The Administration therefore will be proposing comprehensive health financing and Medicaid reforms which promote competition.

It will of course take time to develop and fully implement these comprehensive changes.

In the interim, we are proposing that a ceiling be placed on Medicaid funding to limit the program's growth. Additionally we are proposing that Title XIX of the Social Security Act be modified to provide greater flexibility to States so that they may reorganize their Medicaid programs to deliver care more effectively and at lower cost.

For 1981, the limit would be established by reducing the current base estimate by \$100 million. This ceiling would be increased five percent for fiscal year 1982. After 1982, Federal spending would be increased based on the rate of inflation as measured by the GNP deflator. We believe that this degree of restraint can be achieved by States without reducing necessary services for the needy.

The limit on Federal funding, however, will give the States an additional incentive to reduce the fraud, abuse and waste which have plagued the program. Eligibility errors alone, for example, are expected to account for approximately 1.2 billion dollars of the program's costs this year.

With increased flexibility in program requirements, States also will be able to implement more cost-effective approaches to delivering care to the needy. Currently States are unable to take many steps which could make their Medicaid programs more cost-effective. For example:

- They cannot take advantage of economies of scale by buying in bulk and distributing to disabled recipients items such as canes or wheel chairs;

- They cannot use competitive bid arrangements to purchase laboratory services;

- They must reimburse hospitals on a reasonable cost basis and therefore cannot fully utilize reimbursement approaches which encourage more efficient and effective delivery of services;

- They generally cannot target services to the population most in need of them;

- They are limited in their ability to contract with cost-efficient HMOs to provide services to beneficiaries; and

They often find it difficult to establish appropriate cost effective community based systems of care under Medicaid for the chronically medically ill and the retarded.

The combination of an interim ceiling on the Federal contribution to each State's Medicaid programs and enactment of our proposals to provide greater latitude to improve program effectiveness will stimulate States to improve their programs while adjusting program spending to a more acceptable level.

We also propose to phase-out Federal support of the Professional Standards Review Organization program. The PSRO legislation was passed in 1972 to replace an ineffective system of utilization review.

Unfortunately, evaluations of the PSRO program by the Congressional Budget Office and the Health Care Financing Administration show the PSRO program, at best, to be cost beneficial to the Federal Government only in some areas and overall to actually add to national health spending. Additionally, elimination of Federal involvement will allow States and private insurers to make their own decisions regarding the most appropriate form of utilization review.

We are recommending therefore that Federal funding be continued through 1983 only for those PSROs judged effective in controlling health care costs. This will allow time for implementation of health care financing reforms that promote competition. After 1983, we expect that the most efficient PSROs will be supported by private systems of health care which contract for their services.

In conjunction with the phase-out of the PSRO program, legislation will also be proposed to eliminate the requirement for utilization review committees in providers not covered by PSRO review.

Elimination of Federal regulation in this area will allow State and private health care financing systems to determine the need for, and the most appropriate form of, utilization review, as reforms enhancing competition in the health care industry are implemented. Over the long run, requiring PSROs and other review entities to compete for contracts in the market place without Federal subsidy should ensure a more efficient use of health care resources.

We are also proposing the repeal of several amendments to Medicare and Medicaid adopted by the Congress in late 1980 in the Budget Reconciliation Act Public Law (96-499) and Public Law 96-611 (The Pneumococcal Vaccine amendment).

These involve low-priority benefit expansions that cannot be justified in light of the need for budget austerity. The items include expanded Medicare coverage for hospital care related to performance of dental procedures, the recognition of free-standing alcohol detoxification facilities and outpatient rehabilitation facilities as separate providers under Medicare, and minor home health benefits. None of these expansions would take effect before June 30, so no current benefits would be reduced.

Finally, we are proposing a number of other changes to improve Medicare program efficiency and effectiveness. These include elimination of the current automatic reimbursement bonus paid to hospitals for routine nursing services to Medicare beneficiaries, elimination of the one time deferral of P.I.P. reimbursements, movement to a competitive bid system for Medicare contractors and institution of an administrative hearing procedure to more effectively combat fraud and abuse in the Medicare program.

Conclusion

In conclusion, Mr. Chairman, I want to reemphasize the importance of these programs. They address a wide area of concerns but have common goals:

- guaranteeing that the basic social security program upon which millions of Americans currently depend and to which many millions more will look in the future, is fiscally sound and will remain the primary means to insure income to those who can no longer work;

- insuring that public assistance is focused on those who cannot, through no fault of their own, provide their basic needs; and making certain that those who are able to provide for themselves will have the opportunity and responsibility of doing so;

- providing flexibility and funding to States to enable them to more directly design and control their programs to better serve the needs of their residents; and

- increasing the cost effectiveness of Medicare and Medicaid.

To meet these goals, the President's program for economic recovery—of which these proposals are an important part—should be given prompt consideration and action.

That concludes my testimony, Mr. Chairman. I'll now be happy to answer any questions you may have.

Senator DOLE. We will proceed under the early bird rule.

Senator Long.

I think we will maybe limit the front round to 7 minutes.

Senator LONG. Let me congratulate you on your statement. I believe it reflects credit on both you and the President of the United States. It is consistent with what Mr. Regan first said when he came before our committee testifying against what he at that time believed to be an unwise welfare proposal because it would have enormously increased, probably doubled, and then redoubled the cost of the program.

I really think that your program is pointed in the right direction and I believe it is going to be good for the country.

I am going to vote for it. I hope you will permit me to continue to make some constructive suggestions because I do think that by working together, by considering everybody's suggestion, we can arrive at the best program.

Now there is one thing that has troubled me for years, and I wonder if this would still remain in the program. My understanding is that people over in HEW have for years contended that the law does not permit any of this welfare money to be used to pay people to work. They can use it to pay benefits for not working, but that they can't use it to pay people to work.

Even under the program that you are talking about, my impression is that you are talking about requiring people to work off their welfare payment, or to do some work after they receive a welfare check rather than pay them actually for their work.

My thought about this welfare program has always been that I don't propose to make somebody work for nothing. I just don't want to pay them for doing nothing if they are capable of doing some useful work. And I think we ought to offer them the work alternative.

I've explained this to Mr. Swoap who is sitting beside you and he has served with this committee for some time on the minority staff and, as far as I'm concerned, if he needed a job, he could serve with the Democrats any time. He has made some fine recommendations and done some good work.

Is that still the construction or the interpretation of our welfare laws in the Department, that you cannot pay people to work? That you can only give them a grant of money for doing nothing, but you can't pay them to do any work?

Secretary SCHWEIKER. We basically believe that the current law probably says that, Senator Long.

By the same token, we are proposing to change that. So, it is unmistakably clear what can be done.

Senator LONG. Well, now, in the first place, I don't think the law does say that. I think it has just been construed to mean that. I don't think anybody in the Congress ever voted to intentionally say that you can't give 5 cents of this money to one of the welfare clients to do some work, to do the first decent act, or that you can require them to do something as a condition of being eligible, but that you can't pay them for the work they do.

Secretary SCHWEIKER. You are right, Senator Long, that this has been the traditional position of the Department and we've done it through waiver mechanisms.

Senator LONG. Now, that ought to be changed, Mr. Secretary. How did this thing get in the law? As I understand it, the argument over in the department was that there was a time hundreds of years ago in England when they used to have some poor houses where these poor people had to work very, very hard to survive. And what the bleeding hearts don't seem to understand is that back at that time everybody had to work very, very hard to survive.

But nobody under a work program is expected to do any back-breaking work. We just think that they ought to do something to make themselves useful, and I really think we would have a better program if we simply told people we are not going to make you do any work, all we are telling you is that you have this option. If you want to do something, we will pay you for doing something useful.

Now, if you don't want to do it, that is fine, but you won't be made to do it—but you are not going to get near as much as you would get if you wanted to turn to and do something.

I think that way it would dignify what we are paying and it would be more in line with the traditional American concept that you are paid for what you do, and you are not made to do something against your will.

Secretary SCHWEIKER. Senator Long, let me say that basically I agree with the point you are making. We would propose to combat the problem in two ways: No. 1 is that under our work concept, we would leave it up to the States to present a plan to us and we would have the right to waive some of these things. So, I think I can accomplish some of the same purposes by waiving what some people say is the present requirement of law to each State.

So, I would certainly be disposed to do exactly that for the reasons that you said.

Second, we are recommending that the law be changed so that it would be incontestable in the future. But we can do it by waiver and I assure you we will try to accomplish that in the States that want to proceed in that way.

Senator LONG. Mr. Secretary, I don't think that we ought to be running a program where you are required to waive something where it is an outrage if it is in the law to begin with.

In other words, here are able-bodied people full able to turn to and do something for their own benefit as well as the benefit of society. Everybody in America agrees that you shouldn't be paying money out to able-bodied people who are capable of working. They agree you ought to offer them a job, offer them something to do instead of paying them to do nothing. And it comes as a shock that this is not the way the law is interpreted now. You just talk to any of your constituents, and I don't care whether it is in Pennsylvania or Louisiana, just talk to any of the people that you do business with, other than those in the welfare department, and ask them if they understand that the law does not permit you to pay somebody to do some work.

They will tell you, as a character was quoted as saying in Dickens something to this effect: "Well, if the law says that, then the law is an ass"—because it doesn't make any sense at all. I think that we ought to try to change that and make it clear that we can pay people to do something, rather than have to get around the

law through waivers. Basically, what this program of working off the benefit amounts to is a way of getting around something that never should have been the law to begin with. I hope that we can change that. I hope we can work with you in helping to bring that about. But I will bet you that 99 percent of Americans don't know that the law forbids you, or it is construed as forbidding you, to pay some of these people to do something.

Secretary SCHWEIKER. Well, Senator Long, I completely agree with your general point.

In the meantime, I am going to go back and get a legal counsel opinion to see just how we got in this situation and what we might do about it.

Senator LONG. Well, I will support you in what you are trying to do in that regard. I just think that we could do a little better by repealing this impediment if indeed it is the law.

Secretary SCHWEIKER. Well, we will review this, get an updated legislative counsel decision and address it clearly one way or the other because I agree with you completely.

Senator LONG. Thank you very much.

Senator DOLE. Mr. Secretary, one of the votes we had yesterday, a rather close vote, was on the minimum benefit under social security. Can you tell us how many currently on the benefit rolls would be affected if this minimum benefit is eliminated?

Secretary SCHWEIKER. One and a half million people would be potentially affected, something like 36 million people on the social security rolls at the present time. This would be probably about 4 percent.

Senator DOLE. I am not certain you have given us a profile of recipients, but I think there is some interest in whether or not these people rely on this benefit as their primary source of support, or do they typically have income from other sources, and, I guess, the bottom line question: can you defend this cut other than on financial or budget cutting grounds?

Secretary SCHWEIKER. Well, the breakdown we have is that the number of Federal, State, and local governments annuitants—the people receive some kind of pension from the Federal, State or local government—who also receive the minimum social security benefit is approximately 360,000 people. About 1 million people who receive the minimum benefit are now eligible for SSI, and about half of those—or about 500,000 people—are currently receiving SSI benefits. Also by eliminating the social security minimum benefit, about 80,000 people would become newly eligible for SSI.

Senator DOLE. As I understand, a number of those who now receive the minimum benefit would be eligible for SSI benefits; is that correct?

Secretary SCHWEIKER. That is right.

Senator DOLE. About half? That many?

Secretary SCHWEIKER. Well, we have about 1 million people who receive the minimum benefit and are eligible for SSI, and about half of those—about 500,000 people—are currently receiving SSI benefits.

Senator DOLE. 500,000 out of what, a total of 3 million?

Secretary SCHWEIKER. Yes, 500,000 of the 3 million people who receive the minimum social security benefit currently receive SSI benefits.

Senator DOLE. You mentioned, I think, on Sunday and probably in your testimony, the administration's economic assumptions. There are always questions about any administration's economic assumptions, but even if they are correct, 30 million people or more are receiving social security benefits, we are going to have some problems unless we do something very soon.

I understand you have a task force, and will be submitting your social security plan to the Congress within the next, what, 30 days, or less?

Secretary SCHWEIKER. Yes, 30 days, Mr. Chairman, right.

Senator DOLE. Do you have any idea now what you may be submitting to Congress?

Secretary SCHWEIKER. We can certainly say, Mr. Chairman, that we will do two things specifically. No. 1 is that we will ask for the next 3 to 5 years that there be flexibility between the three social security trust funds, the DI fund, the HI fund and the old age fund—and that there be interchangeability between these three funds.

In addition, we would probably be recommending that we reallocate the tax within those three funds so that more of it goes to the old-age fund where it is obviously needed.

They are the basic things. We probably will be making other recommendations, but we honestly have not decided at this time what they are. Now, I might say that this review is based on the assumption that our proposals, such as the minimum benefit and the student benefit proposals, are accepted, and on the economic assumptions that we have, which obviously economists can differ over. We think this will make a significant improvement in the short-range problem, not necessarily the long-range problem, but the short-range problem. And I think that this will go well toward solving the short-range problem, but there probably will be some other things that we will be including, too.

Senator DOLE. When do you intend to address the long-range problem?

Secretary SCHWEIKER. Well, we hope to be able to make some recommendations on both in the next 30 days. We haven't made decisions yet on the long-range problems because—no question about it—they are harder choices to make than the short-range problem.

Senator DOLE. Is the administration still opposed to altering the cost-of-living index?

Secretary SCHWEIKER. I just left a meeting with the President and he clearly feels that this was a commitment that he made to the senior citizen groups and he feels strongly that we should not change that.

Senator DOLE. Not change it in any way? I mean, you talked about maybe wages and prices, whichever might be the lowest, some adjustment?

Secretary SCHWEIKER. I believe his feeling is that we should try to find other ways to solve the problem. I can't speak for him, but that's my understanding of his statement of the position.

Senator DOLE. But in the event Congress might move in another direction, sometimes occurs, as you well know.

Secretary SCHWEIKER. I have seen that happen. [Laughter.]

Senator DOLE. It may be a matter we would want to discuss further with you. It is in your testimony, and it's been publicized that you propose a recency-of-work test under social security disability program, and I think if that's adopted, I think you just mentioned in your statement, that workers would be eligible for disability benefits only if they have worked under social security for some fraction, a period, 1½ out of 3 years immediately preceding disability, I think the question has been raised whether or not this would prejudice workers suffering from degenerative diseases and those who have been able to work because of gradual deterioration of health.

If that isn't a fact—and I think it is—does the administration have any plan to deal with this particular problem?

Secretary SCHWEIKER. Let me say that it is not our objective to do something here that would affect or influence or hurt those people who might be considered terminally ill or who might have no hope for recovery.

We, frankly, do not believe that this particular proposal will have that effect, but I want to assure this committee if, for any reason, that is the effect, and if there are other approaches to solving the same problem, we are very open minded about it. It is not our intent to go after those people, and if we can draw this up in a little different way that the committee feels would eliminate that possibility, we are certainly agreeable to modifying that. We don't really believe that that's what the impact will be, but we certainly don't want to target those people for reductions.

Senator DOLE. I appreciate that. In fact, I think it is an area that if we have some flexibility, and if, in fact, it is obvious, or becomes obvious that there is a problem, perhaps we can do it at the appropriate time through modification in the language.

Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, one item of your testimony that caught my eye was the national data bank, a central file system that you described.

Could you describe that a little bit more, please? I will tell you why I am concerned. My understanding is, in reading your statement, that not only do you propose this central computerized data bank for people who are receiving some of these benefits, from some of these programs, but you also plan to have retroactive accounting systems which go back into a family's income and financial status.

It looks like on the surface that this could be a fairly comprehensive effort delving into an individual's background and livelihood, particularly when over a third of American households receive some portion of these programs.

Could you describe more fully what you have in mind here?

Secretary SCHWEIKER. Well, the present law provides, Senator, that States now—this is present law—have to secure certain information, such as social security numbers, and wage data, which is required to interface with Federal data.

Other information which may need verification is available through information systems administered by Federal agencies such as the Social Security Administration, the Railroad Retirement Board, the Veterans' Administration, Office of Personnel Management, and others.

The administration's policy has been modified with regard to the establishment of a recipient information system. As proposed in the administration's draft "Social Welfare Amendments of 1981," State and local welfare officials would have access to Federal records as a means of checking on a person's eligibility for welfare. Under the proposal, a central data bank would not be created, but current social security, Veterans' Administration and Federal personnel files would be available for cross-checking.

Our thought is that if we have all this information—it is required by law now—we are just not utilizing it in the proper way. We can put this information into some kind of a national file so that people who administer either a local or a State program, particularly, will have access to information on whether somebody is milking the system.

Senator BAUCUS. My understanding is, though, that this was proposed a few years ago, but was withdrawn. GAO did a study which basically pointed out some of the problems.

Apparently, some States objected to a central filing system because it would increase administrative costs. And, also, GAO apparently came up with a figure of how much all this would cost and stating that the budget increase—through 1986 would cost about \$35 million, but with no showing of benefits.

Are you familiar with earlier attempts to propose this kind of a system and if you are, why were they rejected?

Secretary SCHWEIKER. Well, I don't question, Senator, that we are walking a fine line here. And I think that whatever we do, we have to put in some safeguards so that it does not get out of hand.

By the same token, it seems to be rather logical that if we have the statistics and have this information that we ought to be able to make some use of it so that the people who are genuinely entitled to welfare, get it, and those who aren't do not.

All we are after are the people who are fraudulently using or abusing the system.

Senator BAUCUS. I understand the problem.

Secretary SCHWEIKER.—Right. But I have trouble understanding what your concern is on misuse.

Senator BAUCUS. One concern is: Here is a data bank of the poor, not of the rich. And combined with your earlier statement that you plan to go back and delve very deeply into these families' financial affairs. And it just seems to me that it could potentially be a very comprehensive data bank of the poor of our country. National computerized data bank of the poor, but not of middle income families, or not of the rich.

And it just strikes me as somehow being authoritarian. Somehow a little bit unbalanced. I grant you there is a problem here. That is, you want to avoid duplication and waste, and so forth.

I suppose this comes down to potentially a question of safeguards, but I don't see in your statement, you know, what kind of safeguards you would propose.

Now, does this require legislative action, or can your Department set this program up on its own without legislative rule?

Secretary SCHWEIKER. We believe it would require legislative action.

Let me just point out, Senator—I guess you probably weren't here when I first went through it, the real problem here, and I just want to show this again, because here is the crux of the issue.

Back in the fifties, we had social programs that were spending something like \$19 billion. This year we are going to spend \$300 billion. We have increased spending by basically 1,500 percent in our social programs. They went up 82 percent in the fifties, 188 percent in the sixties, and 313 percent in the seventies.

They are taking off like a rocket. If we don't get our management handle on these programs, we will never get the budget under control.

And here we are, we have duplication, and overlap. We are not counting food stamps in the AFDC program. We are not counting rent subsidies in the AFDC program. We have all these programs that are going through the roof and nobody is counting them. Nobody is considering whether they interact or interface. If we don't get that curve leveled off, we won't be able to afford the program. And the only ones that, I think, we are really going to hurt by these proposals are the people that have been abusing the system.

Now, I agree with you about safeguards and I think it could get out of hand, but that is our objective and it seems to me that we ought to better manage our own data and get our own house in order.

Senator BAUCUS. I understand the problem, and I frankly agree with a lot of your proposals here. I am just concerned about the centralized data bank of the poor. I am concerned about the protections, because it could be very much abused if it is not set up properly.

Secretary SCHWEIKER. Well, let me say that it wouldn't necessarily be just the poor. I mean, for example, in Medicaid, if some of the doctors would come under the program and be charging excessive amounts, that would show up too. So, I mean, it would not necessarily discriminate against the poor.

What it would do is give us information about where the \$300 billion goes.

Senator BAUCUS. But you are not going to include the financial information of all doctors though?

Secretary SCHWEIKER. I am just saying that we would obviously put Medicaid benefits on the record. So there are a number of things that could be looked at. We are not singling out one group of people over another group of people. We are going to try to use it to detect abuse.

Senator BAUCUS. Thank you very much.

Senator DOLE. Senator Byrd.

Senator BYRD. Mr. Secretary, social security, in my view is more important to more persons perhaps than any other Government program. What do you think is the appropriate balance to keep in the social security trust fund?

Historically, as I recall, we have tried to keep it at 12 months the benefit balance. Now, it is down to what, 2½ months; is it?

Secretary SCHWEIKER. You mean what it is now?

Senator BYRD. Yes.

Secretary SCHWEIKER. It is about 25 percent, as I recall, which would probably be about 3 months.

Senator BYRD. About 3 months.

What do you think in the long run should be the desired or appropriate balance?

Secretary SCHWEIKER. Well, we feel that it gets critical around the 14- to 15-percent level. So, obviously we would like to see it above that level.

Senator BYRD. Well, do you feel that the 25-percent level, which it is now, can be construed to be in the critical area?

Secretary SCHWEIKER. Say that, again, Senator Byrd?

Senator BYRD. Do you feel that the 25-percent area, or the 3-month balance, is adequate?

Secretary SCHWEIKER. Well, that's adequate for now, but our projections show that unless we do something we won't be staying at that level. So, the point is while that figure is OK, our projections indicate that we obviously will be going below that area.

In fact, if we don't make any changes, we will go significantly below the 15-percent level. So, while the answer is, yes, 25 percent is adequate now, it won't stay there if we don't make some changes.

Senator BYRD. Well, do you plan to make recommendations to the Congress to improve the financial condition of the social security system?

Secretary SCHWEIKER. Yes, we do, Senator Byrd. We certainly will provide borrowing among the three funds, the disability and the hospital funds are in surplus and the OASI fund is in deficit. We would propose that in the next 3- to 5-year period, that we have the flexibility to transfer funds among the three funds, but not use the general Treasury funds. We also will propose that there be a reallocation of the tax rates. We feel the actuarial projections on the old-age part of it are out of line with those of medicare and disability. So, we will be proposing that.

In addition, based on the assumptions that we now have, if we do those things and if we also adopt the recommendations of this administration such as the minimum benefit and the student benefit, we will, based on our economic assumptions, begin to get out of the problem area rather significantly.

I am not saying that is the whole solution to the short-range problem, but it will make a difference. And instead of going down to a deficit below 15 or 14 percent, we would be able to stay above that. But we will be having some additional recommendations in several weeks to go beyond those. The present proposals are just the basics that we can agree upon fairly readily. There are some others that we will be making within the next 2 or 3 weeks to get the OASI trust fund back in shape.

Senator BYRD. In regard to fraud and abuse, I want to congratulate you for your commitment to reduce or eliminate waste, fraud, and abuse in the programs under your jurisdiction.

As you know, Inspector General Morris, in his report on the then Department of HEW several years ago, indicated that more than \$6 billion was wasted through fraud and abuse.

What is your estimate of the amount of spending that can be reduced by eliminating fraud and abuse?

Secretary SCHWEIKER. Well, I don't have my new Inspector General on the job as yet. I have pretty well picked one out. He is awaiting clearance procedure, so it is a little hard to come up with some hard figures of our own volition that we are able to project.

But, there is certainly a lot of room for savings. The Department is shooting for savings in 1981, this fiscal year, of \$2.1 billion in terms of eliminating waste, fraud, and abuse. We are shooting for \$3 billion saving in eliminating waste, fraud, and abuse in 1982.

Now, I personally think we can do better than that and do more than that, but since I don't have my own person on the job to go in and analyze what I want done, and to set up some new procedures and some new computer comparisons, I don't know what exactly in addition we would find.

If I may just go back to one other issue that bears on your question, using some kind of a managerial data bank can be very helpful to our Department in a case like this to find fraud and abuse. For example, when California reviewed its SSI and AFDC rolls, they found that there were discrepancies in approximately 41 percent of those cases checked. So, here we are in the upper echelon of the welfare recipients, and approximately 41 percent had serious discrepancies and that was just by reviewing SSI and AFDC.

I don't know how we are going to manage this program, or how we can resolve after your question of how we reduce the \$6 billion or \$8 billion in waste, fraud, and abuse—if that is how much there is—unless you give us a management tool to do it in some way. This is just a basic procedure for reviewing the two obvious programs the Department has.

Senator BYRD. I think you are quite right, and I think it is essential that you do have adequate management tools or else, in the long run—the taxpayers will not be able to finance these programs if the abuses continue to the degree that they have in the past.

On page 24 of your statement, you say that in the AFDC program proposals are designed to improve the problem by: One, limiting eligibility to those most in need; two, strengthening work requirements; three, making AFDC a temporary safety net for those who are not economically independent; four, emphasizing individual responsibilities; and, five, improving administration.

It seems to me each of those are sound proposals which, if put into effect, can have a significant positive impact on the entire program of your Department.

As one Senator, I certainly like the way that you are approaching this subject.

Secretary SCHWEIKER. Thank you, Senator Byrd.

I might say that virtually all the proposals that we make in AFDC go to one of those problems or another. So, they do try to do that.

We hope to save, incidentally, about \$1 billion dollars through those measures in the coming year.

Senator BYRD. Thank you.

Senator DOLE. Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman.

Mr. Secretary, I would like to ask you some questions that deal with exactly what it is we are up to. One way to look at it is we are going to take that chart over there and level off that quickly rising line. We are going to get all excited about saving, saving, saving.

Another way, philosophically, to look at it is that we are in the business of cutting, capping, and blocking, and that is sort of a new function of this Federal Government.

Or, a third might give us some long-range clue to what this administration is up to, and I focus particularly on the health care area.

The National Government clearly has done quite a job in the last 15 to 20 years in addressing in the individual sense and the collective sense, the need for health care in this country. But as I go through the three programs of special concern to me looking for some philosophy, looking for what are you up to, I do not get a feel for your philosophy.

I find in the social services block grant, 25 percent less money. The proposal embodies your philosophy that assistance funds can be most effectively used when States have the flexibility to respond to State and local conditions and that the most effective Federal role is to serve the States and localities in this effort through research and other support activities.

I don't know if that means eventually there is no Federal money in the social services area or not.

You move on to the health services block grant and, again, you will see a 25 percent cut. There is no particular statement of philosophy, but I think there is a presumption that we might be moving in the same direction.

In the health services block grant you have another kind of a problem, which is pitting the efforts of group to deal with health care problems one against another. Some efforts have been ongoing for a longer period of time than others, pitting maternal and child health against other health services. It becomes more clear in that area.

Then the third one, of course, is the medicaid cap, and there I am really searching for where we are going. We are taking \$100 million out in 1981 outlays, and \$900 million in 1982 outlays, and we are saying to the States: you can better make eligibility determinations, and so forth.

But my concern is putting this up against the President's commitment to something called devolution, which says we are going to let the States, you know, do more. In effect, are we on the way to devolving health care in this country to a State and local function in the financing of health care.

Is that your basic philosophy?

Secretary SCHWEIKER. No, Senator Durenberger, I think you can sum it up by making several different points. We are trying to consolidate some of the health grant programs into one category,

and I will ask Mike to please put up the health chart again to show the basic services.

Our proposals permit the States themselves to place their own priority on which of those programs are most relevant to their population and those most in need. So, we are down that road, but we still expect to continue that on a long-range basis. This is not a phaseout. I think it is important to say it is a continuation of support, but done by State administered programs.

Second, in terms of the health issue and the national Government, we will be proposing right after we finish our social security proposals, a "competition program" that will incorporate proposals from the Durenberger/Stockman/Schweiker bill and will bring forth what we believe is a national focus on reimbursement mechanism on some reasonable constraints that we believe will keep a national focus, but in a way that will let the competitive element come in.

Third, it is true that we are capping the medicaid program, but we look at the cap as a temporary measure until we can bring the competition forces into being and until we get our other proposals lined up.

I might say that the Governors specifically have asked for seven or eight points of flexibility in handling their medicaid program and a number of them have said that if we gave them that total flexibility, they thought they could meet the cap problem. In fact, the head of the health division in Missouri, Governor Bond's State, very specifically made the statement that they could save money just because we are eliminating the planning process, the requirement for approval, and the administration process of the Federal Government.

Whether we can save all that or not, I don't know, but that is our hope so that we can utilize those services in medicaid.

We are also going to let the States enter into competitive bidding arrangements if they want to.

If they want to contract out to an urban hospital, they can do that. If they want to contract out to an HMO program, they can do that. That's the direction in which we are trying to head.

Senator DURENBERGER. But, again, looking long-range and when we are looking at competition, we are obviously dealing with long-range issues.

Where do State and local governments look to see the Federal Government in the area of subsidizing access to the door to health care.

Are we going to continue in medicaid, in particular, with this sort of 50/50 proposition with more power on their side to deal with eligibility issues, or are we going to give them more access to general revenue sharing or block grants, or something like that, or might we go all the way and say that the Federal Government will take over the financing of medicaid and have States pick up more financial responsibility in other areas? And the Federal Government will leverage these piggybacks on HMO's or the competitive system.

Is there a direction that you believe this administration is heading, or should be heading with regard to the ultimate responsibility for financing the access of the poor to health care?

Secretary SCHWEIKER. Well, I think we are actually working up a partnership, Senator, between the Federal and State Governments in this respect. Yes, we are saying that we feel that the grant programs can be better administered at the local level.

We feel that giving them the flexibility of administration of their medicaid program is an advantage. As for the reimbursement and the financing mechanisms we believe that we can probably do best by retaining some of those prerogatives so that we can do it nationally.

We also believe there is a national responsibility, for example, in the National Health Service Corps, which does serve some of the poor and needy people. And while we don't agree with the Carter administration's rate of growth, we believe that we can participate by having a National Health Service Corps with lower numbers than the Carter administration had, but we are still increasing it from what it was.

So, it is a partnership and a two- or three-track system. It is not an either/or situation.

Senator DOLE. Senator Mitchell.

Senator MITCHELL. Mr. Secretary, I would like to ask a few questions, first about the energy and emergency assistance block grant, and I wonder if we might get that back?

Secretary SCHWEIKER. Yes, we'll put that chart back up again.

Senator MITCHELL. I thought I saw in the chart that your proposal would permit the States to use those funds for weatherization as well as home energy costs, and I want to commend you for that. The previous program which provided for low-income energy assistance did not, under that program, permit weatherization.

There was a separate program under the Department of Energy for weatherization. I wonder if you are aware of whether that program will continue or whether it will be terminated?

Secretary SCHWEIKER. This is not in our department?

Senator MITCHELL. No. Prior to this year—prior to your proposal, existing law provides for the low-income energy assistance program, which is funded at \$1.85 billion, and the Department of Energy operated a weatherization program, which was separate from that.

My question is: do you know whether the Department of Energy's weatherization program will continue?

Secretary SCHWEIKER. This program, as we understand it, is being folded into a different block grant—not our block grant—which covers activities similar to large weatherization projects.

So, I guess the answer is, Senator, that it is going on in a somewhat different form, but in another block, but for larger projects, as opposed to this. This is more for individual households and situations.

Senator MITCHELL. So, that will no longer be available for private home weatherization for low-income persons?

Secretary SCHWEIKER. It could be. It could be. I'm just saying that it is folded into a block and they would have discretion to use it either way.

Senator MITCHELL. While I think that is a good part of your program, because I think it is important to give flexibility to the

States to weatherize, which is ultimately more beneficial, I am very much concerned about the level of funding.

You are proposing, of course, to provide a block grant at about 25 percent less funding than was available last year.

You are aware, of course, that there has been not a 25-percent decrease in the cost of home heating oil, but a dramatic increase in the cost of home heating oil in the past several months?

Secretary SCHWEIKER. Senator, let me give a couple of responses to that. First of all, the home heating program is the one program out of the 40 that has somewhat special status. We almost have made a categorical block grant program out of it. We singled that out for some of the reasons you are getting at. It is a critical program. We didn't want it submerged and divided among other programs because we feel it is a high priority. So, just the fact that we set up an energy block grant program with only two programs in it—one very small, one very large—indicates that the focus is still going to be there.

True, the funds will be reduced 25 percent. By the same token, we do give a flexibility in these programs that within any of the four blocks, 10 percent of that block could be taken from the block and put in another block. So, if a Governor felt that was the key thing in his State, he could take 10 percent from three other blocks and put them in the energy block.

Now, in fairness, it could work the other way, too. If some Governor or State legislature didn't feel that it was a high priority, the 10 percent could be put in the health block.

So, we did provide for a 10, 10, and 10 transfer among those four block grants.

Senator MITCHELL. But, of course, those have been reduced 25 percent as well so there will be great pressure not to do that; isn't that correct?

Secretary SCHWEIKER. Senator, no question, we are cutting the budget. I mean, you can't look at that line and not say, we're cutting the budget. We are cutting a budget, and I don't know how to cut the budget without cutting budget items.

Senator MITCHELL. The thing that concerns me is that, as you know, the President acted to decontrol domestic crude oil prices early. That has produced in my State at least a 15-percent increase in the price of home heating oil since that decision, added on to an earlier 20-percent increase in this heating season.

The price of home heating oil has gone up by one-third just this winter.

Now, when the Director of the Office of Management and Budget was asked by my fellow Senator from Maine, what the administration proposed to do about that effect, his answer was, "Well, we will take care of that. Those in need will be taken care of through the fuel assistance program."

In other words, the administration has taken steps which have resulted in a dramatic increase in the price of home heating oil and now is proposing a dramatic decrease level of assistance for home heating. And I am very much concerned about that.

I understand the budget has to be cut and everybody is committed to cuts, but you are dealing with an essential of life here: A person's heat, a person's being able to live in heated homes.

Secretary SCHWEIKER. Well, that is exactly why we built into this program the provision that you could take 10 percent out of any of the other three programs and put it into a block such as this, and that is why we singled out this particular block to have almost an exclusive category because we share your concern.

I agree with you that, this is an austere budget, but we tried to provide two flexibilities. One, that it had a block of its own. Two, that 10 percent of the money of the other blocks could be put into this block if that was the basic necessity involved, and it well may be in your State.

Senator MITCHELL. Well, it is not just an abstract thing, Mr. Secretary. I am sure you have experienced examples of it. I had the occasion to see it firsthand. As a Federal judge, I presided over a law suit on the administration's program and heard testimony from witness after witness, persons with young children who literally were forced to choose on a day-to-day basis between buying oil and buying food.

It is not an abstract problem. This is a real life problem for Americans faced with tremendously difficult problems.

I know you are very sensitive to that and I know you are very concerned about that, and I must say I am disappointed that because the actions of the administration have contributed to this increase in the price of home heating oil, it has been aggravated and it has been made worse, and this production really makes an already very severe situation even worse.

That is a statement, I guess, not a question. So, you don't have to respond to that.

I guess I have a minute, and I have another subject I would like to cover, but rather than starting now, I'll wait until the next round.

Secretary SCHWEIKER. Let me just respond to one point, Senator.

I share your concern for your State. I know your State particularly is sensitive to these problems. The SSI program and the social security program do have a component which provides for benefit increases based on changes in cost of living. So, when energy costs change it does show up in the recipient's benefits because the benefits are indexed to cost, and energy is a significant cost.

You are absolutely right in saying that the increase, in energy costs has created a severe situation but there is some flexibility in the other end of it in that the other programs—such as SSI, which really gets to your most needy people—would have a cost-of-living index component which partially reflects that increase.

Senator MITCHELL. Well, not to prolong it. I know my time is up.

If I could just say that, Mr. Secretary, in my State over 12 percent of the population received old-age assistance benefits under social security. The average amount received is \$316. The average home heating bill in Maine during the winter months is nearly \$200 per month. It is just an impossible situation for the elderly poor.

And the modest increases you are talking about really haven't even come close to covering the one-third increase in the price of home heating oil this winter.

Thank you.

Senator DOLE. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Secretary, I share the concerns that have been voiced here by Senator Mitchell in the home heating oil situation, low-income assistance there because, of course, every problem he has, I have also.

Let me just say this as a statement. I know everybody is always against fraud and abuse, and usually against overregulation at the same time, but the way, it seems to me, you eliminate fraud and abuse is to have more regulations. It is pretty hard to eliminate one without the other, or to eliminate one without increasing the other.

If you can do it, it will be a very skillful feat, and I will applaud you for it.

I have a concern dealing with AFDC and the changes that you are proposing. Currently, the States have an eligibility to permit low-income mothers carrying their first child to receive AFDC and thus receive the medicaid that goes with it.

Now, as I understand the proposal that you have, it would only be permitted during the third trimester of the pregnancy. And that worries me in connection with the maternal benefits that are going to that woman, both for herself and, of course, for the unborn child.

Could you respond to that? I know during your terms up here, you were always deeply concerned with prenatal care and maternal benefits, and that is an area that appears to me to have been hit by the proposal you are making—the administration is making.

Secretary SCHWEIKER. Well, for a woman who is pregnant and has no other children, the burden up until that point is really not that severe. In other words, it is only when the baby arrives that her costs begin to mount if she has no other children.

Senator CHAFEE. Well, it isn't so much the cost, the large costs, it is the prenatal care we are concerned with and that would be—she would be eligible for as a low-income recipient being on AFDC and thus on medicaid. You can't get medicaid without being on AFDC.

She can't get AFDC until she is in the third trimester under your proposal, and that is what bothers me.

Secretary SCHWEIKER. But she would be eligible for medicaid.

Senator CHAFEE. No. No, because she wouldn't be eligible for AFDC.

Secretary SCHWEIKER. Well, why wouldn't she be eligible for AFDC; I am not sure I follow the point?

Senator CHAFEE. Because your proposal says she wouldn't.

You take that discretion away from the States that they currently enjoy.

Secretary SCHWEIKER. Well, the States now have an option in terms of whether or not to cover the pregnant woman now. So, if it is really a needy situation, the States can make that determination.

Senator CHAFEE. That's right. But as I understand your proposals, you would not permit that in the first birth of a woman—a woman's first pregnancy, and would limit that to the third trimester of her pregnancy.

Now, if I am wrong, I would be glad to know but that is my understanding. In other words, you have changed the discretion that the States currently have.

I think it is important for the States to keep that discretion so that the woman can get the kind of prenatal care that I think is important, which I know you have always considered important.

Secretary SCHWEIKER. Of course, in the other block grant program, we specifically give the State total flexibility under the maternal and child health care programs. There is now duplication of coverage. That is why we are going through the roof at \$300 billion. We cover something three ways.

We have given full authority to the States under this block grant proposal to cover maternal and child health. Which, I think, would go to the heart of the problem.

Senator CHAFEE. So, the answer is that this woman in her first pregnancy could be cared for under the State health block grant—health service block grant; is that correct?

Secretary SCHWEIKER. That is right. And the other point that I didn't make yet, and should have made is: under medicaid, coverage actually can start 3 months prior to getting AFDC. So, you move your problem back 3 more months so that instead of the second trimester, or the beginning of the third trimester, it would be one trimester earlier.

Senator CHAFEE. The first 3 months.

Secretary SCHWEIKER. Only 3 months pregnant.

Senator CHAFEE. OK. Thank you.

The other question I have—

Secretary SCHWEIKER. Well, some of them don't even know it yet.

Senator CHAFEE [continuing]. Yes. The other question I have is on the lump-sum death benefits. If you explained this during your testimony—I read over your testimony, but if you went into some further detail, I apologize.

Is this similar to the provision that was sent up last year by the administration? Last year's administration eliminated it entirely.

Secretary SCHWEIKER. Well, let me say this: originally that was the OMB proposal, but I appealed the proposal successfully and so, all we are really doing is saying that if there is a surviving widow, or surviving minor children, they will still get the benefit.

Senator CHAFEE. If there is. But if there isn't, there is no benefit?

Secretary SCHWEIKER. That's right. We feel—

Senator CHAFEE. Who buries the person then?

Secretary SCHWEIKER [continuing]. Well, whoever was burying them before we had this benefit.

Senator CHAFEE. Life was going on before these programs started, I guess?

Secretary SCHWEIKER. We just feel that the program was set up to help the poor widow who didn't have this money to bury her husband, or to the children who didn't. And we believe that is where the focus ought to be. The thing has gotten to the point where we add on and add on. The only way you can really bring that curve down is to begin to target your benefits. We think that the poor widow and the poor children should have the benefit.

After that, we don't think it is a Federal responsibility.

Senator CHAFEE. Well, I can remember last year hearing a stirring speech on this subject from the then chairman of the committee opposing the elimination of that. He had me convinced. He was up last year running and made a lot of sense on that proposal. I am running this year, and it seemed to me to make a lot of sense this year. [Laughter.]

However you have changed it.

Secretary SCHWEIKER. Wait a minute. The previous administration proposed cutting out the widows and the orphans.

Senator CHAFEE. Right.

Secretary SCHWEIKER. We have put the widows and the orphans back in. We have them in a safety net.

Senator CHAFEE. That is right. So, we are not campaigning against widows and orphans?

Secretary SCHWEIKER. No. Our safety net is working well here.

Senator CHAFEE. Right. Thank you very much.

Thank you, Mr. Chairman.

Senator DOLE. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Secretary, I would like to focus on some of the areas that have already been covered and perhaps one or two that haven't been touched yet.

One of the areas is student benefits. The fact is that there are a lot of students who are now planning to enter this fall who will find reduced benefits when fall comes.

First, do you have any idea how many students are going to suffer that reduction? Don't you think that the proposed reductions in benefits may be too abrupt and that students will not be able to make other plans if they had already assumed that they would be receiving these funds. Might it be more prudent and better for the long run if these cuts went into effect at least a year later so that you could provide a reasonable transition for these students who are in college expecting to get this assistance.

Secretary SCHWEIKER. I think you have to divide it into two parts, Senator Bradley. No. 1 is that anybody in college now will be phased out over 3 years, or their benefits will cease at the end of their college attendance, whichever is earlier.

In essence, if they are in college now, they will get a 25-percent reduction beginning in the fall, and then another 25 percent the following year, and then another 25 percent the next year. So, the people who are actually in college now and geared to a level of support are being given 6 month's notice that come September there will be a 25-percent reduction. I am not sure if you are talking about those or not.

The group that hasn't started college yet, that is now in high school, will not be phased into the program beginning in September. So, we are putting them on notice that they have to go to other sources to get their support. And let me say, this is so typical of why that curve has gone up to \$300 billion a year.

Senator BRADLEY. Which program are you speaking of now?

Secretary SCHWEIKER. I assume you are talking about the student benefit for social security?

Senator BRADLEY. Well, that is only one example.

Secretary SCHWEIKER. Isn't that what you asked me? Maybe I misunderstood.

Senator BRADLEY. That is only one of the student benefit programs. The guaranteed student loan is another. In addition to that there are the Pell grants. Reductions in all of these programs will have a cumulative effect on a middle-class family trying to pay for its children's education.

Secretary SCHWEIKER. Most of these benefits weren't in place for a number of years, now they are. Even with all the cuts we are talking about for fiscal year 1982—they have: \$2.5 billion in Pell grants; a half billion dollars for work study; \$400 million in supplemental grants; \$50 million institutional match for their work study program; \$100 million for State incentive grants, with \$100 million State match; \$300 million for direct loans, with \$400 million direct institution match for that; \$1.8 billion in the guaranteed student loan program; and \$5.7 billion from the lending institutions for loans.

Senator BRADLEY. Could you tell me cumulatively what the effect of the administration's proposals will be for middle-class people trying to send their children to college. What the cumulative reduction would be?

Secretary SCHWEIKER. I can provide that for the record. It really doesn't come under my department, but we'll get it for you.

I do want to say that these figures show that this coming fiscal year we will put \$11½ billion into student aid; \$11½ billion, regardless of all the cuts. And the people who will best qualify for it are the very people we are talking about here who are receiving the student social security benefits.

They will be first comers and that is the way it should be. And that is why we are trying to eliminate the program and channel them into other programs.

Senator BRADLEY. Well, my only point is that it is a little bit late for them to make alternate plans because school begins in only 5 to 6 months. That is my only point in asking the question. I think that if you wanted to make reductions, you could have done so with a little less pain for students and their families. This is a rather abrupt action.

Let me go to another area. I think Senator Chafee covered it a little. It has to do with the reductions in preventive health services, with your proposal to place these services in a block grant and reduce funding by 25 percent.

My question is: How can you justify that reduction on a cost basis?

I can understand how you might get a 10-percent savings out of making preventive health a block grant as opposed to a number of separate programs, but why 25 percent? What is the rationale for cutting back 15 percent in real terms on preventive health?

Secretary SCHWEIKER. Well, let me say, preventive medicine happens to be one of my favorite programs and one of the things I did do was to put it in a special block grant. I was concerned that if we merged it into the regular health block it would get integrated into the basic health services. So, to protect the prevention programs, I set up a special block grant exclusively for them. I think setting up

the special block grant, in essence, puts the pressure on the States to deal with these programs.

Now, let me say, I am not happy about the 25-percent cut. None of the departments are happy with their cuts. You know, you can't cut the budget without cutting the budget. I don't know how else to bring that curve down. I think it is important to say this. If the Congress really doesn't agree with these cuts, then they should propose their own cuts. Because we have got to bring that \$300 billion curve down, or we are not going to have any country left, economically, and we are going to hurt the lowest income people the worst because they get hit most by inflation. So, if the Congress doesn't agree with these cuts, we are rational people and open to finding out about alternatives to our cuts.

I think that we singled out preventive health services here in a rather unique way by having a categorical block grant program to protect them. I would like to see it fully funded. I would like to see all the programs in my department fully funded.

Senator BRADLEY. That is why I asked the question. If you assume you are going to save 10 percent by creating a block grant, then you are going to be left in the position of cutting 15 percent in real terms in preventive health care, particularly in programs for pregnant women and children. I think that you are in the position of saying that you have just chosen to assess to pregnant women and children a 15-percent cut.

What is the rationale for such a cut in the long term? Isn't that a false economy? Because, if you don't provide that health care at an early age, then you are forced to pay much more in taxpayers' dollars down the road in the form of much more expensive care for some health problems that could be averted by early preventive services.

Secretary SCHWEIKER. Well, of course, you do have four or five programs that address the same need. You have title V; you have rural health centers; and have community health centers. I can give you five programs right off the bat—and this is one of our troubles—that address exactly the same need: Rural health care, community rural health centers, community health centers, title IV, the programs here, and medicaid. The problem is that we can't escalate all five at one time to do one job. So, we are consolidating and asking the State to pick the most effective delivery system.

Now, you probably weren't here when I did respond that the director of the State division of health in Missouri says that they really feel they can save the money because they won't have all these Federal obligations: the Federal paperwork requirements and the Federal planning requirements and the Federal administration and monitoring requirements just by the fact that they won't have to do all those Federal things. I don't know if that is the case or not. But here is an activist State that feels they can save the money without Federal harassment.

Senator DOLE. Senator Long.

Senator LONG. Mr. Secretary, I have three questions that have to do with identifying the people who receive the minimum benefit under the social security program, and I will submit them for you to answer for the record.

[Responses to additional questions raised by Senators Baucus, Bradley, Dole, and Long follow:]

OASDI

Question 1. On page 20 of your statement, you indicate an intent to increase the review of disability claims over and above the mandate of the 1980 amendments. Doing more review obviously requires more manpower. Can you supply an estimate of the additional work-years which will be devoted to disability review:

(a) to carry out the 1980 amendments?

(b) to go beyond the requirements of the 1980 amendments?

Please indicate the extent to which these additional work-years represent new employment and the extent to which they will be diverted from other administrative functions.

Response. To perform special reviews of disability claims and continuing eligibility, the Administration has included sufficient resources in its budget request to fund the work-years shown in the table below:

	Fiscal year 1981		Fiscal year 1982	
	Federal work-years	State work-years	Federal work-years	State work-years
1980 amendments:				
Periodic review.....	—	—	986	920
Preeffectuation review.....	300	35	600	78
Subtotal.....	300	35	1,586	998
Beyond the 1980 amendments:				
Accelerated continuing disability effort (CDI).....	542	745	1,143	1,239
Total.....	842	780	2,729	2,237

The work-years reflected in the above table under "1980 Amendments" represent only those resources required for the disability review provisions and not the implementation of the entire Public Law 96-265.

The work-years for the accelerated CDI effort represent work-years over and above the work-years in the Carter budget for title II CDI's; these additional work-years will be achieved both through the recruitment of new employees and a diversion of resources previously budgeted for other functions.

Resources had been budgeted for the SSI Conversion project to assure that current SSI beneficiaries who were "grandfathered" into the Federal SSI disability program from the State programs in 1974 continue to meet the definition of disability. These resources will be redirected to the more cost effective title II reviews as recommended by the General Accounting Office.

	Fiscal year 1981		Fiscal year 1982	
	Federal work-years	State work-years	Federal work-years	State work-years
SSI CDI project:				
Redirected SSI conversion project resources.....	253	610	266	655

Question 2. Up to now, the Department of Health and Human Services has always maintained that the funding of rehabilitation services for DI beneficiaries results in the rehabilitation of beneficiaries who would otherwise stay on the benefit rolls. If that is true, eliminating that funding should cost rather than save money. Could you provide a cost-benefit analysis of this proposal?

Response. The Administration's proposal would eliminate the use of Social Security trust fund money to pay for vocational rehabilitation services for Social Security disability beneficiaries. Also under another proposal, Federal funds for State vocational rehabilitation programs would be consolidated with the Federal block grant program for social services. Social Security disability beneficiaries would continue to be referred to the States for necessary vocational rehabilitation services to be funded under the block grant program.

Block grant funding will (1) put the States in a much better position to take action where previously overlapping services have resulted in the waste of service dollars, (2) give the States flexibility in setting priorities as to the vocational rehabilitation services which best meet the needs of State residents, and (3) permit more efficient State administration of the vocational rehabilitation program.

We cannot provide a cost-benefit analysis of the proposal at this time because we do not know how the States will allocate resources to provide vocational rehabilitation services under the block grant approach.

The rehabilitation of Social Security DI beneficiaries is a very important goal. However, it is essential to the success of the block grant approach that we not exempt certain "favored" programs. We must give the States the flexibility to set their priorities, among many important programs, in order for the block grant approach to be an effective tool.

Question 3. Mr. Secretary, can you describe for us the administrative processes that will be required to identify people getting minimum benefits and recompute their regular benefits? How many man-years will this require? What would be the savings from applying those same man-years to reviewing initial disability claims?

Response. The President's budget included an additional 3,180 Federal work-years in 1981 and an additional 7,302 work-years in 1982 to implement the proposal to eliminate the minimum. The budget estimate of Federal work-years assumes that manual processing will be necessary for the entire task. If this process could be automated the resources necessary to perform this function would be considerably lower. However, the system problems being faced by SSA are such that there will be little chance of efficiently automating this process in the near future.

The administrative processes involved in implementing the proposal to eliminate the minimum benefit would include the following:

- Identifying those beneficiaries with benefits based on minimum primary insurance amounts (PIA);

- Associating available earnings data with each minimum benefit case;

- Applying new computation methods to compute a new PIA;

- Computing a new benefit amount. (In this process, all other provisions of the current Social Security law are reapplied to the new PIA. This could include development of a new family maximum amount, a new actuarial reduction amount, a new delayed retirement credit, a new limit on the widow's benefit amount, reapplying the retirement test, workmen's compensation offset, etc.); and

- Increasing the SSI amount where appropriate.

You also asked, what would be the savings from applying the man-years needed to implement the benefit provisions to reviewing initial disability claims instead. As you know, the Social Security Disability Amendments of 1980 (P.L. 96-265, section 304) provide for an SSA review of State agency disability allowances and continuances.

The review of State agency disability allowances and continuances pursuant to section 304 went into operation in October 1980, and will not be completely phased-in until fiscal year 1983. At the early stage, the effects of this review of State agency decisions on program savings cannot be determined. The Secretary of Health and Human Services is required to submit a report to the Congress on the potential cost effectiveness of this provision by January 1982. We will not be able to determine the potential impact on program savings if the work-years required to implement the minimum benefit provision were instead applied to reviewing disability claims until we collect sufficient data from the section 304 study.

Question 4. Mr. Secretary, according to a document you sent to the Ways and Means Committee, 12 percent of the people who will have their minimum Social Security benefit cut are double dippers—people who also get a Federal, State, or local government pension. Can you tell us something about the characteristics of the other 88 percent?

Response. Of the 3 million beneficiaries (including retired and disabled workers and their dependents and survivors) receiving benefits based on the minimum, a majority would not receive any reduction in total benefits.

33 percent of persons receiving the minimum are dually entitled beneficiaries who are entitled to total benefits higher than the minimum as spouses or

surviving spouses. Generally, they would not be affected because they would continue to receive benefits based on the higher spouses' amount.

17 percent are SSI recipients. (Any reduction would be offset by an increase in the SSI payment.)

7 percent would have benefits based on their own earnings equal to the minimum and would not be affected by the proposal.

Of those potentially affected about 12 percent, as you know, are Federal, State, or local government annuitants. Additionally:

17 percent are now eligible for SSI, but have not applied for benefits.

3 percent would become newly eligible for SSI, and

About 3 percent would be eligible for SSI except for their age (not yet 65).

Question 5. Mr. Secretary, can you tell us something about the age of the people who get the minimum benefit and who will get a cut under your proposal? How many of them are over age 70? How many are over age 75?

Response. Of retired workers receiving benefits based on the minimum PIA in December 1978:

66 percent were age 70 or over.

43 percent were age 75 or over.

The median age for retired worker beneficiaries receiving the minimum was 73 (compared to a median age of 71 for all retired worker beneficiaries). A table is attached showing a more detailed breakdown by age of minimum beneficiaries currently on the rolls.

Retired and disabled workers receiving minimum benefits by age as of December 1978

Age:	Retired workers
Number (in thousands).....	2,215
Percent ¹	100
62 to 64.....	10
65 to 69.....	24
70 to 74.....	23
75 to 79.....	18
80 to 84.....	13
85 to 89.....	8
90 plus.....	4
	<i>Disabled Workers</i>
Number (in thousands).....	104
Percent ¹	100
Under 25.....	5
25 to 29.....	7
30 to 34.....	5
35 to 39.....	3
40 to 44.....	4
45 to 49.....	11
50 to 54.....	11
55 to 59.....	20
60 to 61.....	12
62 to 64.....	22

¹ Columns may not add due to rounding.

Question 6. Mr. Secretary, can you tell us the average benefit reduction that will affect minimum Social Security beneficiaries? Can you also tell us what the range of benefit reductions will be and how many people are affected at the various reduction levels?

Response. The monthly Social Security benefit of about 1.8 million beneficiaries would be reduced if the minimum were eliminated.¹ The average reduction for the 1.8 million affected beneficiaries is estimated to be about 40 percent.

¹ 500,000 of these 1.8 million are SSI recipients and any reduction in the Social Security benefit would be offset by an increase in the SSI payment; another 500,000 are eligible for SSI but are not receiving benefits.

The reductions in PIA's could range from about \$1 to \$151.² However, the reductions in benefit amounts would be somewhat less. The lowest possible benefit for a retired worker would be about \$6—a reduction of about \$147. This benefit would be paid to a worker who reached age 65 in 1954 and had only 6 quarters of coverage, all of which were prior to 1950.

The lowest possible benefit would be about \$1. This benefit would be paid to a young survivor of a worker who died in 1979 after barely meeting the currently insured requirement. However, since this is a young survivor benefit it is based on 75 percent of the worker's PIA and the amount of the actual reduction would be only about \$114.

Preliminary estimates indicate that, if the minimum benefit were eliminated and benefits were based directly on average earnings, the distribution of PIA's for the approximately 2 million non-dually entitled persons currently receiving a benefit based on the minimum would be as follows:

PIA'S

	Percent
\$153 (no decrease).....	10
\$120 to \$153.....	24
\$90 to \$120.....	23
\$60 to \$90.....	23
\$30 to \$60.....	17
Under \$30.....	3
Total.....	100

Question 7: One possible justification for the Administration's proposal to eliminate social security benefits to students (age 18-22) is that Federal aid for education has expanded considerably since 1965 when student benefits were first enacted. Would you give us some background on this? What types of educational aid are available to families and how have they evolved over time?

Response. Federal aid is available to postsecondary students through several programs:

Pell grants; Guaranteed student loans; Supplemental grants; College work-study programs; State incentive grants; and Direct loans.

The largest of these are the Pell grant (formerly Basic Educational Opportunity Grant) and the Guaranteed Student Loan (GSL) programs. The Pell grant program provides entitlement grants directly to undergraduate students to serve as the foundation upon which other financial aid is awarded. Students qualify for these grants under a needs test that takes into account the student's and family's ability to contribute to educational costs. Awards for the 1980-81 school year range from \$200-\$1,750.

In fiscal year 1973, the first year that Pell grants were awarded, expenditures for 185,249 recipients were \$50 million with the average grant \$269. By fiscal year 1980, expenditures to 2.6 million students were estimated to be \$2.2 billion, with the average grant equal to \$839.

The Guaranteed Student Loan (GSL) program makes low-interest long-term loans available to students to help them meet their postsecondary educational expenses. The loans are made by eligible lending institutions using private capital. Students may borrow up to \$2,500 annually and their parents may borrow up to \$3,000 annually, regardless of income. The loans are either guaranteed by State and private agencies and reinsured by the Federal government under the Guarantee Agency program, or are insured directly by the Federal government under the Federal Insured Student Loan program.

\$73 million were expended for the program in fiscal year 1966; 89,000 loans were made, with the average loan \$820. By fiscal year 1980, the estimated loan volume was \$4.4 billion on 2.03 million loans, with the average loan up to \$2,173.

The Supplemental Educational Opportunity Grant (SEOG) program was established to provide financial assistance in the form of grants to qualified students who, for lack of financial means of their own or of their families, would be unable to obtain the benefits of postsecondary education without the grants. Awards range from \$200 to \$1,500 per academic year.

The SEOG program began in 1973. In that fiscal year, 331,000 students received grants, averaging \$571; total expenditures equaled \$189 million. By fiscal year 1980, expenditures were estimated to be \$358 million for 650,000 students, with the average grant \$551.

² AVERAGE PIA and benefit amounts are before the June 1981 benefit increase.

The College Work-Study (CWS) program was created in order to stimulate and promote the part-time employment of students—particularly those with great financial need—who are attending eligible institutions of postsecondary education. There is no minimum or maximum CWS award amount which a student may receive.

In fiscal year 1965, \$33 million was expended under CWS program; 115,000 students working under the program received an average income of \$290. In fiscal year 1980, an estimated \$609 million was expended for the program; the number of students working under the CWS program increased to 980,000, with the average income increasing to \$622.

Through incentive grants to States, the State Student Incentive Grant (SSIG) program is designed to encourage the establishment and expansion of State scholarship assistance to undergraduate postsecondary students with substantial financial need, thus stimulating development and operation of a nationwide delivery system of State programs of student assistance. Federal allotments are matched equally with funds from State resources. By 1978, the SSIG network included all 50 states, the District of Columbia, Puerto Rico, Guam, American Samoa, the Virgin Islands, the Trust Territory, and the Commonwealth of the Northern Mariana Islands. The maximum SSIG award for an academic year is \$1,500.

The first SSIG expenditures were made in fiscal year 1974; the Federal share that year was \$20 million. The average grant for the 76,000 recipients that year was \$500. By fiscal year 1980, the Federal share of the expenditures had risen to \$153 million, and the average grant for the 307,000 recipients remained at \$500.

The final form of Federal assistance available to students is the National Direct Student Loan (NDSL) program. The NDSL program was designed to assist in the establishment and maintenance of revolving loan funds at institutions of higher education so that institutions may provide low-interest loans to help financially needy students pay their educational costs. Students may borrow up to \$10,000 depending upon the amount of school completed.

NDSL funds are a combination of Federal and institutional capital contributions. In general, the institutional capital contribution should equal one-ninth of the Federal capital contribution. The Federal capital contribution is appropriated yearly by Congress for use during the following academic year. (Thus, the NDSL program is said to be "forward-funded.") Allotments to States are based on the number of full-time higher education students in a State compared with the total of such enrollments in the U.S. Allocations to institutions within a State are on the basis of approved applications.

Expenditures for the NDSL program in fiscal year 1965 were \$166 million; 319,974 students received loans averaging \$522. By fiscal year 1980, an estimated \$710 million was lent to 861,000 borrowers; the average loan climbed to \$826.

Postsecondary educational assistance for fiscal year 1982 under the President's economic program includes:

More than \$5.6 billion in direct budget authority for the Pell grant, work-study, direct loan, supplemental grant, State incentive grant, and guaranteed student loan program;

Over \$500 million in State and institutional matching funds through these programs; and

Over \$5.7 billion in loans from banks and other lending institutions as part of the guaranteed student loan program. A more detailed breakout of these amounts (in billions) for fiscal year 1982 is as follows:

Pell	\$2.5
Work study5
(Institutional match)	(.05)
Supplemental grants4
State incentive grants1
(State match)	(.1)
Direct loans3
(Institutional match)4
Guaranteed student loan (covers interest payments, etc.)	1.8
(Lending institution loans)	(5.7)
Federal funds	5.6
Matching funds55
Bank loans	5.7
Total	11.85

Question 8. What do you see as the advantages of a flexible interchange of funds between the social security programs relative to a more direct and permanent change in the schedule of tax rates?

Response. Reallocation of OASI, DI and HI tax rates and interfund borrowing can achieve the same result—adjusting balances in the trust funds so that cash-flow problems do not develop in a single trust fund at a time when overall reserves are adequate. The advantages of reallocating taxes are that there is precedent for it and that it seems to provide greater clarity and visibility regarding the financial arrangements for the various parts of the Social Security program. Also, it is simple to effect operationally.

As a practical matter, however, the allocation schedules have had to be modified frequently over the years and each such modification requires congressional action.

Projections of income and outgo of the three trust funds are so sensitive to changing economic and social circumstances that it is impossible to predict with certainty the precise future status of a particular trust fund. Any allocation of tax rates that appears appropriate on the basis of today's economic assumptions may be rendered inappropriate by differences in actual economic performance, as occurred with the 1977 allocation. Since reallocation requires legislation, Congress would have to adjust tax rates each time trust fund projections change.

Interfund borrowing provides the same assurance that cash-flow problems do not develop in a single trust fund at a time when overall reserves are adequate, without necessitating action by the Congress. Although the computations involved in interfund borrowing, including the amount of interest to be paid back to the lending trust fund, do tend to make its operation more complex, these complexities are manageable.

In practice, the two approaches are not mutually exclusive. Congress could periodically revise the tax rate distribution between funds based on then current projections, while enacting interfund borrowing to adjust for almost inevitable variations between projections and actual experience.

SSI

Question 1. As the social security law currently stands, a small segment of the SSI program is administered by title V crippled children's agencies. In view of the repeal of title V with the block grant proposal, where will this program be administered?

Response. The SSI provisions currently authorize Federal funding of approved State programs of medical, social, developmental, and rehabilitative services for blind or disabled SSI recipients aged 6 and under, or aged 7-15 if they require preparation to enable them to benefit from public educational services. These programs are included in the health services block grant proposal. Under the block grant concept, it is at the discretion of the State whether, or the extent to which, specific programs will be continued and, if continued, who in the State will administer them.

AFDC

Question 1. Concerning the AFDC earned income disregard, how many families are expected to be removed from the benefit rolls as a consequence of the Administration's proposed changes? What do you see as the advantages of your proposals which limit allowable expense disregards for child care rather than permitting the disregard of actual expenses?

Response. The change to standardize the work expense disregard, cap the child care disregard, and change the order in applying the disregards is expected to remove 96,000 families from the rolls. The proposal to apply the \$30 and 1/3 disregard for only 4 consecutive months per year is expected to remove an additional 116,000 families from AFDC, and the imposition of a gross income eligibility ceiling would eliminate another 7,000 families. It should be noted that these figures are not independent—they are based on a sequential screening process which considers the interactions of the other changes in computing the estimates. The cumulative total effect of the three disregard proposals is expected to remove 219,000 families from the AFDC rolls.

The present policy of disregarding actual child care expenses contributes to the administrative burden of calculating benefits, and prevents placing reasonable controls on this expense. The proposed change should simplify administration, reduce error and provide an incentive for AFDC recipients to find the most economical ways to meet their work expenses.

Question 2. The Administration's economic program contains a number of block grant proposals. These would be designed, presumably, to enhance State control and

reduce Federal oversight over the various component programs. With regard to AFDC, however, you propose a set of Federal standards that relate, for example, to the income and expense disregards, age and income limits, and the likes. Do you see these Federal standards as being contradictory to your express goal of expanding flexibility at the State level?

Response. The present situation imposes Federal requirements on State and local governments with diverse needs. This leads to numerous instances of inappropriate or inefficient programs and the resulting waste of funds. The philosophy behind the block grant approach is that decisions regarding health, welfare, and social service assistance programs are better made by the State officials who are closer to the problem and who are in better position to get goals and priorities for policy and service delivery.

At this time, we are not ready to offer a block grant proposal for the AFDC program. This program is particularly complex and it will take time to study the program and design an appropriate block grant proposal. Work on this is continuing.

The first priority of this Administration is to bring government spending under control. Without any change, the AFDC program would cost the American taxpayer \$7 billion in fiscal year 1982. The move to establish new Federal standards is designed to tighten eligibility to assure that the limited funds go to those most in need and encourage individual efforts toward economic independence. These proposals respond to the country's mandate to reduce growth in government spending and to target scarce resources more effectively. The proposals we are recommending will trim Federal costs by over \$1 billion next year.

Question 3. The Administration has frequently spoken about fraud and waste in programs. Does the Administration assume that this 25 percent figure reflects administrative waste in these programs, and if so, how did you arrive at this amount?

Response. The 25 percent cut in funding does not represent waste in the sense that the money was spent incompetently or fraudulently—rather, it represents legitimately required present uses of the funds which would be unnecessary under our proposal.

We think substantial savings can be attained by freeing the States from excessive Federal requirements and restrictions as to program structure and administration, reporting and paperwork requirements, and other red tape that now accompanies the programs. On the Federal side, a significant amount of money can be saved through elimination of the need for Federal direction, approval, and oversight of the State-run programs. Finally, our proposed approach—consolidating categorical programs into block grants—will allow States the flexibility they need to use the funds most efficiently.

Question 4. The Administration is proposing legislation to require welfare recipients to engage in "workfare" projects in return for welfare grants. This concept of workfare is indeed intriguing. But frankly, there does not seem to be too much available describing the history, success and results of workfare experiments.

How many experiments have been done in workfare? Please enumerate the experiments.

Please enunciate the results of each experiment, or please produce for the record.

In those experiments which you consider a success (success defined as removal from the welfare rolls), what kind of employment did the recipients secure? Are they still working? Have they been tracked and have any been placed back on the welfare rolls?

Response. Most of the projects requiring that an individual perform work in exchange for public assistance have been projects for general assistance recipients. Prior administrations have interpreted title IV of the Social Security Act as prohibiting this activity for AFDC and AFDC-U recipients. Attempts by States to demonstrate "workfare" for the AFDC program have been thwarted. Where programs were attempted, in California and Massachusetts, they were conducted within a hostile atmosphere which affected results. This situation would not occur under the legislative authority requested.

Unfortunately, the general assistance work programs, most of which are local efforts, have been subject to little, if any, systematic research and evaluation. In 1977-78, the Department of Labor, with the cooperation of National Association of Counties (NACO), surveyed several work relief programs. Some examples of State and local efforts from that report follow:

Hamilton County, Ohio has had a mandatory work program for general relief recipients for more than 40 years and has found that 60-75 percent of those assigned to the program never show up and therefore are ineligible for assistance. They have also provided a training program (STEP—Service Training and Employ-

ment Program) which assisted participants to secure jobs or training. Participants were volunteers and were excused from work relief while in STEP.

Kent County, Michigan had a program for general assistance recipients which required participants to "work off" the value of their assistance by attending either educational and/or training classes (adult education for completion of high school; work experience or on-the-job training; job search clubs; or further education). Started in 1975, by 1978 Kent County stated that this program had resulted in a 50-percent decrease in the average monthly caseload.

Apart from the findings of the NACO survey, a workfare project for GA recipients also existed in New York. The New York work relief employment program (WREP) replaced an earlier public works program. Both of these programs were essentially "work relief" or "workfare." The primary difference was the conversion of the home relief grant into wages under the WREP.

Although costs under WREP were about 30 percent higher, the State reports that placing recipients on salary resulted in greater work participation than under the Public Works Program—22 percent vs. 2 percent.

The single example of a "workfare" program that has been operational for both general assistance and AFDC recipients is the work experience and training (WEAT) program in Utah, which has been operating since 1974. No formal central office evaluation has been conducted; however, a State report provides the following information. In the first half of 1977, 1,084 AFDC individuals were referred to WEAT; 284 were closed prior to actual assignment because they were already working or chose to terminate; and 800 were given assignments. During this same period, 1,257 WEAT AFDC registrants (which includes those referred prior to 1977) left the program as follows:

- 31 percent for failure to perform;
- 39 percent into employment;
- 10 percent into a WIN component; and
- 20 percent became exempt or left for other reasons.

The Department has conducted experimental programs under its section 1115 authority in California and under section 1115 and WIN in Massachusetts. A brief summary on these projects follows:

California Work Experience Program (CWEP)

This was a 3-year section 1115 demonstration project for AFDC recipients with mandatory nonsalaried work experience (not to exceed 80 hours per month), and was mandatory upon 35 specified counties. Program effectiveness was reduced by limited county participation, and tendency by many staff to make assignments voluntary. A further barrier to implementation was the legislative mandate that all WIN slots be full before CWEP could be operative. As a result, there was low participation by eligible persons; in 1974, 2.6 percent out of 182,735 available registrants participated in CWEP assignments.

Massachusetts Work Experience Program (WEP)

This program was statewide and required participation by AFDC-U recipients who had not been placed through regular WIN or CETA channels. Authority for assignments was WIN work experience (a regular WIN component providing nonsalaried work experience for up to 13 weeks with a limit of 26 total weeks in a year). Project also tested the effect of suspension of the 100-hour limitaiton on employment under AFDC-U. The project experienced major opposition from an advocate coalition. Out of 401 individuals assigned to work sites, 301 actually reported to the sites. Although research on workfare was limited by the small number actually going to work sites, the selection process identified large numbers no longer receiving benefits and significant numbers who left the welfare rolls by obtaining employment.

Many of the problems experienced in the administration and operation of these projects would be overcome by legislation as proposed by the Department in its 1981 welfare package.

A further workfare experience was authorized by Congress under the Food Stamp Act of 1977 to be administered by the Departments of Labor and Agriculture. Food stamp recipients work off required numbers of hours in unsalaried work. Since most AFDC recipients are exempted due to WIN, there is only limited AFDC involvement. Difficulty in assessing data in early sites is the fact that one site, San Diego, involves 50 percent of participants and is significantly different from others in participant characteristics and project results. The interim report provides the following statistics:

	Number	Percent
Individuals eligible.....	3,525	
Number assigned.....	875	24.8
Number worked.....	539	15.3
Number good cause exemption.....	299	8.5
Number sanctions.....	987	28.0

Note that 28 percent of all eligibles are subject to sanction.

This experimental program is still operating, and has been expanded from the original seven test sites.

The final question regarding employment results is impossible to answer, since with the single exception of the Brandeis study of the Massachusetts WEP, no data have been gathered on kinds of employment entered and retention of jobs. In the Massachusetts study, the numbers of individuals entering work experience and subsequently entering employment is so small as to render the information useless.

We identify the following reports on the experiments mentioned above:

1. Work Relief Employment Project (WREP); June 1973–January 1976, Report to Legislature of the State of New York
2. Community Work Experience Program; April 1996—Final Report, State of California Employment Development Division
3. Evaluation of the Massachusetts Work Experience Program—October 1980, Brandeis University
4. Interim Report to Congress; Food Stamp Workfare Demonstration Projects—October 1980, U.S. Department of Agriculture and U.S. Department of Labor.

Question 5. How many workfare programs have been conducted in rural States? How do you design workfare in a remote, isolated geographical area?

Response. In 1978, 35 states chose to provide general assistance to employable persons and of these, 20 had work programs either Statewide or within certain countries. Among these were Indiana, Iowa, Kansas, Maine, Minnesota and Montana, to name a few. Work programs also existed in the rural areas in States such as New York and Ohio. (See attached description of general assistance work projects.)

As to remote isolated areas, States will be free to develop whatever type of program fits their situation. We have suggested schools as a source of positions, and they would be accessible in all areas. In addition child care might be needed. Community work experience programs (CWEP) participants in rural areas could assist social agencies in outreach programs, work on weatherization projects, or assist the elderly. Supervision could be provided by the sponsoring agency or entity at a local level in whatever manner is found appropriate. There would be a great deal of freedom in the administration of this program.

Characteristics of General Assistance in the United States

**U.S. Department of Health, Education, and Welfare
Social Security Administration
Office of Family Assistance
HEW Pub. No. (SSA) 78-21239**

APPENDIX A

Details of Work Projects - State or Local

The States that reported a requirement that an employable person must accept assignment to a work Project in order to be eligible for general assistance were asked to supply a brief statement about the projects. The following points were to be covered:

1. What is the legislative or administrative base for such projects?
2. Are the projects statewide, or local?
3. In what political subdivisions have work projects been in operation within the past calendar year (1976)? List any new areas beginning such projects in calendar year 1977.
4. Does the work project assignment requirement apply to persons needing one-time or short-time assistance, or does it apply to persons who need continuing assistance but are not eligible for Federal-State income maintenance programs?
5. What kinds of work are usually provided?
6. Does the recipient:
 - a. receive assistance and then work it out at some set rate that applies only to general assistance recipient workers; or
 - b. receive an assignment to a public employment type job along with regularly hired employees and receive a cash wage for his work;
 - c. in either case, does he receive a wage prevailing in the community for the work, wages based on a State or Federal minimum wage, or some other specified variation.
7. Is the worker-recipient protected by Workmen's Compensation?
8. Is there any expectation that the work assignment will lead to a job as a regular employee, either full or part-time?
9. Are there any educational or job training aspects built into the work assignment? If so, what determines whether a particular recipient will be offered a particular kind of work project placement?
10. Are there provisions for part-time assignments, during school hours only, for employable women whose children are in school?
11. If the recipient is marginally employable, what provision is there for determining the kind of work he may be assigned to with safety to himself and others?

Not all States responded in full. The entries below record the information provided by each of the 16 States reporting work projects in one or more political subdivisions, plus an entry for Indiana where the "township trustee" may assign the recipient to available public employment. In addition, Florida, Iowa, and South Dakota reported that work projects are sometimes in use in at least one county but provided no details.

State	Details of Work Project
California	<p>General Assistance recipients may be required to work as a condition of eligibility. The work requirement is authorized by Section 17200 of the California Welfare and Institutions Code. The State does not sponsor work projects; however, several of the larger counties do have such projects.</p> <p>Work projects currently exist in San Diego, Los Angeles, Santa Clara, and Alameda counties. The projects differ greatly from county to county; however, they have certain features in common. They are considerably smaller than the assistance case-load and they are voluntary. The participant does not work for pay, although some compensation for expenses is usually provided. The projects all involve vocational counseling, remedial education, training and work experience. Clerk-trainee and nurse-trainee are typical jobs, and employment is typically in a city or county agency. The program is short duration (4-14 weeks). Some work assignments lead to a regular job, and the participants are given some assistance in job search.</p>
Connecticut	<p>State Statute Sec. 281a, b, c, d. Work Relief Programs establishes the legal base for Town Welfare Departments to establish Work Relief Projects for those general assistance recipients classified as employable but unemployed. The projects are entirely local, and presently 40 towns are administering such projects. All work relief projects established by towns must be submitted to the Commissioner of the Connecticut State Department of Social Services for approval. In all towns administering a work relief project, assignments are made to persons needing one-time, short-time, or continuing assistance.</p> <p>Work Projects must conform to the following requirements:</p> <ol style="list-style-type: none"> 1. The work made available will be restricted to projects associated with the affairs of the town government. 2. Only recipients who, in the judgment of the town official, are capable of performing the work available will be referred to such work. 3. The recipient selected to perform the work assigned will not be used: <ol style="list-style-type: none"> a. To replace a regular employee of any department or other unit of the town government. b. To perform any work ordinarily performed by a regular employee of the town government. c. To replace or to perform any work ordinarily performed by a craft or a trade in private employment. 4. The required hours of work will be related to and determined by the amount of the budget deficit of the employable recipient and the dependent members of the family included in the payment. The recipient assigned to employment will not be required to work more hours, at an hourly rate of pay based on the minimum wage, than necessary to equal the amount of the budget deficit. In no instance will the work day exceed eight hours or the work week, forty hours.

(Continued)

State	Details of Work Project
Connecticut (Continued)	<p>The recipient will be liable for reimbursement of assistance payments only to the extent of the excess of such payments over and above the work performed.</p> <p>The recipient's refusal to report to the work to which he has been assigned by the local welfare official will constitute ineligibility for assistance from the town. Under statutes pertaining to Unemployment Compensation, work performed under a work relief project in accordance with the above requirements will not affect a recipient's eligibility for U.C. benefits on the basis of previous work record in private industry.</p> <p>5. The number of hours assigned will be governed by the amount of assistance granted to the individual or family group but will not exceed eight hours in a day or forty hours per week.</p> <p>The worker — recipient is not protected by Workmen's Compensation. Expectations concerning eventual full or part-time employment as a direct result of a work relief project vary from town to town.</p>
Hawaii	<p><u>Assignment to Public Work Project (Section 346.31 HRS):</u></p> <p>An otherwise eligible adult employable individual, as a condition to receiving General Assistance, shall also be assigned to work on public work projects including the Temporary Labor Force Program and to accept such assignment or employment as may be offered to the individual by the Department or by an employer.</p> <p>The required work period on work projects or Temporary Labor Force shall be determined on the basis of the State's minimum wage times hours of work not to exceed the amount of his general assistance grant.</p> <p>The mother of a needy intact family with minor children (under 18 years of age) shall not be subject to the above provisions.</p> <p><u>Disqualification for Failure to Comply with Work Requirements</u></p> <p>Recipients who disqualify themselves due to their failure to comply with any one of the Department's work requirements shall be excluded from General Assistance for a period not to exceed 12 months as follows:</p> <p>a. Refusal to work or failure to work at least one-half the required number of days or hours assigned without good reason on public work projects including Temporary Labor Force — the individual shall be disqualified for a period of 1 month for the first instance of non-compliance, 3 months for the second, 6 months for the third, and 12 months thereafter.</p> <p>(Instances of unexcused absence from TLF assignment of less than half the number of hours or days required — the following month's assistance shall be reduced accordingly.)</p>

State	Details of Work Project
Illinois	<p>Illinois Revised Statutes, Chapter 23, Public Aid Code, Article IX - Sec. 9-16 provides that service and training programs be established in local governmental units (Counties, Cities and Townships) and that local governmental units receiving State funds must refer all recipients capable of engaging in employment to such programs that are established, within or without the governmental unit. Programs may be sponsored by governmental agencies or by non-sectarian organizations. The programs may include, but are not limited to, the maintenance of or services required in connection with public offices, building and grounds, state, county and municipal hospitals, forest preserves, parks, playgrounds, streets and highways, and other governmental maintenance or construction directed toward environmental improvement. The programs are designed to improve the work habits and skills of those persons assigned and for whom jobs are not immediately available. Training and experience are provided for recipients who lack skills so as to increase their opportunities for employment. Currently there are 39 approved programs in 27 local government units receiving State funds and supervision. It is anticipated that, during 1977, 13 new programs will be initiated.</p> <p>All non-exempt GA recipients outside the City of Chicago must accept assignment as a condition of eligibility unless there is good cause for exception. If there is any question as to the propriety of the assignment, in that a health problem exists or limitations should be placed on the type of work assigned, a pre-employment physical examination is arranged. Assignments are made for full and half 8-hour days but do not exceed 40 hours per week and are not made for less than 3 days per month. The recipient is assigned for the number of hours which will not exceed 100 per cent of the budget deficit not including medical costs. Wages, exclusive of employment expenses, paid to the employee are deducted in full from the financial aid which would otherwise have been provided. The difference, if any, would be provided in the grant of aid. Wage rates are based on the prevailing rate in the community and conform to State and Federal minimum wage laws. The worker-recipient is protected by Workmen's Compensation.</p>
Indiana	<p>If able to accept employment, the person must be endeavoring to, but unable to, find employment. The trustee shall require a recipient to do any work needed to be done within the township or an adjoining township for any governmental unit (including the state) having jurisdiction in those townships unless the recipient: (1) is not physically able to perform the proposed work; (2) is a minor or over 65 years of age, (3) has full-time employment at the time he receives poor relief; (4) is needed to care for a person as a result of that person's age or physical condition. This requirement does not apply if there is no work available for the recipient.</p>
Kansas	<p>KSA 39-708c provides the legislative base for general assistance work projects and work and training programs. Projects are available statewide. There is a wide variety of political subdivisions having work projects. In 1976 there 210 work projects. From 1-1-77 through 7-31-77, 22 projects have been added.</p> <p>Non-exempt GA applicants/recipients must register for and work</p> <p style="text-align: right;">(Continued)</p>

State	Details of Work Project
Kansas (Continued)	<p>out assistance received on work projects as a condition of eligibility. The work consists of a variety of tasks which are to be useful and not base or degrading and must be of such type that it is within the ability of the person to perform. The working conditions must not impose undue hardship. Persons assigned to work projects receive 100% of budgetary standards plus a work allowance of \$1.65 per day. The number of days to be worked is determined by dividing the budget deficit (excluding the special work allowance) by the federal minimum wage.</p> <p>The compensation provided participants consists of medical and maintenance needs for persons injured on the project or if they become ill or incapacitated as a result of such work. There is the expectation that work assignments will lead to employment in many instances and the projects should provide educational or job training aspects.</p>
Maine	<p>Legislative base for work projects is State Statute Title 22, Chapter 1251, Sec. 4504 (5).</p> <p>Work projects are locally administered.</p> <p>Work projects have been in operation in various focal municipalities in 1976. Unknown what other municipalities will have work programs in 1977.</p> <p>Work project assignments have no special requirement as to persons needing one-time or continuing assistance.</p> <p>Kinds of work vary in each municipality.</p> <p>Payment on work projects vary in each municipality.</p> <p>Worker-recipient is protected by Workmen's Compensation in most municipalities.</p> <p>There is usually no expectation that work assignments will lead to regular employment.</p> <p>There are no educational or job training aspects built into the local work assignments.</p> <p>Provision for part-time assignments during school hours varies according to the municipality.</p> <p>Work assignments to marginally employed recipients vary according to the local municipality.</p>
Maryland	<p>The GPA-E program provides temporary assistance to jobless able-bodied individuals who cannot receive unemployment insurance benefits and are without resources. This program is optional and is available in only (6) local departments of social services. Maryland law provides that a recipient of this category of assistance accept a suitable job assignment with a public service, government, or non-profit agency. The concept of job development for, and job development of, public assistance recipients is known as workfare.</p> <p>Legislation promulgated in the Annotated Code of Maryland (Article 88A, Sections 3(a), 17A-1 through 17A-3) mandated revision of existing GPA-E policy to include workfare requirements for all recipients.</p>

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State	Details of Work Project
Maryland (Continued)	<p>The workfare project, administered in each local agency offering GPA-E, was begun during the 1977 calendar year as a demonstration/pilot project in the Baltimore County agency and is projected for implementation as soon as possible as other local governments opt to provide funds. The various types of work to be provided are still in development, concurrent with the progressive recruitment of workfare "host" sites.</p> <p>The recipient will receive the normal, monthly assistance payment and then will "work it off" at a rate based on the job's customary pay, if predetermined, or the minimum hourly wage. The recipient-participant will not be protected by Workmen's Compensation. The workfare site host agency shall provide necessary transportation, equipment, and work supervision. Limited opportunity for on-the-job training will be present. Provision for assignment of types of work appropriate to the individual is made through counseling and pre-placement interviewing. Expectations exist that the work assignment may precipitate regular employment, but there are legal discrepancies that have yet to be resolved.</p>
Michigan	<p>The legal base for work projects in Michigan lies within act 280, Michigan Compiled Laws 400.55(a): "Require employable persons to work on work relief or work training projects if available, in return for relief given."</p> <p>Projects are operated on a local basis, i.e., each county DSS office is responsible for establishing work relief sites within the county where the recipient resides. Persons receiving continuing assistance who are determined employable are assigned to work relief or work training projects. Work project assignments include, but are not limited to: clerical, janitorial, health assistance, lunchroom and playground attendants, teacher aides, soil conservation aides, etc.</p> <p>The amount of time a recipient is to participate in a <u>work relief assignment</u> is determined by one of the following methods: (1) Credit for work performance can be at the going rate in the community but no less than the federal minimum wage; (2) Credit for work performed can be at the federal minimum wage. After the wage is determined, the recipient is required to work up to the amount of the assistance grant.</p> <p>A <u>work training project</u> is defined as an unsalaried job training at a clearly defined, well supervised, work site. An individual has the opportunity to develop basic work habits, practice skills learned in classroom training, acquire on-the-job experience, or demonstrate skills to a prospective employer. Work training assignments can be made only to work sites of public or private non-profit agencies and are limited to 13 weeks with an employer. Only two 13-week periods are permitted for each participant. Participation is limited to 40 hours per week and is not related to the amount of assistance.</p> <p>Generally, work training projects are preferred to work relief projects. Assignments are made according to projects available and recipient employability needs. It is hoped that work relief assignments and work training projects will lead to full or part-time employment. Frequently recipients leave general assistance</p> <p style="text-align: right;">(Continued)</p>

State	Details of Work Project
Michigan: (Continued)	<p>rolls after participation in work training or work relief projects due to permanent employment either at the work assignment site or private employers. Work relief often serves as a motivating factor in finding employment.</p> <p>Recipients who are assessed as needing education or training in order to become job-ready may be required to participate in approved education or training program as an alternative to a work relief program. Employment-seeking requirements may be waived during the time a recipient is involved in an approved education or training program.</p> <p>Participants in a work relief or work training program, if injured, may be entitled to workers compensation. The State Accident Fund represents the interests of the Michigan State Department of Social Services in handling claims for workers compensation.</p>
Minnesota	<p>The legal basis for work project requirement is contained in the General Assistance Act 25bD.11:</p> <p><u>"25bD.11 Work Incentive and Registration.</u> Subdivision 1. Every person who is a recipient of general assistance and not employed shall be required, unless exempt by subdivision 6, to register with the state employment service of the department of employment services and the local agency and accept any suitable employment that is offered him.</p> <p>"Subd. 2. The local agency shall provide a general assistance work program for persons who qualify for assistance but who are unable to gain employment through the state employment service of the department of employment services. Local agencies shall adopt a list of work priorities to be met through the employment of eligible recipients when such recipients are unable to gain employment through the state employment or through their own initiative. The local agency may assign the recipient such work as he is able to perform but which is not that ordinarily performed and which would supplement but not replace projects which are ordinarily performed by regular employees of the county.</p> <p>"Subd. 3. General assistance work program recipients shall be paid at the same wage rates as county employees doing similar work, and the number of hours of work assigned to a recipient shall be determined by the needs of himself and his family including expenses incidental to his employment.</p> <p>"Subd. 4. A local agency may contract with the federal government, or with any department, agency, subdivision or instrumentality of the state, for the services of general assistance work program recipients on such terms and conditions as may be agreed upon, with or without consideration paid to the local agency.</p> <p>"Subd. 5. General assistance work program recipients are employees of the local agencies within the meaning of worker's compensation laws, but not retirement or civil service laws."</p> <p>The Department of Public Welfare interprets that section as follows:</p> <p>1. G.A. recipients are not county employees. They are, however, eligible for workmen's compensation.</p>

(Continued)

State

Details of Work Project

Minnesota
(Continued)

2. The monthly G.A. grant serves as payment in advance for work subsequently performed. The work performed shall be credited against the grant.
3. The amount of the grant divided by the hourly rate for the work equals the maximum number of hours which the recipient can work. The value of the work performed shall not exceed the amount of the G.A. grant.
4. There is no requirement that a recipient work off the entire grant if appropriate job placements are not available. (In addition a recipient may be exempt from the work program under the provisions of Minn. Statute 256D.11 subd. (6))
5. For recipients who work less than full-time, credit against the grant should be given only for time worked. Time away from work for such as doctor's appointments, job interviews, and social worker appointments should not be counted.
6. G.A. recipients can be assigned only to jobs 1) "which are not ordinarily performed by county employees" or 2) "which supplement but do not replace projects which are ordinarily performed by regular employees of the county." Examples of the above are brush clearance, or assisting highway maintenance crews, or helping regular clerical employees. Agencies may not maintain a vacant position to be filled by rotating G.A. recipients in the job.
7. The same wage rates paid to county employees doing similar work must be credited to G.A. recipients. Uniform or flat rates of credit, for all recipients doing dissimilar work, do not conform in all circumstances to the requirements of the work program. The recommended procedure for determining wage rates for credit against the grant is explained below.
 - a. Obtain detailed job descriptions for all the various G.A. jobs which have been established.
 - b. Review the job descriptions to ascertain if they meet the criteria of a) work which is not ordinarily performed by county employees or b) work which supplements but does not replace projects ordinarily performed by regular county employees. Delete any jobs which do not meet this criteria.
 - c. Group the jobs into categories such as: clerical, casual labor, food service, laundry, custodial, semi-skilled, etc.
 - d. Review the jobs in each of the various categories to determine if the duties are similar enough to consider them in one pay rate for the category. In making this determination consider the amount of heavy labor work and the skills required to do the job. If you find the jobs to be equivalent within the category, you may group them together for purposes of determining a pay rate. If you find substantial differences in consequences of error or amount of supervision or responsibility, you must use two or more pay rates for the category.
 - e. Determine the pay rate by checking the minimum salary for the particular category.

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State	Details of Work Project
Minnesota (Continued)	<p>(i) Those counties under the Merit System should use the salary schedules published by the Merit System. (Use the same salary schedules under which the agency operates; e.g., an agency on the B Salary Schedule for clerical would use the B Salary Schedule to determine G.A. work program clerical job salaries.)</p> <p>(ii) Hennepin, Ramsey and St. Louis Counties should use their respective civil service salary schedules.</p> <p>(iii) If a particular job category is not found in the salary schedules for the Merit System or the other county civil service departments, check with the local Employment Service Office to find the prevailing minimum wage for the category.</p> <p>(iv) Convert all monthly rates to an hourly salary.</p> <p>(v) Trainee salaries may be used if the performance expectations and the amount of responsibility assigned to the recipients is less than what would be expected of a regular employee doing the same work, or the recipients do not have the skills expected from a regular employee. To reflect these factors in accordance with Merit System standards, a one-step deduction from the minimum salary may be made. However, where work performance warrants, a recipient should receive credit for the regular hourly salary for the category, not the trainee rate.</p> <p>Performance of persons paid below the minimum should be reviewed frequently to determine when work meets normal standards, after which payment must be made within the appropriate salary range.</p> <p>(vi) In no case may the wage rate credited be determined at a rate lower than the applicable federal minimum wage which is \$2.20 an hour effective January 1, 1976.</p> <p>f. When employees of the agency receive a cost-of-living increase, a salary adjustment based on a yearly salary study, or an increase negotiated by the union representing the agency, the same increases should be passed on to the wage credit given to the G.A. recipient.</p>
Montana	All able-bodied persons 18-25 must be registered for work; 18 counties have work programs where recipient is required to work for assistance provided.
New Hampshire	<p>1. The legal basis is in the New Hampshire Revised Statutes Annotated -- 165:31-32 Aid to Town Paupers; 166:23 Employment of Relatives (aid to county paupers); 166:6 Binding Out (county paupers).</p> <p>2. Local projects.</p> <p>3. Municipalities and counties.</p>

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State	Details of Work Project
New Hampshire (Continued)	<ol style="list-style-type: none"> 4. Both continuing and short-term cases may be assigned to work; but usual practice in short-term assistance is not to require work project participation. 5. Jobs are usually provided in municipal or county government support services. 6. In all cases the applicant receives assistance first; but where work is required, the individual receives at least the minimum wage in cash or credit toward amount of assistance provided. 7. Yes, worker-recipient is protected by Workmen's Compensation. 8. Sometimes a work-project assignment may lead to a job. 9. There are no formal educational or job training aspects to the project; but some on-the-job training does take place. 10. Yes, provision may be made for part-time work for women where children are in school, but extent is minimal. 11. If the worker-recipient is only marginally employable, decision as to a safe assignment for him is made at the discretion and by determination of local welfare officers.
New York	<p>There is a requirement that all Social Services Districts in New York State operate a work relief program. All employable Home Relief (i.e., general assistance) recipients must accept assignment to a work project in order to maintain continuing public assistance eligibility.</p> <ol style="list-style-type: none"> 1. The legislative base is New York State Social Services Law, Section 104. 2. Work projects are locally operated by each Social Services district. 3. All New York State counties and New York City operated work projects in 1976. 4. The work project assignment requirement applies to persons needing one-time only or short-time assistance, although in practice these persons may not actually be assigned because the case would be closed before assignment could be effectuated. The work requirement also applies to persons needing continuing assistance. The requirement applies only to employables in the State/locally funded Home Relief Program. 5. The kinds of work usually provided varies widely according to local arrangements and the needs of the participating agencies. 6a. The client must have his case accepted before assignment to work relief. The client then "works off" his or her grant at either the minimum wage or the prevailing wage attributable to the specific work. The rate variation depends upon local procedure and policy. 6b. The recipient often performs work assignments correlating with activities conducted by regularly hired employees of a

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State	Details of Work Project
New York (Continued)	<p>public or non-profit agency. The recipient does not receive a cash wage. The recipient may not be used to replace, or to perform work ordinarily and actually performed by, regular employees.</p> <p>bc. The "work off rate" is equivalent to either the wage prevailing for like work in the user agency or the State and Federal minimum wage. Smaller Social Services Districts tend to use minimum wage; metropolitan districts tend to use prevailing wage rates.</p> <ol style="list-style-type: none"> 7. It is a requirement that all worker-recipients be covered by workmen's compensation. 8. In general, there is no expectation that the work assignment will lead to a job as a regular employee. Some of the more creative local Social Services employment staff have been able to develop arrangements which encourage transition to regular agency payrolls. 9. Educational and job training aspects are generally not built into work assignments, although they could be. Generally, local Social Services employment staff will attempt to develop expressed job skills or interest areas. 10. It is possible, but not probable, that part-time assignments during school hours only are made available for employable women with school children. 11. The law provides that a district may only make work assignments to which the client may be assigned with safety to themselves and others. The user agencies of work relief recipients have the right to reject specific individuals, which tends to screen out clients with employability limitations which might affect job related safety.
Ohio	<p>The legislative or administrative base for work projects is Ohio Revised Code Section 5113.</p> <p>The projects are statewide. All 88 counties have had work relief projects since October 1976. Prior to October 1976, 77 counties had work relief projects.</p> <p>Work relief projects are designed for continuing assistance only; the requirement does not apply to persons needing one-time assistance.</p> <p>The work usually provided consists of clerical jobs, manual labor, and public works employment.</p> <p>The recipient receives assistance and then works it out at a set rate - Ohio's minimum wage. The worker-recipient is protected by Workman's Compensation.</p> <p>Some work relief projects do lead to regular employment.</p> <p>There are some educational training aspects of the work assignments in that there is some specialized work relief training and much on-the-job training. Determinants of job placement are availability of jobs, prior work history, and education of client.</p> <p>The maximum hours possible for work is twenty-four hours per week so that a recipient may actively seek other employment.</p> <p style="text-align: right;">(Continued)</p>

State	Details of Work Project
Ohio (Continued)	<p>Each recipient's work hour needs are taken into consideration at placement. It is possible for part-time assignments to be made for mothers whose children are in school.</p> <p>A recipient's needs, abilities, and handicaps are taken into consideration by caseworkers who work to place the recipient in the best job.</p>
Rhode Island	<p>General Laws of R.I., Sec. 40-6-8, provides that General Public Assistance may be provided in the form of work relief or cash relief. The programs of work relief are under the direction of the Local Director of each city/town. Currently, the following cities/towns have work relief projects: Burrillville, Bristol, Cranston, Gloucester, North Kingstown, Pawtucket, West Warwick, and Woonsocket.</p> <p>Work is provided in a city or town department through a variety of placement. Each community has their own criteria for determining type of placement and other requirements.</p> <p>The recipient receives assistance and then works the appropriate number of hours, determined by the amount of the GPA grant, at a rate of \$2.10 per hour. An additional \$10 per week is added to the grant of participants of this program. There is no protection under Workmen's Compensation.</p>
Utah	<p>Current registration with USES required; assignment to a work experience and training project required of all employable persons.</p> <p>An applicant/recipient is ineligible if he has refused to accept employment "without good cause". Those temporarily unemployable are eligible. The legislative base for projects is found in Utah Code 55-15a-17 and is to provide employment opportunity to employable recipients. Projects are set up on Federal, State, and local levels and are found in all regions. All subdivisions have functioning project areas, and a variety of assignments are available and applied to all eligible employable persons. Although emergency assistance is available, the recipient is encouraged to perform on the project in order to receive his assistance. He is assigned 96 hours per month regardless of the grant base amount.</p> <p>Those persons assigned to a Work Experience and Training project are paid on a prorated basis of hours performed and are closed at this point if full hours assigned are not completed.</p> <p>Workmen's Compensation is provided but no formal job expectation is made. The program is an experience and training program and assignment by skill and desire is considered.</p>
Wisconsin	<p>"Any county or municipality may require persons entitled to relief to labor on any work relief project authorized and sponsored by a county or municipality, at work which they are capable of performing."</p>

Question 6. I am interested in the cost estimates associated with adoption of community work programs. Your estimates show savings of \$37 million in fiscal year 1983 rising to \$98 million in fiscal year 1986.

How did you arrive at these cost savings? Do these savings imply that AFDC recipients will be gainfully employed, or will they simply have dropped off the welfare rolls?

Further, will States be required to offer training in addition to locating jobs for welfare recipients?

Response. In estimating the savings, we assumed that 50 percent of the AFDC population would be exempt from any work requirements. The other 50 percent was assumed to be subject to work requirements and that as a result of CWEP, AFDC caseloads would be reduced by 5 percent by 1985. A national average benefit was used.

The savings would be the result of several factors:

Some recipients would put additional effort into securing employment and become self-supporting;

Some savings would result from the elimination of fraud; and

Some recipients who have a potential source of support (e.g. parents) would not apply.

Welfare reform demonstration projects have recently shown that when individuals are required to report daily for structured job search there is an immediate drop-out of participants. In Lowell, Massachusetts, 7.9 percent of the participants called in and requested their cases be closed. In Weld County, Colorado, the AFDC-U caseload was reduced immediately by approximately 25 percent when the job search requirement was introduced. Weld County is also demonstrating the use of job search with applicants and has found in the last year that 17.2 percent never reported to the job search program. An additional 16.5 percent started in the program but dropped out. Weld County is now trying to track these families. Both Lowell and Weld County report that where a reason was given for dropping out, employment was a significant factor. However, no scientific report is available at this time

In addition, AFDC quality control data has shown an earned income error rate of approximately 5 percent and an unearned income error rate of as much as 3 percent. A requirement that recipients report to community work projects would reduce the amount of fraud due to unreported earned income.

Recipients who have unearned income of any significant amount, which is not now reported, may decide to request removal from the rolls rather than participate in community work.

We expect that States will continue the job search and training programs which now exist under WIN. Furthermore, where feasible the new work projects are expected to provide specific training or skill development needed to qualify for existing jobs in the regular economy. However, States will not be required to offer training as part of each project other than that gained through the work experience itself.

Senator LONG. I would like to also ask about the child support program. Ten years ago the welfare rolls were rising rapidly. The Department of Health, Education, and Welfare—that's when you were a Senator—was projecting that the growth would continue. The growth has not continued, and a substantial reason why it has not continued is that we were successful, over the objection of the Department of Health, Education, and Welfare, in enacting a strong child support program. The figures were showing, and they perhaps still show, that about 75 percent of these children on welfare are listed as being in families where the father is absent from the home. We undertook to track these fathers down and make them pay something to support their children. I think that you have always supported that concept and do so today.

What concerns me is that the proposals would tend to make the support service less available because the nonwelfare families would have to pay a fee in order to get the benefit of the child support help that the law has provided, and also that the States in

going after this matter would not have as much financial incentive as they have in the past.

I wonder if you would agree with me that the big savings in this program come not from what we are collecting from those fathers so much as from the deterrent effect on those many people who otherwise would abandon their families without support when they know that somebody is coming after them to try to make them pay up.

Secretary SCHWEIKER. Well, first, Senator Long, let me say that you have done a tremendous job in this area. I think your leadership and the committee's work in here has really set a standard. We are really trying to follow on from some of your ideas and thinking. So, we are certainly going to be influenced greatly by your feel of this situation. I believe that we want to try to keep the incentive in the system to make it work. And we are certainly open on this matter. I had somebody in the House suggest that maybe we ought to put the 10-percent fee on the absent parent rather than the way that we propose it.

Now, I guess I am saying, in essence, that if you have some other ideas that will still accomplish our purposes in this area, we will certainly listen to them. We do feel there should be some kind of a fee here, but maybe we could put it on the other parent instead of the one who is bearing the lion's share of the burden.

Senator LONG. Well, the problem to me, Mr. Secretary, is that there has been a philosophy down in the Department, before you ever got over there, that when they talked about cutting back, somebody would say, "Well, let's cut out the child support program." Well, for every dollar you would save by doing that you would probably really lose \$10, because that's almost like getting rid of the tax collector. When you cut back on the incentive for States to collect and when you cut back on what is available to help pursue these runaway fathers, that encourages people not to make their support payments. I think that we ought to try to move on the basis that men understand that when they abandon their families they have a burden and that it is expected they will pay it. Meeting that obligation is the thing to do and if they don't do it, we are coming after them and we are going to sue them. We are going to make it attractive for those district attorneys wherever they are to go after them too.

Now, that has cost us some money. But I think that the saving is difficult to estimate because the big saving comes from the people who are not abandoning those families or who are making a cash contribution because they know they are going to be sued.

Before you went over to the Department, Mr. Secretary, I must say we didn't have much help from the Department. We couldn't even get their support when we tried to make the Internal Revenue Service tell us where those fathers are.

In other words, here was the tax collector who knew where the papa was. The papa had a good job, he was able to pay child support. And the tax collector said, "Oh, no. When I collect the tax I've done my job." Well, he hadn't done his job. He also worked for this Government. You know, it took one terrible struggle to fight that matter through and make the tax collector tell us where the father was. Then we had trouble with the Department later on.

That's before you got there, Mr. Secretary. But you may recall that over in the Social Security Administration they didn't want to give us a social security number so that the tax collector could tell us where the father was.

I would hope that you understand, and that you will want to work with us on this matter that we want to make it sufficiently attractive that every district attorney in the United States would be inclined to be active, go out there and prosecute these cases where the man leaves.

I was a poverty lawyer back before the Government started hiring poverty lawyers. I can recall when some poor person would come up to me who had been abandoned with those children. If the man had left town, there was nothing we could do about it. But we have now provided the tools and I just think that we ought to continue to make them available.

I would hope that this fee you want to impose does not give a fellow a better chance to get away with escaping his duty to his family when he abandons that woman and those little children.

Secretary SCHWEIKER. Well, we want to work with you on this, Senator Long.

I share your concern. If that's the impact, then, obviously, we should look at another way of doing it. Now, we did put in here, and I am sure you are aware—just following along this same concept, we put in a tax intercept proposal for that absent parent to make sure that he doesn't get as much of a free ride as he has been getting.

So, the point is: We are working philosophically right down the same road you are going and we are very open to any suggestions or ideas. We are not going to shortchange a program that has been shown to be cost effective.

Senator LONG. Well, you showed the good judgment of hiring one fellow who was on the staff of the majority side of the aisle in previous years, Bill Galvin. If your people listen to his suggestions, I think you would find that you have at least got somebody up there who is really tough on runaway papas, if he has enough influence to make his views become effective up there. He thinks, and he has counseled me for years and other members of this committee, that there is probably a billion dollars more that could be saved in this area by making those fathers pay up. I am satisfied that there is a lot that can be done that has not yet been achieved.

Secretary SCHWEIKER. Well, we certainly are glad to have him with us and we certainly are going to follow those leads.

Senator LONG. Thank you.

Senator DOLE. Mr. Secretary, I have a number of questions that I will submit. But I would like to ask just two or three more for the record.

Does the administration have any current position on increasing cost sharing arrangements in the Medicare program?

We have listed a number of suggestions in the so-called Blue Book, which you may or may not have, on page 70, where we would do a number of things. At least we have suggested a number of things that might be done if you might look at the Medicare program.

Secretary SCHWEIKER. Let me say, Mr. Chairman, that right after we finish our social security proposals to your committee and the Ways and Means Committee, we will get right into the whole health delivery system. And when I answered the question a moment ago about the competitive approach, that review will be broad enough to include specifically the questions you are asking. We will certainly be looking at the very suggestions that you have outlined in a Finance Committee report.

So, I think the answer is: Yes, we will address ourselves to that; and yes, we will very seriously consider the proposed savings and suggestions that this committee has made.

Senator DOLE. And also the largest single expense in the medic-aid program is nursing home care. I think one of the recommendations the Governors made was that a cap be placed on that aspect of the medicaid budget. Is that one of the recommendations made by the Governors that you would support?

Secretary SCHWEIKER. Let me say, that wasn't in their general list of recommendations. It was probably in one of the sublists. But we will certainly look into that. That wasn't in the list they all agreed on.

Let me say, though, that I think it is important to note that it would give them the flexibility if they want to do that. So we would not be antagonistic to doing that. If that's what they want to do, we can give them the waiver to do exactly that under our proposal.

So, the answer is that, yes, we will give them that prerogative, but that wasn't just on their top list.

Senator DOLE. I think one of the problems that may need addressing very soon, is the cost of the ESRD program. It is a very critical program. It is my understanding that in 1979 less than one-half of 1 percent of medicare beneficiaries are patients with renal disease, but they received 5 percent of all the medicare payments. In fact, by 1985 it is estimated that 79,000 patients will be receiving treatment at a cost of \$2.4 billion. There has been some talk in this committee in the past that certain dialysis patients might return to private sector insurance and thus reduce the Federal role in financing their care.

Maybe it's premature, but I am wondering now if the administration is examining ways the Federal Government might reduce its role in the financing of kidney dialysis?

Secretary SCHWEIKER. Well, we are proposing a revised reimbursement rate for chronic renal dialysis under medicare so that we are issuing regulations to promote greater efficiency in the delivery of dialysis treatment.

So, we are beginning to move into this area. This is just something that we are proposing in the interim. I suspect we will be looking at that program in greater detail when we have the whole health delivery system up for review.

Senator DOLE. I mean, I think when it is addressed we need to find some alternative because there isn't any realistic alternative now, unless we can find some place to shift the cost, or some way to reduce the cost. Certainly, the administration will not suggest that we end the program, or cut it back, so that the patients would not receive treatment.

And, finally, the only other thing that I will ask for the record now—

Secretary SCHWEIKER. I might say that our proposal would save \$105 million in fiscal 1982, but that doesn't get to the larger, bigger matter that we will also address.

Senator DOLE. It has been suggested by some and there have been some reports that several hundred thousand families will be affected by the administration's proposal relating to AFDC. Do you have any estimates now on how many families might be affected and the characteristics of some of these families?

Secretary SCHWEIKER. Mr. Chairman, I think this is one of the areas where the argument in the papers begins to miss the point of what we are trying to do and how defined our programs are.

It is interesting that the very figure that was used to this effect was provided by our Department to the Ways and Means Committee. The breakdown shows, for example, of the 658,000 families that would either have their benefits reduced or terminated, a majority of that group of families, some 375,000, if you figure the food stamp allocation in there, would actually be above the poverty line.

So it gets back to the point I was making earlier that, we aren't counting the two or three Federal supplemental programs that we have in these programs. That's why the multiplicity of services just proliferates to the point where one out of three families is now getting some benefit. So, 375,000 of this group would actually be above the poverty line if you include food stamps.

Another 283,000 families that initially claimed to be below the poverty line would not be below the poverty line if you do two other things. That is, to allow stepparents to be counted as income bearers, which seems to me very logical and very rational; the failure to count stepparent income has permitted our costs to escalate.

And the other part of it is assuming that when a person reaches age 18 and finishes school he is eligible to work. So, just making those three assumptions, you will eliminate 90 percent of the 658,000 families. Then you are left with some 70,000 families. Only 20,000 would then be removed from the rolls, out of the whole 658,000. And those 20,000 wouldn't be eligible by the current law definition if they were new applicants. So the present judgment would be not to make those people eligible. But they were somewhat grandfathered in, so we are protecting them. On the other hand, this basically says that a new person wouldn't meet that standard today. So that's the 20,000 that we are talking about. And there is another 50,000 who will get some reduction of benefits. But they will still be better off than some other low-income families who chose not to participate in AFDC. So, you are really talking from 658,000; you are down to about 70,000 and 20,000 of those who wouldn't be eligible today by their own standards.

And let me say that we haven't counted federally subsidized housing—rent subsidies. My figures here did calculate food stamps. If we threw in another Federal subsidy, I am sure the figures would be even less severe than the 20,000 and 50,000 that I just recounted.

Senator DOLE. Well, I'll just say, I think you find both sides of the committee will be supportive of efforts to do something with

the way that one chart indicates that we must do something. But I am also pleased to hear you indicate that if we find other ways to save in other programs, we certainly will have the support of the administration in most cases. Because we do have ideas of our own on how we might save some money and if that in fact could be agreed upon by the committee and by the Congress, it could have less of an impact in some of the recommendations made by the administration.

This is the responsibility we have. We hope that we will be able to consult with the Secretary and members of your staff as we take a hard look at all of these areas ourselves.

Secretary SCHWEIKER. We appreciate that, Mr. Chairman. We are really quite flexible on how to work these savings and accomplish these reductions in gross. So, we are very openminded on those.

Senator DOLE. Senator Baucus.

Senator BAUCUS. Mr. Secretary, I have several fairly concise questions which I will ask for you to answer and have included in the record.

Second, I want to just follow up slightly on a point Senator Bradley made, that is reduction in preventive health care. You might recall during your confirmation hearing the strongest point you made was your desire as the Secretary of the Department to increase preventive health care. I remember I was sitting right here and you were sitting where you were and the tone of your voice was the strongest, I think, on that very point. That is, that seemed to be the chief goal that you were going to pursue as the Secretary. So, I hope that as we devise these programs that you remember your chief goal. I don't know if those were your precise words, but you were certainly most enthusiastic. When you answered that question you made that point. That is that you were trying to increase preventive health care. So, I just encourage you to keep it up.

Secretary SCHWEIKER. Well, first of all OMB presented me with a proposal to block grant everything into a one block grant. They presented me with a proposal to put energy, preventive health care, basic health services, social services into a one block grant. I successfully opposed that and broke down not only energy but preventive health services. So, I did win that battle. We have never had a block grant for preventive health service before.

Senator BAUCUS. I guess what concerns me, though, more fundamentally, is that your proposals—that is, the administration proposals to reduce, for example, medicaid; put the 5 percent cap on future years; as well as your proposal to cut back PSRO money, phase out PSRO's. Other programs are premised on greater flexibility, state administration. They are also premised on subsequent legislative enactments of, for example, more competition in health, and ways to reduce savings. The implication is that will provide not only savings but better health care.

My concern is that to a very large degree we don't know what those premises are. That is, we haven't seen the legislation. We don't know precisely the kinds of flexibility you plan to give the States. We don't know precisely, or anything close to precision, the

kind of competitive models or the competitive nature you propose to build into our health system.

And that concerns us in the Western States, primarily because the competition probably doesn't work quite as well. Because there just aren't that many hospitals or that many doctors. There are some parts in the West where there are not a lot of people, therefore not a lot of different providers of health care. Competition might make a lot of sense—it does make a lot of sense in more urban parts of the country—big cities, lots of hospitals, et cetera. But it is difficult for us in the West to agree with some of your recommendations when we don't know what your premises are. That is, we don't know the degree of State flexibility in the kind of competitive model that you intend to propose.

It also somewhat reminds me of the campaign. You are up here campaigning. We all know in campaigns we promise what we are going to do; it sounds good. But when we are actually trying to accommodate different legitimate competing differences and enact the programs, we run into problems with trying to just do what is best and with limited resources we can't do everything. And, so it's difficult for me listening to your campaign here before I can see with more precision what you have in mind later on, which is the basic premise of your cuts.

When are we going to get some of these proposals, by the way?

Secretary SCHWEIKER. Which proposals?

Senator BAUCUS. Well, in your testimony you say that you are going to provide us with some—

Secretary SCHWEIKER. My statement couldn't be more specific. We have maybe 50 items on specific proposals. I could have gone through the whole thing.

Senator BAUCUS. No, I am talking about—

Secretary SCHWEIKER. So they are very specific.

Senator BAUCUS. Yes. But you say that—Just to take one example, PSRO's. You want to phase it out.

Secretary SCHWEIKER. All right.

Senator BAUCUS. In your statement you say you are coming along later with some legislation to provide more competition to help address part of the problem that PSRO's were created to address.

And the same thing with Medicaid. You see it coming along later with legislation to reduce some of the costs that presently occur because there is lack of competition.

So, when are we going to see that?

Secretary SCHWEIKER. Well, first of all, the block grant program is going through OMB clearance right now. We should have that up within a week. So, we have 50 or 60 specific items in my statement today that makes it clear exactly what we are proposing on the reconciliation package and the fiscal 1982 budget reduction.

Second, we have our block grant program that is in final form and just waiting clearance from OMB. And the only other thing that I think we have talked about this morning was the health delivery system. I told Senator Durenberger that that would come up as soon as we finish social security proposals which this committee has asked me for.

Senator BAUCUS. Roughly when?

Secretary SCHWEIKER. We are going to complete work on the social security proposals in probably 2 weeks. We will then begin to work on that immediately afterwards.

Senator BAUCUS. I just encourage you to—When you devise it, though, and formulate it, that you pay very close attention to rural parts of the country and recognize that the Western United States is not Philadelphia. It's not eastern Pennsylvania, for example.

Secretary SCHWEIKER. Let me say, Senator, that you will be delighted to know that Pennsylvania has the largest rural population of any State in the Union by the census definition. So I have been pretty sensitive to that.

If you look at our National Health Service Corps figures, you will find that we are increasing the National Health Service Corps from the present level of 2,000 slots to 2,500 slots. So that is a 25 percent increase and that specifically is designed to go into your needy and rural areas. So there is no cut in terms of the growth of the National Health Service Corps. We are going from 2,000 to 2,500 slots, which is something that has to be said.

On the prevention aspect, I would like to mention that I fought very hard, and quite successfully, against reducing the NIH budget. I happen to believe in terms of prevention. That is exactly where the ballgame is. If we can research the causes of these diseases; if we can research exactly what the relationship of nutrition and diet is to these diseases, we are going to save people's lives, make them live longer, and we are also going to save health care costs. So, you will find there are no cuts here of significance to the NIH. That is a \$3½ billion operation. So I successfully advocated and won a strong element of prevention through biomedical research. And I happen to believe that is probably our best investment of all in terms of prevention.

Second, I also am going to propose—and I might have mentioned this before—that we use a reimbursement mechanism for health prevention. That instead of just reimbursing people for being sick, we reimburse them for being well and having a proposal that does that. The competitive system is going to foster a group health plan and an HMO concept that pays people for keeping them well. So you are going to find a reimbursement mechanism that goes to the area of prevention.

So there are other ways for doing it just besides the categorical programs. And that's the point that I am trying to make.

Senator DURENBERGER. I might say to my colleague from Montana that competitive health care is not a bill that can be passed easily and then it settles on the whole country like a blanket while you pull a fee-for-service blanket out from under it. I think you are right in making the observation that it will come most quickly and most effectively in the more populated area and that any suggestion that competition is a cure-all that you can budget into the 1983 budget is not very realistic.

Senator BAUCUS. I know the Senator knows that, and the Senator knows that I know that too. I just want to make the point so that the Department, when it sends up its recommendations, also takes that into consideration.

Senator DURENBERGER. OK.

Senator BAUCUS. Thank you.

Senator DURENBERGER. Mr. Secretary, back on your struggle with whoever it was on block grants, did you try to poll—and I know you come from a labor and human resources background and I come from a Finance Committee background—but did you make any effort to preserve title V and keep it from getting blended into the health services block grant, particularly for maternal and child health? And if you didn't, would you tell me why we ought to get rid of title V? Couldn't we get some of the same objectives we are after by keeping maternal and child health and the cripple children in title V and block the rest of those?

Secretary SCHWEIKER. Well, I have to go back to where I had to start from. The OMB proposal was to block grant everything in my department. I disagreed with that and got four. I guess, originally they were going to give me two. So that to some extent I feel I won some battle in that respect. But I don't know how to go further than that unless you establish a separate block grant for it.

Senator DURENBERGER. Would you have any serious problem if we tried to work in that direction, to reserve title V and put everything else into a block grant?

Secretary SCHWEIKER. I think it is important now, Senator, to make a point. We are not destroying programs by block granting them. We really feel that the States have a great sensitivity to these programs and to some extent were perpetuating them because we provide that they must use the money in that block for those programs. What priority they assign is up to them, but they must use it as it has been done in the past. So that will be preserved in the States.

Now the Governor or legislature may well argue about what the priorities would be, but they must use the money. It is not like revenue sharing. They can't just spend it where they want to spend it. They have got to use the money for programs that have been consolidated in that block, including the program you are mentioning.

Senator DURENBERGER. But, unfortunately, on comparing this, the health service block grant, with the social service block grant, here you are putting little kids that don't vote in competition with adults and senior citizens and a lot of other folks to a much greater degree and then cutting the program to begin with.

And I would just suggest to you, and we don't have to debate the point any further, that I would certainly like to give some consideration to preserving title V and keeping the maternal and child health separate from the rest of those programs, unless at some point you can come up with some very strong objection for doing that.

Secretary SCHWEIKER. Let me say, Senator, I share your concern. Let me say that a number of the programs in that health service block are programs that I am a cosponsor of and helped initiate, so I happen to think they are important programs. But I also happen to think that because they are good programs that they will be preserved. I believe that the momentum and the need will justify an ongoing commitment in those programs. We did look at other proposals too: How do we protect different elements in the block? How do we put constraints in? How do we protect rural versus

urban delivery services? How do we make sure that the services are properly targeted?

Unfortunately, the further and deeper we got into it, we just felt that you are almost back to the categorical program approach if you begin to write those things in again.

That is our dilemma. The further you go toward protecting what you think are good programs, the closer you get back to categorical programs. I came up with the 4 block approach because I thought that was a fair compromise between 1 block and 40 categorical programs. There are certain safeguards you can build in, but then I think you get into a problem. How do you prevent 40 different sponsors of 40 different bills from building in a proposal to protect their program and then we are back to the \$300 billion gross rate problem. So, I understand what you are saying, but it is a tough one.

Senator DURENBERGER. I was just reminded of another distinction here, and I have only been here two years and I think you know the distinction. That is that title V is part of coordinated services within the Social Security Act, whereas many of the rest of these are community health based. They come to us courtesy of people like you who have commitments to this area, so there is some distinction.

But let me add in the little time I have left, ask you a question about the future of PSRO's.

Your statement would indicate that we will hang onto the efficient PSRO's and drop the others. My question is: What do you do in terms of some constraint on health care costs in the areas where you have dropped the inefficient PSRO's? Doesn't it make more sense to find out what makes the good ones work; try to get that to work in the inefficient areas during this period of time when we are transiting from the present system to a competitive system?

Secretary SCHWEIKER. Let me say, Senator, that there are certainly some good PSRO's and there are some poor PSRO's. And, unfortunately, they sort of fall into one or the other category. If there is any way that this committee in its wisdom can give us some elements of protecting the good aspects of PSRO's, we are very receptive to that. Because there are some that have really done a good job. The tragedy is that the overall record isn't that great. There are some that have been a dismal flop. So that we are certainly receptive to see if there are some elements of utilization review that we might build into this system.

Senator DURENBERGER. We'll start next Monday morning at our hearings. I am glad that you will be receptive. My time has expired. Senator Mitchell.

Senator MITCHELL. Mr. Secretary, I wanted to ask a couple of questions about the AFDC portion of your statement, specifically page 25 of your statement. While your aide is getting that I will precede it by saying that recently, just a few days ago, I was asked to meet with a group of women in a city in my home state who are recipients under this program, beneficiaries under this program. I thought that the purpose of the meeting was going to be for them to urge me to vote against any cuts in the program, because that is essentially most of the meetings that I know my other colleagues and I are having these days. But that wasn't the purpose of the

meeting. They wanted to tell me that each of them wanted to work; each of them was concerned about the stigma that is associated with receiving welfare in this country; and that each of them wanted the self respect and self esteem that comes with making ones own way in a free society. But they argued the way the law is now administered, particularly the method of calculating earned income disregard, that there was no incentive for them to work and indeed there was a specific disincentive. They argued in each case that they would go out and work. And as I am sure you are aware, most of the people on AFDC are virtually, by definition, persons who do not have a high level of skills and, therefore, are not able to get very high paying jobs, at least as they enter the workplace. After the calculations were made for earned income disregard and all of the benefits were reduced accordingly, they were in most cases worse off, or just about the same, or perhaps slightly better off so that in effect for working 40 hours a week, they were getting a few cents an hour.

I asked them in each case to write it down, exactly how much they were receiving under each program, exactly how the income disregards were calculated, and precisely how they arrived at these calculations. I haven't received those yet—just leading up to this question.

I was, therefore, very much interested to read your statement at the top of page 25, the first sentence, which, of course, says, and I will read it:

The generous disregards applied to earned income under the current law, for example, have allowed AFDC recipients to join the work force to continue to receive public assistance even after they are working full-time.

This is diametrically opposite to what this group of AFDC recipients told me just a few days ago. This is precisely the opposite of what they said.

I don't have a specific question for you now, except to ask that when I receive the specific written information, the calculations by which, or upon which, they based their allegations, I would like to send them to you and ask you to comment on them and ask you whether or not they square with this statement here?

I think getting people off welfare is perhaps the second in popularity; third in popularity in this country to getting the Government off our back. American flag, apple pie, and motherhood, I guess, is the first general phrase. And everybody wants to do it; nobody disagrees. Persons who are paying the bill; persons who are charged with administering the program; persons who are recipients. I think we all agree on that. I know you agree with that. But it seems to me incredible that the information I received, and this was maybe 8 or 10 women—different backgrounds, arrived at their present circumstances by different means—made statements to me which are exactly the opposite of what is stated in your statement here today.

Now you obviously can't comment until I provide you with the information and I don't have it in front of me. I wish I did. Had I known this hearing would be held today, I would have gotten it before now. But I would like to submit that to you in writing—their specific—and these are real people, actual cases—and have you comment how that squares with this statement here today.

Secretary SCHWEIKER. I'd be glad to, Senator. Let me just respond in general to the point you are making.

You and I don't really disagree in terms of where we are trying to go. The problem has been that in the past we have written incentives in the law to give people an incentive to work. However, we have overshot our mark, substantially. Not only do we give people incentives to work, but we also give them incentives to stay on welfare and work. The problem is that we have gone too far the other way and we have got to come back some where to where the incentive is to work and not to stay on welfare. So we submit this proposal on the basis that we will keep an incentive for people to work, but also to get off welfare.

The problem with the present formula is that people can stay on welfare and get higher and higher levels of pay. And that creates a problem of everybody piggybacking on a program. So we are trying to devise a way of selecting it out to do exactly what you want to do.

We are not hidebound on this. If there is a better way to target the incentive for people to work than we have proposed here, we'll listen to your proposal. But, we really feel the present proposal that is current law counts work-related expenses twice and escalates it beyond what it should be. So, we will be glad to look at your individual cases and see how they cut.

Senator MITCHELL. I want to make it clear, I don't have a proposal at this date. I just heard from these people in the last few days and was struck by the directness of the contradiction between what I heard then and what I heard here today.

So, I would like to have you take a look at it. If what you say is correct, I am going to ask them for another meeting and go back and tell them what you have said. If what they say is correct, I would hope, and I know you will, knowing you, that you will have an open mind and consider other alternatives in this area.

Secretary SCHWEIKER. I certainly will.

Senator MITCHELL. Well, I guess there is just you and I, Mr. Secretary. Let me—

Senator DURENBERGER. No. I am still here.

Senator MITCHELL. Oh, I am sorry, Mr. Durenberger. Well, there is pretty soon going to be just you and Mr. Durenberger.

Senator DURENBERGER. Right.

Senator MITCHELL. Thank you very much, Mr. Secretary. I commend you for your openness, candor and, as always, your excellent testimony.

Secretary SCHWEIKER. Thank you, Senator Mitchell.

[Whereupon, at 12:10 p.m., the hearing adjourned subject to the call of the Chair.]

SPENDING REDUCTION PROPOSALS

WEDNESDAY, MARCH 18, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:08 p.m., in room 2221, Everett McKinley Dirksen Office Building, Hon. Robert J. Dole (chairman of the committee) presiding.

Present: Senators Dole, Packwood, Roth, Chafee, Heinz, Durenberger, Long, Byrd, Bentsen, Baucus, Bradley, and Mitchell.

The CHAIRMAN. I think we are waiting for copies of the statement. They are apparently on the way.

Well, we will proceed in any manner you wish, Mr. Stockman. Very pleased to have you here and know this is probably a new experience to come before a committee. We welcome you to the Senate Finance Committee.

You have indicated you would like to summarize your statement. We will ask that the entire statement be made a part of the record and then we may proceed to ask questions. So you may proceed in any way you wish.

[The prepared statement of Hon. David A. Stockman follows:]



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
Wednesday, March 18, 1981

STATEMENT OF DAVID A. STOCKMAN
DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
SENATE COMMITTEE ON FINANCE

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear before you to discuss the President's program for national economic recovery and, in particular, his budget plan. The overall program is designed to break the inflationary psychology that now grips the Nation's economy and to revive investment, job creation, and economic growth. There are four elements to the President's program:

- first, a sharp reduction in budget growth, which will help curtail deficits, limit Federal borrowing, and moderate inflationary expectations;
- second, major tax rate reductions to restore capital formation and productivity;
- third, elimination of unnecessary regulations and streamlining of those that are necessary; and
- fourth, steady decline of money growth, in order to reduce inflation and stabilize financial markets.

The benefits of a lower rate of inflation, a lower tax burden, and a higher standard of living will extend to all Americans.

Tax Proposals

Let me speak just briefly about the Administration's tax proposals, which are, of course, of vital interest to this Committee. The Department of the Treasury can supply greater detail on these proposals. Our proposals will bring about a net reduction in the tax burden of \$56-1/2 billion in 1982. Tax relief will reach \$130 billion in 1984 and nearly \$200 billion by 1986.

The President's program calls for reductions of 10% each year for the next 3 years in marginal tax rates for individuals, beginning July 1, 1981. Compared with present law, tax rates would be reduced by 5% for calendar year 1981, 15% for calendar year 1982, 25% for calendar year 1983, and 30% for calendar year 1984. As a result, marginal tax rates would be reduced from their present range of 14-70% to a range of 10-50%, effective January 1, 1984.

The proposed Accelerated Cost Recovery System would provide for faster write-off of capital expenditures under simplified and standardized rules. This system of accelerated depreciation, proposed to be effective for new and used property acquired or placed in service after December 31, 1980, is estimated to reduce receipts by \$2.5 billion in 1981, \$9.7 billion in 1982, and increased amounts in subsequent years.

Also of interest to the Committee are user fee proposals that will help recover the cost of Federal services involving the Coast Guard, air traffic control, and inland waterways.

Newly strengthened incentives to work and to save, along with more adequate allowance for depreciation, will help stimulate a refurbishment and modernization of American plant and

equipment. Keeping up with new technology is crucial to economic growth, and to our competitive position in the world market. Over the long run, economic growth increases receipts and reduces outlays, thus helping to balance the budget.

I urge the Committee's prompt and sympathetic consideration of this program.

Spending Reductions

The Administration's proposals for tax reduction are coupled with proposals for reductions in spending. Careful discipline over Federal spending will reduce deficits, rebuild confidence, and lower inflationary expectations. Reallocation of resources back to the private sector will free savings and contribute to economic growth.

~~There are~~ over 200 reduction proposals in our budget revisions document released March 10 -- too many to detail here. Outlay savings from these proposals total \$48.6 billion for 1982. These reductions are based on nine carefully developed criteria:

- preservation of the social safety net of basic income security programs;
- eliminating unintended and unwarranted benefits;
- reducing or eliminating benefits for middle and upper income levels;
- recovery of allocable costs of Government services through user fees;
- application of sound economic criteria to economic subsidy programs;
- stretchout of deferrable public sector capital investments;

- restraint on lower priority programs of national interest;
- consolidation of categorical grant programs into block grants; and
- reduction in Federal personnel and overhead costs, and program waste and inefficiency.

Recent decades have witnessed an enormous growth in Federal entitlement programs. For example, entitlements and income security programs comprised 26% of the Federal budget in 1960, but 50% in 1981. New and expanded entitlements grew from \$5.6 billion in 1970 to \$56.9 billion in 1981.

The Federal budget cannot be brought under control if we accept the argument that every aspect of these programs represents an irrevocable Federal commitments that establishes a permanent entitlement to Federal benefits for a large proportion of the country's nonpoor population. We must eliminate unintended benefits and reduce benefits to middle and upper income levels. We must pare entitlements down toward just the social safety net.

The President's budget plan preserves the social safety net that comprises those income support programs on which there is a broad consensus in American society. It also preserves additional benefits for the truly needy. Reductions in income support programs are limited to areas where unintended benefits have developed through lack of careful budget scrutiny and where unnecessary or unjustified, overlapping benefits have grown up.

While social security and disability benefits, basic unemployment benefits, and veterans benefits are not linked to specific demonstration of need, the overwhelming bulk of the

recipients, particularly the retired, have not only earned these benefits but would be poor without them. Included in the social safety net programs are cash benefits for dependent families, the elderly, and the disabled.

The Administration is concerned that other income security programs have grown individually and their benefits are often uncoordinated and overlapping. What we are proposing is simply streamlining the structure of these programs to eliminate or reduce redundancy on the one hand, and assure that they are meeting their basic purposes on the other.

The Administration proposes block grants for health, education, and social services. These proposals would fund the block grants at a lower level than the sum of the individual parts that are being folded into them. Federal regulations tied to categorical programs are enormously costly to States and localities. Categorical programs have very high overhead costs. The States themselves would prefer more flexibility even if it means less money. Block grants are simply a more efficient way of providing Federal assistance. Scores of regulations will be eliminated, as will the unnecessary bureaucracy. Some individual programs will no doubt be cut dramatically, demonstrating that, from the perspective of State and local officials -- those closest to the problems involved -- they are not of the highest priority.

The old approaches to income support, education, and health programs of the Federal Government involved overlapping benefits and unjustified entitlements for income support programs and a wide array of small, inefficient categorical grant programs. These approaches have been thoroughly discredited. In their old

form, they will no longer be tolerated by the American taxpayer. Americans are a compassionate people, but in an era of high inflation and low growth we cannot afford slipshod programs with unnecessary and unintended benefits.

The President's budget plan is, as I indicated earlier, but one part of his overall economic plan. Under the overall economic plan we expect rapid economic growth accompanied by the creation of 13 million jobs between now and 1986. We expect rapid decreases in interest rates and inflation. This plan means steady, productive jobs for those now unemployed, stable prices, and interest rates that will make the possibility of homeownership once again a reality for lower income Americans.

Credit Budget and Off-Budget Spending

The President's program is not limited to Federal fiscal activity formally included within the budget. Curtailment of Federal credit activity is also important to our economic program. We are urging the budget committees to include credit limits or targets in budget resolutions.

Under our budget revisions, direct loan obligations and loan guarantee commitments are \$13.6 billion below the adjusted January credit budget for 1981, and \$21.0 billion lower for 1982. Off-budget outlays are reduced by \$0.6 billion for 1981 and \$4.7 billion for 1982.

Future Steps

I must underscore the importance of steady and reliable implementation of the Administration's budget and tax policies. Consistent, methodical execution of this program is essential to

reducing inflationary expectations and improving the environment for the business investment necessary to a restoration of vigorous economic growth in the United States.

Looking ahead, I must stress the need for additional budget savings in future years. Let me note some possibilities for further reform:

- development of fundamental and comprehensive financing reforms, that would reduce inflation of health care costs;
- more efficient delivery of veterans health services;
- development of alternative ways of financing strategic petroleum reserves;
- improved efficiency of the many Defense Department programs;
- reduction in error rates in income transfer programs;
- reevaluation of the housing subsidy programs;
- better coordination of programs that benefit specific groups of people, such as Indians and migrant workers;
- reform of military and civilian retirement pay;
- review of the Federal credit and loan guarantee programs, with particular attention to improve debt collection; and
- examination of the relative changes in the size of Federal and State and local sectors, and how growth in the public sector in general can be efficiently shared among the three levels of government.

We have achieved a great deal in a very short period of time. Some future savings will require fundamental restructuring of programs, which has not been possible in the brief period

available to us. However, I can assure the Committee that we intend to set in motion a process that will lead to the needed additional savings.

I urge prompt, decisive action, both on our tax proposals and on other elements of the Administration's overall program that fall within the jurisdiction of this Committee.

That completes my prepared statement. I would be happy to answer any questions the Committee may have.

STATEMENT OF DAVID A STOCKMAN, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

Mr. STOCKMAN. Thank you, Mr. Chairman. I am sorry to learn that the statements aren't up here. I thought that they had been distributed. But I would like to submit a copy of the statement for the record and indicate that I would be happy to answer your questions. I am sure they will cover a broad range of matters affecting the entire economic program.

This morning I wanted to focus my remarks on those aspects of the budget savings plan, those changes in social security, unemployment insurance and other programs that would come before this committee as part of the reconciliation process once it gets underway.

Specifically, I would like to point out to the committee that we have proposed more than 29 entitlement changes in social security and these other programs that would fall within your jurisdiction. If these proposals were approved by the committee, they would result in savings of more than \$8.6 billion during fiscal year 1982 and those savings would increase in future years.

The point I think I want to make this morning is that I believe it is very difficult to look at any of these proposed changes, whether it is eliminating the national trigger on unemployment benefits, reforming and focusing the trade adjustment assistance program, or eliminating the student benefit in social security. It is very difficult to look at any of these measures in isolation. I think they have to be looked at in the context of the entire array of income maintenance and assistance programs that we have in this country.

And so I would like to begin today by trying to sketch just a little bit in terms of the dimensions of that system and then give you some idea of the logic, some idea of the policy framework that we were attempting to develop as we proposed these individual changes in each of these programs.

Today, Mr. Chairman, we have more than 45 separate income maintenance programs that operate either on a cash assistance or an inkind assistance basis. Those range, obviously, all the way from AFDC, which is the traditional program, to newer programs like medicaid and food stamps through Cuban refugee assistance and a whole variety of minor programs.

What we discovered, as we attempted to put this budget plan together and recommend these changes to you in the income maintenance system, is that each of these programs was established at a different point in time. The concern was on a very narrowly defined need and over the years there has been very little effort to integrate and to assess the total impact of this system.

But I would like to give you a couple of figures this morning that I think indicate why this total system of income maintenance programs—more than 45 different programs, as I have indicated—need to be reformed and revised in the way that we are proposing.

If you look at the growth of this system, you will find that in 1955 we spent about 3.8 percent of our total gross national product on both cash assistance and inkind income maintenance programs. Today we are spending 11 percent. There has been almost a three-fold increase in the share of GNP devoted to this whole array or set of programs over the last 25 years.

More importantly, in 1955, 94 percent of all the funds that we provided through the Federal/State system for income maintenance for the needy and low income families was provided through the cash assistance programs, mainly AFDC. Today that has so radically reversed due to the growth of all the inkind programs—medicaid, housing assistance, social services and so forth—that only 39 percent of the total amount provided through the Federal/State system is in the form of cash. The other 60 percent is in the form of this whole variety of inkind programs.

Now one of the problems that this approach, this policy strategy, has created is that I believe it has led to an undermeasurement, or an underappreciation, of the amount of support we are providing to the low-income families in this country. And the reason for that is that the typical census bureau analysis of the poverty population or of the distribution of income is focused primarily on money income. And, yet, if we are providing the largest share, or the predominant share of our income transfer assistance in the form of inkind payments and inkind aid, that does not show up in the official poverty statistics or in the official statistics on money income distribution.

But I think I would like to provide some data this morning that indicate what a difference there is if you take into account in the distribution of income in the measurement of the poverty population this enormous amount, tens of billions of dollars, that we are providing to these inkind programs.

If you measure only cash income there are today, or in 1980, 18 million people below the poverty line, more than 8.6 percent of the population. If you then modify that basic measure, which is the statistic we normally see in the census statistics, to include all inkind assistance, other than medical assistance, the poverty population drops from 8.6 percent to 5.9 percent. And then if you take it one step further and factor in the inkind medical assistance that we provide through medicaid and to some degree medicare, the poverty population drops still further to 3.9 percent of the population.

And, so, I would like to suggest that as we examine each of these programs we look at them in the context of this total array of cash and inkind support—the inkind support system that we have cre-

ated in this country over the last 15 years. Because what we are really attempting to do here, Mr. Chairman, are two things: One is to contain the total budget cost of this massive array of programs. But secondly, in the process, to secure a better match between all the program tools that we have available to meet various kinds of needs and the actual needs, that we have in our society. And I think that if you look at each of the program changes that we have proposed, you will see that they fit that general framework. Let me just itemize here a few of them.

In social security we have proposed four changes. The first would be to eliminate the student benefit program in social security. We believe that this is justified. We believe that this is a defensible move to make at this time because since that benefit was created, which is in the social insurance benefit and, therefore, is not means tested, we have had an enormous explosion of direct Federal higher education assistance. In 1965 when that benefit was adopted we were spending less than \$0.5 billion a year for the whole array of higher education assistance programs. Today we are spending \$6 billion a year. The two basic programs, obviously, are the guaranteed student loan program and the Pell grant program.

In light of the availability of that directly targeted assistance system, especially with the changes that we have proposed in that area to focus these programs to those students who have financial needs, it seems to us that there is no reason any longer to continue the \$2 billion a year program in social security that provides benefits without any regard to need or without any regard to financial requirements.

We are proposing, as you know, specifically to eliminate that over the next 4 years. And we believe very strongly that with the Pell grant systems as a backup, and with the availability of guaranteed student loans on a financial-needs-tested basis, that any student of any of the 800,000 students who are receiving social security higher education benefits today, who do have financial needs or who do come from families with limited financial resources, would be assured of the right to obtain a higher education by relying on these alternative programs. But, in the process, we can save more than \$1 billion a year, eventually, because we have moved this type of public assistance from a social insurance to a means-tested basis.

I think the same thing is true, Mr. Chairman, in the case of eliminating the special minimum benefit. Again, when that was originally put into the law, we did not have a national safety net of means-tested assistance for the low-income-elderly population. Since then this committee has taken the lead in creating the SSI program. That provides a floor of support for all of those in our population in the retirement category who do not have sufficient income of their own.

It seems to us that in light of that system that is available and in light of the fact that a substantial share of the 3 million who receive the minimum benefit today also receive SSI, that we can save money in terms of total budget costs and still meet all needs by shifting toward the SSI system for those that have needs and removing the minimum benefit in the case of those who can't demonstrate financial need.

I would stress, and I have done this repeatedly, but I think it needs to be stressed over and over, that this proposal that we have made would result in dollar-for-dollar replacement of special minimum benefits with SSI benefits in the case of all current recipients who meet the means test, the eligibility test, of the SSI program.

We believe that essentially the same argument can be made in terms of the disability changes that we are proposing. The disability program at the Federal level today operates in a context of a multitude source of disability benefit in our Federal/State system. State workman compensation programs in some States have disability benefit programs of their own. What we are proposing is three or four reforms that would better focus and tighten this program which has been growing at an explosive rate over the last 10 years, as this committee is aware.

In particular, I would point out the medicaid cap, which I believe is well justified within the context of what we are trying to do here. It simply says that no Federal disability recipient could receive a higher total of combined benefits under Workman's Compensation, under Federal disability and certain other sources than their earned income at the point at which disability was determined or certified, indexed for the change in the cost of living from that point forward. Again, it's an effort to begin to create some of the benefit integration that we desperately need in this system if we are to contain the total cost.

Now, I would make the same arguments regarding our AFDC changes. This committee is aware that the AFDC system and the eligibility requirements were created largely before we had very large programs of inkind assistance in the housing area, in the food area, and the medical area in particular.

One of the changes that we are proposing to help secure better integration, and therefore lower costs between these multiple-benefit systems, is to include in the calculation of accountable income for the determination of AFDC eligibility and AFDC benefits the cash value of inkind benefits that recipient, or that household, may be receiving in these other programs.

Now, we believe that this is important to do because in the case of the housing assistance programs, for instance, in some cases the inkind benefit equals anywhere from \$3,000 to \$5,000 a year under the section VIII program. And we think it is important to count these other benefits in order to assess total resources available to the family before you calculate the exact cash transfer under AFDC.

A similar case of an effort to tighten these programs and get a better integration of all the benefit tools we have available would be the requirement to count the income of stepparents in an AFDC household. The fact is that today, under the eligibility rules as they are written at the Federal level, stepparent income isn't counted even if it is substantial. It seems to us that is a legitimate source of income or support to count as you are making this determination and if the committee would adopt this particular proposal in the AFDC area, the savings would be more than \$170 million a year just in that case alone.

Now, Mr. Chairman, I won't go through all the other proposals because there are so many and it would take so much time. But, I

think, if you look at our trade adjustment assistance proposals and our unemployment insurance proposals you find this same logic. Benefit integration and cost reduction, better targeting of benefits to those who really have a strong claim on the Federal Government and can establish a clear need for this kind of assistance.

Eliminating the national trigger, I think, is an important step. This committee has endorsed it in the past. But if you look at the problem that has developed in terms of the uneven distribution of unemployment levels in our economy as a result of structural changes that are taking place in basic industries like autos and steel, and so forth, it is clear that the national trigger doesn't make sense anymore. When the national trigger went in July, last summer, 19 States did not have an insured unemployment rate high enough to qualify in terms of the national trigger. Beyond that, eight States actually had insured unemployment rates of below 2 percent.

And, Mr. Chairman, I would suggest that it doesn't make a great deal of sense to provide 13 extra weeks of unemployment in labor market areas where the insured unemployment rate is below 2 percent and where the implied condition is one of relative availability of jobs and, perhaps, even a tight labor market, if you wanted to define it that way.

By going to a State-by-State trigger and by establishing a more realistic threshold in terms of when the extended benefits trigger in, again what we are attempting to accomplish, essentially, is to target, in a much more disciplined and focused way, these benefits into those areas of labor market distress and high unemployment where a strong case can be made for the extra 13 weeks of benefits.

In the case of trade adjustment assistance, there is a very straightforward proposal simply to integrate benefit levels between the State basic unemployment insurance system and the trade adjustment assistance benefits program by putting a cap on the payment level at the State level for basic unemployment benefits and by limiting the duration of total benefits between the two programs to 52 weeks.

Mr. Chairman, let me finally say that we have made other proposals in the health care area and the social services area that essentially attempt to contain Federal costs by giving the States much more flexibility to operate these programs. There has been a great deal of controversy about the medicaid cap. But I would like to stress with the committee this morning that in return for the cap at the fiscal year 1981 level of reimbursement, plus escalation in future years for inflation, we would provide the State with far more flexibility than they have today to alter practically every feature of this rigid medicaid system that they are locked into. By allowing the States to use different reimbursement mechanisms and thereby experiment with ways to contain health care utilization, hospital costs, I believe they can begin to lower their own costs statewide.

By allowing them to charge copayments in the cases of certain services that are obviously overutilized, again another tool is given to the States in order to help hold down their entire medicaid bill.

By allowing them to contract with HMO's without all the restrictions that are in the Federal laws today, a third tool would be

provided. By allowing them to change eligibility requirements and conditions for populations being served today outside the basic AFDC/SSI population, a fourth tool of flexibility and cost containment would be provided.

Mr. Chairman, I don't believe that the medicaid cap is a good long-run solution to this problem. It is not something you would want to keep into place for 5 or 10 or 15 years. But for 2 or 3 years, I believe that it is an effective and a justifiable interim step until this committee and the administration and others who are concerned about the general health care cost problem can come up with the kind of generic reforms that we need to contain and hold down costs in our entire health care system and not just medicaid, but through all the payment systems that we have.

So, this is just a brief review of the variety of statutory and entitlement changes that we have presented to Congress that would fall within the jurisdiction of this committee and I would like to spend the remainder of our time trying to answer whatever specific questions that you may have about these measures or other aspects of the President's economic program.

The CHAIRMAN. Thank you, Mr. Stockman.

We operate under the early bird rule and the early bird is Senator Byrd. [Laughter.]

Senator BYRD. Thank you, Mr. Chairman.

Mr. Stockman, I note that you have been condemned in the press and condemned by some of your former colleagues in the Congress and some of my colleagues in the Senate as being inhuman and many other adjectives that have been applied to your proposals to attempt to get spending under control. I want to say, as one Senator, I applaud your efforts. I applaud President Reagan's efforts. If we are going to get inflation under control, and that is the greatest threat to the American people, as I see it, we have got to get Federal spending under control. And there is no painless way to do that, as I see it.

By saying that I applaud your efforts doesn't mean that I agree with every item that you have recommended to be cut. Several of those items I don't agree with. I also feel that you haven't gone far enough. I say, to you, the administration hasn't gone far enough in its proposed reductions. But, I plan to support your program. Because if we start unraveling this ball, it seems to me we will end up with the whole ball of wax being unraveled and we will get nowhere. So, while I don't agree with all of it, and while I think you should have gone stronger in some of your cuts, I plan to support it. I commend you and I commend President Reagan for having the courage to submit a significant effort to control and to reduce the growth of rate in Government spending.

I think one thing the American people, and many critics of your program, don't realize, there is no proposal to cut spending below what it is now. The proposal is to cut the tremendous growth in the increase in spending that has taken place during the recent years—anywhere from 12 to 17 percent. Now, if we could cut the rate of growth, then we could get to a balanced budget and get back on a sound basis.

Now, let me ask you just a couple of questions.

I note that you assume in the new budget an interest rate on Government bonds at 8.9 percent. And you project that the total cost of financing the national debt in the new budget will be \$99 billion in round figures. Is that 8.9 percent a realistic figure? It seems to me that is a low figure and, if that's the case, the deficit would be increased by whatever amount you are wrong on that rate assumption.

Mr. STOCKMAN. Let me first thank you, Senator, for those comments and underscore the point that you made about slowing the growth rate of the Federal spending. Because that is the key to this whole fiscal program.

In the last 2 years we have had an average 16-percent rate of growth in Federal spending. That is clearly unsustainable. Our revenue base can't expand that rapidly; our economy can't expand sufficiently to support that kind of spending growth. We are simply asking the Congress to help us find ways to produce a budget for 1982 that would represent about a 6-percent rate of growth and then to hold the line on that kind of fiscal discipline in future years.

I believe our economy can support a 6-percent rate of growth. Because that is about the revenue growth that you would get if you had a 3- to 4-percent real expansion with low inflation each year.

Now, on your question about the interest rate, we believe that that is a reliable and realistic forecast for the fiscal year 1982 period, which would extend from October of next fall to the following October. The reason I believe that, and it is roughly in the 9-percent range as an average over that fiscal period, is that if this program is adopted, we believe that expectations and the financial markets will be substantially improved. The effect of that will be to lower, gradually and steadily, the interest rate on long-term bonds. As that interest rate begins to come down on long-term bonds, it will be possible for financial institutions and business enterprises throughout our economy to refinance all their short-term debts and thereby get out of the commercial paper market and get out of the bank market and reduce some of that enormous pressure on short-term interest rates which builds up because of the breakdown of the long-term capital markets and because of the total breakdown of expectations regarding the future.

Now if that sequence of events can occur and the Fed can hold to the targets that it has established in terms of money supply growth and monetary base growth over the next 15 to 20 months, and if you look at where we are today in terms of the T-bill rate, I believe you have a very plausible scenario. In recent weeks the T-bill rate has been falling. It is now somewhere in the 12- to 13-percent range. If the economy slows down and softens over the next 4 or 5 months, which most forecasters are now indicating is a likely possibility, that will decline more.

Then the question really becomes that if this plan is implemented and the economy begins to recover in the fall of this year and throughout the course of fiscal year 1982, what happens to interest rates in that context? And there are two very different views among economists today about what happens.

The traditional view is that as the economy expands, you get a recovery underway, employments rising, real GNP's expanding to

3, or 4, or 5 percent, that interest rates will rise because somehow credit demands have increased given that expansion in the economy.

The alternative view, and the one that we take, is that if you have a firm anti-inflationary policy in place, both on the fiscal and budget end, and at the Federal Reserve, in terms of monetary policy, then when that economic recovery begins to occur late this year and during next year, you will not get a sudden upward surge in the interest rates, but interest rates will continue to decline as they move toward a lower permanent level.

That is the basic difference that we have had in this dispute in the last couple of days regarding the CBO forecast and our own. The CBO assumes that there will be a moderate recovery next year and that the effect of the economy growing and more people working and more factories producing will be to cause the interest rates to be higher in 1982 than almost anybody is forecasting for 1981. Now, I don't believe that is a logical scenario. I don't believe that that is a logical projection.

So I think we have a reliable interest rate indicator. But I must stress that it is dependent—as a policy forecast, it is dependent on the implementation of our entire spending control, tax reduction, regulatory program, and it assumes that the Fed is able to meet the targets for slowing money growth that it has established in the last couple of weeks.

Senator BYRD. I have other questions, but my time has expired. Thank you.

Senator DOLE. Pursuing the little flap over the CBO comments about the Reagan economic assumptions, in addition to what you have indicated to Senator Byrd, I think they also indicated that some of the spending items are underestimated and that the administration has overestimated the favorable effects that the budget, if adopted, would have on the economy.

Has there been an analysis of the CBO analysis by your office that is now available?

Mr. STOCKMAN. There isn't anything that I can put in the record at this point. But I can say that we have done a preliminary, quick and dirty analysis and we have very serious problems understanding the CBO forecast. The CBO—

The CHAIRMAN. They have a problem understanding yours, I understand.

Mr. STOCKMAN. Well, I understand that. But, let me tell you essentially what the CBO forecast says. The CBO forecast says that after the most radical change in economic policy in a good 10 or 20 years, \$48 billion in spending reductions, sharp downward movement in the spending growth rate, across-the-board tax reductions on both the business and individual side, substantial regulatory relief, and a further tightening of money growth policy, further hardening of the anti-inflation resolve of the Federal Reserve, that the effect of all those changes in policy on the economy next year is to have the interest rate go up from a 12-percent, or so, average for 1981 to more than 13½ percent in 1982; it's to have the inflation rate barely come down on a GNP deflator basis from a little over 10 percent in 1981 to a little less than 10 percent in 1982.

The effect of all this is to have the unemployment rate rise from 7.8 percent they are forecasting for this year to 7.9 percent for next year.

Now, my problem with that is that it essentially says that this entire shift in economic policy will have no effect on the economy. And I don't believe that. I think that there is where the basic difference lies and it is a judgment that everyone is going to have to make in terms of assessing their numbers for interest, and inflation, and unemployment, and GNP versus ours.

We strongly believe that our program will have a favorable effect on the performance of the economy and that will be registered in these various numbers or variables that we use to measure the track of the economy.

The CHAIRMAN. As I understand it, then, you are sticking with your assumptions?

Mr. STOCKMAN. Yes. We most certainly are.

The other half of it, Mr. Chairman, is on estimating spending, setting aside the economic assumptions. Almost all of the difference there is on defense. They use, as far as I can understand it, and we do not have a complete detailed technical report as to their difference, but it is about a \$6 billion difference in 1981 outlays in defense given the budget authority level that we are requesting.

But as I understand it, they have used a historic ratio of defense budget authority to the cash outlay or spendout.

We believe that in the context, in fiscal year 1982, of an economy that is rapidly expanding more than 4 percent, in a situation where you have had a large buildup in defense orders over the last 2 years, and our defense increments only add to that rapid, very rapid buildup, that the spendout rate for these procurement items and long leadtime items will be somewhat slower than has been the historical relationship over the last 4 or 5 years and that, therefore, our number is a better bet, is far more reliable than theirs.

But let me make one final observation. You are dealing with a \$700-billion budget. The margin of—

The CHAIRMAN. I might add—I might say right there that I think this committee has jurisdiction of about \$382 billion of that.

Mr. STOCKMAN. That's right. But in terms of these differences, the \$25-billion set in the abstract or in isolation looks large and why is there this great variance or difference?

But, in the context of the totality of the budget in an economy that constantly interacts with the budget, you are talking about a 3-percent margin of error either way. And when you take into account all the interactive effects of interest rates, and inflation, and unemployment levels, and growth levels on various automatic Federal spending activities; when you take into account the near impossibility of accurately estimating the spend-out rates for many of these contract-type procurement programs, both defense and nondefense alike, there is plenty of room for technicians to argue within that margin. And so it's not that we believe that we are 100-percent right they are 100-percent wrong, it is just that you are dealing with a very difficult estimating problem, a very difficult problem of economic analysis and you have to come to a conclusion in order to write a budget. And we believe that our conclusions,

our assumptions, and our estimates of spending are more solid, are firmer than those that have been suggested by the CBO.

The CHAIRMAN. Well, if they are accurate, then we should have more spending reduction.

Mr. STOCKMAN. That would be one way to solve the problem, yes.

Mr. CHAIRMAN. Are you opposed to that?

Mr. STOCKMAN. I'm not.

The CHAIRMAN. So, as I understand it, we may have disagreements on where to cut in this committee, but if in fact we not only reach the goal outlined by the administration, but exceed it, that would not be frowned upon by the administration?

Mr. STOCKMAN. It wouldn't be frowned upon, Mr. Chairman, but I think we ought to all look at the same target.

The real target is not the magnitude of the savings because that turns on your assumptions about where you start from. I think the real target ought to be where we end up; what is the outlay level for 1982? And can we hold it to a 6-percent growth rate, or so, over 1981? And if we have differences on assumptions and, therefore, on the baseline from which we start, then we will need more or less policy changes and reductions in order to reach the bottom line.

But the bottom line is critical. We have to demonstrate to the financial markets, to the American people, to our economy that this Federal Government and this Congress can control its own spending. And we haven't done that for 2 or 3 years with these massive \$50 billion overruns that we have had both in fiscal years 1980 and 1981. And that's critical, I think, to the success of this whole economic policy change operation.

The CHAIRMAN. Now, will the administration oppose any efforts to change the indexing or any other facet of the social security program in addition to the areas you mentioned—the minimum benefit and student benefits?

Mr. STOCKMAN. Well, Mr. Chairman, the President has taken a pretty unequivocal and clear position that we should not tamper with the whole adjustment mechanism for the basis retirement benefit programs. At this time we would be opposed to any effort to try to deal with that issue.

The CHAIRMAN. Senator Long.

Senator LONG. Mr. Chairman, I was the early bird around here this time, but it turned out that nobody else was around here. I showed up with the 9:30 crowd—[Laughter.]

But, I am glad to see our Byrd go first. He is a good man; he has made a fine contribution here.

Mr. Stockman, you are going to find this committee interested in the same things you are interested in. I really think one reason that the Finance Committee traditionally is interested in trying to limit spending and trying to get our dollar's worth is that we are the committee that has to recommend the taxes to pay for all this spending. When the cost runs up, that burden falls on us. We will support the kind of reductions you have been suggesting here.

Now, there are one or two matters that I want to get into with you here in my brief time.

One point is this: when President Johnson was in the White House he recommended that we change the way we keep the Federal books to consolidate the social security trust funds into the

overall budget approach. Of course, that helped him at that point to balance the budget. Can you provide for the record—I would like to see it as soon as it can be provided—some comparison under the different Presidents. I would just like to see how it works out, starting with President Truman, as to how many of those budgets were balanced budgets on a consolidated basis as compared to where we would have stood on a Federal funds basis, which was the case prior to President Johnson. I am sure you have looked at that matter.

Mr. STOCKMAN. Senator, you are asking to provide a record for the Federal funds experience both before and after the change that was made in 1965; is that—

Senator LONG. Yes. I would like for someone to clear up the confusion that I entertain about that subject. I have heard someone talk about Harry Truman having four balanced budgets. I don't recall him having four balanced budgets. But maybe they are saying that looking at it on a consolidated budget basis, perhaps he might have had a balanced budget.

Mr. STOCKMAN. Yes. Well, Senator, I can provide that and I think your suspicion is right. If you look at the budgets from 1946 to about 1962, roughly 40 percent of the years the current data will show a balanced budget, but that's on a unified budget basis. During that period you had large surpluses in the social security trust fund.

So, I am pretty certain that if you looked at it on the Federal funds basis you would probably find a little different picture.

Between 1940 and 1980 there were only 2 years—1949 and 1969—when the unified budget was in surplus but the Federal funds were in deficit. In all 39 other years, either both were in surplus or both were in deficit. Thus, Truman had four balanced budgets on a unified budget basis—1947, 1948, 1949, and 1951—but only three on a Federal funds basis.

Senator LONG. Which do you think is the more appropriate way to keep the books. Federal funds or on a consolidated basis?

Mr. STOCKMAN. I would even go beyond the consolidated. I would go to the point of including all the so-called off-budget outlays of the Federal Government. Because what we are really after when we look at this outlay and deficit question is the cash flow between the economy and all of the accounts, agencies, and operations of the Federal Government; that is really what we are measuring.

And it seems to me that since there is essentially no difference between a dollar of outlay or deficit created at the FFB or in other offbudget categories or one created onbudget, since both have to be financed by the Treasury in the same credit market with the same additional T bills, that we would be well advised to go one step further to build on the Johnson reform and have a comprehensive Federal budget in terms of total outlays and total deficits measured on a cash flow basis with the rest of the economy, because that is the relevant variable in terms of the Federal impact on credit markets, inflation, and so forth.

Senator LONG. If you do that, I wonder what attitude you would take toward the Federal Reserve. In order for our Nation's economy to move, and in order that our Nation could just achieve its objectives—I am talking about the private sector as well as the

public sector—the Federal Reserve finds it necessary both to expand and to reduce the amount of money in circulation, when you include credit particularly. My understanding is that those Federal Reserve activities that have the effect of expanding or reducing the money supply are not listed either as increasing or reducing the deficit; is that correct or not?

Mr. STOCKMAN. I would have to check for you on the technicalities, but basically, I believe, the balance sheet of the Federal Reserve is independent of the income and outgo statement of the Federal Government, so you would be correct.

Senator LONG. I discussed it one time with Arthur Burns. He didn't even agree with the way the Federal Government put the Federal Reserve in the budget.

But my impression is that the Federal Reserve's activity of expanding or reducing its operation—particularly as far as they are expanding or reducing the money supply—does not reflect itself in the budget, or, at least if so, only indirectly or slightly. It does not affect the full burden of what's being done there.

One of the points I have in mind when I mention that subject is that one of the recommendations that you are making has to do with the Export-Import Bank. That was one of those items that was put in the consolidated budget during the Johnson years. At least, I believe that was the case. We might check it and see.

It seems to me that when a private bank discounts a note with the Federal Reserve, that neither increases nor reduces the profit or loss of that bank. But if the Export-Import Bank expands the amount of loans it has, that goes on our books just as though it were a loss; that is because of our single entry system. But I frankly feel that if we have to clamp down on the Export-Import Bank, that is being suggested as a budgetary matter. That's going to mean that not only are we not going to sell airplanes abroad, which is the big item that we hear mentioned and it might involve just one company, but we are also not going to be able to sell atomic generating plants abroad.

There is an area where the United States made the initial breakthrough. The initial science and background information was developed by this country and I would hate to see this development in an area where we were the first. We are the ones that make the breakthroughs and provide all the information to the rest of the world and then, by not matching what the other fellow is doing, by letting them make more favorable loans, they simply wipe us out of high-technology exports.

Now, I am sure you realize that if that does mean a short-term gain for the Treasury, it has got to mean a long-term loss. Because if we lose out in exporting airplanes or atomic generating plants and these various other high-technology things in which I know you would like America to lead—I know I would—areas where we were once preeminent, I should think that this is going to cost us a lot of money in revenue loss for the Treasury over the long run.

Mr. STOCKMAN. Well, Senator, I guess you could go into a long argument or analysis about that. But I would point out that we are not withdrawing from the competition. Even after the reduction and holddown on new lending obligations that we have proposed

for the Eximbank, there is still \$4 billion left for new lending in fiscal year 1982.

Now, what we have proposed is that it be better targeted so that where you are dealing with head-to-head subsidized credit competition with France or other countries that indulge in that practice heavily, then there is assistance available. But it seems to us that what has happened over the last 2 or 3 years is the total level of activity in lending at the Eximbank has grown at an explosive rate. There simply hasn't been that disciplined focus of that subsidized credit in those markets and in those categories of transaction where it might do some good.

And if you look at the airplane market, for instance, you see that much of what was going to finance planes that really do not have direct head-to-head competition for that category of plane or the market that it serves from other competitors around the world.

The second point to always keep in mind, though, and I think it is terribly important, is that the Export-Import Bank only subsidizes 2 percent of our exports and the rest of those exports are financed with private credit and the 98 percent, I think, is pretty important too.

The point is we can get more total volume of exports if we can control the costs and the interest rates in our general economy. And that's what this whole economic program is designed to do. By getting inflation, and costs, and interest rates down, I believe you will provide far more stimulus to export expansion and to increase competitiveness in the international markets across the board on the other 98 percent of our export base, than you could possibly do by ginning up the level of activity at the Export-Import Bank.

Senator LONG: Could I just ask one more question, Mr. Chairman? Thank you.

Mr. Stockman, the people who understand this the best are people who supported this administration enthusiastically. I am not here to wave the flag for the Boeing Co. They don't have any payroll in Louisiana to my knowledge and if somebody has to lose out, it could just as well be them as far as this Senator is concerned. I wouldn't advise you to decide this issue based on what the Boeing Co. thinks about it, but you can bring in people here who are chief executive officers of a number of great American companies as well as those who are some of the outstanding leaders of finance in the private area who have been enthusiastic supporters, and are today enthusiastic supporters, of this administration, but who have a difference of opinion with you about this matter. I would hope very much that they be accorded the opportunity to fully express their view because if you are in error, I think that you would want to correct it, just as I would when I am in error.

I do have, may I say, one person who has tried to look at it from both sides—both from your point of view and theirs. It seems to me that they have a very good point that should be thoroughly considered before we finally close judgment on this matter.

Mr. STOCKMAN. Well, Senator, we want to look at any case that can be presented, not only regarding the changes in this area, Ex-Im, but the other 300 changes that we have proposed.

Admittedly, it was done in a 6-week or even a 4-week basis, because the economic circumstances in this country compelled

quick action and a plan to be sent to the Hill so that this Congress could act. And that means that errors could have been made along the way. We have no doubt about that. And that's why we hope that an especially active role will be taken on the Hill to discover, to identify, to point those out as you move through all these recommendations and where a good case can be made, obviously, we would be willing to look at other ways of achieving the bottom line.

But, I feel very strongly in the case of the Ex-Im that \$4 billion in lending resources is enough if it is properly targeted. That we can do more for our exports by improving the general health of the economy. And that when we will be cutting so many social programs and programs that are targeted toward people assistance, that the 66 percent of Ex-Im lending that went to five or six big companies last year can be cut in the spirit of that general process without any undue harm either to our export trade or those companies.

The CHAIRMAN. Mr. Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Stockman, I am just curious what the administration is going to do if it turns out the CBO's assumptions and some of the projections by other outside organizations turned out to be accurate—that is, the administration's economic assumptions of interest rates, and CPI, and so forth are not accurate. Now, is the administration then going to come up and suggest that the Congress adopt more of the same—that is, spending cuts much greater than we have adopted so far, as well as a Kemp-Roth kind of proposal—even further than, perhaps, we may have done thus far?

I am just curious, too: Is the administration looking down the road? If it turns out the assumptions of the administration are not quite as accurate as they are—I think that we all hope that they are—but if, as a matter of fact, they are not, what is the administration's next step?

Mr. STOCKMAN. Well, Senator, I would suggest that our next step is to get this plan adopted, working with you and the House and Senate, so that we are in a position to find out in terms of the performance of the economy over the next 18 months, whether CBO is right or we are.

Now, that doesn't mean that we haven't thought about contingency plans. But we constantly get this question before we have even gotten to first base in terms of moving a fundamental change in economic policy through the process on Capitol Hill. And I know that you have to be concerned about whether our economic forecast or assumptions are better than theirs, and so forth. But it seems to me to dwell entirely on the CPI number, or the interest rate number, rather than on the substances of the policy changes which have to be made in any case. Whether their numbers are right, or ours, really avoids the essential responsibility that's before the Congress.

Senator BAUCUS. I think we all agree there should be spending cuts. I think you will find a lot of sympathy up here on this committee for that.

I am just curious, though, as to your thinking down the road. You know, what your thinking is? That is, if your thinking is we should pursue more of the same—that is, more tax cuts in the way

that you are suggesting, and spending cuts in the way you are suggesting, that might lead us to certain conclusions if it turns out that the results aren't as beneficial as we would like.

For example, if you are going to recommend further spending cuts, will they be in social security? Will you then look at the potential changes in the COLA for example?

I am just curious as to, you know, what your next—what your thinking is?

Mr. STOCKMAN. Well, in terms of specific policy options, we have got 48 billion dollars' worth on the table. I would be somewhat reluctant to put on another 10 or 20 before we fully digested and acted on these.

But, as a general matter, if the economy performs less well on what I would call the financial side—that is that interest rates are substantially higher, inflation rates are higher, and thereby total outlay levels exceed or threaten to exceed substantially those benchmarked targets that we have established—I think you have to come in with more policy changes, program reductions in order to achieve the discipline on total spending growth we think is key to turning around the economy.

Senator BAUCUS. Let me ask you another question about another subject that has been bantered about a little bit and that is tax expenditures.

All of us in the Congress, and you too, have supported tax expenditures. I have cosponsored bills for credits and exemptions and so forth. We are now talking about a 10-5-3, which is a kind of tax expenditure. It is deductions in credits and so forth. At the same time, last week before the Senator Budget Committee, you said that you thought that there are a lot of tax expenditures which are obsolete, inefficient, and that it should be a good tax policy to reexamine them and take a look at them.

I am just curious as to what kind of examination the administration has undertaken to try to determine which tax expenditures are obsolete, inefficient, or, conversely, which areas should Congress look at to increase tax expenditures? Have there been any studies or analysis of this basic question?

Mr. STOCKMAN. That process is underway. But I think there is a very clear and essential distinction you have to make.

We have rejected the notion that you balance the budget by eliminating tax expenditures. Because we feel you have got to cut spending, not raise taxes. And that is essentially what you do when you eliminate tax expenditures.

Senator BAUCUS. I'm not talking about—

Mr. STOCKMAN. But, then there is a totally separate area of policy.

Senator BAUCUS. I'm not talking about the first one. What you mean? What's second?

Mr. STOCKMAN. The second time around you might want to reform the structure of the tax code—

Senator BAUCUS. That's correct.

Mr. STOCKMAN [continuing]. So that it is more neutral regarding its impact on the economy and so that it is more efficient in terms of generating revenues without all these distorting effects. But that's a matter of tax reform. And any time you do that I believe

that it ought to be offset dollar for dollar with rate reductions in the basic schedules, whether it is the corporate or the income tax.

Senator BAUCUS. Oh, I wouldn't disagree with that. I am just curious as to what analysis the administration has undertaken with respect to reform. Then we will go on to the next step of offset that with dollar for dollar.

Mr. STOCKMAN. In the first 6 weeks it hasn't been a high priority. Because in the first 6 weeks our major orientation was toward those changes in both spending and tax policy that would be directly related to reviving the performance of the economy. The matter of tax restructuring and reform of the code is the next step. But we simply haven't gotten to that, I think for reasons that you can understand.

Senator BAUCUS. Can you give me an idea as to when you might get to it or when you might send up an analysis.

Mr. STOCKMAN. Well, I think you would have to talk to the Secretary of the Treasury about that when he comes to testify. Because that would be in his primary area of jurisdiction. But, certainly, over the coming months we will be examining those longer term questions as part of the second tax bill proposal that we have made.

Senator BAUCUS. Thank you.

[Responses by Mr. Stockman to questions submitted by Senator Baucus follow:]

Question:

One of the basic philosophies underlying this Administration is to get the Federal government off the backs of the states and the people of this Nation. Is that not so?

It seems to me, in going through several of the proposed changes in Finance Committee programs, that the Administration is violating the spirit of that philosophy. Rather than decrease Federal intervention, in some cases you seem to be encouraging Federal intrusion in the lives of states and Americans.

Please explain to me how you can talk about reduced Federal interference, but require states to:

- A. Establish mandatory community work programs for welfare recipients.
- B. Mandate states to amend the suitable work provision by requiring unemployment recipients to accept any job paying at least their weekly benefit or minimum wage after collecting 13 weeks of benefits.
- C. Establish a national recipient file on all Americans receiving public benefits.

Answer:

Let us distinguish between gratuitous Federal interference in private-sector productive processes that seek nothing from the Government, interference that reduces the productiveness of those processes, on the one hand; and the establishment of criteria for eligibility for Federal benefits and payments, to prevent waste, fraud and excessive Federal spending, on the other. The former we oppose; the latter is absolutely essential if the growth of Federal spending is to be brought under control.

Question:

Mr. Stockman, the Administration is proposing many bold and courageous changes which fall within the jurisdiction of the Senate Finance Committee, for example, the Administration is proposing sweeping changes in:

- AFDC
- Medicaid flexibility
- Competition health reforms

My question is: precisely when will we see draft legislation to implement these proposals. I am concerned because the Finance Committee has already embraced the President's spending cut figure of \$9.3 billion. The Budget Committee is now writing its instructions to committees. The Finance Committee will meet, oh, probably within a month, to accomplish these legislative changes through reconciliation. When will we see the draft legislation explaining the implementation of these proposals and others, such as block grants?

You were a Congressman. You were a legislator. I know many of my colleagues don't like to read bills, but I do. I want to read the legislation describing the implementation of the proposals within the Finance Committee. Will we have these bills before finance marks up under reconciliation?

Answer:

Yes. As noted during the hearing draft bills should be ready within ten days of this hearing.

Question:

Mr. Stockman, would you say that Medicare is an entitlement program?

Would you say that Medicaid is an entitlement program?

Answer:

Yes, on both counts. This assumes the usual meaning of "entitlement program," viz. a program under which persons who meet certain criteria specified by law are entitled to benefit payments.

Question:

The Administration proposes to block grant a series of health programs, including the Title V Maternal and Child and Crippled Children's programs (within this Committee's jurisdiction), and to then reduce the amount of funds to states by 25%. I am especially concerned about this issue since Federal statistics show that the cost to the states of administering medicaid is only about 5%. Unless the cost of administering other health programs is five times higher, the Administration's proposed reduction in this and the other block grants will make substantial incursions into the amount of money states spend to actually deliver health services.

The Administration frequently speaks about fraud and waste in programs. Does the Administration assume that this 25% figure reflects administrative waste in these programs, and if so, how did it arrive at this amount?

Answer:

Through the years, the Federal Government has created many categorical grant programs that provide funding for health activities. While each grant program typically was established to meet specific national goals, the proliferation of these narrow-purpose grants has resulted in a counterproductive maze of Federal law, regulations and controls.

Because of the fragmented nature of the current funding system, persons in need of health services often must go to several different and unrelated grantees for different services and must obtain related health services from different providers. The current system's administrative requirements have resulted in nearly insurmountable barriers for states, local governments, communities, and even individual providers who wish to integrate funds from all grant programs into comprehensive assistance systems. Nevertheless, because of the enormous complexity of this array of programs and requirements, it is not feasible, from the Federal level, to determine with precision what programs, in which of 12,000 grant sites, are necessary and

efficient and which are duplicatory or wasteful. Such determinations can best be made by State and local governments. The 25% reduction is thus an allowance which is anticipated to be adequate, with improved planning and management, for maintaining essential services to the truly needy and is not based on ^especific estimates of administrative waste.

Finally, the intent of the Administration's grant consolidations is to insure the improved management of health delivery services at the State and local level. As States align their health programs consistent with their own priorities -- not Washington's -- the proposed funding changes should not result in a reduction of essential services.

Question:

The premise of the block grant is to collapse and consolidate dozens of health and social service programs into several large blocks. The categorical nature of these programs are changed to permit the State flexibility in deciding how to spend the funds.

We're talking about a lot of money here. How do you assume accountability? What kind of guarantees will the legislation contain to combat fraud and abuse? Just because the State will be administering the programs is no reason to assume that fraud, abuse, and excesses won't occur. What kind of monitoring system can or should be established?

Answer:

First of all, the questions as posed implies several erroneous assumptions about the Administration's intent in proposing block grants and the level of accountability in the current mix of Federal categorical programs.

The Administration has not proposed grant consolidations as a means of curbing fraud and abuse. Our objective is much broader. The main purpose is to return authority to States and localities. It is wrong for the Federal Government to specify in great detail how States and localities should meet their own needs.

Regarding accountability, the existing system has serious problems. Through the years, a complex, duplicative, and uncoordinated array of Federal categorical programs has developed. Aside from the confusion caused by the lack of coherence in several areas, day-to-day management has developed into a bureaucratic morass of planning, regulating, and reporting at the Federal, State and local levels. These management problems not only result in inefficiencies but they distort many of the objectives that the Federal Government seeks to promote.

The confusion and problems of management and accountability in the current system is directly attributable to the proliferation of narrow categorical grants and the associated requirements. This Federal overreach, and imposition of so-called national priorities, has become unenforceable. Monitoring compliance with this complex of programs have become impossible.

By consolidating these categorical programs into certain general areas many of these specific requirements can be eliminated. This does not mean that accountability will be eliminated but it does mean that State and localities will have more responsibility for using the funds effectively. There is good reason to believe this will happen. The Federal Government does not have any special knowledge that makes it more effective at eliminating fraud and abuse. States and localities are equally or more concerned about fraud and abuse than the Federal Government, and giving them this responsibility is likely to result in strong and efficient programs. Accountability will not be lost.

Question: Do any of the proposals pertaining to the Rural Electrification Program have a potential impact on the demand for electric power in rural areas?

Answer: We do not anticipate that the changes in the method of financing or that the changes proposed in the interest rates for these programs will have any serious impact on the demand for electric power. The demand for power is related to increased housing, increased manufacturing, and similar factors in the service area of the borrowers concerned. The Economic Recovery as anticipated in the President's program would, of course, result in lower interest costs and lower inflation, both of which could improve the economy of rural areas. In this sense, there might be some positive potential impact on the demand for power.

Question: If growth in demand is likely to continue, won't electric cooperatives need to construct new facilities to meet that demand?

Answer: We anticipate that there will be growth in demand and that cooperatives will need to construct facilities to meet that demand.

Question: Won't the co-ops' need for capital therefore stay about the same, regardless of whether or not they raise it through the FFB or directly from private lenders? In other words, won't the amount of investment capital going into new rural electric generating and transmission facilities be about the same with FFB participation or without it?

Answer: We expect the demand for capital for the electric cooperatives to continue at about the same level and that is what we have approved for 1982. We do not see the movement of REA from its current arrangement with FFB as having a big effect on demand for capital.

Question: Then, it is correct to say that insofar as demand for credit is concerned, ending FFB participation in these loans won't accomplish anything except perhaps by creating a "perception" of reduced federal activity?

Answer: The purpose of changing the current arrangement REA has with FFB is not to reduce the demand for capital. The change will accomplish an actual reduction in Federal credit activities as Treasury will no longer have to borrow to provide FFB with the cash to support the requirements of the REA systems. These systems will not be borrowing from FFB but directly from the capital market. This is not just a "perception."

Question: Who, other than the banks and other investors already reaping the benefits of double digit interest rates, would benefit from the proposed termination of FFB involvement in the REA guarantees?

Answer: A reduction in the amount of outstanding debt owed by the Treasury is a part of the President's Economic Recovery Package. That package will reduce the cost of Treasury borrowings and the amount of interest which must be paid from the revenues. This Administration believes that everyone in the country will benefit from reduced inflation and lower interest rates paid on Treasury borrowings.

Question: How much additional interest do you think electric cooperatives would have to pay if they borrowed directly from private lenders, rather than having the FFB available to them as a conduit for these funds?

Answer: This is a difficult question to answer. The interest differential may be as low as 50 basis points since the 100 percent Federal guarantee remains on these loans.

Question: In OMB's earlier proposal for barring the Tennessee Valley Authority from use of the FFB, it was stated that doing without FFB would cost TVA about 1 percent extra on its interest.

Answer: The estimated 1 percent differential (100 basis points) should be reduced once the market becomes accustomed to these loans. The Farm Credit System, through its fiscal agent, obtains large amounts of capital for its member banks for as little as 40 basis points above Treasury borrowings for similar maturities.

Question: Why was the Federal Financing Bank created by Treasury Secretary William Simon during the previous Republican Administration? Wasn't the major purpose of the bank to coordinate the entry of the federal loan guarantee programs into the credit market to keep them from competing among themselves, thereby driving up the cost of interest?

Answer: One of the major reasons behind creation of the FFB was to eliminate the practice of agency borrowing and sales of loans in the private market at costs in excess of Treasury borrowing costs. Many Federal agencies formerly made direct loans and sold them in the private market. The FFB was created with a major objective to reduce the Federal cost of financing these direct lending operations. It was not originally contemplated that the FFB would become an originator of direct Federal lending with guarantees by other Federal agencies like the REA.

Question: What has changed, then, to remove the need for this kind of coordination?

Answer: There has been no change in the view that agencies should continue to sell individual loans or certificates of beneficial ownership (CBO's) to the FFB instead of attempting to sell them in the private market. This practice will continue for REA CBO sales as well as loan or CBO sales by other Federal agencies, i.e., Farmers Home Administration CBO sales. The FFB direct loan origination function is what is being discontinued.

Question: To your knowledge, has the government ever lost money on an REA guaranteed loan?

Answer: We have not as yet had any defaults on REA guaranteed loans. This loan program started in 1974 and is used generally for financing large generation and transmission facilities which may take as long as 10 years to bring on-line.

Question: Based on the amount of REA guaranteed financing expected to be needed in future years, I'm told that over the next decade, this extra 1% of interest would add about \$2.75 billion to rural consumers' electric bills.

Is it fair, do you think, that residents of rural America who, by and large already are paying higher than average electric rates, should be forced to pay this much more to accomplish no real purpose other than to create a "perception" of reduced federal activity in the credit markets?

Answer: The movement proposed for REA is more than a "perception" of reduced Federal activity in the credit markets. It is an actual reduction in the amount of Federal credit activity and will be so reflected in a lower ceiling for the National debt. Successful attainment of this Administration's Economic Recovery Program objectives for substantially reducing the rate of inflation over the next several years will likely result in substantially lower costs in rural areas than would otherwise be the case.

Question: One of the reasons for cutting back the REA programs set forth in your proposal is that (and I quote) ". . . the REA has largely accomplished its purpose -- to provide the basic investment capital necessary to provide electric and telephone service in rural areas" (end quote). You also cite the fact that more than 99% of all farms now have electric service. What percentage of the people in New York City, would you guess, now enjoy access to central station electric power?

Answer: I would guess that most of the people in New York City have central station electric service. I also know from my own experience that they have achieved this through private investments and at rates somewhat higher than are generally charged by the rural cooperatives.

Question: Would you say that, since virtually all these people now have access to power, that the job of providing basic electric service to the consumers of New York is finished also?

Answer: The job of providing electric service to consumers in New York is not completed. The capital needs are being and will continue to be met through the private sector. It would appear that systems serving rural areas should obtain more of their credit needs through the same credit channels the New York companies are using.

Question: Can you explain then why it was necessary for the Consolidated Edison Company -- the investor owned utility that provides electric service in the City of New York -- to increase its capital investment in facilities and equipment by more than a quarter of a billion dollars during 1979 alone?

Answer: The question is, of course, a leading question. The reference to the job of REA being done is a reference to meeting a goal of extending services to nearly all rural areas. That goal has largely been accomplished. The need to hook up new houses, businesses and industry in a given service area is always the responsibility of the public utilities serving that area. Now that the responsibilities of rural areas are more like those of New York in that power is available in almost every area, it is time that systems serving rural areas begin to pick up more of the cost of extending this service in the same manner that their counterparts have been doing for some time.

Question: Approximately what percentage of all REA financing under the insured and guaranteed loan programs is made available to borrowers at the special 2% interest rate?

Answer: In 1980, out of a total REA electric loan and loan guarantee program of \$6.585 billion, \$142.5 million was provided in 2 percent lending. For the REA telephone program in 1980, out of \$437 million, \$103 million was provided at a 2 percent interest rate.

Question: At the 5% interest rate?

Answer: Of the \$6.585 billion electric loan and loan guarantee program of REA, \$782 million was made at a 5 percent interest rate in FY 1980. For the REA telephone program, of the \$437 million, \$147 million was made at the 5 percent interest rate in FY 1980.

Question: If, in fact, only about 14 percent of the entire REA loan program is operated at sub-market interest rates, and the other 86 % is being loaned at the government's cost of money plus $\frac{1}{8}$ of 1% through the FFB, do you feel it's fair for the entire REA program to be categorized as "low-interest financing"?

Answer: The characterization of the REA loan and loan guarantee program as low interest financing is really a reference to the fact that the Federal Government, by providing a guarantee to most REA borrowers, is in effect assuring that those loans will be made at below the normal market rate for a similar investor-owned utility. The figures in your question do indicate a considerable achievement brought about in the REA program through the 1973 REA Act Amendments. The administration, however, feels that additional changes are warranted at this time.

Question: What, if any, impact would increasing the interest rate on the 2.2% of REA loans now going out at the special 2% interest rate have on the federal budget?

Answer: The current REA Revolving Fund budget reflects no budget authority or outlay in 1982 and therefore has no effect on the on-budget deficit. There is, however, a growing concern that the REA Revolving Fund by making a portion of those loans at 2 percent and, at the same time, paying 12 percent on funds needed to make the loan advances is, in fact, creating a significant deficit in the Fund which will be reflected in future appropriation requests, whether they be on-budget or off-budget at that time. Further, when Certificates of Beneficial Ownership are sold to the FFB, the FFB borrows money from the Treasury under the Federal Debt Limitation. One should also keep in mind that when the Act was amended in 1973 establishing the 5 percent rate, the average Treasury borrowing cost at that time was between 5 and 6 percent. Now that Treasury costs are over 12 percent, it would seem a very small request to have those borrowers pay more than the current 2 percent rate they are paying.

Question: In reality, then, the only effect of this two-and-one-half times increase in interest rates for these very low density, very low revenue cooperatives would be to increase the rates they charge their consumers for electric energy. Aren't increasing costs with no corresponding increase in productivity a primary cause of inflation?

Answer: Although the change in interest would increase costs somewhat, the relative rate of the increase would be small when compared to much larger increases which have occurred in power purchase and related costs. The lack of increase in productivity is, we feel, heavily influenced by the Federal intervention in the private sector. Through the adoption of the Economic Recovery Package, we expect to achieve a general lessening in inflation rates and interest costs which would offset any slight increase the electric user would have to pay because of this change.

Question: Who would gain, then, by what you have proposed with regard to the REA 2% loans?

Answer: Adoption of the Economic Recovery Package would result in a significant gain for everyone, rural and urban, in reducing inflation and interest costs. The increased rates the current beneficiaries of this heavy subsidy would pay would be largely offset by lower costs on other commodities and lower income taxes.

Question: To your knowledge, has the government ever lost any significant sum of money on REA insured or direct loans during the more than 45 years this program has been in existence?

Answer: The evidence is that REA has never had any large defaults. We might add that this record leads us to believe that the program is financially sound and can easily withstand the small sacrifices this budget requests.

Question: How many federal -- i.e., appropriated -- dollars are being loaned to the electric cooperatives at the 5% and special 2% interest rates under the present REA insured loan program?

Answer: There are currently no appropriated dollars being loaned to electric cooperatives at 5 percent or 2 percent.

Question: What, then, is the source of the funds being loaned to rural electrics through the REA insured (direct) loan program?

Answer: The funds for this program come from interest receipts on prior loans which were dedicated to the REA Revolving Fund in the 1973 Act, principal repayments on prior loans which were dedicated to the Revolving Fund in that same Act, and the sale of Certificates of Beneficial Ownership in the pool of loans held by the Revolving Fund. The Revolving Fund is currently paying over 12 percent interest on loans which have been sold and the income on new loans at 2 percent cannot cover the 12 percent being paid. The net result is an increasing erosion of the assets in the Fund. At some

point in the future, appropriations will be needed to cover interest subsidies and whether they are on-budget or off-budget at that time will be meaningless as appropriations directly from the Treasury will be required.

Question: What impact, if any, do the insured loans made from this Revolving Fund have on the federal budget?

Answer: As indicated in the previous question, the insured loans made from this Revolving Fund do not have a direct impact on the Federal budget deficit since they are off-budget. They do, however, require the Federal Treasury to borrow additional money which increases the amount of debt owed by the Treasury subject to the Federal debt limitation.

Question: If the entire rural electric loan program was to be wiped off the books tomorrow, what effect would that have on balancing the Federal budget?

Answer: The loans do not impact on the Federal deficit and, therefore, are not involved in balancing the Federal budget. This does not mean that they do not cost the Federal taxpayer any money.

Question: If cutting back on the insured loans for electric cooperatives doesn't help to balance the budget, what purpose does it accomplish other than to increase the electric bills of co-op consumers?

Answer: The fact that cutting the insured loan program does not help to balance the budget does not mean that these loans do not have a cost to the Federal taxpayer. A portion of the Funds come through guarantees and through the FFB's purchase of REA's assets both of which are funded through Treasury borrowing. Both of these programs therefore increase the National debt and interest costs thereon which are borne by the taxpayers. Furthermore, if you assume that this action will have the effect of increasing energy costs, it must certainly be assumed that in the current set of circumstances the Federal Government is actually subsidizing these loans in order to have the effect of keeping these bills down. If that were not the case then discontinuing this program would not have any effect on co-op customers' bills.

Question: Don't increased energy costs add to inflation?

Answer: Yes. Increased energy costs do add to inflation but adoption of this Administration's Economic Recovery Package will improve the total economy and reduce inflation much more than the small increase required by this one proposed change. On the balance, rural consumers should come out ahead.

Question: Statistics from the Department of Energy publication "Typical Electric Bills" indicate that, on average, the electric rates being charged by REA financed rural electric cooperatives already are 10-12% higher than the national average. Yet in the Administration's proposal for cutting back REA lending, you state that just the opposite is true, that REA customers, receive power and telephone services at rates that average 10-12% below customers of non-REA-financed utilities. Can you provide us with some details about how your figures were calculated, and perhaps explain how they differ so completely from those published by the DOE?

Answer

On the average, customers of REA-financed systems tend to pay lower rates for electricity than customers of other utilities. Official data published by REA and DOE on the average residential cost nationwide as of January 1, 1980, indicates that except for the smallest customers (250 KWH), the average charge by REA-financed systems was 3.3% to 9.9% lower than the average charge by other utilities (investor-owned and publicly-owned utilities combined). For the smallest class of residential service, which accounts for only a small portion of the total, the rural systems charged 3.3% more (see below).

Cost of Residential Service by Monthly Consumption Category
(Cents per KWH, January 1, 1980)

	<u>250 KWH</u>	<u>500 KWH</u>	<u>750 KWH</u>	<u>1000 KWH</u>	<u>2500 KWH</u>
REA-Financed Systems	6.31	5.19	4.76	4.52	3.99
All Other Utilities	6.11	5.50	4.92	4.88	4.43
Percent Difference	+3.3%	-5.6%	-3.3%	-7.4%	-9.9%

While this is the national picture, within individual States rural systems may charge more or less than other utilities depending on the systems' access to public power projects (e.g., TVA and Bonneville), the availability of coal and nuclear generation vs. oil generation, and other cost factors such as number of customers per mile of line. A higher proportion of REA-financed systems vs. other systems are located in lower cost States, but within those lower cost States the rates of the rural systems may be lower or higher than other utilities in the State. In contrast, there are few REA financed systems in some of the highest cost States. For example, only 22 of the 924 REA-financed distribution systems (2%) are located in the high cost States of Connecticut, Rhode Island, Massachusetts, Virginia, New Hampshire, New Jersey, Delaware, New York and Hawaii, where the cost of residential service for other utilities averages from 28% to 54% higher than the national average for the co-ops. These 9 States account for 14% of electricity sales (KWH) by other utilities but less than 3% of sales by the co-ops.

Comparing cost of service on a State-by-State basis, i.e., ignoring the greater concentration of the co-op market in the lower cost States, we find that in the 46 States where REA-financed co-ops are located, the average residential rate of the co-ops (for 1000 KWH) is higher than other utilities in 30 States and lower in 16 States. In 18 of those 30 States, however, the average residential rate of the co-ops is lower than the national average for other utilities.

Question: Do you have evidence, or any reason to believe, that the REA loan program is in any way being misused, or that it is in some way failing to accomplish the mission assigned to it by Congress in the Rural Electrification Act, as amended?

Answer: -No. there is no evidence that the REA program has been misused or that it has failed to accomplish the mission assigned to it. The success of the program, however, strongly indicates that there is less need for the Federal subsidy than there was when it was originally established.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Mr. Stockman, the combination of tax cuts and budget cuts that the administration is proposing—according to your own estimates—would result in a \$45 billion deficit in 1982. Now, that's the most optimistic one that I have seen. We have seen what CBO and some of the others have forecast. I hope you are right on your number.

If the Treasury is going to finance that kind of a deficit, it must compete as you were stating earlier, with capital needs in the private sector. It will certainly keep interest rates higher than necessary.

In fact, the deficit you are optimistically predicting for 1982 would call for about twice the amount of Government financing as you would have released for investment by your accelerated depreciation provisions.

I believe the entire Nation wants your program to succeed. But, wouldn't it be wiser to cut either deeper into Government expenditures or not cut taxes as deeply in order to narrow your deficit and fight inflation? One of the suggestions would be to cut back on the size of individual tax cuts to reduce the deficit and to bring them more into balance with the business tax cuts which came out of the Finance Committee last fall. Reducing your deficit in 1982 would do a better job of fighting inflation than the \$45 billion deficit that you forecast.

Mr. STOCKMAN. Let me try to answer that with about three points:

The first is I don't believe it is simply the dollar value of the deficit, taken in the abstract, that is the problem. It's the context in which that deficit materializes. And, actually, we are cutting the budget for 1982 far more than \$48 billion. If you look at the relevant measure in terms of where policy is heading, and that's budget authority, it's somewhere in the \$65 to \$70 billion range. But because of the built-in lags in the Federal expenditure system, whereby budget authority reductions are converted into cash savings, much of that will be realized in 1983 and in subsequent years.

So in terms of policy context in which you have demonstrated and implemented pretty severe changes in the direction of spending, that \$45 billion deficit is not nearly as troublesome as one that would occur in the context in which there was no effort, or serious effort, in the long term underway to control spending and thereby the clear impression, or implication, exists that deficits will rise or stay at that level in the future.

We believe our policy demonstrates that that deficit is coming down rapidly during a 36-month period.

Now, second, in terms of savings available in the economy to finance that interim \$45 billion, there are really three sources. You have only identified one. The first is the increased cash flow to business enterprises, due to depreciation reform. But, second, you have got \$44 billion worth of individual tax cuts and some fraction of that is going to be saved. A far higher fraction than if the money were collected by Government and spent for one program or another.

The third point is that if in combination the very severe expenditure restraint, the steady downward movement on money supply

growth that the Fed has put in place today, those two things in combination, I believe, will cause an increased savings flow in the economy away from tangible investments that really don't finance anything in terms of productive activity into financial assets that will help to relieve some of the pressure in the market between private and public sector credit demands.

So, from those three sources, I believe, on an interim basis you have the savings available in the market to finance the deficit without undue upward inflationary pressure, if it is looked at in context.

Senator BENTSEN. We would have some difference of opinion regarding the share of the the individual tax cut that would be saved. We have a library full of empirical studies that would lead us to think otherwise.

Is there any alternative to the precise formulation of your tax bill which would yield equivalent positive results? For example, where you are talking about three 10-percent cuts, suppose you had 5 or 6 years of 5-percent cuts. Suppose instead of just hoping that a percentage of savings would be made to the extent you think it would, we had something along the lines of my bill that would allow tax-free interest to the extent it went into savings accounts dedicated to home building. Our savings and loans have had a \$28 billion hemorrhage of funds last year; interest rates on home mortgages have escalated to a point where only 5 percent of the families today can qualify for a mortgage on a \$65,000 home. The American dream of owning a home is out of reach of at least 95 percent of our people.

Now, you have said that you are against fine tuning the economy. And, yet, you tell us that if we don't pass this fine-tuned program exactly the way you fine tuned it, that we will have no positive impact on the economy. Isn't the policy that you have presented one of fine tuning?

Mr. STOCKMAN. Well, I don't think so. I guess it would depend on how you define fine tuning. My notion of fine tuning is—

Senator BENTSEN. Is it just that all other alternatives are fine tuning, but yours is not?

Mr. STOCKMAN. Well, my notion of fine tuning is that you take a look at the whole structure of the economy and then you try to target things into this area or that area where you think extra stimulus or an extra boost is needed. But we are not proposing that. We are cutting rates across the board and then allowing the economy to work against those changes in tax rates, and in the after-tax return on investment, and personal income.

What I would consider fine tuning is an effort to say that the aggregate savings rate is too low and we will change the tax code so as to cause income to flow to certain types of instruments—in certain types of instruments in certain types of institutions.

Now, essentially that is what you proposed here, increasing the exemption for deposits into savings accounts.

But I think there are an awful lot of technicians and economists who will argue that may not increase the aggregate level of savings in the economy at all, but simply cause investments to be switched from one type of instrument to another from that that is less

favorably treated as a result of this policy change that you have proposed.

Senator BENTSEN. Mr. Stockman, I believe people respond to incentives, and that more incentive to save will boost savings, not just switch savings from one institution to another.

Mr. STOCKMAN. They do. That's the problem.

Senator BENTSEN. And I think that is one of the things that would be accomplished here now. But I really believe that what we have seen happening to the thrift institutions of this country is something that will be an extremely difficult thing for them to recover from. I think we must have some way to try to encourage home building in this country, so people can afford a house again.

Mr. STOCKMAN. Well, I agree with that. And I didn't mean to neglect addressing that problem. But it seems to me the things killing the thrift institutions today are the high nominal rates of interest in the market and the extreme financial volatility that we have had in the last 18 months in which you have seen interest rates move from below 10 percent to 20 percent, back down and then up. And, in the process, you have simply wrenched the whole ability of those basic financial institutions to function.

Senator BENTSEN. You have also homogenized thrift financial institutions, so they are now more and more like banks; they are going to arbitrage and other means of trying to keep afloat. But, I am afraid what you are saying is that there is a long-term trend away from home mortgages by these thrift institutions. It concerns me very much. I think we are going to have to find a way to create an incentive for people to do more savings in this country along with fighting inflation. Obviously, that is one of the very major ones.

Mr. STOCKMAN. Senator, I guess I would agree with you. I'd only say that it is not just savings alone that will solve the thrift institution problem. They need two things: One, an adequate savings and deposit flow, but, second, a stable financial market.

Because even if you had a substantial increase in the level of savings and the markets were as unstable as they are today with these hot flows of money back and forth, the thrifts would still face the liquidity problems that they are facing now, and many of them would still be in the kind of bind on earnings that they are now.

So, it takes both—both savings and financial stability. And I don't think you are going to get the latter until you get Federal fiscal policy disciplined so that monetary policy can work without the pressure that it has faced in the past.

Senator BENTSEN. Well, I am not going to argue that one with you. I agree with that. I think you are going to have to do something, though, in addition that is quite dramatic in this situation so that they are able to turn themselves around.

I would like to ask you about one continual rumor I am hearing. I hear that the OMB and the administration are studying the phaseout of what remains of the depletion allowance on oil and gas production. Could you enlighten me as to the administration's position on that?

Mr. STOCKMAN. The administration has no position in the sense that we have not recommended any change in the depletion allowance. There are various people, including myself, who have a pri-

vate or personal opinion about it. But that is not on the table in terms of the package of tax and spending proposals before you.

Senator BENTSEN. Would you like to tell me your personal position?

Mr. STOCKMAN. Well, my personal opinion is that it is an obsolete benefit that we probably don't need in the tax system any longer. But, I haven't—that is not part of the administration's recommendation.

Senator BENTSEN. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Durenberger.

Senator DURENBERGER. Dave, I am glad that you haven't shown any signs of tiring of entertaining Senators or Congressmen. I guess we are just lucky that you go to work at 6 a.m. in the morning and stay until midnight.

The former chairman of this committee said something a little while ago that characterized this committee as the committee that has to provide the taxes to do all of the things that somebody else decides we ought to do. Well, it seems to me he has been around here long enough to remember when this committee raised taxes. I haven't and I think most of the folks in this committee have not either. We spend our time either cutting taxes or reforming taxes, or whatever. And I wouldn't mind being in a position where it was my responsibility to make decisions about the revenues that have to go with somebody else's decisions about the spending.

My concern is that the tax cut proposal, the 3-year tax cut, does not do the obvious and that is take us to eliminating bracket creep from our tax system. My question is: Why don't we say that this is our objective, if it is, and why don't we do it?

Mr. STOCKMAN. I guess your question is: Why don't we index—index after the—

Senator DURENBERGER. Well, I wish we could think of another name, but that is what it used to be called.

Mr. STOCKMAN. Well, actually, I would suggest, Senator, that the 10/10/10 does more than simply eliminate bracket creep, prospective bracket creep, in the future. It actually compensates for some of the unintended increase in tax rates, marginal tax brackets, that have occurred over the last 6 or 7 years due to the interaction of inflation and the progressive income tax schedule.

And I think the measure of that is simply to look at where we end up in 1984 after both of these tax proposals are implemented, at least on a calculated basis. We end up taking 19 percent of the national income as the tax share. Today it is about 22 percent. And what that essentially tells you is that the effective levels of taxation on both individual and business income are lower at the end of this program and, therefore, you have actually reduced taxes in a real sense, not simply prevented a prospective bracket creep from occurring in the future.

Senator DURENBERGER. Well, I think what we are dealing with here, and I think the administration goes about 90 percent of the way of dealing with it, is the expectations theory with regard to inflation. I have here—I hope you have had time to read the latest speech that Mark Willis gave on the subject about economic models being wrong because they ignore people. And I would suggest to CBO that they read it and to a lot of other people that are chal-

lenging it. Because it makes the point very clearly that people are making the decisions that are either building or wrecking the economy at the present time.

Right now it seems to me that they are looking to us to do the kinds of things that we have been telling them to do, and that is build some restraint into our decisionmaking and do some planning for the future.

It just seems to me that a 3-year tax cut, regardless of what the net result may be—unless there is some commitment to a balanced budget—may not cause people to do the kinds of things that you said in three parts they are going to do. It is going to be hard to resist the effort to balance the budget through the Constitution, or tie spending to something else through the Constitution. And the opportunity, it seems to me, is here for this administration to say clearly: We are on our way to the year when we balance the budget and we put the income tax system in a situation where we will have to raise taxes after that point if we make spending decisions that exceed our revenue.

Mr. STOCKMAN. Well, I guess the point you are making, and I agree with it 100 percent, is that the prospective benefits from reducing tax rates could be eroded, or even nullified, if on the spending and budget side of the policy equation we don't take credible efforts to demonstrate that that is under control; that it is being disciplined; that we are moving toward a balanced budget.

Because then, on the basis of pure expectations, people will expect high deficits, high spending, and high inflation in the future and that will be reflected in their behavior in the economy, in the financial markets, and in interest rates. And all of that behavior could easily neutralize the incentive effect of the tax change. And I think you are precisely right. That's why this whole package is an integrated whole, none of which can achieve its objectives without the other part being implemented as well.

Senator DURENBERGER. Well, let me ask you a question that relates to the spending side. I think your statement, better than anything I have seen lately, lays out what it is that you are trying to do this year versus what you are going to do in the future.

We have a lot of problems, for example, with the medicaid recommendations with State and local government trying to determine whether or not that is a sense of direction. Is capping, and cutting, or blocking health and social services a sense of direction? Is this part of the devolution process? Are you dumping responsibility on the States and the bill for that responsibility as well?

As I read what you said on page 3 of your statement about today and on page 7 about tomorrow in which you make the point about the relative changes in size of Federal and State and local sectors, and how growth in the public sector in general can be efficiently shared, it seems to me safe to draw the conclusion that your recommendations on medicaid, for example, do not take a position with regard to whether or not health care for the poor should be a Federal or a State responsibility. I might draw the conclusion that this administration eventually wants to dump it on the States, but I would like you to tell me that I am wrong; that the option of federalizing this part of the process is still open.

Mr. STOCKMAN. On the question of Federal/State responsibility, no conclusion has been reached. This, as I indicated in the case of a previous question is an interim fiscal containment measure only. And whether you want to—and on the other two issues that are relevant here, who ultimately pays the cost? And, second, how on a long-term basis do you contain the cost, the explosive cost growth of our health care system—those are very tough issues that we haven't addressed yet, but we realize we must at a very early date, and we are working on that intensively, and will make recommendations to you and the committee on both, hopefully, in the near future.

Senator DURENBERGER. Thank you.

The CHAIRMAN. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

Mr. Stockman, 2 months ago, at another Senate committee hearing, you were questioned by my colleague, Senator Cohen, of Maine, about decontrol of crude oil prices and energy assistance for low-income persons. To refresh your recollection, let me quote some brief excerpts from the transcript of that hearing. Senator Cohen asked you this question:

Listening to your statements about the need for deregulation about the free market system, I try to bring it back to a practical application. Maine happens to be a very poor State. We are perhaps the lowest per capita income of any State, under \$6,000 a year. We have had temperatures at 35 below zero for the past week. We have people who can't heat their homes. Assuming we permit immediate deregulation; assuming the price of oil climbs 5 or 10 cents a gallon, or higher, what do I tell the people of the State of Maine who can't pay their oil bills? It creates social as well as economic problems.

Mr. Stockman, that is precisely the reason why we created the heating fuel assistance program. The idea behind that was, yes, let the price clear the market, allocate the supplies, don't subsidize energy use. That is what you do when you hold down the price. Don't subsidize energy imports, which is what we were doing. But if there are targeted populations, categories of people—the elderly or low income—that live in regions of the country with a specially heavy impact, because of temperature and so forth, then we should respond to that directly with transfer payments.

Now since then we have decontrolled and there has been a dramatic increase in the price of home heating oil in just the few months of this heating season, which, of course, involves increases before and after decontrol. The price has increased by as much as 35 percent. It now costs over a \$1.30 a gallon in many parts of Maine. The average cost of heating a home in Maine is now close to \$1,500 a year. A State where, according to Senator Cohen, per capita income is less than \$6,000 a year.

As I understand it, the Reagan administration budget for fiscal year 1982 involves proposed cuts of about 6 percent from the Carter budget. Yet, the hardship block grant, which involves low-income energy assistance, proposes cuts of 26 percent. This is an area, home heating, which is a necessity of life, and in which prices are rising much more rapidly than in almost any other area of domestic economic activity.

And my first question to you is: Is this proposal not inconsistent with your remarks to Senator Cohen?

Mr. STOCKMAN. I don't think it is inconsistent at all. I think the existing program level is too big; it is improperly targeted; it is diffused and spread all over the country; it is \$2 billion, far in excess of a tighter definition of where the needs are, like in your State.

We have proposed to reduce the aggregate level of spending in that program.

[A television crew's light falls over.]

Senator MITCHELL. Could that be an omen?

Mr. STOCKMAN. I hope not. [Laughter.] This is heating assistance, not lighting assistance, I guess. [Laughter.]

We have proposed to reduce the aggregate level, but there would still be over \$1.1 billion left and we are developing an allocation formula that I hope would put the money where the need is and that will give the States the flexibility to distribute that aid to those families that need the kind of assistance you are talking about.

I don't think there is any conflict at all. But I feel very strongly that a program that grew from scratch in 1978 to over \$2 billion in the course of 3 or 4 short years, with very little oversight, very little control—and you read all the stories last year about payments going out to people who lived in institutions and didn't even pay their own heating bill—it is pretty clear that by retargeting we can get the job done on a reduced aggregate level of resources.

But I hope that you would support our effort in those States where it is needed and not to pay for air-conditioning in some other States where that might not be a justifiable thing to support. [Laughter.]

Senator MITCHELL. Well, of course, the success or failure of a block grant program depends upon two factors. First, the level of funding and second, the method of allocation.

Now, I would be interested in knowing what the proposed method of allocation is, because that is important.

Mr. STOCKMAN. That is what we are working on now, Senator, and that will be up to the Hill very shortly, as soon as we have tested the whole range of possible formulas that are available by computer.

But I would suggest today that we are going to try to target it to heating assistance and not as a kind of general income transfer to all the States that will simply elicit arguments that everybody needs a little aid, regardless of the climate that they live in. I don't think we can afford to do that.

Senator MITCHELL. Well, I am in, of course, complete agreement with that. But we are being asked to approve the reduction before we know what the formula is.

Mr. STOCKMAN. Well, I think it—

Senator MITCHELL. And I ask you whether or not that is a reasonable course of action for us to take?

Mr. STOCKMAN. I think before you approve that specific reduction, in terms of a legislative change that this committee or other committees might deal with, you will have the legislation, the State allocation formula, the statutory specifications as to how the States will run this block grant program.

I would hope at this date to convince you that you will be satisfied with the proposal that we present.

Senator MITCHELL. Well, I want to say that I am very much encouraged by your remarks, because I agree with you.

Let me ask you: When is it likely—and if you can't say, I accept that—that we will have such a proposal before us in writing that we can look at.

Mr. STOCKMAN. We will endeavor to have a statutory draft to you within the next 10 days. That is what our schedule is at the present time. And hopefully, at the earlier part of that 10-day period, rather than the latter.

Senator MITCHELL. Thank you, Mr. Stockman.

Senator BENTSEN. Mr Chairman, will there be a second round of questions?

Mr. STOCKMAN. Well, Mr. Chairman, I——[Laughter.]

The CHAIRMAN. You were almost out the door. So, now, just let me yield a minute to the Senator from Texas, in case he needs it. Senator Roth has agreed to that.

Senator BENTSEN. Thank you very much, Mr. Chairman.

I recognize Mr. Stockman is from where—Michigan?

Mr. STOCKMAN. That's correct.

Senator BENTSEN. Michigan.

Mr. STOCKMAN. I was born in Texas, Senator.

Senator BENTSEN. Well, you didn't stay long. [Laughter.]

You should have stayed longer. [Laughter.]

It has been some time since you experienced a hot summer day and night in Texas. We had on the order of 10 to 20 times as many people die from heat last year as we did from cold. A lot of them were poor people, aged people, who couldn't afford the price of a fan, or a window air-conditioner, or to pay the utility bill. So, when you talk about weather fatalities, we have serious problems in Texas. We have had incredible heat waves, where for as long as 2 weeks at a time you had temperatures of over 100 degrees, day after day after day.

Mr. STOCKMAN. Senator, I understand that. But, I would still argue that the heat wave that you and other States in the region had last summer was an extraordinary, unusual phenomenon; it doesn't occur every year. But, it does get cold in Michigan and Maine every winter and I think you can make a clear difference. Not that only the Northern States should get part of these funds and the Southern States get none of them. But I think the distribution formula ought to be weighted to that area of the country where the recurring and persistent problem is. Clearly, that is those States with very severe winter temperatures, rather than those States that have sporadic or occasional severe heat in the summer.

Senator BENTSEN. It has been some time since you have been in Texas. Our summer heat is certainly as dangerous and debilitating as your winter cold.

The CHAIRMAN. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman.

The CHAIRMAN. This is Mr. Roth, of Roth-Kemp, in case——

Mr. STOCKMAN. Thank you, Mr. Chairman.

Senator ROTH. Dave, I would like to talk to you about taxes for a few minutes.

On April 15, all working Americans will be paying taxes. And it seems to me that there is a lot of talk—here in Congress a lot of talk among the big spenders that we ought to once more soak the working class. Isn't it a fact that the working people of America are paying substantially higher taxes this year because of inflation, because of social security, because of the windfall profits tax. It is just the same as if we don't do something about tax cuts for the individual we in effect vote a tax increase?

Mr. STOCKMAN. Senator, I think the short answer to that is precisely, yes. And you simply need to look at the tables on current tax law out over the next couple of years and you can see as clear as a bell progressively higher levels of taxation on all taxpayers.

Senator ROTH. I have a strong feeling that maybe we ought to call April 15 tax freedom day, because we are trying to do something about it.

How much have the taxes increased during the last 4 to 5 years on the typical working family?

Mr. STOCKMAN. In dollar amounts or in the aggregate?

Senator ROTH. Dollar amounts. Could you give that figure?

Mr. STOCKMAN. I don't know that I could give you an example off the top of my head, unless you told me the income level. But, obviously, it has been substantial. If you would like we could submit for the record a representative number of cases showing their combined social security and Federal income tax in 1976 versus what they would be liable for in 1982, if the tax changes are not adopted.

Senator ROTH. Let me point out that in the early 1960's Mr. Kennedy, Jack Kennedy, offered a tax cut very similar to what President Reagan has proposed. Have any studies been made to show what happened to savings as a result of that tax cut? And, what do you anticipate will happen as a result of the Reagan proposal?

Mr. STOCKMAN. Well, I think that the results of that are pretty clear. After that tax cut and during the middle 1960's, we had the highest rate of savings and investment that our economy has experienced in the post war period. We also have very clear evidence that there was an increased revenue flow to the Treasury after the reductions took effect and that, particularly, in the upper brackets the amount of tax collections each subsequent year rose substantially, even after the top bracket was lowered from 90 percent to 70 percent as a result of those tax policy changes.

Senator ROTH. I think it is worth pointing out that the same forecasters of gloom and doom predicted in Mr. Kennedy's days that it wouldn't work when he was arguing that it was essential to reduce the tax burden, to do something about productivity. And despite those predictions, as you point out, in fact it meant more revenue long-term for Government; it meant more income for the working people of America and the United States prospered because of that move.

But, I would just like to point out. I don't know whether you have noticed or not, but I have been very interested in watching what some of the people here in Washington have been saying—

some of the traditional big spenders who suddenly have become conservative and are talking about balancing the budget, or that we ought to do something about reducing the deficit.

This sort of intrigues me. Because, I would say if I were a big spender, I, too, would not want to reduce individual taxes. I would want to keep that revenue in place. Sure, it is all right, temporarily, to cut spending this year and next year. But, if I want to go back to my past practices of big spending, the important thing is to keep revenue in place.

Do you have any forecast as to how much the revenue of the Federal Government will go up in the next several years?

Mr. STOCKMAN. Yes. We can provide that. I would just give you one example for 1982. If you kept the current tax law, and under our economic forecast, revenue levels would exceed \$700 billion, it would be about \$710 billion in 1982. The expected level of revenue in 1981 is slightly over \$600. So, you have a built-in revenue increase under current law of over \$100 billion. Some of that merely reflects higher wages and prices. But a good deal of it reflects higher real rates of taxation on both businesses and the wage and salary workers.

Senator ROTH. Isn't it a fact that the revenue between 1980 and 1985, of the Federal Government, of all types will grow from something like \$500 billion to over a \$1 trillion.

Mr. STOCKMAN. It would be well over \$1 trillion, Senator. Revenue would grow at a 17-percent rate over the next 5 fiscal years, if current tax law remains in place intact.

Even after the reductions that you have proposed in the Roth-Kemp tax bill that is now part of the administration's proposal, and this is constantly ignored, there would be a 10-percent revenue growth each year out during the 1980 to 1986 period, even after the tax deductions. There would a \$350 billion revenue gain even after the tax deductions.

So, the point that I am trying to stress here is that without tax reduction, there will be a massive increase in both the tax rate and in the revenue level if the economy held up. With the tax reductions, there will be decreases in the tax rates, but still sufficient revenues to finance the necessary expenditures of Government.

Senator ROTH. Would it make any sense to cut spending, and to cut depreciation, and do nothing for the individual?

Mr. STOCKMAN. No; I don't think it would make any sense at all. We have heard a lot of talk about tax expenditures, and loopholes for the rich, and why don't you do something about that. But, the fact is that if we allow the nominal rate brackets to continue to creep up on tens of millions of middle- and upper-middle income taxpayers, we are simply going to drive more and more of the savings flow of our economy into sheltered investments, which, by and large, are not as productive as taxable investments through our financial markets.

So, I think it would have devastating effects on all the aspects of economic improvement that people are looking at. Investments, savings effort, and the whole range of variables that are important to stimulate the process of growth and prosperity in this country again.

Senator ROTH. Well, Mr. Chairman, my time is up. But, I would just like to underscore again that there seems to be a move to, as I say, soak the working people of America. It is those that earn between \$10,000, I think, and \$50,000 that pay something like 60 percent of the income tax and they will get 62 percent of the return. It makes no sense to me to just try to help business out and not do something for the working people whose taxes have very, very substantially increased during the last inflationary period of 5 years.

Thank you, Mr. Stockman.

The CHAIRMAN. Let's see. Senator Heinz is next. But he was called away to a phone call. He will be right back. Maybe if Senator Packwood will proceed.

Senator PACKWOOD. Dave, I don't understand—and skip your plan for the moment and we'll get back to that—how all of our major economic competitors have significantly higher rates of taxation than we do and, yet, also higher rates of savings, capital formation, and productivity?

Mr. STOCKMAN. That is a complicated story. But I would make one flat statement that is roughly correct. Most of them have lower effective levels of income taxation than we do.

Senator PACKWOOD. All right.

Mr. STOCKMAN. They have a higher average of national taxation because they have sales taxes, social insurance taxes, and so forth.

Senator PACKWOOD. Can I rephrase your answer as follows? What they have basically done is push the incidents of taxation onto the middle and lower income classes?

Mr. STOCKMAN. No; I would rephrase it differently. What I think they have done is put the incidents of taxation on categories of activities that are less relevant for savings, investment, and economic growth.

Senator PACKWOOD. They have put them on consumption?

Mr. STOCKMAN. On consumption and on labor costs.

Senator PACKWOOD. Yes. And, who pays those in bulk in most countries?

Mr. STOCKMAN. Well, ultimately, they feed through the prices and to the consuming public, or to foreign purchase, in many cases.

Senator PACKWOOD. Almost all of Europe does it with a value added tax, which is one of their high revenue producers and it is perpetually attacked in this country as being regressive, as a tax on the little wage earner.

Are these statements true?

Mr. STOCKMAN. Well, I think, as a general matter, if your only concern is equity and income distribution, you would say that a sales tax is less progressive than an explicitly progressive income tax. But, in practice, our income tax is not as nearly as progressive as the rate schedule looks and many value added taxes and sales taxes are structured to reduce their regressive impact with exemptions or different levels of taxes for different types of purchases; higher for luxury, lower for necessities.

So, in the empirical world of operating tax systems around the world, it would be very difficult to make a generalization as to one being much more regressive or progressive than another kind.

Senator PACKWOOD. I have a tentative summary of a study from the Library of Congress which won't be finished for another 2 or 3 weeks yet. But it is clear that what it is going to conclude is that Germany, France and Italy are normally in the 40- to 41-percent range on taxes in relation to their gross national product.

We are around 32 percent counting State and local taxes. And what the report is going to conclude is that they tax income, savings, capital relatively lightly in comparison to the United States.

And they tax their working class, if you want to call it that, significantly higher than the United States by virtue of the consumption taxes.

Now, I am not asking for your answer on that, necessarily, because this is what the report is apparently going to conclude.

If that is true, and if what we want to do is to encourage savings, investment and productivity, shouldn't we be structuring our tax structure similar to theirs?

Mr. STOCKMAN. I think that the basic question you raise about whether we have the appropriate mix of tax systems in our economy and the effects of that is probably the most profound economic discussion and debate that we can have. And, certainly, that is something that this administration will be greatly interested in looking at. But, in terms of accomplishing a set of tax policy changes in 6 weeks that Congress can act on quickly, given the economic emergency, or crisis, that we have in our country today, I don't believe you can restructure a tax system on that kind of basis. It takes very careful analysis, deliberation, consideration, and consensus building before you can move away from the kind of tax system and bases we have today. But, it is certainly something to be looking at, and I think that your analysis supports what we are trying to do on the income tax. And that is, reduce the incidents of taxation on those sensitive activities that are so important for economic growth.

Senator PACKWOOD. Well, yes, and it may be, and this is what troubles me a bit about the administration's proposal.

I am told in Japan—I can't verify this; I will soon—that they exempt \$55,000 of interest a year, per person, from tax. I find that an incredibly high amount. But, in any event—and I am told they have no capital gains tax. I have been given those figures before and I find there is often some slight of hand. But, in any event, if we wanted to encourage savings, wouldn't we be better to, say, exempt the first \$1,000 and \$2,000 of interest from tax rather than just a generic across-the-board tax cut? If, what you want to do is to encourage savings?

Mr. STOCKMAN. Well, my answer is two points. And we have been discussing this this morning. One, the problem isn't simply the aggregate level of savings, it's the quality of the investment that occurs from that.

And when you have a high proportion of taxpayers, more than one-third in brackets have 30 percent, really 40 percent, if you count State and social security, you are getting enormous distortions, both on the aggregate level of savings and where it is flowing. Because of the natural seeking by people of shelters in order to increase their after tax rate of returns.

So, I think the first thing you have to do is to get those high marginal rates down for a large share of the taxpaying population.

Then the next step is to look at the more generic question that you are raising as to how you can shift among tax systems to even further encourage savings and investment.

Senator **PACKWOOD**. I can remember on one occasion when I had a discussion with Art Laffer, and I don't know if it would still be his position today, but he indicated where we really ought to be heading in terms of taxation is cutting the rates on those people who are paying above 35 or 40 percent first and significantly, if you wanted to increase savings and investment, rather than spreading out the revenue loss across the board.

I think my time is up, Mr. Chairman.

The **CHAIRMAN**. I call Senator Chafee.

Senator **CHAFEE**. Thank you, Mr. Chairman.

I got here a little late, so I am not sure this subject hasn't been discussed. And, if it has, maybe you could just summarize.

Concerning the President's 10-5-3 proposal, which is his program for accelerated depreciation, we spent considerable time on that last year in this committee and we found the 10 extremely expensive and really not contributing to the great thrust of increased productivity, greater competitiveness. And, in view of the fact it was so expensive, we didn't adopt it in this committee last year by a vote either of 19-1 or 20-0.

Could you give me the rationale? Outside of the fact that the President promised it in his campaign, which, I suppose, is some reason for presenting it as a program. Give me the reasons, if you would, for the 10?

Mr. **STOCKMAN**. Well, two points: One is, it is phased in over 5 years. And that is a reflection of the same revenue loss problem that this committee grappled with last year. Second, we believe that the entire depreciation system, both on structures, and on machinery, and tools, and equipment is hopelessly obsolete in terms of the underdepreciation that occurs from the historic accounting method. And that if you are going to provide a better tax climate, increased cash flow, and incentives for reinvestment in the declining structures and equipment of our economy, then you have to have changes in both categories of industrial investment.

We believe on a phased-in basis the new method of depreciation for both structures and equipment is well justified in terms of both tax law and in terms of the economic effects that we are trying to induce or stimulate.

Senator **CHAFEE**. Well, of course, our view was that we accepted there was a productivity crisis, or, certainly, a severe emergency and, thus, we concentrated on the machinery and equipment. We didn't go to a 5-year writeoff for all machinery and equipment. We adopted a 10/7/4/2 schedule, again, because of the cost. But, you could see that we were concentrating on the machinery and equipment. We put the buildings at 15 years, owner-occupied, and 20 years nonowner-occupied.

To me, that made a lot of sense. To put the thrust in the machinery and equipment rather than worrying so much about the buildings. But, you find the buildings are an important aspect?

Mr. STOCKMAN. Well, I suppose if we had the ability to sit down and rank order all the possible investment needs of the economy and come to some conclusion as to which was the first priority, the second priority, the third, and define, and classify, and categorize all this, we could design a tax proposal that would have the maximum efficient effect of moving tax reduction to the top priorities first.

But, every time you try to do that you get distortions in the economy that you never anticipated. We found in recent years, for instance, on the investment credit available only for machinery, that some economists argue that has caused a distortion in the investment split between machinery, on the one hand, and structures or ineligible properties on the other.

Our view of it is the economy is very complex. We don't know whether the answer is tools, or buildings, or any of the thousands of subcategories of each that really exist or are needed out there in the economy. And, what we ought to strive for is neutrality in terms of changing the tax code in a way that will stimulate increased inputs of all those investments throughout our national economy.

Senator CHAFEE. Now, I know that you have spent considerable time on savings, what to do on savings here. And I read about your testimony in the House. I am supportive of a bill that Congressman Moore and I have introduced, which I believe you are familiar with, which exempts the first \$2,000 in an IRA, but also permits not only withdrawals for the first equity payment of a house, but also higher education expenses. We thought that would be an incentive for young people to get into these IRA's, for which there is not much incentive now, because they are solely for retirement.

Even though you have discussed that briefly here before, could you repeat that? Particularly, in connection with that proposal dealing with the incentives for education, housing, and retirement.

Mr. STOCKMAN. Well, I think the basic problem with targeted incentives is twofold: One, you get a whole variety of political struggles developing between people who think education is more important than retirement, between people who think that thrift institutions are the proper place for savings to go versus those who think that money markets are fine, or that the stock market is better, or that venture capital companies are even better. And, it seems to me the inevitable problem that you get into with targeted tax incentives is making choices. First, about where savings ought to flow and, second, designing a tax system that doesn't cause all kinds of unintended distortions and administrative difficulties.

The market is very smart. Someone asked me before about incentives. And the minute I make the after-tax rate of return on one type of savings instrument better than another, you get a lot of transfer of savings, but not necessarily an increase.

And I think what we are looking for is an increase in the aggregate level of savings and in the efficiency with which those savings are invested. And the best way that we can do that is to lower tax rates on all taxpayers and then allow them to make their choices, both about savings and where those savings are deposited or invested.

Now, I understand what you are trying to get after with your proposal. And, it is probably one of the more balanced and comprehensive of the targeted savings tools available. But, I still think that is the difficulty with any effort to target savings to one purpose or institution versus another.

Senator CHAFEE. One quick question, if I might. The 200/400 interest and income dividend exclusion expires this year.

Mr. STOCKMAN. My understanding was that it was calendar year 1982 that it expires.

Senator CHAFEE. In calendar year 1982. All right. What would be your view toward extending that?

Mr. STOCKMAN. We haven't taken an official position on that. But that is an exclusion that is pretty broadly based. In other words, interest returns, dividend returns, interest returns of any type are all given the same level of tax preference. I suppose my answer would be that that ought to be continued when the time comes.

Senator CHAFEE. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Heinz has arrived and then Senator Bradley.

Senator HEINZ. Thank you, Mr. Chairman.

Mr. Stockman, I suppose we have more questions for you than anybody else in the administration. But, under the 5-minute rule, you will be spared most of them. [Laughter.]

It is almost like the House of Representatives in that regard.

Picking up on savings, where everybody knows we have the lowest savings rate of any developed nation in the world. What would you think about providing a highly targeted type of approach, as follows: that is to say, that we provide capital gains tax treatment for savings and interest income—that is, both interest and dividend income—in excess of 7 percent of adjusted gross income?

Now, the reason I chose the 7-percent number is that that, according to IRS statistics, is the average rate of interest and dividend income reported on the form 1040 by individuals. Therefore, what you achieve is you give a very strong incentive at the margin—words that I have heard you use on occasion. You give the strongest possible incentive at the margin for savings and you don't discriminate as to whether it is interest income or dividend income. And, obviously, you integrate at the same time with capital gains, because that is the rate that you are choosing.

How do you react to that suggestion? Because I believe that we can't just sit here and talk a nice game about how we want to increase incentives for savings and investment. We have to do something about it.

Mr. STOCKMAN. Well, as I have indicated, we prefer the broad generic incentive for savings, of lower rates, rather than targeted. This is a new one that I haven't heard.

Senator HEINZ. This is lower rates. And, this is integration.

Mr. STOCKMAN. You are proposing capital gains treatment for any interest or dividend income that exceeds 7 percent of gross income?

Senator HEINZ. Of adjusted gross income.

Mr. STOCKMAN. Well, the adjusted gross income includes returns from investment as well as from earnings?

Senator HEINZ. That is right.

Mr. STOCKMAN. And, so, therefore, if someone had \$100,000 income that was entirely investment income, then they wouldn't pay tax on any of it other than the first 7 percent?

Senator HEINZ. No, No. You would pay the existing tax rate on the first 7 percent and then you would pay the capital gains rate on the rest.

Mr. STOCKMAN. Well, the effect of that, then, would be to lower the rate of taxation on investment income to 28 percent?

Senator HEINZ. That's exactly right. On interest income and on dividend income.

Mr. STOCKMAN. How would you treat the common problem—and I think you should be asking the Treasury these questions; I came here to talk about budget reductions—but, how would you treat the common problem of people borrowing large sums to invest and thereby generating investment income in order to get favorable treatment under your new tax incentive and then have to come before this committee and defend why we have a tax system so riddled with tax expenditures and loopholes that have untoward economic consequences and great negative equity impacts?

I am afraid you may have a real monster here if you analyze the thing all the way through in terms of how the shelter industry will put it to good use. And, not that I—I share your objective. But, I am afraid that it's a pretty convoluted way, it sounds to me, to get there. And that the better approach would be to lower rates on capital gains, as they are defined today, and on income as it is defined today.

Senator HEINZ. How are you ever going to solve the problem—talking about differential investments and a differential attractiveness—of the fact that we do have a relatively attractive capital gains rate and a relatively unattractive return for interest income and dividend income?

Mr. STOCKMAN. Senator, I see what you are getting after but—

Senator HEINZ. I should think you would want to be neutral in terms of the incentives you want to propose. And my point is—and I don't think we are going to get a resolution of this issue—but, I urge you—and I am going to urge Don Regan, I am going to urge the rest of the Reagan administration, to come forward—not necessarily to endorse this proposition, which I make to stimulate your thinking, but to look at this issue seriously. There is a lot of concern on the committee, as expressed, about interest and increasing savings.

So far, notwithstanding the good intent of the cut in the marginal rate, that simply is not going to be a strong enough incentive in my judgment.

May I go to a second issue that is of particular concern to me, and I might add a lot of people in my State, and that is the single, solid tax increase of any major proportion that you have proposed. And that is the increase from, roughly, 6, 8, or 10—depending on the year you take it—to 30, 34, 36 cents a gallon on barge fuel for waterway users.

And, because time is necessarily short, I am going to ask you the basic, bottom line, question, which is: Given the fact that the General Accounting Office says that the reclamation projects in the West are not, by any stretch of the imagination, amortized by user fees; and given the fact that those projects are not necessary to interstate commerce, they are local area projects, how on earth do you justify only taxing interstate navigation improvements on one class of users, not the entire class of beneficiaries, and exempt the beneficiary of the irrigation and reclamation projects funded by the Water and Power Service?

Mr. STOCKMAN. I don't think we have exempted anyone yet. We established, as a fundamental criterion of this fiscal reform effort, the imposition of user fees wherever benefits were clearly allocable to certain classes of users. And that those benefits—

Senator HEINZ. Why don't you do that with irrigation projects? They are clearly, clearly—

Mr. STOCKMAN. Well, I want to say that in 6 weeks, Senator, we have been able to develop and send to the Congress proposals for appropriate cost recovery for barges, for Coast Guard service beneficiaries, for the air traffic control users, for the deepwater port users. And, as we begin the process of looking in other areas where you have clear private economic benefits, I would suspect that we will have additional user fee proposals. And this would be a good target. But the GAO report just came out last week and couldn't cover every possible user fee within the course of the limited time we have had to develop it.

Senator HEINZ. But, you do intend to cover it?

Mr. STOCKMAN. I intend to look at it very carefully. I don't make public commitments to propose a plan until I have analyzed the issues to see whether or not it is justified and appropriate.

Senator HEINZ. Now, you make the point that you are trying to amortize the cost of the locks and dams by imposing a diesel fuel tax on waterway users. What do you say to the argument made by many people, including the waterway users, that you are taxing them on behalf of other beneficiaries—the people who benefit from recreational uses; the people who benefit by virtue of having a stable water supply, municipalities. Which is one of the things that locks and dams, in fact, do provide. And, in some cases, although not all, flood control. How do you justify—

Mr. STOCKMAN. Well, the answer there is that the tax would reflect the allocable cost to that class of users. And where Army Corps of Engineer maintenance cost can be clearly allocated to other classes and other purposes, whether it is flood control, or bank stabilization, or a whole variety of other benefits, those costs wouldn't be counted in the calculation of the tax. And, we are working on that very carefully.

But, the principle is very clear. Only those directly allocable costs would be used in order to calculate the cost recovery fee, or the tax, as you call it.

Senator HEINZ. The concept, Mr. Chairman, will take 30 seconds, if that.

The concept of user fees is not a concept I am opposed to. But, I do think it ought to be implemented intelligently, fairly, and across the board, if we are going to do it. I don't want to—

Mr. STOCKMAN. We intend to do it, strive to that end. And if you find other areas where user fees could logically, and justifiably be imposed in order to recover cost—and we have proposed for wheat, and tobacco, and a whole variety of other services that the Government provides—we would be interested in hearing your proposal.

Senator HEINZ. Well, I proposed one to your office about a month ago. It is the same one I proposed to you again today, and I am delighted to hear you are going to come forward with some proposals on it.

Mr. STOCKMAN. I didn't hear myself say that, but—[Laughter.] We will be looking at it, Senator.

Senator HEINZ. Well, we don't want—it would be a rare situation where you waffled on something. [Laughter.]

I don't want anybody to accuse you of waffling, so I am saying for you that which I am sure you really do intend to say, which is: You will be proposing—[Laughter.]

A user fee on water reclamation projects. [Laughter.]

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Stockman, last night in the Senate, the Budget Committee voted to cut about \$3 billion out of the strategic petroleum reserve. Now, I know you are interested in that, and I know that you have looked at a number of private financing mechanisms—oil bonds, various other off-budget items.

I am just wondering, could you tell us today what is the administration's private financing mechanism for the strategic reserve; what are you prepared to recommend?

Mr. STOCKMAN. We do not have a finalized recommendation at this time.

Let me make two points, Senator: We think that the 230,000 barrel per day purchase level is essential. And our policy mark is to find a way to finance that, whether on-budget or one of these alternative means during fiscal year 1982. But, we believe we still have a little time to assess and study very carefully what is the best way to elicit private financing for this proposal rather than direct budget expenditures.

Senator BRADLEY. But you are not prepared to make a recommendation today?

Mr. STOCKMAN. I am not.

Senator BRADLEY. But you will make a recommendation?

Mr. STOCKMAN. We are looking at that very carefully and I think that I can assure you, with some confidence, that we will have a recommendation for fiscal year 1982, and it will be here on a timely basis.

Senator BRADLEY. In hearings held here in the Finance Committee in the last months of the previous session, there was a witness who testified that: generally what we have to do in this country is reduce taxes on those things we like, that is, capital and labor, and increase taxes on those things we don't like, like oil imports and pollution.

Now, would you generally be in favor of a reallocation of tax burden in that way?

Mr. STOCKMAN. We discussed that before. I think we need to carefully assess our tax system, because in my judgment it bears

too heavily on income, on returns to capital, and on incentives. Now, where you shift that, if you are going through some basic generic restructuring, I am not sure. I don't think you could get very much by taxing pollution in terms of what we need to pay for the cost of Government.

Senator BRADLEY. Are you familiar with the comprehensive tax?

Mr. STOCKMAN. Yes.

Senator BRADLEY. Are you generally supportive of that concept?

Mr. STOCKMAN. I think the broader the base and the lower the rates, the better tax system you are going to have, both from a tax policy point of view and from an economic growth, and efficiency, and neutrality point of view.

Senator BRADLEY. So, that as a goal, you would support the comprehensive tax?

Mr. STOCKMAN. I think most people do. But it remains a very elusive goal, for reasons that we are all familiar with.

Senator BRADLEY. Could you achieve that goal without eliminating tax expenditures?

Mr. STOCKMAN. Yes.

Senator BRADLEY. You could?

Mr. STOCKMAN. The volume of tax expenditures is a direct function of the level of marginal rates. And if you look at the data over the last 3 or 4 years, you can very clearly see that. We have more than \$26 billion in mortgage interest tax expenditure this year, partly because the middle class is moving into higher and higher rates and is shifting more of its savings into housing investment and out of taxable instruments.

So, it is clear that as you bring the rates down, the attractiveness of these tax expenditures will be less and they will wither in some relative sense as you bring rates down.

Senator BRADLEY. Last year in the hospital cost containment debate there were Members of the House who opposed it on the grounds that it treated both the fat and the lean the same, meaning that it put a cap on the costs and if you were efficient, you had the same cap as if you were not efficient.

Could you make that same argument about the medicaid cap that you have put on this budget? There are some States that have voluntary arrangements, where costs have been kept under control. In medicaid you also have State ratesetting boards in some States. Can you generally make that same argument against the medicaid cap that was made last year in the House against the hospital cost containment?

Mr. STOCKMAN. Well, I wouldn't. I think there is a basic difference.

Here you are talking about a Federal/State matching program that transfers dollar resources to the State. The States then manage an incredible array of services from physician services to skilled nursing homes, to medical laboratories, to hospitals of every shape and variety. And, simply what we are proposing is to give them far more flexibility than they have today to control the costs that come through that system.

And, I don't think it is similar at all to a rigid numerical formula for revenue calculation that would have been applied to 7,000 hospitals under the Carter cost control program last year. You can

always stretch an analogy. But, in this case, I don't think it is a very apt comparison.

Senator BRADLEY. The thrust of the budget, as I understand it from your explanations and other members of the administration, is that you are trying to encourage people to work, people who are not working today.

I am curious if you haven't really achieved a false economy, or shot yourself in the foot, if you look at the cumulative effect of cuts in CETA program, food stamp eligibility, plus the cuts in food stamps, plus the medicaid. And, you kind of consider the basic working poor and consider it like a stool. You begin to cut different legs and, suddenly, you don't have anyone there, or you don't have the stool standing, and you don't have anyone who is working.

So, what I am asking you: Are these economies, in your view, going to translate in the longer term into higher costs? And, how are they going to encourage people to get back to work?

Mr. STOCKMAN. Well, I've heard that charge, or argument, a number of times. But I have yet to see any specific evidence or illustrations cited to justify it.

Now, on food stamps, for instance, we are saying that a \$14,000 a year family is no longer eligible. That \$14,000 family might lose, at most, \$100 a year worth of food stamp benefits. I can't believe, for the life of me, that someone earning \$14,000 now will quit working and become totally dependent because it faces the prospect of losing \$100 worth of benefits.

In the medicaid program, I don't believe that we are necessarily going to have any direct effect in terms of service delivery to any particular member of the medicaid eligible population.

What we expect to occur is efficiency savings by allowing the States, for instance, to provide medicaid services to efficient hospitals and not through inefficient ones, or through HMO's, rather than the way that it is provided today.

So, if you take those two examples, or a variety of others, I don't see any structural proposals that we have made that have clear, demonstrable and explicit disincentives for self-support and work.

Senator BRADLEY. What about the food stamp/school lunch offset? That's not the \$14,000 eligibility. That's going to the mother of a child that is very poor, maybe a working mother, or maybe someone who is on AFDC who is maybe in a tougher circumstance because the restrictions have been tightened.

Mr. STOCKMAN. But I can't see how that would have any effect, whatsoever, on work effort, since the food stamp program is the best structured income maintenance program we have in terms of work incentives. You only lose 30 cents on every dollar of additional outside income. And our proposed change here would not have any impact at all on that incentive rate, that low marginal rate.

The CHAIRMAN. We will start the second round. Senator Byrd.

Mr. STOCKMAN. Mr. Chairman, I think I was to arrive at the next meeting at 12:15 p.m.

The CHAIRMAN. Oh, well, we will——

Senator BYRD. I can waive my questions, Mr. Chairman.

The CHAIRMAN. All right. I have some questions I can submit in writing. Senator Long, do you have any parting shots?

Senator LONG. Well, with those limitations, I would pass, Mr. Chairman. I would like to continue this at some future point.

The CHAIRMAN. You can return another time?

Mr. STOCKMAN. I certainly can, Mr. Chairman.

Senator LONG. But, in view of the witness commitment, I'll pass.

The CHAIRMAN. Well, I have other questions, too, but if there is some other opportunity we can talk, I will pass too. Well, maybe, rather than submit them in writing, we can work out another appearance.

Mr. STOCKMAN. Yes, Mr. Chairman, I would be happy to come back.

The CHAIRMAN. Anyone else on this side need to ask a question?

Senator CHAFEE. Well, I just want to say, Mr. Chairman, I commend Mr. Stockman for what he has done and urge him, particularly, to continue his look into the black lung program. That is a program I have paid some attention to and it has really been scandalous. It isn't a question that the cuts are going to hurt those who are really suffering, it's that the whole program needs a drastic review, and I would—I know your interest in that and I would urge you to continue your efforts.

Mr. STOCKMAN. Thank you.

The CHAIRMAN. Thank you very much and I understand you will be back within the next couple of weeks in any event, so we can pursue the questions we have at that time.

Senator LONG. Let me just congratulate Mr. Stockman on being a very forthright witness. I think most witnesses in that situation would have ducked quite a few of those questions.

[Whereupon, at 12:10 p.m., the hearing adjourned subject to the call of the Chair.]

SPENDING REDUCTION PROPOSALS

THURSDAY, MARCH 19, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:12 a.m., in room 2221, Dirksen Senate Office Building, Hon. Robert J. Dole (chairman of the committee) presiding.

Present: Senators Dole, Packwood, Chafee, Byrd, and Bradley. The CHAIRMAN. The committee will come to order.

I might say to our witnesses, we are very pleased that you are here. We have a number of conflicts this morning, including the Budget Committee and the Republican Policy meeting.

We had hoped during the course of your testimony we will have other members come and go.

Senator Packwood and I will be pleased to hear the testimony. I am glad to welcome our panel of economic experts this morning.

Before we get into the details of budget cutting, it is a good idea for us to get some background on how spending restraint relates to economic activity.

We are looking for our witnesses to tell us about the general relationship, telling us how budget changes are going to affect the economy and, in turn, how economic activity will limit what we try to do.

This background will help guide this committee to make decisions in the structure, as well as the size of the expenditure in tax cuts we are going to consider.

Our witnesses this morning are first, Dr. William J. Fellner, who was many years professor of economics at Yale. Then, a member of the Council of Economic Advisers from 1973 to 1975. He is now a resident scholar at the American Enterprise Institute.

President Hendrik Houthakker was also a member of the Council of Economic Advisers from 1969 to 1971, which interrupted his tenure in 1960 at Harvard University, where he is now Henry Lee Professor of Economics.

Mr. Erich Heinemann comes to us from Morgan, Stanley & Co. in New York and is widely known for his interest in macroeconomic policy matters and the behavior of the economy.

He was, for many years, an economic journalist for Newsweek and then with the New York Times.

I am not certain whether you have a plan on how you should proceed. You need not proceed in the order I called your names, but unless you have another plan, perhaps we can do it in that way.

Dr. Fellner.

Senator Byrd has now arrived. So, we are in good hands.

**STATEMENT OF DR. WILLIAM J. FELLNER, RESIDENT
SCHOLAR, AMERICAN ENTERPRISE INSTITUTE**

Dr. FELLNER. Thank you very much, Senator Dole. Thank you for the honor to be allowed to appear here and express my views on the problems that were described as those with which you are concerned at the present moment.

I have a brief writeup on this, which I will present. It does not extend to all problems that might be considered here, and I will be very glad to answer questions as well as I can if they come up later.

In my appraisal, one of the essential requirements of restoring a satisfactory productivity trend is to prevent a further increase of the ratio of the tax burden to the income produced, an increase that has largely resulted from inflationary distortions of our tax structure. Indeed, we need to reverse the recent significant increase of this tax ratio.

Unless we were prepared to run a large deficit for a long period to come, this objective cannot be achieved without undoing also the large recent rise of our budgetary outlay relative to the income produced.

In the fiscal year 1981, we will presumably collect a Federal tax revenue corresponding to about 21 percent of our GNP, and our fiscal outlay will correspond to about 23 percent of the GNP.

The administration hopes to establish budgetary balance by the fiscal year 1984 with taxes and outlays relative to the GNP at the level of approximately 19.5 percent in that future year.

I feel convinced that this reduction of the tax ratio from 21 to 19.5 percent of the GNP is a constructive program and that it is essential that the program should receive the full cooperation of Congress.

Let me add here that I favor indexing the tax structure after completion of the program now under consideration.

This, by the way—if I may insert something here—has been considered as part of the general program for a while, and I don't see traces of it in the recent writeups of the program. I mean indexing after the completion of the 3-year phase.

The planned Federal tax ratio of 19.5 percent relative to the 1984 GNP is about that ratio which we had 2 or 3 years back in 1978 and 1979.

Even this ratio is appreciably higher than was that of the mid-sixties at which time the proportion was about 18 percent.

The 19.5 percent is only about 1 percentage point lower than was that of 1969, though in that year defense outlays were much higher relative to the GNP than those now in prospect for the years to come and though in 1969 we had no deficit.

Returning to the 19.5 percent tax ratio, this cannot be regarded as an over ambitious objective if we are determined to restore the incentives needed for the efficiency of the economy.

And given this tax objective, reducing the outlays significantly relative to our GNP is necessary if we are to avoid continued deficits of large size that would diminish the savings available for productivity-raising investment and would cause substantial harm.

Over no reasonable time horizon can the interest raising effect of significant deficits, and their investment limiting effect be offset by easy-money policies of the monetary authorities, because such policies steepen the inflation rate and thereby raise interest rates, even if possibly with a short time lag.

It is true that along with high nominal rates of interest inflation often produces low or even negative real rates of interest, but in the midst of the inflationary uncertainties and inefficiencies, this merely reflects the inability of the users of investable funds to commit themselves to investment projects at real rates more favorable to the lender. Hence, it reflects the failure of the borrowers bid up the nominal rates to the full equivalent of what otherwise would be the normal real rates of interest, plus an allowance for inflation over the relevant periods.

To restore the health of our economy, we need to return to noninflationary demand management with perceptible speed rather than engage in the misguided and hopeless effort to reduce interest rates by accommodating deficits through inflationary methods.

We need to return to a tax policy creating much less disincentive than that which has been created by our recent tax burden, a tax structure seriously distorted by inflation, and we need to combine the tax adjustments with budgetary savings and with a policy of effective monetary restraint.

The view sometimes expressed that reducing corporate taxes stimulates investment, while the reduction of individual income taxes does so only to a minor extent, I consider misleading. I believe that one of several reasons for this is not sufficiently appreciated.

For a good many years now, the market has valued corporate stock at very much less than the value of the equity estimated on the basis of the replacement cost of the physical capital of the corporations.

There is a very large difference between the market valuation of equity and its valuation when the valuation is based on the replacement cost of physical capital. The market valuation is only a little more than one-half of the replacement cost valuation of equity.

This has created a situation in which the equity financing of new investment is becoming increasingly unprofitable.

Considering that prudent debt financing certainly has its limits, the low market valuation of equity stands in the way of achieving a larger volume of investment in plant and equipment. Not only our corporate taxes, but also the high marginal rates incorporated into our individual income tax structure and our capital gains taxes have contributed significantly to creating an environment in which corporate equity is valued very much below the valuation that would express the replacement cost of the invested physical capital.

The low market valuation has had substantial adverse consequences for investment and growth. In other words, I would not subscribe to the view that reduction of corporate income taxes does, whereas, the reduction of high marginal tax rate in the individual tax structure and the reduction of capital gains taxes does not

stimulate investment. I think that both of these have an important role in the determination of investment.

Thank you, Mr. Chairman.

[The prepared statement of Dr. William Fellner follows:]

Testimony Before the Finance Committee
of the United States Senate
Submitted on March 19, 1981

by

William Fellner
American Enterprise Institute
Yale University, Emeritus

(1) In my appraisal one of the essential requirements of restoring a satisfactory productivity trend is to prevent a further increase of the ratio of the tax burden to the income produced -- an increase that has largely resulted from inflationary distortions of our tax structure -- and indeed to reverse the recent significant increase of this tax ratio. Unless we were prepared to run a large deficit for a long period to come, this objective cannot be achieved without undoing also the large recent rise of our budgetary outlay relative to the income produced.

In the fiscal year 1981 we will presumably collect a Federal tax revenue corresponding to about 21 percent of our GNP and our fiscal outlays will correspond to about 23 percent of the GNP. The Administration hopes to establish budgetary balance by the F.Y. 1984, with taxes and outlays relative to the GNP at the level of approximately 19 1/2 percent in that future year. I feel convinced that this reduction of the tax ratio from 21 to 19 1/2 percent of the GNP is a constructive program and that it is essential that the program should receive the full cooperation of Congress. Let me add here that I favor indexing the tax structure after completion of the program now under consideration.

(2) The planned Federal tax ratio of 19 1/2 percent relative to the 1984 GNP is about the ratio which we had two or three years back, in 1978 and in 1979. Even this ratio is appreciably higher than was that of the mid-sixties, at which time the proportion was about 18 percent. The 19 1/2 percent is only about one percentage point lower than was that of 1969, though in that year defense outlays were much higher relative to the GNP than those now in prospect for the years to come, and though in 1969 we had no deficit. Returning to the 19 1/2 percent tax ratio cannot be regarded as an overambitious objective if we are determined to restore the incentives needed for the efficiency of the economy. And, given this tax objective, reducing the outlays significantly relative to the GNP is necessary if we are to avoid continued deficits of a large size that would diminish the savings available for productivity-raising investment and would cause substantial harm.

Over no reasonable time horizon can the interest-raising effect of significant deficits -- and their investment-limiting effect -- be offset by easy-money policies of the monetary authorities, because such policies steepen the inflation rate, thereby raising interest rates, even if possibly with a short time lag. It is true that, along with high nominal rates of interest, inflation often produces low or even negative real rates of interest, but in the midst of the inflationary uncertainties and inefficiencies this merely reflects the inability of the users of investible funds to commit themselves to investment projects at real rates more favorable to the lenders; hence it reflects the failure of the borrowers to bid up the nominal rates to the full equivalent of what otherwise would be the normal

real rates plus an allowance for inflation over the relevant periods. To restore the health of our economy we need to return to noninflationary demand management with perceptible speed rather than engage in the misguided and hopeless effort to reduce interest rates by accommodating deficits through inflationary methods. We need to return to a tax policy creating much less disincentive than that which has been created by our recent tax burden -- a tax structure seriously distorted by inflation -- and we need to combine the tax adjustments with budgetary savings and with a policy of effective monetary restraint.

(3) The view sometimes expressed that reducing corporate taxes stimulates investment while the reduction of individual income taxes does so only to a minor extent I consider misleading. I believe that one of several reasons for this is not sufficiently appreciated. For a good many years now the market has valued corporate stock at very much less than the value of the equity estimated on the basis of the replacement cost of the physical capital of the corporations. This has created a situation in which the equity financing of new investment is becoming increasingly unprofitable. Considering that debt-financing has its limits -- prudent debt-financing certainly does have its limits -- the low market valuation of equity stands in the way of achieving a larger volume of investment in plant and equipment. Not only our corporate taxes but also the high marginal rates incorporated into our individual income tax structure and our capital gains taxes have contributed significantly to creating an environment in which corporate equity is valued very much below the valuation that would express the replacement cost of the invested physical capital. The low market valuation has had substantial adverse consequences for investment and growth.

The CHAIRMAN. I think, if it is all right with the panel, we will have each member read or summarize his statement, and then we'll have questions.

Mr. Houthakker.

**STATEMENT OF DR. HENDRIK S. HOUTHAKKER, HENRY LEE
PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY**

Mr. HOUTHAKKER. Thank you, Mr. Chairman. I appreciate the honor of being invited to appear before the Finance Committee.

Perhaps I should say that there may have been some misunderstanding on my part as to the exact focus of this hearing and my remarks deal more with long-term than with short-term issues.

The President's program is the main subject, any particular expenditure reduction, and I want to say at the outset that I am in basic sympathy with the overall goals of the President's program, but not necessarily with all of its details.

There are four parts: tax reduction, expenditure reduction, deregulation, and support for a noninflationary monetary policy.

I would like to say that I have little or no quarrel with the last two parts of the program, monetary policy and deregulation.

In the area of taxation, my only serious doubts have to do with the proposed depreciation reform along the lines of the "10-5-8" plan. This plan, in my opinion, will introduce harmful distortions in the Tax Code without addressing the crucial problem which is adjusting the Tax Code to the continued existence of inflation.

The most heartening feature of the President's proposal perhaps is that the expenditure reductions are made at all.

During the campaign, one sometimes got the impression that tax reduction was nine-tenths of Mr. Reagan's program, and that the tax reduction generates so much revenue that it would be no great need for expenditure reductions.

I did not find this an acceptable position and I am glad to see that it has now been abandoned.

During the four preceding administrations, in one of which I served myself, Federal expenditures simply went out of control. Not only did the Federal Government initiate several new and expensive programs of its own, but it also foisted large amounts of money on the States and local governments who were often unable to find productive use for these funds.

Some of the transfer programs were inspired by laudable concern for the welfare of those who cannot help themselves, but even there some excesses soon crept in.

Other programs appear to have resulted from a mistaken view as to the role of the Federal Government in providing goods and services to the community.

Underlying all this was the belief that the Federal income tax, that miraculous money machine, would bring forth all the needed revenue, a belief that has not been confirmed by experience since, at the present, we are running very large deficits.

I can't claim any particular expertise in the area of transfer payments, and, therefore, I will pass over it briefly, except to note that there still is a poverty gap, which was about \$18 billion in 1977 despite all these programs which makes one wonder what exactly the programs accomplish.

Turning to other parts of the expenditure budget. Defense is another area where I can only speak with some diffidence. As a student of energy economics, I have become convinced of the urgent need for a stronger presence in the Middle East without weakening our position in other parts of the globe. This clearly calls for a stronger Navy and, in general, for greater flexibility in the deployment of our forces.

I have some more specific ideas on this subject and if there is interest, I will be glad to expand on it.

It is in the nondefense and not transfer payment areas of the budget that the greatest scope for drastic expenditure reductions can be found.

I shall just discuss three examples: revenue sharing, synfuels, and Amtrak.

When revenue sharing was first proposed, the State and local governments were not in a strong financial position, but when it was enacted, their position had improved markedly. The States in particular ran considerable surpluses at that time and have continued to do so.

Nevertheless, revenue sharing has grown by leaps and bounds to the present level of about \$80 billion per year.

The States and local governments have come——

The CHAIRMAN. I don't want to interrupt, \$80 billion, are you talking about something in addition to the Federal revenue sharing program? The budget calls for \$4.6 billion. It was \$6.9 billion, the State's share. That means the \$80 billion must have something in addition to that.

Mr. HOUTHAKKER [continuing]. Yes, sir. I am not talking only about so-called general revenue sharing. I am talking about the total grants made by the Federal Government to States and local governments——

The CHAIRMAN. Right.

Mr. HOUTHAKKER [continuing]. And those are presently in that order.

The CHAIRMAN. Yes.

Mr. HOUTHAKKER. Spread out over many different programs.

Now, the fallacy in revenue sharing, in my opinion, is that the money ultimately comes from the same citizens that also pay the state and local taxes and that, therefore, this revenue is not free to the governments involved.

I also believe that too much of the energy of Congress is going into the procurement of additional funds for the local areas and that many of the resulting expenditures would never be made if there were clear understanding as to who bears the ultimate cost.

I don't have to go far for an example because in my place of work, Cambridge, Mass., a massive subway extension has been underway for some years and will no doubt continue to disrupt the traffic for many more years. It is only about 3 miles, but it will probably cost about a \$1 billion; it is already \$600 million now and with that money could buy 10,000 buses.

Once it is built, operating subsidies will be needed to keep it going. Yet, this is a purely local project.

The State of Massachusetts, not to mention the city of Cambridge would never think of building a subway from its own revenues, or using its own borrowing.

Somehow, the people who take pride in this, never mention the fact that they got this money because they supported similar projects in other parts of the country. This represents log rolling on a scale that makes the rivers and harbors bill look insignificant.

The second program I would like to say something about is the synfuels program. It arose out of a justified concern about our energy situation.

Nevertheless, I believe, it is based on a misconception as to the role of the Federal Government in this area.

To have the Federal Government subsidize large plants on a cost plus basis to the tune of \$100 billion is to ask for waste and corruption. Moreover, it is totally unnecessary. We do need more domestic fuel production, but this can be done at a small fraction of the budgetary cost by confining the Federal contribution to essentials.

Those who build such plants need protection against unexpected changes in the price of crude oil. This can be done by option agreements under which the Federal Government undertakes to buy the output of these plants at prices fixed in advance.

These prices should approximate the prospective marginal social cost of imported oil at the time the output will be available.

Options of this kind could actually be sold to the highest bidder while the financing and management of the installation would remain in the private sector. A modest program of research, development and demonstration is a proper object for Federal involvement, but there is no need for Federal financing of projects that are within the capability of private enterprise.

In addition to this, a tariff on imported oil, or a higher tax on gasoline could be used to further stimulate domestic energy production and to reduce domestic consumption and, also, most importantly to shift some of financial burden to OPEC. This, I think, is the one aspect that has not been sufficiently recognized that if we put a tariff on part of it, perhaps most of it will be made by the cartel and not by our own citizens.

As a final example of what the Federal Government should not do, let me cite Amtrak. I was present at the creation of Amtrak and I well remember a session at the White House, the first appearance of Mr. Charles Colson, who had not yet achieved his subsequent notoriety in which he maintained that Amtrak was needed because most railroad passengers are Republicans.

Unfortunately for his case, the only railroad passenger he could mention by name was Senator Mansfield. [Laughter.]

It may be that the departure of Senator Mansfield to Japan has been the death blow to Amtrak. I am not sure how much traveling he actually did, but the fact is that Amtrak evolved into something more grandiose than could be justified by any economic standard.

It also has not contributed anything to the solution of the energy problem because there just has not been enough traffic to make any difference to our overall transportation patterns.

Only the Northeast corridor and one or two segments elsewhere in the country have any prospects of viability. There is no need for a national corporation to provide these essentially local needs.

The Northeast corridor should be turned over to an interstate compact with some assistance from the Federal Government, as responsible for the District of Columbia.

Any other routes with sufficient traffic—apparently there is one in California—should be similarly operated, not by a national corporation, but by a local organization.

If the States concerned are unwilling to provide these funds, one can only conclude that the service is not needed. Moreover, the fare should be high enough to cover at least operating costs.

The expenditure cuts proposed by the President should be the occasion for a fundamental reconsideration of the justification for Federal expenditures, including division of responsibility between the Federal Government, the States and the local governments.

There is no case, I think, for a redistribution between levels of government. That merely obscures the link between the services provided by government and the revenues required to support the services.

Our budgeting procedure should be reconsidered to make this link more explicit. Harvard University, to which I belong, has long had the principle of "every tub on its own bottom." This bit of Yankee wisdom needs to be applied more widely.

We are now getting away from the notion that Federal revenues can be counted upon to grow steadily without harm to the private economy. That the main concern to the administration and the Congress is to find ways of spending this revenue.

From now on, both existing and new Federal programs should be considered more carefully with respect to their ultimate costs and benefits.

Thank you.

[The prepared statement of Hendrik Houthakker follows:]

FEDERAL EXPENDITURE POLICY

Outline of remarks of Hendrik S. Houthakker, Henry Lee Professor of Economics, Harvard University before the Senate Finance Committee, Washington, D.C., March 19, 1981.

Mr. Chairman, I am grateful for the honor of being invited to appear before your committee as it considers the President's economic program. Let me say at the outset that I am in basic sympathy with its overall goals, though not necessarily with all of its details. The President's program has four parts: tax reduction, expenditure reduction, deregulation, and support for a noninflationary monetary policy. Before proceeding to the particular subject of this hearing, which is expenditure policy, may I say that I have little or no quarrel with the last two parts of the program. In the area of taxation my only serious doubts have to do with the proposed depreciation reform along the lines of the "10-5-3" plan. In my opinion this plan will introduce further harmful distortions in the tax code without addressing the crucial problem, which is adjusting the tax code to the existence of inflation. I shall be glad to respond to questions on these subjects, but will confine the rest of my remarks to expenditures.

Perhaps the most heartening feature of the President's proposals in the area of expenditures is that they are made at all. During the campaign, Mr. Reagan and his supporters gave the impression that tax reduction was nine-tenths of his economic policy, and that this would generate so much traditional revenue that there would be no great need for expenditure reductions. Among with most economists, I found myself unable to accept that position, which appeared to be

based largely on wishful thinking. It is reassuring that after assuming office the President has become convinced that expenditure reductions must accompany the needed tax reductions if the American economy is to undergo the revitalization we are all hoping for. During the four preceding administrations federal expenditures simply went out of control. Not only did the Federal Government initiate several new and expensive programs of its own, but it also foisted large amounts on the states and local governments who were often unable to find productive use for these funds. Some of the transfer programs were inspired by a laudable concern for the welfare of those who cannot help themselves, although even there excesses soon crept in. Other programs appear to have resulted mostly from a mistaken view as to the role of the Federal Government in providing goods and services to the community. Underlying all this profligacy was the belief that the Federal Income Tax, that miraculous money machine, would bring forth the needed revenue, a belief that has not been confirmed by experience.

I can claim no particular expertise in the area of transfer payments, which have become such a large part of total expenditures since the 1960's. It is clear that transfer payments have gone far beyond the point where they would eliminate the so-called poverty gap, which in 1977 was estimated at less than \$18 billion before allowing for payments in kind. It would seem, therefore, that the transfer payments include a considerable amount of duplication, and that many recipients must be receiving more than is needed to raise them out of poverty. There is nothing sacred about the particular definitions used in calculating the poverty gap, but at the same time

providing people with substantial transfer incomes must reduce the willingness of some of them to work, to the detriment of the economy as a whole. There can be little doubt about the need for more careful management in this area. The President's proposals appear to be well-designed to introduce needed restraint in transfer payments without inflicting hardship on those who can least afford it.

Turning to other parts of the expenditure budget, defense is another area on which I can only speak with great diffidence. As a student of energy economics, I have become convinced of the need for a stronger presence in the Middle East without weakening our position in other parts of the globe. This clearly calls for a stronger Navy and in general for greater flexibility in the deployment of our forces. The choice of a highly regarded former budget director to head the Defense Department gives confidence that military expenditures will not be allowed to rise above what is strictly necessary.

It is in the remaining areas of the Budget that the greatest scope for more drastic expenditure reductions can be found. Out of many examples I shall choose three for more detailed discussion: revenue sharing, synfuels and Amtrak.

When revenue sharing was first proposed in the early 1960's, the states and local governments were not in a strong financial position. By the time that revenue sharing was actually enacted in the early 1970's, this was no longer true; the states in particular ran considerable surpluses. Nevertheless, revenue sharing has grown by leaps and bounds to the present level of about \$80 billion per year. The states and local governments have come to look on revenue sharing as a free gift, yet the revenue is derived from their own citizens. Altogether

too much of the energy of senators and congressmen has gone into the procurement of additional funds for their local areas, and many of the resulting expenditures would never be made if there were clear understanding as to who bears the ultimate cost. In the City of Cambridge, Massachusetts, where I work, a massive subway extension is presently in progress. It covers only about three miles, yet it will probably cost about a billion dollars by the time it is finished, enough to buy at least ten thousand buses. Once it is built, large operating subsidies will no doubt be required to keep it in business. Yet the benefits of this extension are purely local. The State of Massachusetts, let alone the City of Cambridge, would not even think of building this subway from its own revenues, or by issuing its own debt. The local politicians who point with pride to this largesse from Washington somehow never get around to mentioning that it was conditional on their support for similar, and equally unneeded, projects in other parts of the country. All this represents log-rolling on a scale that makes the River and Harbors Bill look insignificant. Rationality in expenditure policy requires a more explicit consideration of the burdens that projects such as these represent.

The synfuels program arose out of a justified concern about our energy situation. Nevertheless it appears to be based on a misconception as to the role of the Federal Government in this area. To have the Federal Government subsidize large plants on a cost-plus basis to the tune of \$100 billion is to ask for waste and corruption. Moreover it is totally unnecessary. We do need more domestic fuel production, but this can be done at a small fraction of the budgetary cost by confining the federal contribution to essentials. Those who build such plants need protection against unexpected price changes,

which can be done by option agreements under which the Federal Government undertakes to buy the output at prices fixed in advance. The price offered should approximate the prospective marginal social cost of imported oil at the time the output will be available. Options of this kind could be sold to the highest bidder, while the financing and management of the installations would remain in the private sector. A modest program of research, development and demonstration is a proper object for federal involvement, as is the continued operation of a strategic petroleum reserve, but there is no need for federal financing of projects that are within the capability of private enterprise. In view of the lack of competition in the world oil market the tariff on imported oil, possibly supplemented by a higher tax on gasoline, could be used to further stimulate domestic energy production, and to shift some of the financial burden to OPEC.

As a final example of what the Federal Government should not do, let me cite Amtrak. The original purpose of Amtrak was to enable the railroads to disengage themselves from the passenger business in which they were forcibly retained by regulation. This purpose was accomplished, though in the process Amtrak evolved into something more grandiose than could be justified by any economic standard. The emergence of the energy problem caused some people to think that Amtrak might reduce our dependence on automobiles and airlines. By now it is quite clear that the possible contribution of Amtrak to the energy problem is minimal, if not negative. The legislative requirement of a national railroad network is simply unrealistic. Only the Northeast Corridor and one or two segments elsewhere in the country have any prospects of viability. There is no need for a national corporation to provide these essentially local needs. The Northeast Corridor should be turned

over to an interstate compact with some assistance from the Federal Government, because of its responsibility for the District of Columbia. Any other routes with sufficient traffic should be similarly operated. If the states concerned are unwilling to provide funds, one can only conclude that the service is not needed. As in the case of local transit, the fares should be high enough to cover at least operating costs.

The expenditure cuts proposed by the President should be the occasion for a fundamental reconsideration of the justification for federal expenditures, including the division of responsibility between the Federal Government, the states and the local governments. There is a case for transfer payments to help those in need, but there is no case for a redistribution that merely obscures the link between the services provided by Government and the revenues required to support these services. Our budgeting procedures should be reconsidered to make this link more explicit. The university, at which I teach has long held to the principle of "every tub on its own bottom"; this piece of Yankee wisdom could with advantage be enshrined in the halls of Congress and in the Office of Management and Budget. We are at last getting away from the notion that federal revenues can be counted on to grow steadily without harm to the private economy, and that the main concern to the Administration and the Congress is to find ways of spending this revenue. From now on both existing and new federal programs should be considered more carefully with respect to their ultimate costs and benefits.

**STATEMENT OF H. ERICH HEINEMANN, VICE PRESIDENT,
MORGAN STANLEY & CO., INC.**

Mr. HEINEMANN. Senator Dole, thank you very much for the opportunity to be here. I would like to start off by noting that my submission for the record has two parts. A personal statement and also the policy statement issued on Monday of this week by the Shadow Open Market Committee, of which I am a member.

I would like to make some brief informal comments about the scene as I see it today from the viewpoint of one who lives and works in the financial marketplace.

It certainly does seem in the financial markets that we are now beginning to deal with some of the root causes of the basic malaise in the U.S. economy and, of course, particularly so since last November.

To identify a basic symptom of this underlying malaise, I suppose I would start by observing that, as I calculate the figures, real GNP per employed worker in the U.S. economy grew over the decades of the fifties and the sixties at an annual rate of somewhere between $2\frac{1}{4}$ and $2\frac{1}{2}$ percent.

In the seventies, the annual rate of increase has been less than 1 percent. I think that we are now seeing the consequences of long-term distortions in our national economic policies. They have very much come to roost. It certainly appears to an outsider that the political process is now responding.

Obviously, some portion of the basic slowdown in real growth and the parallel increase in inflation from near zero as a basic imbedded rate at the end of the Eisenhower administration to, say, 8 to 10 percent today can be traced to the real shock of higher energy prices.

However, I think it is a fundamental error to assign to a single factor trends as deeply imbedded as this. In any event, I think it must be recognized that these fundamental trends were well underway long before 1974, long before the first basic shock to the U.S. economy of higher energy prices.

We have seen a fundamental acceleration in the monetary growth trend despite all of the professions of anti-inflationary zeal by the Federal Reserve over many, many years. At the same time, we have seen real transfer payments rise on a sustained basis at a rate roughly three times that of real GNP.

I think that the fundamental slowdown in real growth that we've seen is a natural result of those policies—which have been principally aimed over the last 20 years at redistribution of income rather than growth.

In this context, as I view it, two major strategic themes emerge from the administration's program. One, monetary stabilization, a fundamental reduction in monetary growth. The desired pattern is a much more stable growth in the money supply. And secondly, a basic reduction in the real size of government as a proportion of the total economy.

Personally speaking, while I continue to be very concerned about the achievement of a statistically balanced budget at the earliest possible opportunity, this is not critical to the program so long as the resulting deficit is not financed by the Federal Reserve, and we

see steady progress in the budget toward a reduction as a percentage of the overall GNP.

It seems to me, and it seems to my friends and colleagues on the Shadow Open Market Committee that the strategies of the Reagan administration, if pursued persistently over the next 2 years, will lead to lower inflation, lower interest rates, higher productivity and real growth, and, in time, a sustained acceleration in the growth of real wealth in the economy, which I think is clearly the ultimate goal that this administration is pursuing.

So far as the subject of today's hearing is concerned, I believe it has long been a cliché that Federal spending is out of control, out of control in the sense that most of the budget is not now subject to the normal appropriation process and out of control in the sense that certainly the prior administration was not able, in a sustained manner, to forecast the level of spending even for short periods into the future.

I think, however, that the general observation that the budget is out of control is not particularly helpful in identifying the sources of upward pressure on Federal spending.

You see the underlying pattern clearly only when you look at the budget in real terms, broken down into its two primary components in the national income accounts: Purchases of goods and services and transfer payments.

I think it is very interesting that for calendar year 1980 Federal purchases of goods and services came to about \$108 billion in real 1972 dollars, which is roughly 6 percent below the level of Federal spending for goods and services in real terms in the first year of the Eisenhower administration.

Now, that is, to some extent, an exaggerated comparison because the Korean war had led to a major increase in military spending in the first year of the Eisenhower administration. Nonetheless, it is a fair observation that the basic trend of real Federal purchases of goods and services has essentially been flat over the last 30 years.

There have been declines subsequent to periods of military hostility, and then subsequent increases. But the long-term trend has been flat.

I think that it is fair to say that over the last generation or so there has been little or no change in the Federal Government's demand on the real resources of the economy. The near doubling in real Federal expenditures since the early 1950's clearly, at least as I analyze the data, is traceable to the rapid rise in the level of real transfer payments.

In this framework, the Federal Government's contribution to inflation comes not from bidding scarce resources away from the private sector, but rather by shifting resources from surplus to deficit units—from savers to consumers—and by driving the monetary authorities toward excessive monetary expansion through large budget deficits.

There is no ironclad rule why this has to be the case, but this, in fact, has been the practical reality over a long period of time.

It seems to me, difficult as the task may be politically, there is no alternative if the budget is to be controlled other than to begin to reduce, in a material way, the rate of growth in real Federal transfer payments.

In this regard, I might say that I regret the administration's decision apparently to exempt totally several major social programs from budget review and constraint.

I would simply point to the fact that the Carter administration which, I think, was very conservative in this estimate, has projected that the present social security program, as the law now stands on the books, would require by the year 2030 an increase in taxation ranging somewhere between 15 and 17 percentage points of GNP. This would be required in order to cover the benefits which are now scheduled, given the demographic changes that are likely to occur over the next 50 years or so. I think at the same time, real Federal tax burdens must be reduced so as to cut the real size of Government as a percentage of the overall real economy. It is only in this way, so far as I am concerned, that you will see real after-tax rates of return on private sector investment rise sufficiently to stimulate the investment, the commitment required in new capital to raise productivity and restore historic rates of real growth.

The CHAIRMAN. Mr. Heinemann, I wonder if you might just sort of summarize and we can get into questions.

Mr. HEINEMANN. Politically, the issue is not the size or, indeed, the validity of the needs that are to be met by Government transfers, in my opinion, but rather the decision about the proportion of total income that is to be allocated by the private market as opposed to Government bureaucrats.

Thank you very much.

[The prepared statement of Mr. Heinemann follows.]

Statement of

H. Erich Heinemann, Vice President
Morgan Stanley & Co. Incorporated

I want to thank you for the opportunity to present my views on the state of the economy, its capital markets, and the course of public policy to this distinguished committee. We meet at a propitious time for stocktaking -- early in the new year and early in a new Administration. More importantly, however, we also meet at a time of crisis. It may be that the peak of the inflation fever has passed for now and that we can look forward to a progressive decline in the rate of increase of prices and a return of interest rates to levels more in keeping with traditional standards in the United States. But let there be no mistake: Both the financial system and the economy that it nourishes have been seriously abused in recent years and are far from healthy today. Fundamental changes in fiscal, monetary, and regulatory policies are required if the American people are to enjoy an optimal reward for their efforts.

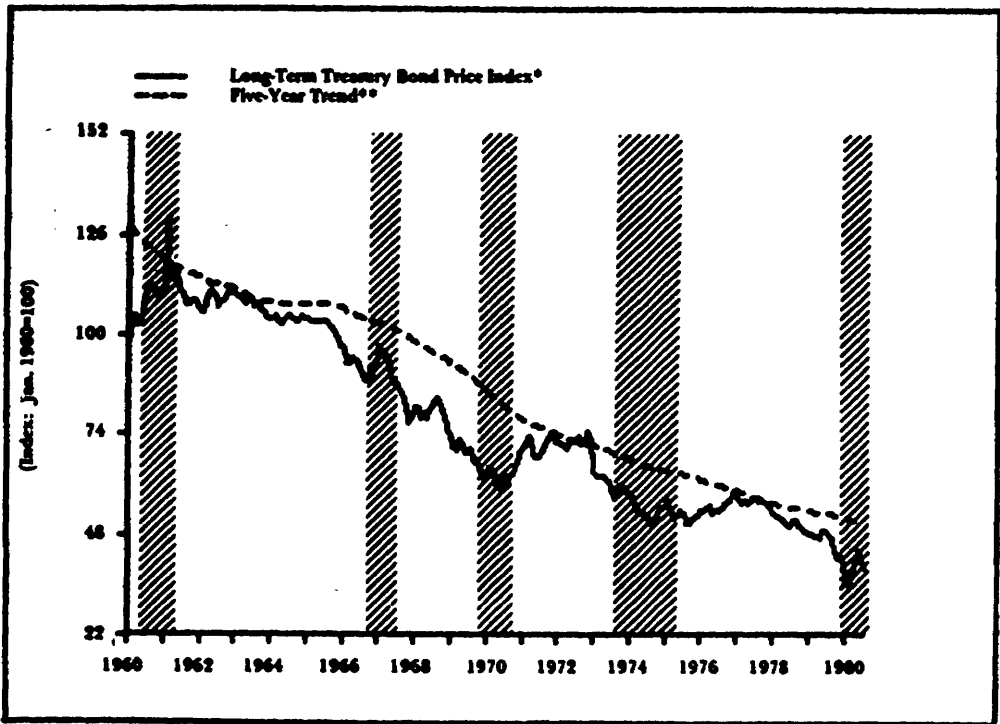
My plan this morning will be to review briefly some critical trends in the real and the financial sectors and their relationship to basic governmental policies. Sustained long-run acceleration in the rate of inflation and the parallel increase in transfer payments have tended:

- To reward present rather than future consumption;
- To favor the nonproducer at the expense of the producer;
- To emphasize the redistribution and not the expansion of income and wealth.

One result of these policies has been to produce the 20-year downtrend in bond prices that is shown clearly in Figure 1. In consequence, capital markets have become agitated and volatile, market makers have

Figure 1

The Long, Steady Decline in Bond Prices



*Assumes constant maturity and constant coupon

**60-Month Trailing Moving Average.

Shaded areas, except for the mini-recession of 1966-1967, represent periods of recession as designated by the National Bureau of Economic Research.

Sources: Chase Econometric Associates Data Base; Morgan Stanley Research

become increasingly reluctant to assume risk to facilitate transactions, so that governments, corporations, and individuals have found it more and more difficult to obtain long-term funds at a fixed cost -- no matter what the interest rate. The bond market is not dead in early 1981, but continued assaults from misdirected government policies could easily wound it mortally.

To deal with this dilemma, we must markedly reduce the burden of counter-productive regulation. The specifics of such an effort are beyond the scope of this brief analysis, but in my view they have been well documented by numerous researchers. In fiscal policy, the real size of Government -- both revenues and expenditures -- must be reduced as a proportion of the real economy. Only in this fashion will real after-tax rates of return on investment in the private sector increase sufficiently to induce the commitment of resources required to restore growth in productivity and real income to "normal" levels. At the same time, the Federal Reserve must stabilize and then gradually reduce the rate of monetary expansion. In my view the technical problems associated with a serious program of monetary stabilization are moderate and soluble. What has been lacking until now is sufficient political commitment on the part of elected officials -- both the executive and the legislative branches -- to achieve this goal.

My approach today will be, first, an overview of the economy and the markets and their relationship to government; second, a closer look at the disorderly state of the financial marketplace; and, third, an outline of a suggested program of governmental reforms.

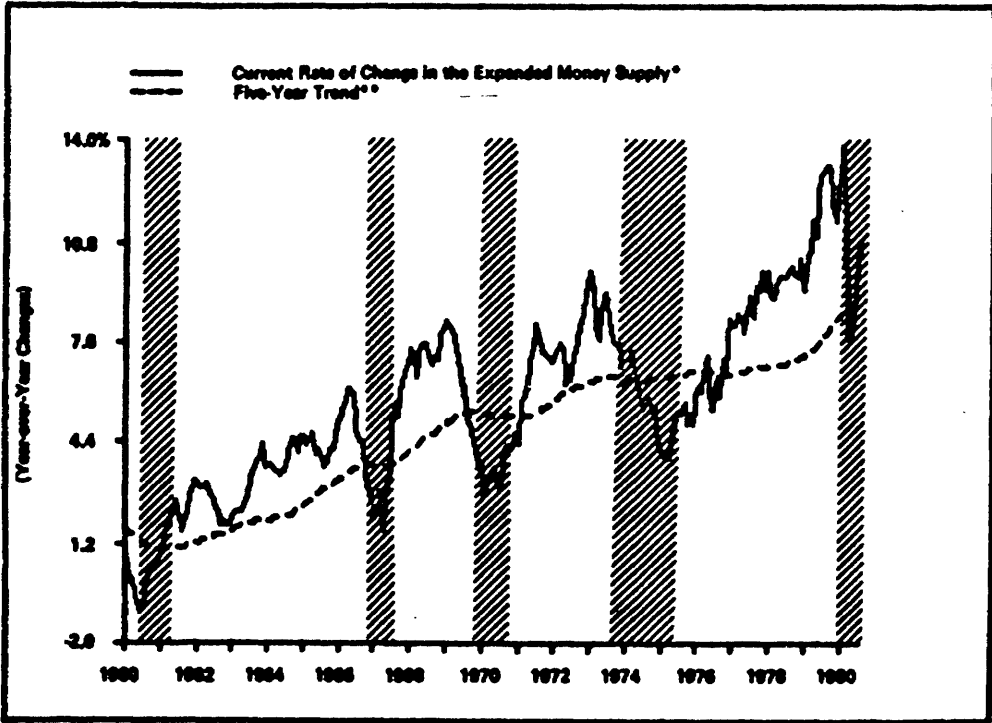
THE FORMULA FOR STAGFLATION

Over the last ten years, the American economy has been characterized in my opinion by a singular failure. In the aggregate, Americans have been working harder than ever. The proportion of the adult population actually at work reached a new postwar cyclical peak during the most recent business expansion. Yet, at the same time, the rate of growth in real GNP per employed worker during the 1970s was less than half the norm over the prior 20 years. In part, of course, this change is a function of the massive transfer of real resources that has accompanied the increase in energy prices. However, this is only part of the story -- unstable and mistaken domestic policies have contributed substantially to the structural imbalances that underlie our current stagflation. Wide swings in the rate of monetary expansion around a steeply rising trendline have produced, predictably, a parallel response in the price level (see Figures 2 and 3). The resulting inflation has, obviously, represented a direct tax on the accumulation of wealth, so that it is not surprising that levels of real net savings and investment have fallen significantly both absolutely and relative to those of other industrial nations.

Coincident with, and in response to, the stagnation in the rate of increase in wealth, other basic distortions have surfaced in American society. For example:

- The national political debate has become increasingly sharp and socially divisive, as major groups have been forced to compete for shares of a total that is now expanding much less rapidly than had been typical previously.

Figure 2
Cycle and Trend in Monetary Policy



*The expanded money supply includes (1) M-1 until December 1969, and M-1B thereafter, plus (2) overnight repurchase agreements, (3) overnight Eurodollar borrowings, and (4) 50% of Money Market Fund shares outstanding.

**60-Month Trailing Moving Average.

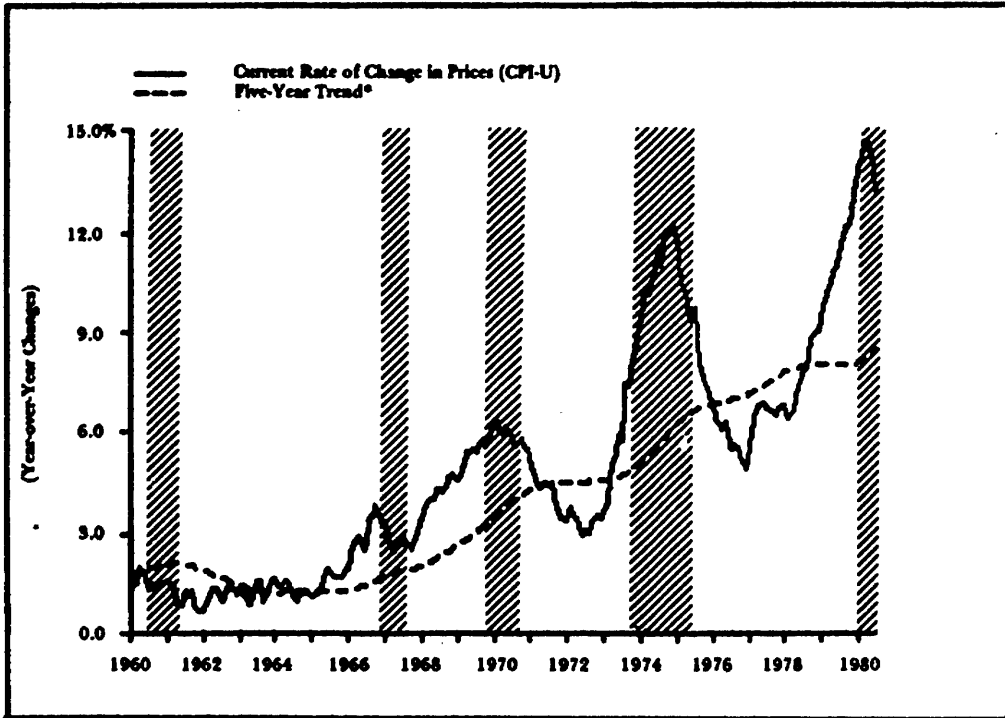
Shaded areas, except for the mini-recession of 1969-1970, represent periods of recession as designated by the National Bureau of Economic Research.

Source: Chase Economic Associates Data Base; Morgan Stanley Research

- The demand for transfer payments (which shift resources from productive to nonproductive sectors of the economy) has increased markedly. Successive Administrations -- both Democratic and Republican -- have accommodated this pressure with a proliferation of income-maintenance programs. Since the advent of the Great Society in the mid-Sixties, real transfer payments have risen at a compound annual rate of 8%, almost double the 4.6% growth rate over the prior 15 years. Because most of these programs operate outside the normal congressional appropriation process, some three-quarters of the Federal budget is now purportedly "uncontrollable." Since the early 1950s, all of the real growth in the Federal budget has been in transfer payments.
- Over time, falling growth and rising inflation have created their own constituencies, as large sectors of the economy have adopted hedging strategies to protect themselves. The explosion in household sector debt in the last five years or so is the best example of this development. Individuals in large numbers have in effect sold money short in order to go long real property, thereby benefiting from the systematic transfer of real resources from creditors to debtors that accompanies the inflation process.

However, in my opinion, the underlying thrust of American economic policy over the last 10 to 15 years -- which has stressed redistribution of income and wealth rather than growth -- runs counter to the basic self-interest of the electorate in the United States. The increasingly con-

Figure 3
Cycle and Trend in Inflation



*60-Month Trailing Moving Average.

Shaded areas, except for the mini-recession of 1966-1967, represent periods of recession as designated by the National Bureau of Economic Research.

Sources: Chase Econometric Associates Data Base; Morgan Stanley Research

servative tone in national politics, clearly evident in the recent elections, would suggest that voters are now beginning to recognize this fact. I say this for two reasons:

- First, taxpayers today outnumber the beneficiaries of transfer payment programs (Social Security in particular) by a substantial margin. This will not be true 50 years from now, but it is still true today.
- Second, despite the huge increase in household sector debt over the last five to ten years, the fact remains that individuals in the United States represent overall a net creditor interest, not a debtor interest. According to estimates compiled by the Federal Reserve Board, at the end of last year the financial assets of individuals (exclusive of the value of residential real estate) totaled about \$4.2-trillion, as compared with total debts of almost \$1.9-trillion, which thus implies a financial net worth of about \$2.3-trillion.

Interestingly, more than three-quarters of the financial assets held by individuals were estimated to be fixed-income in character -- and therefore vulnerable to the tax on wealth that inflation represents. While granting that this ownership of wealth is not evenly distributed through the population, the working middle class (the broad center of the electorate) appears in my analysis to be a net lender rather than a net borrower. In particular, the data show that both voter participation and net worth are positively correlated with age. If this line of speculation comes reasonably close to the mark, then there is an

odd perversity in governmental policies that have systematically rewarded the debtor over the creditor during the past 15 to 20 years. Plainly, the recipient of Government transfer payments (whose real benefits have been rising rapidly in recent years) has enjoyed a higher rung on the political ladder than the workingman who has tried to safeguard his savings in Treasury bonds (whose real principal values have been steadily eroded). But quite apart from arguments concerning the balance of basic political power, the consequences of regularly penalizing thrift and the accumulation of wealth are now apparent enough -- low investment, low productivity, low growth, and high inflation.

WHAT IS GOOD FOR AMERICA

In the power struggle over economic policy that is evolving in the country today, it seems to me that there are three principal constituencies. The first is comprised of those who benefit from, or depend on, Government expenditures -- some people on Federal purchases of goods and services, but many more on Federal transfer payments. The second group, mainly the middle class, pays taxes. Clearly, these two populous groups are directly and immediately impacted by Government's decisions concerning taxes and expenditures, and their conflicting desires are quickly translated into votes. The third constituency is less obvious, but equally as important. These are the holders of wealth those who voluntarily decide from day to day to finance the discrepancy between what the first group wants and the second is willing to pay. This is not a well-defined voting bloc. Indeed, most fixed-income securities are owned indirectly -- through mutual financial institutions,

pension funds, insurance companies, banks, and the like. Inflation, which is one important result of the uncontrolled growth of Federal transfer payments, is a direct tax on holders of fixed-income assets, but only an indirect tax on those who depend on such assets for future income. Inflation produces a stream of individually small but cumulatively large negative effects far into the future -- quite unlike the immediate real and psychological impact of expenditures and taxes. In short, wealth holders do not vote at the polls -- instead, they vote every day in the bond market.

In fact, it is the capital markets that have provided the most sensitive index of the general malaise in the economy. The bond market, which of course is the primary source of long-term funds in the economy, has become notoriously thin and unstable. There have been several episodes over the past 12 to 18 months when long-term money has been largely unavailable even to high-grade borrowers -- no matter what the interest rate. Bond prices, traditionally thought to be relatively slow-moving, have been exceptionally volatile of late.

Conditions of this sort reflect in my judgment a general loss of confidence on the part of investors in the willingness -- indeed, the ability -- of public policy to deal with the problem of accelerating inflation. Each surge of interest rates in recent years has been to a higher level than the one previous -- each decline in bond prices has

been to a new low. For market participants as well as for the economy in general, time is running out -- each round of negative developments brings not only new peaks in rates and new lows in prices, but also basic structural changes in the market itself. This does not mean that funds have ceased to flow into the bond market -- as the Statistical Appendix to this testimony shows, a record volume of long-term funds was raised through public sales in the American bond market last year. Total underwritten nonconvertible debt came to \$37.2-billion in 1980, compared with the previous record of \$35.1-billion in 1975. But this overall performance conceals sharp swings in activity from month to month -- a record high of \$7.4-billion in June and a low of only \$973-million in November, the lowest monthly total since 1973. Furthermore, there is clear evidence of structural change. Some 42% of total bonds sold last year were for maturities of ten years or less. In 1979, the comparable figure was 29%.

This shortening of maturity preferences -- on the part of both borrowers and lenders -- is a cyclical phenomenon typical of periods associated with a temporary peak in financing costs. However, in my observation something more fundamental is at work here as well. As one of the nation's leading investment bankers, Morgan Stanley quite naturally maintains very close relationships with the major suppliers of long-term capital, and in particular the major life insurance companies. It is disturbing to report that on the basis of these contacts we now find that few, if any, of the nation's largest life insurers are willing today even to consider providing funds for commercial mortgages on a fixed-rate basis -- again, no matter what the interest rate.

Home buyers, too, have discovered that when funds can be found, lenders are most likely to demand one of the many financial innovations that have developed in recent years to gear the yield on the mortgage to the current market and the current inflation rate.

From the viewpoint of social policy, I find it a sad commentary that the primary buyers of long-term fixed-rate bonds continue to be insurance companies and pension funds, whose liabilities constitute the life savings of a large cross-section of the American public. These claims, of course, are characteristically expressed in fixed-rate terms and thus are most vulnerable to the tax on wealth that inflation represents. In a social sense, we seem to be according the lowest priority to protecting the capital values of our most productive citizens. So far as the bond market is concerned, it will exist in its present form -- namely, dominated by long-term, fixed-rate issues -- only so long as private pension and insurance benefits are not directly linked to inflation. If, as, and when private retirement benefits are indexed to inflation, as Social Security and federal pensions are already, then the bond market as we know it today would, indeed, be dead.

As the major suppliers of capital -- the holders of wealth -- vote in the bond market every day, they are making it plain that they have great uncertainty concerning the ability of public policy to deal with the problem of inflation that underlies the increasingly disorderly pattern in the capital markets. They are saying they will no longer subsidize borrowers -- whether the United States Treasury or the average home buyer -- at less than the ongoing rate of inflation. To be blunt,

we are reaching the point where continuing failure to deal with inflation could permanently damage one of our great national assets -- the broadest and most effective capital market in the world. Life will not cease if we destroy the bond market, but there is ample evidence that the cost in real economic terms will surely be great. What is good for America? Among many things, plainly, a smoothly functioning mechanism for the transfer of savings to investment for growth and the production of wealth.

A PROGRAM FOR POLICY

There are obviously many elements in an effective economic policy: a reduced regulatory burden, balanced and comprehensive fiscal restraint, and monetary stabilization. As I noted earlier, detailed discussion of regulatory reform is beyond the scope of this testimony, as would be any line-by-line analysis concerning the budget. However, I would like to make two general points regarding fiscal and monetary policy and then go on to some specific comments about my special area of interest -- the Federal Reserve:

- It has long been a cliché that Federal spending is out of control -- out of control in the sense that most of the budget is now not subject to the normal appropriations process and out of control in the sense that the Carter Administration was not able to forecast accurately the level of spending even for short periods into the future. However, this general observation is not particularly helpful in identifying the sources of upward pressure on Federal spending. In fact, the underlying

pattern is clear only when the budget is examined in real terms, broken down into its two main components -- purchases of goods and services and transfer payments. For the calendar year 1980, Federal purchases of goods and services came to about \$108-billion in real 1972 dollars, which is roughly 6% below the level of Federal spending for goods and services in the first year of the Eisenhower Administration. (The drop, of course, is largely owing to the drop in real military outlays.) This means that over a span of almost 30 years there has been no increase (in fact a decline) in the Federal government's demands on the human and material resource base of the economy. The near-doubling in real Federal expenditures since the early 1950s is traceable to the rapid rise in the level of real transfer payments. In this framework, the Federal government's contribution to inflation comes, not from bidding scarce resources away from the private sector, but rather by shifting resources from surplus to deficit units (from savers to consumers) and by driving the monetary authorities to excessive monetary expansion (through large budget deficits). Difficult as the task may be politically, if the budget is to be controlled, there is no alternative to actions that will begin to reduce the rate of growth in real Federal transfer payments. At the same time, real Federal tax burdens must be reduced so as to cut the real size of government as a percentage of the overall real economy, and increase real aftertax rates of return on private sector investment. Politically, the issue is not the size and/or

validity of the "needs" that are to be met by government transfers, but the proportion of total income that is to be allocated by private decision makers as opposed to government bureaucrats.

- Monetary policy, meanwhile, must remain at the core of the economic strategy that evolves under the Reagan Administration and Congress. The root of the inflation is to be found in the sustained, long-run acceleration of growth in the money stock -- which systematically has preceded the speed-up in the rate of change of the price level. Much of the argument concerning monetary policy is in the technical area -- how to measure the money supply, what targets the Federal Reserve should establish, and so forth. My own proposals for Federal Reserve actions are couched in these terms. But the longer I have the opportunity to observe and study the monetary policy process, the more convinced I am that the principal issues are political not technical. At bottom, monetary policy is an exercise in resource allocation -- most simply, between debtors and creditors, but also more broadly throughout the economy as a whole. The process is by its very nature political, the purported "independence" of the Federal Reserve from political influence to the contrary notwithstanding. As one of America's greatest central bankers, the late Allan Sproul, once observed, the Federal Reserve is independent within the government, not of the government. No popularly elected government could, or should, tolerate frustration on issues of economic strategy from technicians within the central bank.

The position of the Federal Reserve in Washington, it seems to me, is very similar to that of the Joint Chiefs of Staff in the Pentagon. The generals do not make wars, they fight them. And, by the same token, central bankers do not make monetary policy, they implement it. Given consistent and forceful political direction, the Federal Reserve will find a way to control the money supply.

Since taking office, the Reagan Administration has begun to define a new relationship with the Federal Reserve. While still clearly recognizing the independent role of the central bank within the government, the Administration has been unusually blunt and forthright in defining its views on monetary policy. Most important, the White House is calling for a steady reduction in the rate of growth of money and credit over the next five years to levels one-half of those in 1980. At the same time, Treasury Secretary Regan has indicated on several occasions that he believes that there are important technical modifications which the Federal Reserve could make which would improve control of the money supply, cut its volatility, and "produce monetary results more in line with policy objectives." Overall, I think the Administration's initiatives have defined a new type of relationship with the central bank, which, over time should sharply reduce the uncertainty about monetary policy implementation. By itself, this should help in the process of getting interest rates down to acceptable levels. As I noted earlier, monetary policy by its very nature is political, and, ultimately, the Administration will have to take the credit or the blame for the results of the Federal Reserve's actions.

Despite the Federal Reserve's stated emphasis since October 1979 on controlling bank reserves, their variability -- over both short- and intermediate-term periods -- has increased. At the same time, the Federal Reserve Board has delayed -- apparently bowing to political opposition from smaller banks -- a proposal to reinstate contemporaneous reserve accounting. Under present procedures, the required level of bank reserves is based on the average level of bank deposits two weeks earlier. (Contemporaneous accounting, as the name implies, would link deposits and reserves in the same periods as, in fact, was the case over most of the Federal Reserve's history.) Monetary economists have long identified this system of lagged reserve accounting as one of the principal technical barriers to the achievement of a more stable monetary policy focused on the growth of the reserve aggregates. But despite its "new" policy orientation, the central bank has remained wedded to a technically flawed approach.

At the same time, the Federal Reserve has kept its own discount rate well under the cost of funds in the open market -- which has provided banks the opportunity to acquire needed reserves at a subsidized cost, and which in turn has delayed adjustment in the banking system to restrictive monetary policies. Much more appropriate, in my opinion, would be a floating discount rate pegged slightly above the alternative cost of overnight money in the marketplace.

In my judgment, there are three actions the new Administration and the Federal Reserve must take if they are to achieve a stabilizing monetary

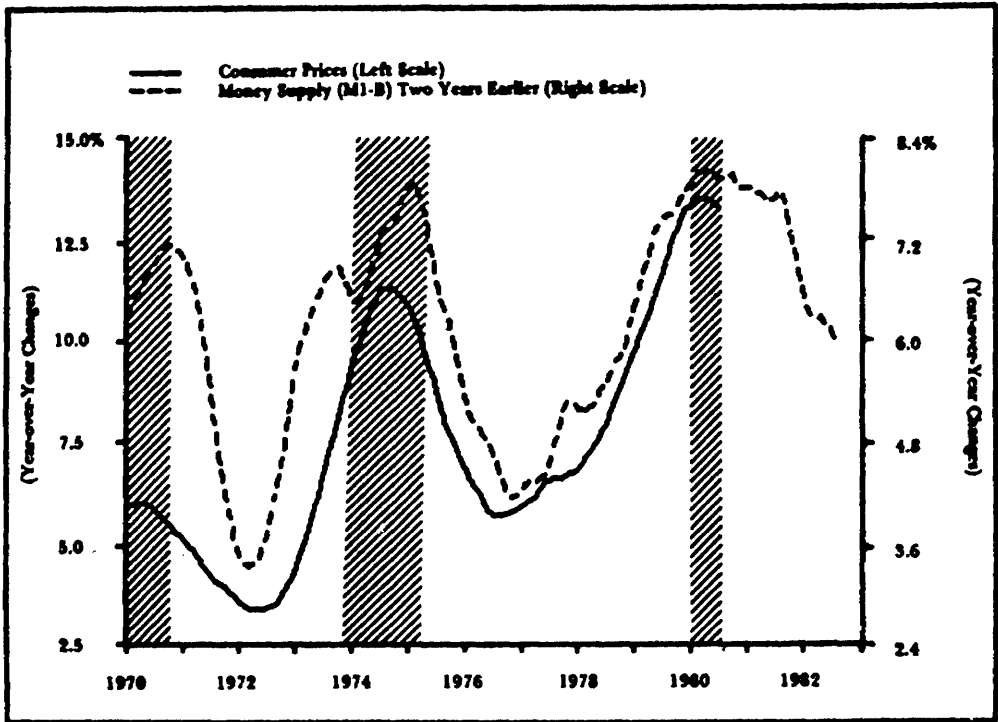
policy and, equally as important, to regain the confidence of market participants that they are capable of so doing:

- The Administration must make a clear, simple, and unequivocal political commitment to a sustained reduction in monetary expansion. The strategy of monetary policy will inevitably be governed by the priorities established by the White House, and these should be set forth in a clear and straightforward manner.
- Over and above such technical reforms as the ending of lagged reserve accounting and floating the discount rate, the Federal Reserve must commit itself to the management of the one monetary aggregate over which it in fact has direct control -- namely, the size of its own balance sheet. In practice, this means that growth targets should be established in terms of the monetary base. Multiple targets for various flavors of the money supply, bank credit, and liquid assets held by the public serve only to obscure whether or not the central bank is performing according to plan. Simple targets, simply stated, are essential.
- Growth targets for the monetary base, once established, should be disclosed promptly. Under present procedures, according to Mr. Volcker, the Federal Open Market Committee is seeking to manage bank reserves rather than short-term interest rates. Yet, the only targets that are disclosed are those for the Federal funds rate, as well as various forms of the money supply. According to one Federal Reserve official, the public would only be "confused" by the publication of the existing targets for the monetary base and bank reserves. As far as I can see, that is a judgment the public -- and not the Federal Reserve -- should make.

The task ahead is neither easy nor simple. But it can be done, and we must try. Thank you very much.

Figure 5

The Linkage Between Money and Inflation



Data are 12-month moving averages.

Shaded areas represent periods of recession as designated by the National Bureau of Economic Research.

Sources: Economist Data Base; Morgan Stanley Research

STATISTICAL APPENDIX - CAPITAL MARKET ACTIVITY

TABLE 1

BOND MARKET VOLUME 1971-1981*

PUBLICLY OFFERED IRREDEEMIBLE BOND
(\$ MILLIONS)

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
JANUARY	1960	3483	1130	2521	2600	2670	2064	1370	1090	2770	2700
FEBRUARY	2115	1046	662	2071	2790	2223	1271	1212	1042	1405	2122
MARCH	2134	1001	1643	2300	2604	3267	2652	2700	1731	1620	
TOTAL 1ST QUARTER	3999	6220	3394	6892	11123	8260	6007	5222	5464	6012	
APRIL	1797	1076	1968	2140	2046	2712	2262	2521	2070	2742	
MAY	1908	1563	910	2200	2024	2425	1400	2120	2057	4272	
JUNE	1814	1216	1562	1917	4750	2610	2000	1847	2576	2570	
TOTAL 2ND QUARTER	5319	4756	3970	6254	10660	8740	6440	6700	8011	14204	
JULY	1547	1790	1300	2063	2112	1601	2052	2007	2020	2045	
AUGUST	1450	1420	927	2010	1207	1746	1025	1471	2005	2000**	
SEPTEMBER	2154	1206	671	1025	1500	2244	2104	1574	2400	1705	
TOTAL 3RD QUARTER	5199	4476	2898	5100	3040	5607	6000	5112	6420	9000	
OCTOBER	1000	1040	1000	2645	2345	2027	2290	2262	2700	2270	
NOVEMBER	1202	1901	1020	2111	2292	2425	2470	1712	1620	270	
DECEMBER	1422	1200	2110	2701	2527	2607	1712	1004	1200	1027	
TOTAL 4TH QUARTER	3622	3201	3720	6277	6174	7067	6266	3160	3712	3904	
TOTAL	24022	20721	15024	27731	20125	20446	27104	22200	26420	27190	

*EXCLUDES FEDERAL, STATE, AND LOCAL ISSUES AS WELL AS TAX-EXEMPT POLLUTION CONTROL FINANCING; INCLUDES A LIMITED NUMBER OF UNDERWRITTEN OFFERS BY FEDERAL AGENCIES

**EXCLUDES ONLY OFFERINGS

SOURCE: HOBAS STALEY & CO., INCORPORATED

TABLE 2

PUBLIC BOND SALES BY TYPE OF ISSUER

(\$ MILLIONS)

	BANKS & FIN.	FOREIGN & PROV.	INDUS- TRIALS	TELE- PHONE	TRANS- PORT.	UTILITY	MISC.	TOTAL
	-----	-----	-----	-----	-----	-----	-----	-----
1979								
TOTAL 1ST QUARTER	1310	1185	754	1150	150	735	200	5484
PERCENT	23.89	21.61	13.75	20.97	2.74	13.40	3.65	100.00
TOTAL 2ND QUARTER	3245	800	2120	625	320	1795	6	8911
PERCENT	36.42	8.98	23.79	7.01	3.59	20.14	0.07	100.00
TOTAL 3RD QUARTER	1731	1125	2075	675	191	635	100	6532
PERCENT	26.50	17.22	31.77	10.33	2.92	9.72	1.53	100.00
TOTAL 4TH QUARTER	470	575	1360	1250	104	1945	0	5712
PERCENT	8.23	10.07	23.95	21.88	1.82	34.05	0.00	100.00
TOTAL 1979	6756	3685	6317	3700	765	5110	306	26639
PERCENT	25.36	13.63	23.71	13.89	2.87	19.18	1.15	100.00
1980								
JANUARY	700	450	219	450	134	825	0	2778
FEBRUARY	150	0	377	475	63	340	0	1405
MARCH	0	250	100	190	74	1115	100	1829
TOTAL 1ST QUARTER	850	700	696	1115	271	2280	100	6012
PERCENT	14.14	11.64	11.58	18.55	4.51	37.92	1.66	100.00
APRIL	650	0	1000	530	62	500	0	2742
MAY	1775	125	2507	1085	255	425	100	6272
JUNE	1950	500	3339	165	110	1160	130	7370
TOTAL 2ND QUARTER	4383	625	6946	1780	435	2085	230	16384
PERCENT	26.75	3.81	41.78	10.86	2.66	12.73	1.40	100.00
JULY	800	100	3296	430	64	140	215	5045
AUGUST	145	0	1116	575	173	880	0	2889
SEPTEMBER	75	200	400	300	275	415	100	1765
TOTAL 3RD QUARTER	1020	300	4812	1305	512	1435	315	9699
PERCENT	10.52	3.09	49.61	13.45	5.28	14.80	3.25	100.00
OCTOBER	85	550	67	350	102	920	200	2274
NOVEMBER	350	90	73	40	25	395	0	973
DECEMBER	410	400	274	500	50	223	0	1857
TOTAL 4TH QUARTER	845	1040	614	890	177	1538	200	5104
PERCENT	16.56	20.38	8.11	17.44	3.47	30.13	3.92	100.00
TOTAL 1980	7098	2665	12768	5090	1395	7338	845	37199
PERCENT	19.08	7.16	34.32	13.68	3.75	19.73	2.27	100.00
1981								
JANUARY	175	250	1059	40	280	805	100	2709
PERCENT	6.46	9.23	31.09	1.48	10.34	29.72	3.69	100.00
FEBRUARY	325	350	686	275	15	475	6	2132
PERCENT	15.24	16.42	32.18	12.90	0.79	22.28	0.28	100.00

SOURCE: MORGAN STANLEY & CO. INCORPORATED

TABLE 3

PUBLIC BOND SALES BY RATING OF ISSUER

 (\$ MILLIONS)

	-----HOODY'S RATING-----				UNRATED	TOTAL
	AAA	AA	A	BAA	OR LOWER	
1979						
TOTAL 1ST QUARTER	2921	1259	940	240	124	5484
PERCENT	53.26	22.96	17.14	4.38	2.26	100.00
TOTAL 2ND QUARTER	3160	1885	2519	580	767	8911
PERCENT	35.46	21.15	28.27	6.51	8.61	100.00
TOTAL 3RD QUARTER	2759	1815	1015	305	638	6532
PERCENT	42.24	27.79	15.54	4.67	9.77	100.00
TOTAL 4TH QUARTER	2260	1065	1505	505	377	5712
PERCENT	39.57	18.64	26.35	8.84	6.60	100.00
TOTAL 1979	11100	6024	5979	1630	1906	26639
PERCENT	41.67	22.61	22.44	6.12	7.15	100.00
1980						
JANUARY	983	982	609	130	74	2778
FEBRUARY	249	264	825	40	27	1405
MARCH	425	576	450	330	48	1829
TOTAL 1ST QUARTER	1657	1822	1884	500	149	6012
PERCENT	27.56	30.31	31.34	8.32	2.48	100.00
APRIL	875	912	705	225	25	2742
MAY	1870	1923	2197	150	132	6272
JUNE	1093	1845	2495	741	1196	7370
TOTAL 2ND QUARTER	3838	4680	5397	1116	1353	16384
PERCENT	23.43	28.56	32.94	6.81	8.26	100.00
JULY	854	1602	1714	115	760	5045
AUGUST	499	834	1170	175	211	2889
SEPTEMBER	250	825	350	240	100	1765
TOTAL 3RD QUARTER	1603	3261	3234	530	1071	9699
PERCENT	16.53	33.62	33.34	5.46	11.04	100.00
OCTOBER	651	474	735	285	129	2274
NOVEMBER	340	334	225	65	9	973
DECEMBER	800	430	299	120	208	1857
TOTAL 4TH QUARTER	1791	1238	1259	470	346	5104
PERCENT	35.09	24.26	24.67	9.21	6.78	100.00
TOTAL 1980	8889	11001	11774	2616	2919	37199
PERCENT	23.90	29.57	31.65	7.03	7.85	100.00
1981						
JANUARY	40	950	1400	260	59	2709
PERCENT	1.48	35.07	51.68	9.60	2.18	100.00
FEBRUARY	690	0	550	350	542	2132
PERCENT	32.36	0.00	25.80	16.42	25.42	100.00

TABLE 4

PUBLIC BOND SALES BY TYPE OF MATURITY

 (\$ MILLIONS)

	<u>FIVE TO TEN YEARS</u>	<u>OVER TEN YEARS</u>	<u>TOTAL</u>
1979			
TOTAL 1ST QUARTER	1180	4304	5484
PERCENT	21.52	78.48	100.00
TOTAL 2ND QUARTER	3343	5568	8911
PERCENT	37.52	62.48	100.00
TOTAL 3RD QUARTER	1947	4585	6532
PERCENT	29.81	70.19	100.00
TOTAL 4TH QUARTER	1177	4535	5712
PERCENT	20.61	79.39	100.00
TOTAL 1979	7647	18992	26639
PERCENT	28.71	71.29	100.00
1980			
JANUARY	850	1928	2778
FEBRUARY	440	965	1405
MARCH	833	996	1829
TOTAL 1ST QUARTER	2123	3889	6012
PERCENT	35.31	64.69	100.00
APRIL	1075	1667	2742
MAY	2470	3802	6272
JUNE	3390	3980	7370
TOTAL 2ND QUARTER	6935	9449	16384
PERCENT	42.33	57.67	100.00
JULY	2468	2577	5045
AUGUST	1010	1879	2889
SEPTEMBER	350	1415	1765
TOTAL 3RD QUARTER	3828	5871	9699
PERCENT	39.47	60.53	100.00
OCTOBER	925	1349	2274
NOVEMBER	609	364	973
DECEMBER	1058	799	1857
TOTAL 4TH QUARTER	2592	2512	5104
PERCENT	50.78	49.22	100.00
TOTAL 1980	15478	21721	37199
PERCENT	41.61	58.39	100.00
1981			
JANUARY	1050	1659	2709
PERCENT	38.76	61.24	100.00
FEBRUARY	1606	526	2132
PERCENT	75.33	24.67	100.00

SOURCE: MORGAN STANLEY & CO. INCORPORATED

TABLE 5

PUBLICLY OFFERED CONVERTIBLE DEBT

(\$ MILLIONS)

	INDUS- TRIALS	BANKS & INS.	TRANS- PORT.	MISC.	TOTAL
1979					
TOTAL 1ST QUARTER	0	0	0	0	0
TOTAL 2ND QUARTER	35	0	150	0	185
PERCENT	18.92	0.00	81.08	0.00	100.00
TOTAL 3RD QUARTER	178	146	30	165	519
PERCENT	34.30	28.13	5.78	31.79	100.00
TOTAL 4TH QUARTER	158	0	20	0	178
PERCENT	88.76	0.00	11.24	0.00	100.00
TOTAL 1979	371	146	200	165	882
PERCENT	42.06	16.55	22.68	18.71	100.00
1980					
JANUARY	8	0	0	0	8
FEBRUARY	25	30	0	0	55
MARCH	400	0	0	0	400
TOTAL 1ST QUARTER	433	30	0	0	463
PERCENT	93.52	6.48	0.00	0.00	100.00
APRIL	377	0	0	0	377
MAY	395	0	0	0	395
JUNE	205	0	0	0	205
TOTAL 2ND QUARTER	977	0	0	0	977
PERCENT	100.00	0.00	0.00	0.00	100.00
JULY	70	0	0	0	70
AUGUST	645	100	60	0	805
SEPTEMBER	400	0	40	40	480
TOTAL 3RD QUARTER	1115	100	100	40	1355
PERCENT	82.29	7.38	7.38	2.95	100.00
OCTOBER	549	155	0	3	707
NOVEMBER	264	80	0	50	394
DECEMBER	135	50	0	40	225
TOTAL 4TH QUARTER	948	285	0	93	1326
PERCENT	71.19	21.49	0.00	7.01	100.00
TOTAL 1980	3473	415	100	133	4121
PERCENT	84.28	10.07	2.43	3.23	100.00
1981					
JANUARY	244	0	0	50	294
PERCENT	82.99	0.00	0.00	17.01	100.00
FEBRUARY	565	28	0	0	593
PERCENT	95.28	4.72	0.00	0.00	100.00

SOURCE: MORGAN STANLEY & CO. INCORPORATED

TABLE 6

 UNDERWRITTEN PUBLIC COMMON STOCK SALES BY TYPE OF ISSUER AND ISSUE

(\$ MILLIONS)

	BANKS & FIN.	INDUS- TRIALS	TYPE- PHONE	UTILITY	TRANS- PORT.	SECONDARY OFFERS	MISC.	TOTAL
1979								
TOTAL 1ST QUARTER	4	170	0	916	33	98	4	1225
PERCENT	0.33	13.88	0.00	74.78	2.69	8.00	0.33	100.00
TOTAL 2ND QUARTER	8	241	0	517	35	61	5	867
PERCENT	0.92	27.80	0.00	59.63	4.04	7.04	0.58	100.00
TOTAL 3RD QUARTER	9	477	33	893	0	106	4	1522
PERCENT	0.59	31.34	2.17	58.67	0.00	6.94	0.26	100.00
TOTAL 4TH QUARTER	41	455	23	1089	0	73	0	1681
PERCENT	2.44	27.07	1.37	64.78	0.00	4.34	0.00	100.00
TOTAL 1979	62	1343	56	3415	68	338	13	5295
PERCENT	1.17	25.36	1.06	64.49	1.28	6.38	0.25	100.00
1980								
JANUARY	0	428	0	176	64	0	0	668
FEBRUARY	16	513	0	559	69	8	0	1165
MARCH	0	354	0	305	0	62	0	729
TOTAL 1ST QUARTER	16	1295	0	1040	133	70	0	2562
PERCENT	0.62	50.55	0.00	40.59	3.19	2.73	0.31	100.00
APRIL	0	219	3	209	0	298	0	729
MAY	58	188	0	418	1	182	0	847
JUNE	98	200	0	342	8	97	0	745
TOTAL 2ND QUARTER	156	607	3	969	9	577	0	2321
PERCENT	6.72	26.15	0.13	41.75	0.39	24.86	0.00	100.00
JULY	2	279	6	352	0	127	0	766
AUGUST	27	486	9	373	0	108	0	1003
SEPTEMBER	67	218	0	423	54	486	5	1253
TOTAL 3RD QUARTER	96	983	15	1148	54	721	5	3022
PERCENT	3.18	32.53	0.50	37.99	1.79	23.86	0.17	100.00
OCTOBER	8	954	0	344	0	265	13	1584
NOVEMBER	60	1126	0	273	25	62	19	1565
DECEMBER	28	1209	11	440	0	87	6	1781
TOTAL 4TH QUARTER	96	3289	11	1057	25	414	38	4930
PERCENT	1.95	66.71	0.22	21.44	0.51	8.40	0.77	100.00
TOTAL 1980	364	6174	29	4214	221	1782	51	12935
PERCENT	2.84	48.10	0.23	32.83	1.72	13.88	0.40	100.00
1981								
JANUARY	61	664	0	309	45	48	0	1127
PERCENT	5.41	58.92	0.00	27.42	3.99	4.26	0.00	100.00
FEBRUARY	0	408	1	140	66	93	0	708
PERCENT	0.00	57.63	0.14	19.77	9.32	13.14	0.00	100.00

SOURCE: MORGAN STANLEY & CO. INCORPORATED

TABLE 7

PUBLIC PREFERRED STOCK SALES BY TYPE (P ISSUER)*

(\$ MILLIONS)

	UTILITY	TRANS. & INDOS.	TELE- PHONE	BANKS & INS.	TOTAL
1979					
TOTAL 1ST QUARTER	347	0	0	0	347
PERCENT	100.00	0.00	0.00	0.00	100.00
TOTAL 2ND QUARTER	226	47	0	25	298
PERCENT	75.84	15.77	0.00	8.39	100.00
TOTAL 3RD QUARTER	380	305	0	6	691
PERCENT	54.99	44.14	0.00	0.87	100.00
TOTAL 4TH QUARTER	287	249	25	5	566
PERCENT	50.71	43.99	4.42	0.88	100.00
TOTAL 1979	1240	601	25	36	1902
PERCENT	65.19	31.60	1.31	1.89	100.00
1980					
JANUARY	233	0	0	0	233
FEBRUARY	75	0	0	0	75
MARCH	121	161	0	0	282
TOTAL 1ST QUARTER	429	161	0	0	590
PERCENT	72.71	27.29	0.00	0.00	100.00
APRIL	110	50	0	0	160
MAY	185	6	0	0	191
JUNE	110	4	0	225	339
TOTAL 2ND QUARTER	405	60	0	225	690
PERCENT	58.70	8.70	0.00	32.61	100.00
JULY	273	86	0	0	359
AUGUST	20	30	0	30	80
SEPTEMBER	175	150	0	25	350
TOTAL 3RD QUARTER	468	266	0	55	789
PERCENT	59.32	33.71	0.00	6.97	100.00
OCTOBER	200	265	49	20	534
NOVEMBER	82	170	0	0	252
DECEMBER	25	197	0	0	222
TOTAL 4TH QUARTER	307	632	49	20	1008
PERCENT	30.46	62.70	4.86	1.98	100.00
TOTAL 1980	1609	1119	49	300	3077
PERCENT	52.29	36.37	1.59	9.75	100.00
1981					
JANUARY	110	225	50	0	385
PERCENT	28.57	58.44	12.99	0.00	100.00
FEBRUARY	70	3	0	0	73
PERCENT	95.89	4.11	0.00	0.00	100.00

*INCLUDES CONVERTIBLE PREFERRED STOCK

SOURCE: MORGAN STANLEY & CO. INCORPORATED

TABLE 8
 PRIVATE PLACEMENTS BY TYPE OF ISSUER
 (\$ MILLIONS)

	BANKS	FOREIGN	INDUS- TRIALS	TELE- PHONE	TRANS- PORT.	UTILITY	MISC.	TOTAL
1979								
TOTAL 1ST QUARTER	361	279	3335	12	579	561	188	5315
PERCENT	6.79	5.25	62.75	0.23	10.89	10.56	3.54	100.00
TOTAL 2ND QUARTER	649	58	2328	104	749	1405	94	5387
PERCENT	12.05	1.08	43.22	1.93	13.90	26.08	1.74	100.00
TOTAL 3RD QUARTER	304	194	1573	120	538	903	51	3683
PERCENT	8.25	5.27	42.71	3.26	14.61	24.52	1.38	100.00
TOTAL 4TH QUARTER	803	166	2650	135	1140	1654	16	6564
PERCENT	12.23	2.53	40.37	2.06	17.37	25.20	0.24	100.00
TOTAL 1979	2117	697	9886	371	3006	4523	349	20949
PERCENT	10.11	3.33	47.19	1.77	14.35	21.59	1.67	100.00
1980								
JANUARY	161	104	364	0	7	81	0	717
FEBRUARY	75	139	847	6	105	403	5	1580
MARCH	215	23	800	55	173	91	6	1363
TOTAL 1ST QUARTER	451	266	2011	61	285	575	11	3660
PERCENT	12.32	7.27	56.95	1.67	7.79	15.71	0.30	100.00
APRIL	154	0	485	62	141	87	0	929
MAY	124	75	517	75	369	48	30	1238
JUNE	162	0	299	0	159	245	23	888
TOTAL 2ND QUARTER	440	75	1301	137	669	380	53	3055
PERCENT	14.40	2.45	42.59	4.48	21.90	12.44	1.73	100.00
JULY	144	0	379	28	250	275	78	1154
AUGUST	281	10	488	58	63	110	0	1010
SEPTEMBER	62	0	408	0	128	113	10	721
TOTAL 3RD QUARTER	487	10	1275	86	441	498	88	2885
PERCENT	16.88	0.35	44.19	2.98	15.29	17.26	3.05	100.00
OCTOBER	45	45	594	45	45	140	0	914
NOVEMBER	213	20	189	0	53	55	7	537
DECEMBER	112	0	597	41	67	81	0	898
TOTAL 4TH QUARTER	370	65	1380	86	165	276	7	2349
PERCENT	15.75	2.77	58.75	3.66	7.02	11.75	0.30	100.00
TOTAL 1980	1748	416	5967	370	1560	1729	159	11949
PERCENT	14.63	3.48	49.94	3.10	13.06	14.47	1.33	100.00
1981								
JANUARY (REVISED)	74	19	718	0	87	70	4	972
PERCENT	7.61	1.95	73.87	0.00	8.95	7.20	0.41	100.00
FEBRUARY	25	0	266	8	1	1	0	301
PERCENT	8.31	0.00	88.37	2.66	0.33	0.33	0.00	100.00

SOURCE: MORGAN STANLEY & CO. INCORPORATED

SHADOW OPEN MARKET COMMITTEE

The Committee met from 2:00 P.M. to 8:00 P.M. on Sunday, March 15, 1981.

Members:

Professor Karl Brunner, Director of the Center for Research in Government Policy and Business, Graduate School of Management, University of Rochester, Rochester, New York.

Professor Allan H. Meltzer, Graduate School of Industrial Administration, Carnegie-Mellon University, Pittsburgh, Pennsylvania

Dr. Robert J. Genetski, Vice President and Chief Economist, Harris Trust and Savings Bank, Chicago, Illinois

Mr. H. Erich Heinemann, Vice President, Morgan Stanley & Co., Incorporated, New York, New York

Dr. Homer Jones, Retired Senior Vice President and Director of Research, Federal Reserve Bank of St. Louis, St. Louis, Missouri

Dr. Jerry Jordan, Dean, Anderson Schools of Management, University of New Mexico, Albuquerque, New Mexico

Dr. Rudolph Penner, American Enterprise Institute, Washington, D.C.

Professor Robert Rasche, Department of Economics, Michigan State University, East Lansing, Michigan

Professor Wilson Schmidt, Department of Economics, Virginia Polytechnic Institute, Blacksburg, Virginia

Dr. Anna Schwartz, National Bureau of Economic Research, New York, New York

POLICY STATEMENT

Shadow Open Market Committee
March 16, 1981

We welcome the Reagan Administration's proposals for fiscal, monetary, and regulatory policies. If adopted, these will increase saving, investment, productivity, and real growth. They will also serve to reduce inflation, unemployment, tax rates, and the growth of the public sector. The administration's program, which is similar to policies we have advocated for many years, has two main themes: monetary stabilization and reduction in the size of government. We remain confident that these policies will bring the economy closer to its historic real growth path of 2 1/2% to 3 1/2% -- and bring the inflation rate down to 3% by 1985.

Success of the program depends very much on the Federal Reserve, and Congress should consider means to increase the System's accountability. The administration has indicated that it favors the policy of gradually reducing growth of the monetary base as advocated by this Committee in past statements. The Federal Reserve has affirmed its support for administration policies and has expressed its intention to persist in efforts to reduce monetary growth. However, it has chosen for its current target a measure of the money stock -- M-1B adjusted for definitional changes -- which cannot be monitored regularly.

We are skeptical about Federal Reserve statements, and others share our skepticism. Commitments to slower money growth have been made many times in the past but have not been kept. Research within and without the Federal Reserve System has demonstrated that comparatively few changes in operating procedures would substantially improve the quality of monetary control, but these changes have not been made. Indeed, the Federal Reserve has within its power the means of improving its operations so as to achieve the targets it sets. The failure to improve control procedures, in the face of continuing inability to achieve announced targets, increases our doubts about the Federal Reserve's commitment to the policies we, and they, agree are required to end inflation.

ACCOUNTABILITY

The central problem is not technical. It is political. The Federal Reserve is an independent agency within government and has wide discretion in the conduct of monetary policy. Repeated failures to achieve announced targets have not brought reform or encouraged responsibility.

Authority and responsibility are separated, and oversight by Congress thus far has not imposed standards of performance on the Federal Reserve. When shifts in monetary policy increase inflation, increase unemployment, or cause recessions, voters hold elected officials, not

Federal Reserve officials, responsible. More than a decade of destabilizing monetary policies has not spurred improvements.

We believe that the Congress should consider means of increasing the responsibility and accountability of the Federal Reserve. Among the options to achieve this purpose are vesting complete authority for monetary policy in the administration or having Federal Reserve governors serve at the pleasure of the President. On our part, we propose the following approach for discussion:

- (1) The Federal Reserve should choose a single target rate of growth for an observable monetary aggregate of its own selection, and should announce the target publicly.
- (2) If the Federal Reserve misses the annual average target rate of growth by more than one percentage point, each member of the Board of Governors would submit his resignation to the President.
- (3) Governors may accompany their letters of resignation with an explanation of the failure to achieve the target rate of growth. The President may choose to accept the explanations instead of the resignations, and thereby, himself, accept responsibility for the policy. If the President accepts the resignations, new Governors should be chosen to fill the unexpired terms, subject to confirmation by the Senate.

The aim of our proposal is not to force resignations, but to increase accountability of the officials responsible for monetary policy, and to reduce skepticism and uncertainty about future monetary policy. The Federal Reserve would remain independent, within government, but would become more accountable to the President, the Congress and the public. We urge Congress to debate this and other proposals to increase the accountability of the Federal Reserve.

MONETARY POLICY

In three of the past five years, the Federal Reserve has failed to achieve the targets it announced. The table shows the five-year record and makes clear that despite many commitments to sustained reductions of monetary growth, there is no evidence of any reduction.

The table, which is on page 3, greatly understates the uncertainty caused by recent monetary policy. Money growth often varies over a wide range during the year. For example, in 1979, the seasonally adjusted quarterly average growth of M-1 -- currency and checking deposits -- varied between 4.9% and 10.8%. Quarterly average growth at annual rates for M-1B in 1980 covered a wider range -- from -2.4% to 15.5%.

MONEY GROWTH 1975-1980*

<u>Period</u> <u>Fourth Quarter</u>	<u>Percent Change from Fourth</u> <u>Quarter of Previous Year</u>	
	<u>Target</u>	<u>Actual</u>
1976 (M-1)	4.5%-7.5%	5.8%
1977 (M-1)	4.5 -6.5	7.9
1978 (M-1)	4.0 -6.5	7.2
1979 (M-1)	3.0 -6.0	5.5
1980 (M-1B)	4.0 -6.5	7.1

*The table shows the most frequently cited target for currency and checking deposits, formerly denoted M-1 and now denoted M-1B.

If the Federal Reserve achieved its annual targets more frequently, quarterly deviations would be less important. Observers would have greater confidence that quarterly deviations from announced targets were temporary and would act on this belief. The failure to achieve annual targets shifts attention from the targets to the less reliable monthly or weekly reported growth rates. The Federal Reserve is critical of the attention given to weekly announcements of money growth. It does not, however, take the most important step to reduce the attention given to weekly reports; that is, increase the credibility of the pre-announced targets by achieving the targets.

We favor six changes in procedures to improve monetary control by reducing the variability of money and interest rates on credit and debt.

- (1) Revision of the rule under which required reserves depend on deposits held two weeks earlier. Required reserves should be determined in relation to current deposits as was the case prior to 1968.
- (2) Simplification of the complex system of reserve requirements based on type of deposit, location of deposit and size of deposit.
- (3) Prompt adjustment of the discount rate charged on loans to depository institutions to maintain equality with the market rate on short-term credit.
- (4) Introduction of staggered reserve settlements under which one-fifth of the financial institutions settle

each day instead of requiring all of them to settle on the same day.

- (5) Elimination of seasonal adjustment of monetary aggregates. Non-seasonally adjusted aggregates should be reported for the most recent period and for the corresponding period of the previous year. To satisfy demands for data on short-term changes, reports of monthly changes for the most recent period available and the corresponding changes for the same period of the previous year should be made available.
- (6) Publication of targets for reserves and the monetary base to enable the public to monitor the Federal Reserve's performance relative to its targets.

Neither technical changes nor increased accountability can reduce inflation. To reduce inflation, the Federal Reserve must reduce the growth of money. For 1981, we favor a 6% rate of increase in the monetary base, as computed by the Federal Reserve Bank of St. Louis. Current institutional changes have less effect on the growth of the base than on most other aggregates, so we continue to specify targets for the base.

A 6% rate of growth of the base would bring the level of the monetary base to \$172-billion in the fourth quarter of 1981. This rate of growth would be a step on the path to lower rates of monetary growth and lower inflation.

THE ADMINISTRATION'S FISCAL POLICY

Many popular accounts of the administration's fiscal policy suggest that the policy is a risky strategy based on some new, untested principles of economics. Such statements are incorrect. The principles on which the success of the program depends are old, established, tested, and reliable. The SOMC has repeatedly favored simultaneous cuts in tax rates and in government spending. An important distinction that all economists recognize is the distinction between marginal and average tax rates. Reductions in the growth of government spending permit the average tax rate to fall, or rise more slowly, and, thereby, consistent with a balanced budget, raise the anticipated average return from work and from investment. Reductions in marginal tax rates with an unchanged average tax rate shift tax burdens from one taxpayer to another and from current to future income. Such programs have smaller and less lasting effects on output and employment than the programs recommended by the administration, and favored by this Committee, to reduce permanently average and marginal tax rates at the same time.

The success of the administration's program will not be achieved quickly. Even in the most favorable environment, people do not instantly adjust prices and reallocate resources in response to new conditions. After fifteen years of promises to end inflation and ten years of promises to increase productivity, none of which were realized, many people will now wait-and-see whether the program survives.

Doubts about the budget and tax rates will not be resolved until Congress approves, or rejects, the proposed cuts in tax rates and the growth of spending. Doubts about the size of the deficit will not be removed even if Congress approves the entire program. The administration's forecasts of the growth of nominal income for 1982-86 appear to us inconsistent with its assumptions about monetary and fiscal policies and the historical record of performance of the American economy. The estimates of real growth are more optimistic and the estimates of the slowing of inflation more pessimistic than we believe the administration's policies will achieve.

We have serious reservations about the compatibility of the administration's forecast for 1981 and current Federal Reserve policy. Currently, the Federal Reserve continues on the slam-bang, stop and go course that is a main cause of stagflation. For the past three months the growth of the monetary base has been 2.5% at an annual rate -- far below the rate we recommend. Continuation of this low rate of growth would bring recession in 1981. A recession and steeply rising unemployment would delay the investment in the new plant and equipment required to increase productivity growth in future years.

IMPORT QUOTAS

The administration's fiscal and regulatory program is based on the belief that free markets allocate resources efficiently. Tariffs and quotas on imports from Japan, or other countries, reduce market efficiency, raise prices paid by consumers, provide a safety net for inefficient producers and reduce overall productivity growth.

The administration can show its commitment to market processes and its opposition to bureaucratic processes by reaffirming the principles of open competition and by rejecting current pressures for quotas on imports, "voluntary" or legislated, and other protectionist measures.

The CHAIRMAN. I guess just a general question. We have had a lot of debate. In fact, this past week we have had expressions from the Congressional Budget Office as opposed to economic assumption of the Reagan administration, but the three of you believe that the administration's expectations of the effect of its program on interest rates, inflation and real growth, or whatever, that was realistic and we have had a lot of discussion this past week, and probably have a lot more the next several months on whether or not their assumptions are valid as opposed to other assumptions.

I think Dr. Houthakker pointed out there were a lot of rosy predictions made during the campaign, and I think there were many who believed that we are just going to cut taxes; that would increase revenues; we would have to reduce spending. I don't believe the candidate ever felt that way.

Certainly, as you indicate, the President has indicated almost on a daily basis the two must go together.

But, are you as optimistic as some of the administration, Mr. Stockman, and others may be?

Mr. FELLNER. Mr. Chairman.

The CHAIRMAN. Dr. Fellner.

Mr. FELLNER. This is, of course, very largely guesswork. This is a scenario which might come through as it is described there. However, I think that all these projections are very uncertain and nobody else could have made projections of which I would say that I have great confidence that the details will come through as they are.

My own reaction to this is that if we are going to get inflation down and practically eliminate it within a limited number of years, which is the only way to proceed, if we are to restore health to this economy, then, the early part of the period to which these projections relate is likely to be less favorable—to show less expansion in real terms than is implied in the scenario. That is, if we are to follow a monetary policy, and the fiscal policy which will get inflation down within a limited period of time, then the large cyclical recovery rates, which are in this projection are likely to come later. That is to say, then, we are likely to have to go through a period which is slower than this scenario assumes.

And after that, we would get a more durable recovery. I think if we get to these large cyclical expansion rates in the very near future then that would be very difficult to reconcile with getting inflation rates down to where they should go within a few years, which should be practically zero after a number of years—after 4 or 5 years.

The CHAIRMAN. Is there a general agreement on that point with the members of the panel?

Mr. HOUTHAKKER. Well, may I say something not to contradict what Dr. Fellner has just said, but more to amplify it. I believe that the fiscal policy proposed by the administration, assuming that most of it is adopted by the Congress, will not be the major factor determining the course of the American economy over the last few years. Over the next few years, the major factor will be monetary policy and I believe that under its present leadership, the Federal Reserve will stick to the monetary policy it adopted a little more than a year ago.

It has, on the whole, been consistent in this policy and apart from a small departure in the early part of 1980, I believe it will stick with it.

Now, if that is the case, then fiscal policy will not have a major independent effect for a considerable time to come.

Now, with the monetary policy we have had for the last year and a half, or so, has, I think, had some effect already. It is not a major effect because it takes a long time for the effect to be felt. So, there will be—there has already been some reduction in inflation. Nothing spectacular, but nevertheless a turn in the right direction.

This will, I believe, have favorable effects on the real performance of the economy in 1982 and 1983, not in 1981 where I foresee a rather slow year with many disappointments, but ultimately, I believe, we will succeed in getting the economy on a more stable path and this will have a favorable effect on the performance overall, including productivity.

That is why I think the administration's proposals are not very well supported by evidence. That other analysis point to something that goes basically in the right direction. But I do not really think that the fiscal policy proposals that are before your committee should be looked at primarily from the macroeconomic point of view because that, I think, is really being done by monetary forces.

The CHAIRMAN. My time has expired. Maybe Mr. Heinemann could just briefly comment.

I note in your statement you talk about monetary policy.

Mr. HEINEMANN. I do, sir. I think if you assume that the monetary policy, which has been enunciated by the administration and to which the Fed says it is committed, is in fact implemented, then I strongly agree that the near-term performance of the economy is going to be a good deal weaker than the official projection by the administration.

As a practical matter, we have to be very concerned about the size of Treasury financing in terms of the conduct of our business from day to day.

We are projecting a level of actual borrowing by the Treasury, which is considerably higher than is implied in the administration's budget. As far as interest rates are concerned, which were another part of your question, if the Fed sticks to its policy, then rates will come down and they will come down substantially.

I think we have had a fascinating laboratory demonstration in the last 60 days: A huge level of Treasury financing, close to \$100 billion at a seasonally adjusted annual rate; a very tight monetary policy with little or no growth in money supply, and a material decline in interest rates.

This, according to some of the pessimists, wasn't supposed to happen, but it did. I think it shows the powerful impact of a stabilizing monetary policy on inflationary expectations and on the aggregate level of borrowing.

The Treasury is a big demander of funds, but it is not the only one, and it is certainly not the biggest. I think we are seeing that the impact of monetary policy on the economy, and on inflationary expectations is such that we have been able to bring interest rates down materially already in the face of this very large financing burden.

So if the Fed stays on course, and I would hope the Congress would give it strong support in that regard, then we have a chance to get interest rates down very substantially and to reduce significantly price expectations.

Mr. FELLNER. If I may add a word to that, I think then the near-term outlook will be less rosy than in the scenario, but I think the long-term outlook very much more favorable.

Mr. HEINEMANN. I totally agree.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. In the testimony to be presented this morning by the American Federation of State, County, and Municipal Employees, you disparage the theory that the level of taxation, and especially its relation to the gross national product percentage is a relevant factor. And they cite West Germany, and I'm quoting: "With a much larger social welfare program than ours. It spends nearly 10 percentage points more of its GNP on Government than we do. Yet, has an inflationary rate half as large as ours and its productivity is the envy of the world."

Indeed, that statement is accurate. And from the—this is a report last year of the OECD in April. I would expect, there will be another one out this April and it confirms what that report says with everyone of our major competitive partners except Japan.

They all have significantly higher rates of taxation in toto than we do and yet exceed us in productivity, savings, and investment.

How do they achieve that?

Mr. HOUTHAKKER. Perhaps I may respond to this question. There is, of course, a lot to be learned by comparing different countries and their economic system.

It is true that many countries abroad have higher ratios of taxation to GNP than we have. It is also true that they have better productivity performance in many instances. I believe that there are a number of reasons for this, including the fact that we are still, to a very large extent, the country that shows the world which way the things are going in a very general sense.

In other words, other countries are still, to a very large extent, in the process of catching up with the kind of economy we have in this country.

That, I think, is a large part of the reasons why Japan and Germany have been successful. This means, among other things, that they do not have the same kind of uncertainty that we have had as to what exactly the future will be, because the future to them, to a large extent, is what has happened in the United States.

There are factors that are at work here. In Japan, for instance, there was a very large sector in agriculture and small business and that was obsolete and all the workers were ready to be absorbed much more productively by industry, and they have done this in a very remarkable way. This cannot go on forever. It is not something that we have in the United States because our agriculture, as Senator Dole well knows, has transformed itself. This transformation happened long ago.

We now have agriculture consisting of large individual farms, which is very productive. We do not have the reservoir of underemployed workers that exist in these countries.

In the case of Germany, there was, of course, a large inflow of people from other parts of Europe that helped.

Now, the comparison between these countries does suggest that taxation by itself is not the only factor, and without the observation, I fully agree. It does not mean though that we should take our cue from what happens in these countries because it is just as easy to find bad examples as good examples.

Take the example of the United Kingdom, for instance, the policies followed in Britain have been quite similar to those followed in Germany. They just have more experience in the United Kingdom, because they started earlier. They were the leaders in huge social security schemes in free health services, and so on. And they are now experiencing some of the consequences of this.

So, I would not go just by Germany; I would look at many other countries in Europe and elsewhere and see how they have done with those policies.

Senator PACKWOOD. I would like to hear the other two of you respond, if I might?

Mr. FELLNER. One thing you have to do in terms of the international comparisons of those countries is to explore by what kinds of taxes these tax revenues are collected.

I have not done that recently for specifically Germany and the United States, though I have done it some years ago. You would find very large differences there. We have a tax structure—

Senator PACKWOOD. Large differences in the kinds of taxes?

Mr. FELLNER [continuing]. In the types of taxes that are collected, direct and indirect taxes and with what marginal tax rates.

Senator PACKWOOD. What does Germany do that we don't?

Mr. FELLNER. Well, as I said, I have not recently compared these two. I have done some work on that years back and the comparison of direct versus indirect taxation was very different in the different countries, and we came out with very high direct taxation and higher marginal tax rates than the other countries did, and with capital gains taxes that provided very much more disincentive—created very much more disincentive in this country than elsewhere. So, the least one needs to do is to compare the tax structures by which these tax revenues are collected.

The Germans now also have substantial difficulties, by the way, and they are attributing these to a reduced productivity trend in Germany, which is still higher than ours is now, and to low profitability of investment in Germany.

Furthermore, and this is a point which Mr. Heinemann made a little while ago, the German—the Bundesbank, the equivalent of our Federal Reserve System, had very restrained monetary policies throughout this period and they avoided the inflationary uncertainties that developed in this country and that again created a great deal of disincentive. So that more than this tax ratios relative to GNP need to be considered in any such international comparisons.

Mr. HEINEMANN. Senator Packwood, as a starting point, I don't want to quibble about detail, but I certainly would want to make sure that the data were fully adjusted for the fact that in European countries, in particular, there are many important public services which are in the public sector that are in the private sector in this

country: telephones, railroads, utilities are characteristically Government services.

One can raise the question of how much of our railroad sector is private these days, but these are important considerations. I haven't reviewed the data on which this analysis was made so, I really can't comment on that.

I think that I would strongly support the statement Professor Fellner just made. I think the typical mix of taxation, especially in Europe, is much more heavily centered on spending and much less on income, which tends to encourage higher savings rates and higher investment rates.

I would further observe that the very tight monetary policy which the Bundesbank has traditionally run has forced the German government to finance its deficit out of real savings, which means that there is a crowding-out effect.

If you look at long-term trends of productivity in the German economy, you see that the German productivity machine, if you will, is beginning to run down. Their advantage is less and less. Their increase in productivity is progressively slower over the years. I have some awareness of commentary that is currently published on the German economy, and I think there is a rising level of concern in the financial community in Germany about loss of competitiveness.

I don't think they have found some kind of a magic formula that will allow them to boost their output in a rapid manner indefinitely while still maintaining exceptionally generous public sector benefits.

I would also observe that, to me, the important thing about the transfer payment trend, for example, in the United States is the way it has changed.

As Professor Fellner observed, Germany started the social security concept in the 19th century. We have gone from very small levels of transfer payments in the early 1950's to a point today where we are running somewhere between 12 and 13 percent of GNP. It is this rapid change, out at the margin, which has so significantly impacted the structure of incentives in the U.S. economy and has produced the long-term slowdown in growth that is now so much a subject of concern.

The CHAIRMAN. Senator Byrd.

Senator BYRD. I think each of you have presented the committee an excellent statement. I find myself in almost total agreement with each of you. If three of you had been in the Senate during the past 15 to 20 years and if your viewpoint had prevailed, we would not be in the fix we are in today, as I see it.

That is assuming, of course, you didn't change your view once you became a politician.

Mr. Fellner, the only statement that I could take issue with you on would be that you would favor the indexing of the tax structure. I would find it difficult to support that, except possibly for capital gains. I don't think I could support indexing the regular income tax. It seems to me that would lead to accepting inflation and we would probably never get the inflation rate down, but, anyway, that's the only place that I would differ with your statement.

Mr. Houthakker, I didn't get the same impression that you got of Mr. Reagan and his supporters that tax reduction was nine-tenths of his economic policy. It seems to me that the great need in this country and on the part of the Government is to reduce the tremendous annual increase in the cost of Government.

I do not know of anyone who advocates that the total expenditures be reduced below what they are now. The way I see it is: What we need to do is—and what President Reagan recommends is that instead of having a 16-percent increase in the cost of Government annually, that we have a 6 percent, which seems to me to be a realistic target, a realistic goal. And if we can do that, I think we can get ourselves straightened out in Washington.

Let me state it this way: Let me give my own view and then see if you would be willing to comment on it.

I think controlling expenditures, controlling the rate of increase in the cost of Government is more important—if you have to put a priority on it, is more important than a reduction in taxes.

Now, if you can do both that is fine, but if you have to choose one or the other, I would feel that reducing expenditures is of greater importance.

Would the three of you comment on that?

Mr. HOUTHAKKER. Well, frankly, Senator, I do have real difficulty with that statement although I certainly appreciate your general position and share most of it, but I happen to feel that the Federal Government is doing too much and that there is called for a more drastic reduction in Federal expenditures than the administration has proposed.

Senator BYRD. Well, I agree with that.

Mr. HOUTHAKKER. However, I would hope at the same time that much of the resulting change in the budget would be used to reduce taxation, and, therefore, I really don't find myself able to say that one is more important than the other. I would hope that both expenditures and taxes can be reduced substantially.

I believe that both would be beneficial to the country as a whole.

Senator BYRD. Well, I certainly agree with that. The only point I was making is that it is essential to get spending under control, and if we can do that, then I think the tax problem can be worked out.

Mr. HOUTHAKKER. Maybe I should add one thing, if you will permit me. There is, at the moment, more of a problem on the expenditure side than on the tax side because we do have this large deficit. In that sense, I would agree with you if that is what you had in mind.

Senator BYRD. I noticed you mentioned revenue sharing. I voted against that when it was originally enacted. It appeared to me that the Government had no revenue to share. We were heavily in debt going more and more in debt every year and every day. So, I have never favored the so-called revenue sharing proposal.

Mr. Heinemann, what you say on page 2 appeals to me also. What has been lacking until now is sufficient political commitment on the part of elected officials in both the executive and legislative branch to achieve the goals that the country needs to achieve to get back on a sound basis. And I think that's the real problem. We haven't, in the Congress and the previous administrations, and I

might say both, as you did, both Democratic and Republican have not been willing to bite the bullet, so to speak, and take the necessary and unpopular course of attempting to control some of these out-of-hand expenditures.

I just want to ask one question. In regard to interest rates, am I correct in assuming that there is no practical way that the Federal Government can legislate a decrease in interest rates.

Mr. HEINEMANN. That is correct.

Senator BYRD. I had a group of members of the Boilermakers Union come to see me yesterday and they were very concerned about interest rates. I expressed a view to them that I didn't see any way that the Congress could tackle the question of interest rates by legislation, other than to bring about a control of, or a reduction in the vast increase in Government expenditures. It seems to me that is the way to tackle interest rates.

Mr. HEINEMANN. That is a major contribution, Senator. At the same time, the Congress can also do a great deal in providing strong, stable, steadfast support to the Federal Reserve in reducing the rate of monetary expansion.

Only through a sustained long-run reduction in monetary growth will the inflation component in interest rates—that's the big component that has changed in recent years—come down.

Professor Fellner noted before in periods of rapidly rising inflation sometimes the real rate of return on money goes down. The real rate of return on money is not particularly high in today's economy certainly on a sustained basis. It may be briefly due to a shock of some sort in the marketplace, but this has not been the long-term characteristic.

The huge rise in interest rates is a function of the rising inflation and it is only through persistent long-run efforts over many years, spanning many administrations, that we will fundamentally reduce the actual and anticipated rate of change in prices. That will bring the rate of interest down.

I note that during the 8 years of the Eisenhower administration, the trend rate of growth in the money supply, narrowly defined, was about 1.8 percent.

At that time, corporations could borrow in the long-term market at $4\frac{1}{2}$, $4\frac{1}{4}$ percent, somewhere around that general area.

Large insurance companies were willing to lend for periods as long as 100 years. There are actually a few examples of that on the record at rates of interest below 4 percent. There was a profound price stabilization, which spread through the economy as a result of a sustained effort on the part of the Federal Reserve to control inflationary expectations.

It produced some short-run costs in terms of three short-lived, fairly sharp recessions in the 1950's, but on balance real growth was much higher than with low money growth than it was in the 1970's when money growth was much higher.

Senator BYRD. My time has expired, but I would like to ask: I agree with what you say about the Congress supporting the Federal Reserve. I think in doing that we must be careful that we don't jeopardize the independence of the Federal Reserve. I don't know of anything worse that could happen to this country than to have the

485 Members of the Congress attempting to direct the Federal Reserve Board what to do.

We are in a mess now; we would be in a heck of mess then.

As I see the interest rate problem, and I wish, Mr. Heinemann, you, or any of the others would comment on this, interest rates appear to me to be coming down, but coming down to a relatively high plateau.

Does that sound reasonable? It seems unlikely that we will get back to the interest rates of a few years ago, but while they won't continue necessarily at the present rate, whatever reduction there is will be to a higher plateau rather than to the previous rates that we have been used to for many years.

Mr. HOUTHAKKER. I would agree with that general statement, because as long as the inflation is running at somewhere between 8 and 10 percent, which is where I would put it right now, one cannot expect the long-term rates, anyway, to be lower than that. They will presumably be positive real rates. In other words, the nominal rate of interest will have to exceed the rate of inflation by something like 2 percent maybe. That is why I agree with your statement.

May I perhaps also add something to what Heinemann said earlier in response to your question about legislation. It seems to me that legislation with respect to interest rates has done a great deal of harm. Let me just mention two examples. One, of course, is regulation Q, and the associated ceilings on the savings interest rates. These, I think, have done a great deal of harm mostly to people with very small means who were unable to get adequate returns on their savings and have taken a loss after inflation year after year.

The other piece of interest rate legislation that also, I think, has had very unfortunate results in the past is one that effectively prohibited the Federal Government from issuing long-term bonds for many years because there was a ceiling on the—it was quite unrealistic. I believe it would have been better if in those years the Federal Government had relied less on short-term borrowing and more on long-term borrowing, but this interest rate legislation made it impossible.

Senator BYRD. Well, I think, perhaps the most dramatic example that you can't legislate interest rates is that a few years ago virtually every State in the Union had a ceiling on interest rates and, now, I believe every State in the Union has been forced to take off whatever ceiling they had, or else to greatly increase the ceiling.

You can't, by legislation, force people to loan money out. I questioned the Boilermakers yesterday. I happen to know several of them there, and know that several of them had a small savings account. I asked whether any of them felt that we should pass a law requiring someone to loan money at a particular rate. None of them seemed to feel that they would be very happy with such a law as that.

Thank you.

The CHAIRMAN. Dr. Fellner.

Mr. FELLNER. I think we all more or less agree on the possibility that a dilemma may arise in connection with getting the inflation

rate down effectively. In this case, the near-term cyclical expansion outlook might well be less favorable than the now published scenario suggests.

The CHAIRMAN. In the near-term, you are talking about how long?

Mr. FELLNER. One or two years.

The CHAIRMAN. One or two years.

Mr. FELLNER. Less favorable since these scenarios contain a very high cyclical recovery rate after 1 year of weak growth.

Senator BYRD. I am not sure I understand.

Would you mind repeating that? I am not sure that I understood what you said.

Mr. FELLNER. There is some question in the minds of, I think, all of us, whether you can get the inflation rate down the way in which it should, and have very forceful cyclical recovery start as soon as the now published scenario suggests, or whether in order to get the inflation rate down by the appropriate monetary restraint, it will be necessary to postpone the time when very forceful cyclical recovery will start.

And there, I think, one should stand with those who are willing to go through a more difficult near future in order to get a durable and forceful recovery and one that really remains durable over many years.

Now, if that is what will happen, then I think interest rates will come down. If, on the other hand, something will happen which I hope will not, if in the event of that dilemma there should be an easing of monetary policies so as to promote a very early good performance which, however, would be an inflationary performance and would not lead to a durable recovery, then, I think, interest rates will not come down and that would be the wrong choice to make.

We can't predict with certainty that this dilemma will develop. It might very well develop. I think the markets must be in great uncertainty as to whether this dilemma will develop. And if it does develop, and it might very well develop, then I think the right attitude is to get the inflation rate down even if the near-term future is less rosy than the published scenario suggests, and to go for a durable recovery that starts somewhat later. I hope the choice would be made that way, and then I think we will get interest rates down and that is the only way of getting them down.

The CHAIRMAN. Thank you very much.

We have other witnesses, but there may be—

Senator Packwood, do you have another question? We can allow another 10 minutes for this group.

Senator PACKWOOD. Dr. Fellner, you talked about Germany's heavy reliance upon indirect taxation?

Mr. FELLNER. Yes.

Senator PACKWOOD. That is true.

The Library of Congress is preparing for me in stages—they have not completed it all yet—analysis of the tax systems of the seven major industrial countries.

Mr. FELLNER. Yes.

Senator PACKWOOD. What they have initially concluded is that without exception every country taxes wealth and capital less than

we do, and shifts their incidence of taxation toward the middle class and lower class through indirect taxation. They have not yet finished preparing for me an actual analysis of the incidence of taxation by income categories. It is going to take them several weeks, but they will have it done. They have orally told me, however, that they see no reason why that latter part of the study should do anything other than confirm that first part.

If that is the case and if these other countries have higher rates of productivity and savings and investment because of that form of taxation, should we be moving toward that form of taxation?

Mr. FELLNER. Well, I believe that we should watch not so much the relative position of these various income classes, but tell ourselves that if we get higher productivity, then even those who have lower incomes relative to the others will benefit from it a good deal.

I think to look exclusively at the relative income positions and say that it is bad to have indirect taxation because it hits consumption and thereby may be less directly harmful to the higher-income groups that save more of their income, is not the right way of looking at it. If you see that with one kind of tax structure productivity trends are much more forceful than with another kind of tax structure, then this means that all income groups will, after a little while, fare better even if relatively to one another, there might be greater discrepancies.

Senator PACKWOOD. Well, let me give you a specific—

Mr. FELLNER. I don't know whether that was a clear answer to the question.

Senator PACKWOOD [continuing]. They all use the value added tax.

Mr. FELLNER. Yes.

Senator PACKWOOD. Should the United States be moving toward a value added tax and use the receipts to offset taxes on capital?

Mr. FELLNER. Well—to offset which taxes?

Senator PACKWOOD. To offset taxes on capital investment, saving, productivity. Any of the capital formation devices that seem to result in a higher incidence of investment in savings, but in order to do it you have to pick up the revenue someplace else. I am curious if we should be moving toward that form of indirect taxation?

Mr. FELLNER. Well, I think, for that one would have to know just precisely what kind of indirect taxation. One would really have to engage in a study in which I have not engaged. If you pose the question specifically in terms of one or the other kind of tax, then one would have to know by how much one expects productivity to increase as a result of that shift.

If there is a substantial shift toward higher productivity performance, then I would favor such a change even if the relative position of various income classes changes for the time being in favor of the higher income groups, provided this really leads to a sufficiently higher productivity performance to benefit the community as a whole. And this may be what has happened in those countries, but as I say, I have not engaged in a recent study of that.

What I do remember is that I did engage in a study of that years back and there was very substantial difference between the direct/

indirect ratio in the various countries. That the United States was very high up on the list for direct rather than indirect taxation, and this might very well have had something to do with disincentives of investment.

But, I have not undertaken a recent study of that.

Mr. HOUTHAKKER. Senator, may I try to add something to this. I hope that in the study which you are having made, particular analysis is made of our comparison with Canada. The comparison with Canada—

Senator PACKWOOD. Excuse me. Analysis of what?

Mr. HOUTHAKKER [continuing]. Of our tax system with the Canadian tax system, because Canada is a country that is after all much more like the United States than Japan or Germany and there are some interesting differences.

For instance, in Canada, if I understand it rightly, there is no taxation of capital gains. There are also provisions in the tax laws that favor private saving. There is no interest ceiling on savings deposits by small savers. As a result of this, the Canadian tax rate has been consistently higher than ours over the last several years.

Now, if this were to happen in Japan, we would say, well, there are many things different in Japan, but Canada is not all that different and that is why this comparison is relevant.

Senator PACKWOOD. Well, it is interesting, and you are right, our level of taxation is roughly 32 percent of our gross national product counting all levels of taxation. Canada's is about 37. Yet, for the last 20 years on the average, our increased productivity has been 2½ percent; their's has been 4 percent.

But, again, they have a higher level of taxation, but you are right, it is a different incidence of taxation.

Mr. HOUTHAKKER. Now, on the question of the value added tax, perhaps I may also say a few words on that.

I am not in favor of Federal value added tax. I believe that if we have a Federal structure disposed with a particular structure of taxation and expenditures, there are certain expenditures that belong at the State level and local level, and the Federal level, and there are also certain taxes that belong in each level.

Now, to my mind, the indirect taxes belong basically on the State level, and that includes, more particularly, the sales tax.

So, I would regard the establishment of a Federal value added tax as an invasion of territory that belongs more properly to the States.

Senator DOLE. Senator Byrd.

Have you finished, Senator Packwood?

Senator PACKWOOD. Yes.

Senator BYRD. Just one question. There is quite an ongoing debate in the Congress as to whether the top marginal rate of 70 percent should be reduced to 50 percent.

Does the panel have a view on that as to its importance?

Mr. FELLNER. The 70 percent as against the 50 percent yields very little revenue according to estimates I have seen. It is a punitive differential and it would be good to remove it and to abolish this difference between wage and salary incomes on the one hand and incomes from property. It essentially means that the part of wages and salaries people save, and on which they then earn

income from property, may be subjected to this punitive rate which doesn't yield any noteworthy amount to the Treasury. So, I would, indeed, favor a reduction of that 70 to 50 percent. And, to treat it from there on as all other income.

Mr. HEINEMANN. I would simply observe that I support what Professor Fellner said and I would add that our experience in reducing the capital gains rate certainly suggests that the effect would be a sharp increase in Treasury revenue. The very high marginal rates of taxation are very inefficient as a tax collection device. A reduction of that sort would almost certainly lead to a higher revenue yield overall to the Treasury.

Senator BYRD. And greater economic activity, I would think.

Mr. HEINEMANN. That certainly would be my presumption.

Senator BYRD. I haven't researched it recently, but my recollection is that when the Kennedy administration reduced the top marginal rate from 90 to 70 percent that there was a substantial increase in activity and no loss—as I recall, no loss of revenue. I don't know whether anyone remembers those figures or not.

Mr. HOUTHAKKER. Senator, I would just like to point out that very few people pay these very high rates and that they avoid these by various tax shelters, by municipal bonds, and so on. So, I believe, that the main effect of a reduction in the top rate would be a depression in the tax shelter industry. And I believe that we can do without because many of these tax shelters really amount to putting money into investments that don't make any sense.

I often pass in Vermont a railroad siding where there are hundreds and hundreds of new boxcars. I don't believe they have ever been used. They are standing there collecting rust because somebody has a tax shelter involving railroad boxcars. And there are hundreds of schemes like that. Those are the ones, I think, that would suffer if the top rates were reduced and the revenue effects would be, if anything, possible.

Mr. HEINEMANN. If I might offer one gratuitous comment. There have been several questions raised here this morning about regulation Q while limits the interest paid to savers and about the possibility of legislating lower interest rates. I think it is worthwhile to note that individual voters in the country are on balance creditors. They are lenders, not borrowers. Estimates compiled by the Federal Reserve Board suggest that the financial assets of individuals total well over \$4 trillion and the debts of individuals total about \$1.9 trillion. There is a very substantial individual financial net worth exclusive of the value of residential real estate. To the extent that there has been a debtor bias, if you will, in a lot of legislation in recent years, it has all too often left me wondering which majority interest the Congress was serving.

It seems to me very clear from the data that on balance it is the consumer, the individual, who provides the savings who provides the lending to keep the economy going—whether directly, or indirectly through financial institutions.

Senator BYRD. It is one of those issues that is subject to demagoguery. We have heard a lot of it already. A man with a \$200,000 investment income is going to get a \$10,000 reduction and somebody with a \$20,000 income is only going to get \$500 reduction, or whatever the thing might be.

So, it lends itself to that type of demagoguery, but we had another issue last year which lent itself even more to such demagoguery and that was the three-martini lunch. And when it finally came to the vote in the Senate, despite the best efforts of the then President of the United States, and then somebody who was then running for President, the motion to repeal that three-martini lunch only got 14 votes. So, I think that while there are issues that sound good from a demagogic point of view, I think the people of this country are pretty wise and have good judgment. And in that case, the Senate recognized that good judgment and they might even do it on this; I don't know.

The CHAIRMAN. Well, I thank the panel very much. We could probably keep you here all day, but it has been very interesting testimony. Your statements will be made part of the record even though you may not have completed in the time allotted.

Thank you for coming. We hope to have you back again.

Mr. FELLNER. Thank you very much, Mr. Chairman.

The CHAIRMAN. I am wondering, we have three additional witnesses, if anyone objects if we would call Ms. Edelman first?

Does anybody object to that?

[No response.]

The CHAIRMAN. Senator Chafee has an interest in that testimony and he is not able to stay as long as others.

STATEMENT OF MS. MARIAN WRIGHT EDELMAN, PRESIDENT, CHILDREN'S DEFENSE FUND

Ms. EDELMAN. Thank you, Mr. Chairman, Senator Chafee, I appreciate the opportunity to present our views.

I will be brief and we have prepared a written statement, which we would like to have submitted in the record, and we have provided to each of you our children's defense budget,¹ which is our detailed reaction to the Reagan proposals and their impact on the neediest children and families.

Our basic conclusion is that children who don't vote and don't lobby, who are homeless and handicapped and poor are being unfairly hurt in the current Reagan proposals, and we hope that the Congress will be thoughtful and specific in its reaction to some of these specific proposals.

In our budget, we talk about the impact, but we have tried to be very hard-nosed and selective. We have not tried to defend every categorical program or to say that we don't understand the need to balance the Federal budget, but we have tried to lay out the case for why those effective, successful, and cost-preventive programs should be continued, and I want to mention three of those critical priorities today.

The Adoption Assistance and Child Welfare Reform Act of 1980, this committee 8 months ago, and this Congress passed this bill which was an attempt to reform the child welfare system which actively breaks up families, keeps children for an average of 5 years and costly, ineffective foster care, which keeps children from being adopted. You put some money into trying to begin to insure these reforms for preventive services and for adoption subsidies.

¹ A copy of "A Children's Defense Budget" is retained in the committee's files.

The current Reagan proposals would block grant this program and wipe out those intended protections and preventive services.

Not only would this mean that children will be denied permanent families, it means that taxpayers are going to continue to pay costly, costly sums for out-of-home care. In fact, the Department of Health and Human Services estimates that if these reforms were given a chance to work and if as few as 30 percent of the children now in costly out-of-home care were kept out of that care, that savings as high as \$4 over 5 years might be accomplished.

We were pleased that last week in the Public Assistance/Public Welfare Subcommittee of Ways and Means in the House that a number of those members, including Congressman Rousselot committed themselves to trying to keep this program out of the block grant. We hope that this committee that did support almost unanimously these attempted reforms in the child welfare system will also attempt to keep this program out of the block grant and allow these homeless children who are truly needy and who have no effective voice to speak up for themselves if this program is block granted at the State level to get the chance to have a permanent family.

Second, we want to just highlight the problems of children who are now on welfare because very substantial cuts are proposed in the AFDC program. In fact, the Reagan administration is proposing to cut \$1.2 billion, which would mean a total cut of over \$2.2 billion when we combine State matching funds.

These cuts will hurt truly needy children; 66 percent, or 7 million of those who depend on AFDC are children. Unlike military, congressional, or retirement retirees and SSI recipients, poor welfare children and mothers get no automatic cost-of-living increases.

In the last 4 years, each child on AFDC has lost \$1 of every \$8 he or she previously received.

In effect, children have already paid 45 cents a day, or 12 percent of their total benefits to fight inflation.

The average benefit per child is \$93.13 a month. That means \$3.10 a day. Let's just take a Texas mother and three children as our example of what the impact of the proposed Reagan administration cuts will be.

The average Texas mother and three children now receive \$1,440 in AFDC benefits and \$2,664 in food stamps for a total of \$4,104 a year.

If the current budget cut proposals go through, each mother and child will lose about \$350 a year in food stamp benefits as a result of the Helms amendment. They will face cutbacks in their medic-aid benefits if the cap that is proposed is approved by this committee and the Congress, which will require more out-of-pocket money for currently provided medicaid services.

They will see their unindexed benefit levels which have already been eroded over the last years to inflation further eroded.

They will have their heating bills rise, while their child care and social services are cut back and decreased. They will watch the previously targeted programs, the compensatory education to title I be put into a block with a 25-percent cut and, indeed, there would be no assurance at all that the neediest and most disadvantaged

children educationally would get any of this money at the State level the way the block grant proposal is currently written.

If these families have a handicapped child, that handicapped child under the current proposals will lose their right to education.

And, finally, they will see their child care feeding cut back, and they will have less nutritional meals available to them if their children still have the kind of day care that they need.

Even by conservative estimates, proposed cuts will completely cut off 10.7 percent of all families on AFDC, which will be a total of more than 400,000 families. They will slash benefits of 6.9 percent of all families, another 250,000 families.

We are concerned that many of the welfare proposals will be a disincentive for parents to work by cutting back the amount of allowable work expenses and we are concerned about the proposed workfare proposals which do not have any assurances that adequate child care will be provided for mothers with children under six.

Mainly, we are concerned about the adequate protections for the kinds of jobs that would be required, particularly, since we already have work incentives in the current law and if we look at who is on welfare, and I just want to very briefly say that a number of 4 out of every 10 AFDC mothers are taking care of preschool children. Another three are already working, or in training, or seeking work outside the home, and we hope you will look very closely at any proposed new workfare proposals.

Finally, the third area, and I know I have gone over my time and we have prepared detailed testimony to be submitted on the effect of the medicaid cap. And under title V, proposed block grant on children and their health care, we obviously oppose this cap. The situation of children's health in this country is already disastrous with 1 in 3 children who have never seen a dentist. With 1 in 7 who have no access to regular health care. It would be the longest range, I think, mistake to talk about paying less of the Federal dollar on prevention.

We should be strengthening preventive health services for children. I hope that you will look carefully before you do agree to impose a cap and look at this impact on the neediest children and families, and I hope that you will look carefully before you decide to take away the focused authority under title V, which this committee and its chairman has supported very strongly, that focuses attention on the neediest mothers and the neediest children.

We have laid out in great detail in our testimony our alternative proposals and what we think the impact of this will be, and in subsequent testimony before you on health, we'll have our detailed considerations, what we hope you will do. But we just hope we will not go backward on an already disastrous child health situation.

I hope that you will look at our Black Book very carefully. We have tried to be constructive. We have tried to be specific. We have tried to ask you to respect those programs that are successful, that are preventive, that are cost-effective because we think in the long run that we are going to save a lot of money by making sure that we have healthy and not dependent children.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Well, Mr. Chairman, I want to say it is a very forceful case. I guess no one has worked more vigorously in this field and with greater effectiveness than she has for the Children's Defense Fund.

Ms. Edelman, you referred to document material you will be submitting now. Is this in the so-called "Response to the Black Book"?

Ms. EDELMAN. Yes, sir. We have set out the impact in seven or eight areas in very specific terms. I have offered alternatives that we think that the Congress should take to save money without hurting needy children and families. It is all here.

Senator CHAFEE. I haven't had a chance to review this. Do you suggest any areas, and I am not trying to put you on the spot—

Ms. EDELMAN. OK.

Senator CHAFEE. Do you suggest any areas in here where we might get the money to carry on the activities that you are espousing here?

Ms. EDELMAN. Yes, sir.

Senator CHAFEE. In other words, as you know, what is going to happen is that—and I am absolving this committee from it, because we have agreed that the Budget Committee is going to present us with a ceiling, a limitation and we can move around within that, but for everything we take—we have to make it up from somewhere else.

Do you have any thought?

Ms. EDELMAN. Well, we do set out some of our ideas in our testimony itself. And since we think that the greatest cost in the health area obviously is an institutional cost, and that is where 70 percent of the medicaid expenditures come, and we think that it is that direction that one ought to look, and we do layout a number of specific proposals.

In addition, in the back of our black book we have set out more than a dozen alternative budget options where we think that you ought to look to find some of the cost savings to make up for some of the things that we are proposing to spend here. All of these programs are not within the jurisdiction of the Finance Committee, but we think that many of them are on the domestic side and we are simply trying to say there are places to look without hurting the preventive programs for needy children and families. But we do set these out and in our health testimony, which will be submitted, we have very detailed alternative proposals for where these savings might be found.

Senator CHAFEE. Fine.

Well, thank you, that is helpful.

Now, we will be having hearings. You will come forward to give testimony?

Ms. EDELMAN. Yes, sir.

Senator CHAFEE. Thank you very much.

Ms. EDELMAN. Thank you, Senator.

The CHAIRMAN. I think Senator Chafee made a point and I hope that we have that testimony. We will have to find something within the jurisdiction of our committee. We can't find some other committee, so it does give us the responsibility. I think there are areas. I've said earlier this week that we are going to be independ-

ent. We are not going to be a subcommittee of the Budget Committee. It is not the intent of this chairman, or I hope, any other chairman in the Senate or the House, but we understand the need to do something. So, if you have—if you say, well, we can't cut this program, then please tell us one that we might nibble at it would be very helpful.

And one that I have noted in your testimony is that you don't believe we should count the stepparent income as a source to support stepchildren. Is there some—something here that I have overlooked? It seems to me that it ought to be counted. Why shouldn't we count it?

Ms. EDELMAN. Well, I think that one of our concerns, as we state in the black book, is that this will be a discouragement, I think, to a number of families getting together. It may well be a disincentive for people to get married, because, again, the level of AFDC benefits for the children would not be reduced if the parent and her partner are simply living together without the benefit of marriage.

I'm afraid that it may well be a disincentive for many people to get married, and we are concerned about that.

Often, many stepparents are not, in fact, able or legally obligated to support their children. We are assuming certain things.

The CHAIRMAN. Well, if they don't have any income then it won't make any difference.

Ms. EDELMAN. Well—

The CHAIRMAN. Where they have income, I don't know why it shouldn't be counted.

Ms. EDELMAN [continuing]. But basically we think it will be a disincentive to marriage. And one of the things we want to do is not penalize the kind of people who are trying to form families and to maintain those families.

The CHAIRMAN. I just happened to catch—I think it was last night, or the night before—a segment on channel 4 about workfare in the District, how successful it had been in reducing the case load in 1 area from 600 to 200. And we hope to find the director and have him come before this committee.

It seems to me that many people, of course, didn't return when they were required to work, but many did. We think if that news account is accurate, it is certainly a strong testimony for some workfare provisions.

Ms. EDELMAN. Well, I hope you will look carefully at the workfare experiences. We have gone through as much as we can find on those experiences, and we have found very mixed records and, indeed, in many instances the workfare has cost far more to administer than it has saved, but I think the most we can ask is that one do a very careful scrutiny at the experience that we have had, and, second, try to make sure that one builds in some provisions for protection of mothers with small children in terms of child care.

The CHAIRMAN. I agree with that. I think there may be cases and I am not one of those who believe that everybody ought to be out working if they receive welfare. All these lazy people collecting money. There may be some. There are some who are able to work, then it seems to me that that provision certainly should be considered.

Ms. EDELMAN. Well, again, we would like to see the specific proposals, which have not been forthcoming yet and we don't quite know what we are dealing with, but I just hope that the adequate protections will be there about the kind of work and, I think, we need to ask seriously whether in the light of the Talmadge amendments there is a need for additional workfare, particularly when we are cutting back on child care and cutting back on jobs at the same time.

We think the solution lies in increased training and increasing jobs provisions. But, again, I think as you are going to be doing a specific look at the experience on workfare, I am sure you will take all these things into account.

The CHAIRMAN. Well, with this committee's jurisdiction and I also happen to be chairman of the Nutrition Committee, I will probably be seeing a lot of you in the several months.

Ms. EDELMAN. I am afraid so. [Laughter.] I am afraid so.

The CHAIRMAN. But I would hope there are some areas—in fact, I noticed the budget, at least, the earlier report was that the Witt program has been spared.

Ms. EDELMAN. Not any longer.

The CHAIRMAN. Senator Hatch was able to put back the billion dollars into some of the other programs that we have an interest in. So, maybe—I think there is a recognition that we need to be very careful in some of the areas of spending reduction. We just hope we can offset—balance some other program that may not have the impact on—we use the term “truly needy” or whatever term may be used.

Ms. EDELMAN. Well, Senator, I would just end my time with you by simply saying that a program like the Homeless Children program, which you were a very strong supporter of, to encourage adoption and to encourage handicapped children to get out of the system is an instance where by supporting those reforms, we are trying to put into place long-range savings and here is an instance where if there ever was a program to save money now, and over the long run, here it is.

I am hoping that, at least, in this instance that this committee will take a very strong position to allow this set of new reforms to work, be given a chance to work. Particularly, we have put in here in evidence that where they have been put into place, these things have cut down on savings substantially. I mean, allowed children to get their families and at least, I hope, this one will be given a chance to work.

The CHAIRMAN. I think in a question we directed to Budget Director, Mr. Stockman, in a letter, we asked about that specific program. At any rate, there are a couple of programs that we have reservations about whether or not they should be block grants.

Ms. EDELMAN. Good.

Senator CHAFEE. Ms. Edelman, let me just ask you a philosophical question. I know that you sat here through the testimony of the three prior witnesses who were talking rather on macroeconomics, and you have been, of course, extremely close to those whose cause you are espousing today and are familiar with their problems.

Do you think that the goal that we have, which is to eliminate inflation and bring down interest rates, do you think that's a goal

that is going to be beneficial to your clients, if I can phrase it that way?

Ms. EDELMAN. Oh, I think that there is no American who does not agree with the goal of trying to control inflation. And we see that balancing the Federal budget is one step, but only one step in that process.

Our concern is that in the process of trying to balance that Federal budget and to get some control over Federal expenditures that we do so in a fair manner and without scapegoating those people who have been least—you know, who are least able to bear it and who have been most affected by inflation and unemployment in the first place.

Our objections here today, you know, is not with the goal of trying to control Federal spending; it is how it is being done. We don't think that—we think that what is involved here, the rather wholesale unspecific, unthoughtful attack on all social programs for the poor without attempting to figure out which ones have worked; which have not. You know, which ones will increase productivity; which will not. Which ones have been successful and which have not.

All we are asking is that we really look closely at the specific impacts on certain programs which are the lifelines of the neediest families and that we be fair.

And as it now stands, it is not fair. I cannot see the rationale for not touching SSI benefits, for instance, and cutting back severely on AFDC benefits, which are not indexed unlike SSI.

And when we look across at a range of programs, we just think that young children and handicapped children and homeless children are being asked to bear an unfair brunt and it is that process of imbalance that we are objecting to.

Senator CHAFEE. I noticed, for example, one of the items you singled out—I just flipped through it—was an item we have struggled for and I think we are going to succeed on this year and that is the double adjustment for Federal retirees.

Certainly, we are cutting everything in sight, including adoption services for children, food stamps. It doesn't seem quite fair that one group goes on, not only untouched, probably doing better—

Ms. EDELMAN. That is right. The military retirement benefits. I think that every part of this budget should be examined again for specific areas where we could cut and not just these social programs for needy children should be the ones that are affected.

And at the moment, it is just palpably unfair and that is what we object to.

Senator CHAFEE. Fine. Thank you.

Senator BRADLEY. Mr. Chairman, I don't have many questions. I'd just like to ask if you would be willing to come back to testify when we make our CHAP II initiative.

The chairman has already said that we would make another attempt on CHAP, and I hope that you'd come back then so that we could discuss the issue more specifically.

Ms. EDELMAN. We would be delighted.

Thank you, Senator.

[The prepared statement of Marian Edelman follows:]

TESTIMONY OF MARIAN WRIGHT EDELMAN,
PRESIDENT, CHILDREN'S DEFENSE FUND,
BEFORE THE
SENATE FINANCE COMMITTEE

MARCH 19, 1981

I am Marian Wright Edelman, President of the Children's Defense Fund. Thank you for providing this opportunity for me to testify about the impact of the proposed Reagan budget cuts on the group of our citizens who can least afford to sustain them -- children.

I am not here today to defend big government or every federal categorical program, regulation or civil rights compliance order, or claim that government has not been guilty of excesses, inefficiency, and failures to achieve the best bang for the buck.

I am not here either to cling to the past or to discard those constructive lessons, programs and approaches from which millions of Americans have gained. As a result of the programs passed by Congresses in the late 1950's, fifteen million Americans, including five million children, were removed from poverty, and I'm proud of that. As a result of the civil rights laws of the '60's, thousands of black young people got an opportunity to go on to college, law and medical schools. The number of black lawyers increased by 25 percent, black doctors by 48 percent, though the rate of progress has declined significantly in recent years.

This is a time when all of us must be tough-minded about our priorities. We at the Children's Defense Fund have tried to be. We recognize that the nation cannot afford to throw money thoughtlessly at any of our problems. But we also cannot afford to neglect problems that will undermine the productivity of coming generations and cost all of us as taxpayers far more to resolve in the future. In our view, if the Reagan Administration proposals affecting children which we discuss here are accepted by this Congress, millions of children as well as taxpayers will pay now as well as later in costly remediation, dependency and lower productivity.

The Children's Defense Fund has recently published A Children's Defense Budget: A Response to President Reagan's Black Book. The document contains detailed information on the impact of the President's proposals in six critical areas for children and families: programs that are successfully serving poor, homeless and handicapped children and their families; programs designed to meet basic survival needs and ensure minimum opportunity for the most vulnerable children in our country. They are:

- (1) The Adoption Assistance and Child Welfare Reform Act of 1980.
- (2) Title I, the education program serving disadvantaged children.
- (3) The Education for All Handicapped Children Act.
- (4) Medicaid Preventive Health Programs for Children.
- (5) Head Start and Title XX Day Care and Social Services.
- (6) AFDC Benefits, Food Stamps, and Child Feeding Programs.

I hope you will use this book as a resource in your deliberations.

A lot has been said and a lot has been speculated in the last week about the impact of the Reagan proposals, about the response of the Congress to them, and about how and whether they will be implemented. What I would like to do today is to express the Children's Defense Fund's concerns about the decisions pending with regard to three crucial areas: The Aid to Families with Dependent Children program; homeless children who would be served by the new Child Welfare Reform and Adoption Assistance Act; and the millions for whom Medicaid and other federal health programs are the only source of desperately needed care.

[The above mentioned book is in the committee's files.]

AID TO FAMILIES WITH DEPENDENT CHILDREN

1. The Reagan budget proposals do hurt the truly needy. In fact, they directly attack and undermine the already inadequate system of income maintenance supports for the poor by severely cutting benefits for the neediest families and children.

The Reagan Administration is proposing cuts in AFDC of \$1.2 billion -- a total cut of over \$2.2 billion when combined with state matching funds. These cuts will hurt truly needy children.

- Two thirds of those who depend on AFDC are children. Unlike military, Congressional, or government retirees and SSI recipients, poor welfare children and mothers get no automatic cost of living increases. In the last four years, each child on AFDC has lost one dollar of every eight he or she previously received. In effect, children have already paid 45¢ a day, or 12 percent of their total benefit to fight inflation.
- Children receive an average monthly benefit of \$3.10 per day per child.
- There is not even one state where the combined basic benefits of AFDC and Food Stamps alone bring a family of four up to the official poverty line.

-- Even by conservative estimates, the proposed cuts will completely cut off 10.7% of all families on AFDC -- a total of more than 400,000 families. They will slash benefits to 6.9% of all families -- over a quarter of a million families.

2. CDF is extremely concerned that the President's proposal to require AFDC recipients to work as a condition of preserving their eligibility for assistance will be harmful to children.

-- Although details of the proposal are not yet available, the "workfare" concept ignores evidence that many poor people able to work already do so; and many of those not working desire to do so, but the jobs often do not exist.

- For example, of ten mothers on AFDC, 4 are caring for pre-school children; 3 are working, seeking work, or in training; 1 is disabled; and 2 are not currently seeking work. But more than half of this last group are either over 45, have never been employed, or have completed WIN training and are awaiting job assignments.

- Workfare compels AFDC recipients to take jobs in return for welfare rather than real earnings. It does not help parents find the jobs necessary to enable them to eventually get off welfare.

- We believe the emphasis would be better placed on ensuring decent jobs and training opportunities for all parents able and wanting to work outside the home, and adequate income for families who cannot.

-- In any proposal for work requirements, the special needs of children must be accommodated.

- The proposal must recognize that the choice to stay at home to care for young children is a legitimate one for parents to make. Parents with sole responsibility for raising children under seven should not be required to work. The President's proposal, we understand, would exempt parents with children under three from the workfare requirement, but require mothers of children aged three to six to work, unless child care was not available.

- We also believe that single parents responsible for children with special needs ought to be specifically exempt from all work requirements, regardless of the age of the children. Handicapped children require intensive care, and even when the children are receiving some special help from facilities or professionals outside the home, demands on the parent can be immense.

- Provision for child care for children whose parents choose to work or are forced to work is essential.
- Special attention must also be given to the quality of the work available, and wages paid for the work performed.
- Without attention to these issues, unscrupulous employers could exploit both the poor who would be forced to take substandard jobs, and regular workers whose wage standards would be jeopardized if AFDC recipients were required to take jobs at less than the prevailing wage for that job.
- The basic principle of equal pay for equal work must be maintained.

3. These cuts will gut income disregards which now encourage AFDC parents to work.

- The Administration would set standard caps on work expenses of \$75 per month for work expenses (tax, transportation, uniforms, supplies, etc.) and \$50 per month per child for day care. These caps do not reflect the real cost of working: in 1976-77, the mean monthly cost of center-based day care was \$135 per child -- almost three times what the Administration will allow. Mothers' grants will be reduced by earned income they do not have because it is eaten up by the real cost of child care. Or, they will be forced to put their children in substandard child care which comes within the \$50 limit. Or, they will simply give up working, since they will not be able to purchase adequate child care which will allow them to go to work with the assurance that their children are not suffering from their decision to work.
- The Administration would base the \$30 and one-third disregard on net, not gross, income. A mother with two children in day care would lose at least \$58 per month from this change alone.
- After four months, that mother would not receive the \$30 and one-third reduction at all. She would lose all incentive to work, since her AFDC grant would be reduced dollar-for-dollar for all her earnings. She could be just as well off by staying at home and collecting a full AFDC grant as she would be by struggling to work.
- The combined effects of these cuts is devastating for the working parent. The loss to a working mother in Illinois is a graphic example. Today, an AFDC mother of three who earns the minimum wage and has work expenses of \$300 would have an income of \$539.23 per month, of which \$266.56 would be a partial AFDC grant. Under the Administration

proposals, she would have \$355.89 per month, of which \$43.22 is from AFDC -- a reduction of more than one dollar in every three of her total income. After four months, she and her family would no longer be eligible for any AFDC payments. She would have to support her family on \$312.66 per month -- less than half of the poverty level for a family of four.

- Other proposed cuts -- eliminating AFDC payments under \$10 per month, assuming that the family received monthly Earned Income Tax Credit payments whether they do or not, and limiting AFDC for working parents to 150% of the standard of need -- further discourages parents who are trying to rejoin the workforce.

4. The Administration proposals are anti-family.

- By allocating only \$2.32 per day per for a child's day care, they penalize children of working parents and do not allow parents enough money to purchase minimally adequate day care.
- By considering a step-parent's income as automatically available to a step-child, whether or not the step-parent actually supports the child or has a legal obligation to do so, they discourage the formation of new family ties. A child could lose all AFDC benefits, placing early strains on a marriage and perhaps resulting in its breakup.

CHILD WELFARE

1. President Reagan's proposal to include the Title IV-B Child Welfare Services Program and the Title IV-E Foster Care and Adoption Programs in the Social Services Block Grant will eliminate the targeted funding and important protections for children in P.L. 96-272, The Adoption Assistance and Child Welfare Act of 1980 and severely harm the over 500,000 homeless children in this country living away from their families.

These children are the most vulnerable of our nation's children.

Indeed, the truly needy. Yet,

- Thousands of children will continue to be needlessly separated from their families each month and placed in foster care.
- They will be placed inappropriately, often at great distances from their families.
- They, together with the half million children already in care, will be lost.

← They will languish in care; growing up without permanent families of their own or adoptive families.

2. This Committee played a crucial role in the passage of P.L. 96-272, which has given over half a million homeless children and the thousands entering care each month, the hope of permanent families.

- You heard firsthand about the child welfare system's failures on behalf of these children. The problems were the same throughout the country. Foster care studies in New York, Oregon, Delaware, Pennsylvania, Iowa and New Jersey -- to name only a few -- have documented the gross public neglect of children by state and local governments.
- You heard evidence too that the current system is not only harmful to children but cost-ineffective as well. Lives and dollars were being wasted. The vast majority of funds were being used for out-of-home care, rather than for cost-effective alternatives to preserve families, to reunite children with their families, or to provide new permanent families through adoption.
- This Committee and the Congress recognized that federal leadership and direction were needed to turn this country's child welfare system around.

3. The children and families who will be helped by P.L. 96-272 are real children and families.

- They are Mrs. R's three pre-schoolers who entered foster care when the furnace of their rented home broke during a very cold winter. The \$250 necessary to fix the furnace would have been a much wiser investment.
- They are Mrs. G's five children. They too were placed in foster care in four different foster homes when Mrs. G. went to the local child welfare agency for help. Her older sister had been killed in a car accident, and Mrs. G was too depressed and overwhelmed to meet her demanding family needs.
- And they are children like Dennis S. Dennis, at age 17, was in his sixteenth foster home, after being freed for adoption at birth.

4. Congress recognized that more dollars were necessary to effect much needed reforms.

Targeted funding for services to prevent placement and reunify families, and to provide adoption assistance to children with special needs is essential and a crucial part of P.L. 96-272. But P.L. 96-272

also addresses the historic state neglect of these children by encouraging states to implement certain procedural safeguards -- to protect children and ensure dollars are well spent.

- By protections I am referring to the Act's requirements for preventive and reunification services programs -- homemaker services, for example, which would have helped Mrs. G cope with her loss and keep her family of five intact.
- I'm talking about case plans for children so that their needs can adequately be met by the systems charged with responsibility for them.
- There must be information systems and periodic case reviews to keep children like Dennis S. from being lost in the system.
- If the IV-B and IV-E programs are consolidated in the block grant, the important protections in P.L. 96-272 will be repealed. The reforms Congress believed were so essential just over 8 months ago will halt.

5. The reforms anticipated by P.L. 96-272 will result in increased efficiency at the state and local levels and in long range cost savings.

- Long range cost savings will be realized when the costs of implementing preventive and reunification services and adoption subsidy programs are contrasted with the costs of leaving a child to grow up in foster care.
 - * The Department of Health and Human Services itself estimates that P.L. 96-272 will save over \$4 billion in out-of-home care costs over the next five years, by reducing the number of children in care by 30 percent.
 - * The Assistant Commissioner for Social Services for New York City testified before you two years ago that services to prevent family break-up could be provided at a cost less than half of that required to keep a child in foster care for only one year.
 - * During a three year period ending in November 1978, the State of Iowa's Department of Social Services ran, in a seven county district, a group of preventive services programs for children who had been determined to need institutional care. The services were delivered to families in their own homes, and resulted in an estimated savings of over \$1 million.

- * A permanency planning effort in Oregon which provided intensive services to 509 children who had been in foster care a year or longer and were believed to have little chance of being reunited with their families, resulted in 29 percent of the children being returned to their families, and 36 percent being adopted. During the three year period of the project it was estimated that over \$1 million in direct room and board payments was saved.
 - * Minnesota currently has 208 children in adoptive homes who are receiving adoption subsidies at an average cost to the state of \$140 a month, a significant savings when contrasted with the average foster care costs for these same children which averaged \$400 a month.
- Significant savings are evident too when you think of the costs to the state when children who have been harmed by the system end up spending their lifetime in institutional care. We just heard in the House last week, for example, that the California experience has shown that half of the children who enter care at age 7 or 8 and grow up there can be expected to spend at least half of their adult lives in other institutions at a cost to the state for each of them of \$25,000 - \$30,00 per year.

MATERNAL AND CHILD HEALTH

1. Background

This Committee has a longstanding commitment to maternal and child health. The Committee has been responsible for this country's two major maternal and child health programs -- Medicaid and the Title V Maternal and Child Health and Crippled Children's Programs. Medicaid, the health insurance program for the poor, provided services to more than 23 million persons in FY '76 -- 45% of them children.

The Title V Maternal and Child Health Program represents the nation's oldest commitment to the cause of maternal and child health. Enacted 46 years ago (1935), Title V provides formula grants to states to enable them to develop services and provide health care to needy mothers and children. Presently,

about 13 million children receive some kind of health service through Title V programs. The Title V program with its special maternal and child health mission has served as a galvanizing and targeting force for serving this vulnerable population.

2. The Impact of the Administration's Cost-savings Proposals on Maternal and Child Health

The Reagan Administration has provided this Committee with the vaguest of cost-savings proposals in the area of health. The proposals seriously threaten the longstanding public commitment to health care for mothers and children. The Administration proposes that Congress take the following actions:

- Limit federal expenditures under the Medicaid program by placing a cap on federal funds and granting states "increased flexibility", although that flexibility has not yet been defined by the Administration.
- Repeal the Title V program, along with approximately 25 other targeted public health programs and replace them with two general purpose block grants to the states. Each state would receive 75% of the funds that currently flow to the state, or entities located within that state, no matter what the state's unmet health needs are or regardless of how seriously the state is affected by the Medicaid cap.

The effect of each of these proposals on maternal and child health will be profoundly negative. The proposed policies are dangerous and are unnecessary if Congress adopts other approaches which would be effective in cutting the health budget.

A. The Proposed Medicaid Cap

Several serious consequences could flow from the Administration's proposed cap on Medicaid:

First: Over 13 million low-income pregnant women and children could be left without guaranteed health care.

Second: State Medicaid programs are already operating bare-bones programs. This year 28 states have already reported that they are considering drastic program reductions. Given the significant reductions states are planning, or have already implemented, the cap will eviscerate their programs.

- Increasingly, hospitals in Maryland are refusing to admit high risk mothers for deliveries because they fear their babies will require care in intensive infant care units beyond the amount that Medicaid will allow. This will happen in other states if a cap is levied.
- Of the mothers and children presently covered by Medicaid, nearly 1 million currently fall in optional coverage categories. From past cutbacks, we can expect that these beneficiaries will be among the first to be eliminated from Medicaid under a cap.
- States are already requiring families to share in the cost of such basic services as prescription medications and physician visits. They are also limiting the number of clinic or doctor visits that recipients can receive, or eliminating services entirely, even though they are key in keeping children out of hospitals. These

limitations will increase under a Medicaid cap and poor children will be forced to go without care they desperately need.

Third: The public and inner city hospitals and clinic systems, on which millions of Medicaid beneficiaries depend for both hospital and outpatient care, will be threatened.

Public and voluntary hospitals and clinics located in urban areas rely heavily on Medicaid to finance their services. For Medicaid recipients, as well as for the millions of persons served by these public health facilities who have no health insurance at all. The public health sector is already facing a crisis in health care financing. A cap on Medicaid will intensify the crisis.

Fourth: Limitations on access to Medicaid may affect the general public health.

As health care programs for the nation's disadvantaged shrinks, the possibility of widespread disease increases. In Orange County, California, for instance, where restrictive health care policies left thousands of persons without essential health services, public health data in 1977 showed:

A 57% increase in tuberculosis

A 14% increase in infectious hepatitis

A 153% increase in syphilis

B. The Proposed Repeal of the Title V Maternal and Child Health and Crippled Children's Programs

If the Administration's proposed repeal of the Title V program is adopted by this Committee, the already critical situation created by the Medicaid cap will be intensified for several reasons.

First: The Administration's block grant scheme will eliminate the separate legislative authority for, and focus on, mothers and children, thereby further endangering their access to essential health services.

The health care needs of mothers and children are unique and require special attention -- a fundamental public health concept recognized by Congress since 1935. Mothers and children need a special group of primary and preventive care, as well as health-related supportive services, such as outreach and transportation assistance. These services are often the most vulnerable in a cutback situation. The vulnerability of the services is compounded by the fact that the political voice of mothers and children is small and often not heard when program cuts are made. If Title V is repealed, then the agencies whose major function is to represent the cause of maternal and child health in their states' health budget process will be fundamentally threatened. The continued existence of a separate maternal and child health authority within each state will be left to the political process, where mothers and children historically have not fared well. We can expect that preventive services like prenatal care and children's checkups will be neglected and that taxpayers will pay dearly later on treating expensive health problems that could have been prevented.

Second: There will be no guarantee of at least a minimum commitment of funds in every state to maternal and child health services.

A general purpose block grant, as envisioned by the Reagan Administration, permits states to spend their funds on a variety of health purposes. There is no guarantee that any funds will be committed to maternal and child health clinics and projects that have taken years to develop. Many of these project sites are located in areas that have no other maternal and child health resources.

Third: A general purpose health block grant will mean a substantial loss in program accountability.

If funds are dispersed to the states for a variety of program purposes, without specific goals or bases on which to look at state performance, there will be no way to verify whether hundreds of millions of dollars in federal funds are being spent in ways that

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work to improve the health status of mothers, children and others who depend on the public health system.

CDF's Recommendations

We believe that the cost savings Congress intends can be far more effectively achieved through other measures which do not sacrifice the lives of children and their families. Rather than instituting an across-the-board Medicaid cap, we urge you to consider ways of reducing Medicaid expenditures for institutional care, expenditures that comprise 70% of the Medicaid budget. Experts estimate that measures like prospective budgeting for institutions and improved coverage of ambulatory care could save hundreds of millions of dollars. Our detailed health testimony lays out these alternative cost saving strategies in greater detail.

In addition, we believe that preservation of a separate legislative authority for mothers and children, distinct from other health block grant programs, is absolutely essential. As federal funds grow increasingly scarce, a strong voice for mothers and children will be critically important.

The Title V program represents one basis on which to build an effective maternal and child health legislative authority. We believe that the key elements of an independent authority would include:

- An earmarked appropriation to be used solely for provision of maternal and child health services.
- Authority to harness and direct the expenditure of that portion of any other health block grant funds which represent current service expenditures for mothers and children under health programs other than Title V.
- Responsibility for assuring the availability of essential primary and preventive health services in all areas of a state, utilizing current health resources where they exist and developing new services where they are needed.

- Development of minimum criteria for the basic prenatal and preventive services available through the program so that all mothers and children utilizing service sites developed by the agency are assured adequate basic care.
- Development of minimum program goals standards and reporting requirements that provide an assurance that funds are being appropriately spent.
- Improvements in the relationship between state maternal and child health authorities and state Medicaid agencies in the administration of the EPSDT program.

In sum, a cap on Medicaid, accompanied by a repeal of Title V and the creation of a general purpose health grant in its place, will spell the undoing of over a half century of public commitment to the cause of maternal and child health. We are convinced the goals of a reduced federal budget and streamlined program administration will not be accomplished by these proposals. We urge the Committee to advocate the alternatives we have recommended.

* * * *

Finally, I'd like to make some general points about this process of cutting the budget and eliminating or restructuring many of our social programs. I hope you will try to avoid some pitfalls and consider a few positive suggestions for how to approach the budget balancing process.

Pitfall One: Avoid scapegoating those most victimized by inflation -- the poor, the young, the handicapped, the elderly, and working class families. Children, my primary concern, are the poorest of any age group in America: 1 in 6 is poor and 1 in 4 is on AFDC at some time in his or her lifetime. Yet how striking is the discriminatory treatment of AFDC children whom I assume are the "undeserving needy," in President Reagan's eyes, through no fault of their own. Social Security and Medicare benefits for the elderly, indexed for cost of living, are ruled untouchable

by the Reagan Administration, while unindexed AFDC benefits and Medicaid for poor mothers and children are cut back further. 7.3 million of our poorest children -- 1 in 9 -- currently depend on welfare to survive. 13 million children (45% of the Medicaid eligible population) depend on Medicaid to pay their doctor bills. Although in these last four years, each child on AFDC has lost one dollar of every eight they previously received -- that is, every child has already paid 45 cents a day, 12 percent of their total benefit, to fight the war on inflation -- military retirement benefits were left untouched even though they are adjusted for price changes twice a year, are adjusted by CPI and computed in manner that offers a double adjustment in the first year of retirement. Perhaps we should eliminate these extra features and save over \$1 billion in FY '82 and make sure we don't further squeeze needy children and families if we are really serious about being fair and not hurting the truly needy.

Pitfall Two: Avoid unfairness and work to find an equitable balance in the budget balancing process among all our interests; rich and poor; domestic and military; individual and corporate.

As you consider where you can further tighten food stamp eligibility, you should also consider charging fair market prices for the federal irrigation water supplied by the Water and Power Resources Service which could save about \$400 million in FY '82. Consider having the Service raise user fees and cut supply until the free market price and supply levels are reached. You might look at the Land and Water Conservation Fund and consider freezing and transferring some or all of it to the general account. In FY '82, it is budgeted for \$526 million plus

\$1.4 billion in an earmarked trust fund.⁵

If you've got to cut programs for our young, I would suggest you cut the creches, development centers, and laboratories for sports fish in the U.S. Fish and Wildlife Service sports fishery resources budget which is set at \$51 million for FY '82--a 25 percent increase over this fiscal year--and protect the recommended levels of \$220 million for implementing the new Adoption Assistance and Child Welfare Act--slated for a \$55 million cutback--which is our number one priority for preservation.

Pitfall Three: Take special care to avoid budget cuts that on the surface appear fair but in reality are profoundly inequitable. Some have called for a 20 percent cut across-the-board so that all will share the burden of our current budget problems, and that is the purported intent of some of the Reagan proposals. But a 20 percent cut for homeless children or hungry children is not the same as a 20 percent cut in college tuition loans to the middle class--a program that has increased

⁵The Outer Continental Shelf Lands Act transfers upwards of three-quarters of a billion dollars a year into this fund. The outgoing administration proposed a 40 percent increase in the appropriation for FY 1982 expenditures over FY 1981, but the fund balance will still grow by over \$400 million. Roughly half this money is given to states to buy new state recreational areas, and the other half is used by Interior to buy new federal lands, primarily for recreation. Together, the federal and state governments already own over 40 percent of the total land area of the nation. Perhaps you should consider a moratorium on further major federal purchases of land, and subsidies to other governments to purchase land, until we can afford to maintain or expand human service programs to keep up with inflation and

(footnote continued)

by 778 percent over five years and which recommended cuts from \$3.2 billion to \$2.3 billion for FY '82 are now being made.

It offers federally guaranteed and subsidized loans for enrolled students without regard to family income or financial need. And I urge you to be careful about voting new tuition tax credits for the middle and upper middle class in a time of budget stringency. I hope you will avoid looking at only one side of the ledger and trying to do at the back door what you are pretending to avoid at the front door. Look at tax credits and loopholes as well as expenditures. They both cost money.

Pitfall Four: Don't automatically reject all new spending increases. Sometimes we have to invest a little to save a lot.

I think this is true with preventive programs for children and young people. For example, every year we fail to come to grips with the massive problem of teenage pregnancies that result in over 600,000 babies being born annually is a year we are adding new and longterm welfare and social services costs to the tune of about \$8.3 billion in combined federal, state and local costs according to a Population Resource Center Study (SRI International). Don't we need to confront realistically (a) the education and other preventive services young women and men need to avoid pregnancy; (b) the parent education, child care

5 (cont'd) population growth. While recreational land is an important national asset, there are now 12 federal acres of it for each child in America. I would vote to make do with that until our higher priority needs can be attended to.

and income supports they need in order to go back to school after the babies are born and prepare themselves for (c) the jobs that will help them become more self-sufficient and contributing citizens. Similarly, wouldn't it be sensible fiscal policy to invest more of the federal health dollar in prevention and stop paying through the nose for costly remediative and hospital emergency care? Someone has to have the political courage to say that it's important to invest now in our young before they get sick, drop out of school and get into trouble.

For example, at a time when we are all concerned about escalating medical and hospital costs, we ought to be making sure that every pregnant mother and child gets the preventive checkups that can prevent billions in remediative and emergency health costs. In the 10 years after measles vaccine was introduced, the Surgeon General estimated cost savings of \$1.3 billion. In North Dakota, total Medicaid expenditures per child were 36-44 percent lower for children who had been screened than for those who were not. Expenditures for inpatient hospital services were 47-57 percent lower for those who had been screened. Yet only 2 million of the 12 million children eligible for the Early and Periodic Screening, Diagnosis and Treatment Program (EPSDT) are being screened. With the proposed Reagan Administration cap on Medicaid, we can expect a further cutback on needed health services for the poorest children.

Erase federal Title I safeguards and cut its concentration funding for disadvantaged children and we can expect higher costs in education remediation.

In 1978, over 650,000 14- to 17-year-old students were two or more years behind grade level. If improved education had prevented their grade retention even one year, the nation might have saved some \$1.3 billion in education costs. If improved instruction eliminated one extra year of schooling for all children who lose at least one year, we would save \$7.0 billion at 1978 prices. In addition, these students might have contributed more to society by being less likely to drop out of high school and more likely to enter the labor force and pay taxes.

* * * *

Our national budget is our national Rorschach test. We see in it what we are and believe in as a people.

The decisions made by this Committee will have as great an impact on the present and future lives of millions of American children as any decisions made by any other body in the Congress. The Children's Defense Fund hopes that in making these decisions you will remember that strong families and healthy children are vital to preserving our national values and fulfilling our national purpose.

We must not let these children and families fall through the gaping holes of the "social safety net" which has been presented to the Congress for approval.

The CHAIRMAN. Well, thank you very much and I appreciate the two gentlemen standing aside for a lady and that indicates we're moving in the right direction.

Mr. Calhoun.

STATEMENT OF JOHN A. CALHOUN, DIRECTOR, CENTER FOR GOVERNMENTAL AFFAIRS, CHILD WELFARE LEAGUE

Mr. CALHOUN. Thank you, Mr. Chairman, welcome back.

The CHAIRMAN. Thank you.

Mr. CALHOUN. I will try and abridge my testimony. I represent the Child Welfare League of America, 400 members and affiliates; 1,600 affiliate agencies.

We do stand at a critical moment in our history and we concur with Ms. Edelman, we, too, wish to restore us to economic health. We applaud the President's drive to release again the spirit of volunteerism, to trim bureaucratic fat and to avoid duplication of effort.

If we don't have economic health, we in the social service field will be continually forced to divide up an ever-diminishing economic pie.

You have a tough task in front of you.

However, we have got to ask in terms of the stated goals of the administration: Are the policy objectives going to be consistent? Is the safety net under the neediest?

We do not think they are.

Are State and local governments able to assume all the fiscal and administrative responsibilities thrust upon them?

We do not think they are.

Will these proposals support the American family?

We do not think they will and we have serious doubts as to whether the citizens of this country intended that children be the primary targets of the budget cut.

There is much reliance on block grants, if not a total reliance. A return to State and local control is a laudable goal; however, in the case of vulnerable children the Federal Government saw fit to create categorical programs because many of these children were falling through the cracks.

The issue is really not who controls the funds for children, but that they are underserved. The abused, neglected, homeless and truly poor and hungry were targeted as needing Federal assistance.

Some block granting is not bad. There are efficiencies, but children must be protected.

I want to concentrate quickly on two programs, title XX and 96-272, the Adoption Assistance Act.

After 5 years of intensive work, you passed the landmark Adoption Assistance and Child Welfare Act of 1980. It profoundly reforms the child welfare system, shifting the direction over the past two decades of a pattern of child welfare services which has been characterized by reliance on out-of-home care.

I am happy to tell you that the system does work. Precursors to 96-272 in California, experienced projects in Shasta and San Mateo Counties, have demonstrated that it is feasible and that there are cost savings. Kids are in care for shorter periods of time. More kids are adopted. More kids find permanent homes.

It is also proven a success in other States, such as Oregon and Virginia.

Let's look at what the law means quickly in human terms. An abused child is given treatment in a local medical center for cigarette burns on the soles of her feet. The father is arrested and convicted of child abuse and is on probation.

As a result, he has lost his job. He and his wife are now separated. His wife receives AFDC for her two other children. He receives unemployment insurance. The abused child is paid for in foster care. No work is being done with the family.

Each are supported in their individual situations. Nothing is being done to bring them together. Note carefully where the money and services lie: with the individual; outside the sphere of home and family. The social costs are staggering; the human costs even higher.

Given the family focus mandate of 96-272, the responses of both the judicial and the human service system would have been radically different. I will not go into detail. The example is more detailed on page 6 of my written statement.

Another provision in the law establishes the adoption subsidy program to assist families willing to adopt hard to place system. For nearly 20 years we have had experience with this in the league, and we have found that it does, indeed, work and I have shown some cost savings from various selected States, on page 8 of my written statement, where it has, indeed, worked and has saved these States money.

The title IV-E, adoption subsidy program, depends on the implementation of the total system set up by the new law, including adequate funding for title IV-B, child welfare services.

We strongly recommend that the Congress separate 96-272 from the proposed social services block and maintain its unique identity. It must be given the opportunity to work. We request that this committee recommend the \$220 million advance funding for title IV-B in 1982. It serves no purpose to preserve the law symbolically without adequate funding.

This new law is directly linked to the title XX social services program and the full funding of title XX. Sixty-two percent of title XX funds target children. We have provided a chart for you to show the expenditure of those services.

Indeed, it was President Ford who signed title XX into law, and as you well remember, Senator Dole, it grew out of concern similar to those being expressed today about the proper balance in Federal/State relations.

The 1975 report of the Senate Finance Committee, stated very clearly what was felt that the balance should be. I have quoted that on page 11 of my testimony.

It seemed to strike an adequate balance between Federal and State levels of government—modest Federal guidelines and strong State control. We feel that placing title XX in a larger block grant without these planning features with further reduction of funding would dilute and politicize the program and put children even more at risk.

We have provided in the back of our testimony a list of what, indeed, the impact of title XX reductions will be on a State-by-State basis.

In fiscal year 1981 Kansas received \$31 million of title XX funds. Given the administration's proposals, the reduction in funding for Kansas would be almost \$8 million. This would mean that at least 1,900 children from low-income families would lose day care services.

In Louisiana and other States—I have appended this to the back of my testimony—I show the effects of the reduction in title XX.

The CHAIRMAN. And that is assuming no savings on the block grant?

Mr. CALHOUN. That is correct. But there is another assumption that the States will continue to pay their current maintenance of effort level. That has also been removed.

Congress may be forced to repeal title XX, Public Law 96-272, including titles VI-B and VI-E, and rescind the statutes and the important features which have led to self-sufficiency and cost-effective change for children and their families.

The funding will severely be curtailed. The 25-percent reduction of social welfare programs and the removal of maintenance of effort could mean a total cut of 50 percent.

Thousands of national programs forced to reduce services by 50 percent will close. Day care centers will close and mothers will be forced onto welfare. Abused children will remain unprotected and untreated.

The reform family bill will languish; children will remain homeless. Shelters will close; families willing to adopt children will not be connected with those homeless children, and, ironically, the cry for categorical programs will begin again.

We understand the need for economizing, but the administration's twin goals, local control and reduction of social service funding by 25 percent collide directly with two other goals: providing a safety net for the needy and support for the American family.

In this collision, children will be the victims. They have no voices, so they have traditionally been victimized.

Under block grants with no restrictions, with a cut in funds, there is no guarantee that kids will receive any funding at all.

Is this indeed the intent of Congress?

We shortchange children now; we shortchange the next generation and we halt the process of reform which you in your wisdom set in place on June 13, 1980.

Thank you very much.

The CHAIRMAN. Thank you. I am just checking here to see the dollar figures.

There is, as I've indicated to Ms. Edelman, there is some concern on this committee, both sides of the committee. It is an area that we did raise with Mr. Stockman and will be raising with Secretary Schweiker.

We will, of course, take your concerns into account, because we understand your experience.

I think you said earlier, you are not opposed to block granting some of the program; is that correct? Are those listed in your statement?

Mr. CALHOUN. They are not.

The CHAIRMAN. Do you have the feeling if everything they suggest is block granted that some programs will do better than others? Do you have a concern that children will be more or less left out of the program?

Mr. CALHOUN. I do quite strongly, Senator. I have also had experience on the State level as a commissioner and there are other groups, frankly, that are a bit more well organized and a bit more powerfully politically connected than children's groups often are, and, indeed, Congress in its wisdom saw fit to protect these kids because they were not being properly served on the State level. So I do indeed worry, in answer to your question.

I might also add that the appendix, Senator Dole, was prepared by Pete Stark over on the House side in the Subcommittee on Public Assistance.

These figures comes from that subcommittee. Not the pie chart, but the State-by-State breakdown on the impact.

The CHAIRMAN. Well, I assume that, as I have just said to the last witness, that we will probably be seeing you frequently and we appreciate your testimony.

I think you summarized your statement. The entire statement will be made a part of the record.

Thank you.

Mr. CALHOUN. Thank you very much.

[The prepared statement of Mr. John Calhoun III follows.]

CHILD WELFARE LEAGUE OF AMERICA
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CHILDRENS
RIGHTS, SERVING
CHILDRENS
NEEDS

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TESTIMONY

OF

THE CHILD WELFARE LEAGUE OF AMERICA

BEFORE THE

SENATE FINANCE COMMITTEE

U.S. SENATE

MARCH 19, 1981

PRESENTED BY:

JOHN A. CALHOUN, III

DIRECTOR

CENTER FOR GOVERNMENTAL AFFAIRS, CWLA



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MR. CHAIRMAN, I AM JOHN A. CALHOUN, DIRECTOR OF THE CHILD WELFARE LEAGUE OF AMERICA'S CENTER FOR GOVERNMENTAL AFFAIRS. I WISH TO THANK YOU FOR THIS OPPORTUNITY TO TESTIFY BEFORE YOU. I REALIZE I AM ALLOTTED BUT THREE MINUTES AND THEREFORE THE BULK OF MY TESTIMONY WILL BE SUBMITTED IN WRITTEN FORM.

THE CHILD WELFARE LEAGUE OF AMERICA WAS ESTABLISHED IN 1920. ITS 400 MEMBERS AND AFFILIATES, NUMBERING 1600 AGENCIES, PROVIDE ADOPTION SERVICES, DAY CARE, DAY TREATMENT, FOSTER CARE, INSTITUTIONAL CARE, MATERNITY HOME CARE, PROTECTIVE SERVICES, RESIDENTIAL TREATMENT, RUNAWAY AND SHELTER CARE, GROUP HOME SERVICES, EMERGENCY SHELTER CARE, SERVICES TO CHILDREN IN THEIR OWN HOMES, AND SERVICES FOR CHILDREN AND FAMILIES UNDER STRESS. IT IS THE ONLY NATIONAL VOLUNTARY MEMBERSHIP AND STANDARD SETTING ORGANIZATION FOR CHILD WELFARE AGENCIES IN THE COUNTRY.

WE STAND AT A CRITICAL MOMENT IN OUR HISTORY. THE PRESIDENT WISHES TO RESTORE US TO ECONOMIC HEALTH. HE WISHES TO RELEASE AGAIN THE SPIRIT OF VOLUNTARISM. HE WISHES TO TRIM BUREAUCRATIC FAT AND AVOID DUPLICATION OF EFFORT. WITH THESE GOALS THE LEAGUE IS IN FULL ACCORD. WE NEED ECONOMIC HEALTH, AND DO NOT WISH TO PRESIDE OVER THE DIVIDING OF AN EVER - DIMINISHING ECONOMIC PIE. THE QUESTION IS HOW ONE CAN RESPOND TO THE

NOVEMBER VOTERS AND STILL MAINTAIN CRITICAL SERVICES. AND THERE ARE ADDITIONAL QUESTIONS: IS THE SAFETY NET UNDER THE NEEDIEST? WE DO NOT THINK IT IS. ARE STATE AND LOCAL GOVERNMENTS ABLE TO ASSUME THE FISCAL AND ADMINISTRATIVE RESPONSIBILITIES THRUST UPON THEM? WE DO NOT THINK THEY ARE. WILL THESE PROPOSALS SUPPORT FAMILIES? WE DO NOT THINK THAT THEY WILL. THUS THREE MAJOR POLICY OBJECTIVES OF THE NEW ADMINISTRATION WILL NOT BE MET BY SOME OF THE PROPOSALS BEFORE YOU. FINALLY, WE HAVE SERIOUS DOUBTS WHETHER THE CITIZENS OF THIS COUNTRY INTENDED THAT CHILDREN BE THE PRIMARY TARGETS OF BUDGET CUTS.

THE ADMINISTRATION INTENDS REFORM THROUGH TOTAL RELIANCE UPON BLOCK GRANTS. A RETURN TO STATE AND LOCAL CONTROL IS A LAUDABLE GOAL. HOWEVER, IN THE CASE OF VULNERABLE CHILDREN, THE FEDERAL GOVERNMENT SAW FIT TO CREATE CERTAIN CATEGORICAL PROGRAMS BECAUSE THESE CHILDREN WERE FALLING THROUGH THE CRACKS. THESE CHILDREN HAVE A VARIETY OF NEEDS, AND THERE ARE A VARIETY OF FUNDING SOURCES TO MEET THESE NEEDS: A MIX OF REVENUE SHARING, BLOCK GRANTS, AND CATEGORICAL PROGRAMS. THE ISSUE IS NOT WHO CONTROLS FUNDS FOR CHILDREN -- STATE OR LOCAL GOVERNMENTS -- BUT THAT CHILDREN ARE UNDERSERVED. THE ABUSED, NEGLECTED, HOMELESS AND TRULY POOR AND HUNGRY CHILDREN WERE TARGETED AS NEEDING FEDERAL ASSISTANCE. A SINGLE BLOCK GRANT WITH REDUCED FUNDING WILL GUARANTEE THAT

THEY WILL AGAIN FALL THROUGH THE CRACKS. SOME BLOCK GRANTING IS NOT BAD. THERE ARE EFFICIENCIES. BUT CHILDREN MUST BE PROTECTED. TODAY I WOULD LIKE TO FOCUS ON TWO PROGRAMS, TITLE XX OF THE SOCIAL SECURITY ACT (SOCIAL SERVICES) AND THE ADOPTION ASSISTANCE AND CHILD WELFARE ACT, TITLES IV-A,E AND B OF THE SOCIAL SECURITY ACT.

AFTER FIVE YEARS OF INTENSIVE WORK, CONGRESS PASSED THE LANDMARK ADOPTION ASSISTANCE AND CHILD WELFARE ACT OF 1980 -- A SYSTEM FOR SOUND CHILD WELFARE REFORM -- A SYSTEM FOUNDED UPON CLEAR FOCUS, SOUND PLANNING, AND MOST IMPORTANTLY, STRENGTHENING OF FAMILIES, WITH EMPHASIS ON SERVICES TO ENABLE CHILDREN TO REMAIN IN THEIR OWN HOMES OR, IF THAT IS NOT POSSIBLE, TO FIND PERMANENT HOMES THROUGH ADOPTION.

THE SPECIFIC PROVISIONS OF P.L. 96-272 WERE WELL TAILORED TO ADDRESS THE SYSTEMIC ABUSES OF THE FOSTER CARE SYSTEM. DURING THE 60'S AND 70'S THE PLACEMENT OF CHILDREN IN OUT-OF-HOME CARE JUMPED ALARMINGLY, AND WORSE, WE DID NOT KNOW HOW MANY CHILDREN WERE IN THE SYSTEM, OR IN SOME CASES, WHERE THEY WERE.

THE SYSTEM (AND I EMPHASIZE SYSTEM) OF P.L. 96-272, IS FOUNDED UPON CLEAR MANAGEMENT TECHNIQUES: AN ASSESSMENT OF THE NUMBERS

OF CHILDREN, GOOD CASE PLANNING FOR THOSE CHILDREN, REVIEWS OF THE CASES WITH CLEAR RESPONSIBILITY, AND THE PROVISION OF SERVICES UNDER TITLE IV-B WHICH ENABLE THE NEW SYSTEM TO SUCCEED. THE PREVIOUS OPEN-ENDED FUNDING STREAM UNDER TITLE IV-A FOR OUT OF HOME CARE WAS CAPPED, AND THE NEW AND CRITICAL EMPHASIS WAS PLACED WHERE IT BELONGS IF REFORM IS TO SUCCEED -- WITH INCREASED FUNDING FOR THE FRONT-END OF THE SYSTEM -- CHILD WELFARE SERVICES WHICH ARE FAMILY OR PERMANENCY BASED.

AND I AM HAPPY TO TELL YOU THAT THE SYSTEM DOES WORK. IN 1976, CALIFORNIA PASSED THE FAMILY PROTECTION ACT, THE PRECURSOR FOR P.L. 96-272. A DEMONSTRATION PROJECT IN SHASTA AND SAN MATEO COUNTIES DEMONSTRATE THAT THE LAW CAN WORK, AND DOES SO WITH A SIGNIFICANT COST SAVINGS AS DEMONSTRATED IN THESE IMPRESSIVE RESULTS:

- . THE NUMBER OF DEPENDENT CHILDREN IN OUT-OF-HOME CARE WAS REDUCED BY 33 PERCENT
- . THE AVERAGE LENGTH OF TIME A CHILD REMAINED IN OUT-OF-HOME CARE WAS REDUCED BY 45 PERCENT
- . 50 PERCENT OF THE CHILDREN WHO WOULD HAVE BEEN PLACED OUT-OF-HOME WERE NOT, 33 PERCENT OF THE CHILDREN WERE RETURNED HOME WITHIN 24 MONTHS; AND ONLY 7 PERCENT

OF THE CHILDREN REQUIRED LONG-TERM SUBSTITUTE CARE.

THE EXPERIENCES OF OTHER STATES ALSO DOCUMENT THE SUCCESS OF FOSTER CARE REFORM:

OREGON -- PRIOR TO THE PERMANENCY PLANNING PROJECT, THERE WERE 4000 KIDS IN FOSTER CARE; NOW THERE ARE 2700 -- A 32 PERCENT REDUCTION.

VIRGINIA -- SINCE PERMANENCY PLANNING EFFORTS WERE INITIATED, THE SIZE OF THE TOTAL FOSTER CARE POPULATION DECREASED FROM 11,303 TO 8,251 -- A 22 PERCENT REDUCTION.

I REPEAT, WE HAVE A SYSTEM WITH CHILDREN PROTECTED AT BOTH ENDS THROUGH INCREASED SERVICES UNDER TITLE IV-B, AND CARE AND PROTECTION FOR CHILDREN WHO REQUIRE OUT-OF-HOME CARE. THE CONCEPTS OF THE LAW DO WORK, HAVE BEGUN, AND SHOULD NOT BE LOST. FEDERAL MONEY IS NEEDED TO CONTINUE THE IMPETUS. AN INCREASING NUMBER OF STATES HAVE STARTED MOVING TOWARD IMPLEMENTATION OF THE LAW IN ANTICIPATION OF FEDERAL MONEY. AS FEDERAL DOLLARS SHRINK AND STATES ARE FORCED TO PICK UP OTHER ESSENTIAL SERVICES, THIS MOVEMENT WILL NOT CONTINUE. P.L. 96-272 PROVIDES THE FEDERAL INITIATIVE FOR FOUR YEARS TO HELP STATES SHIFT DIRECTIONS IN SERVICES TO CHILDREN.

LET'S LOOK AT WHAT THE LAW MEANS IN HUMAN TERMS.

AN ABUSED CHILD WAS GIVEN TREATMENT IN A LOCAL MEDICAL CENTER FOR CIGARETTE BURNS ON THE SOLES OF HER FEET. THE FATHER WAS ARRESTED, AND CONVICTED OF CHILD ABUSE, AND IS NOW ON PROBATION. AS A RESULT OF THIS HE HAS LOST HIS JOB. HE AND HIS WIFE ARE NOW SEPARATED. HIS WIFE NOW RECEIVES AFDC FOR HER OTHER TWO CHILDREN. HE RECEIVES UNEMPLOYMENT INSURANCE. THE ABUSED CHILD IS IN FOSTER CARE PLACEMENT. NO WORK IS BEING DONE WITH THE FAMILY. EACH ARE SUPPORTED IN THEIR INDIVIDUAL SITUATIONS. NOTHING IS BEING DONE TO BRING THEM TOGETHER. NOTE CAREFULLY IN THIS EXAMPLE WHERE ALL THE SERVICES AND MONEY LIE: WITH THE INDIVIDUAL; OUTSIDE THE SPHERE OF HOME AND FAMILY. THE SOCIAL COSTS FOR FOSTER CARE, UNEMPLOYMENT INSURANCE AND WELFARE PAYMENTS ARE ASTRONOMICAL. THE HUMAN COSTS AND PERMANENT DAMAGE ARE EVEN HIGHER. AND THIS IS FOR ONLY ONE, SINGLE FAMILY. GIVEN THE FAMILY FOCUS MANDATE OF 96-272, THE RESPONSE OF THE JUDICIAL AND SOCIAL SERVICE SYSTEMS WOULD HAVE BEEN RADICALLY DIFFERENT. NEW "FAMILY BASED" PROGRAMS ARE SPRINGING UP ALL OVER THE COUNTRY AND THE INITIAL RESULTS ARE STAGGERINGLY SUCCESSFUL. IN THIS CASE, THE FATHER WOULD HAVE BEEN ASSIGNED BY THE COURT TO PARENTS ANONYMOUS, WHERE IN A WEEKLY MEETING WITH OTHER ABUSING PARENTS, HE WOULD HAVE HAD THE OPPORTUNITY TO SHARE HIS THOUGHTS, PROBLEMS AND FEARS. HE AND HIS WIFE WOULD RECEIVE MARRIAGE COUNSELING. THE CHILD AND THE FATHER WOULD HAVE THE OPPORTUNITY TO SEE IF REUNION WAS POSSIBLE. THIS REPRESENTS THE WAVE OF THE FUTURE. THE NEW LAW, 96-272, HAS RETURNED US TO SENSIBLE, MORE NATURAL, AND PERMANENT FORMS OF CARE. PLEASE DO NOT TURN THE CLOCK BACK NOW.

ANOTHER PROVISION IN P.L. 96-272 ESTABLISHES A NATIONAL ADOPTION SUBSIDY PROGRAM TO ASSIST FAMILIES WILLING TO ADOPT HARD-TO-PLACE CHILDREN WITH SPECIAL NEEDS AS PART OF A NEW TITLE IV-E. (TITLE IV-E ALSO INCLUDES FOSTER CARE FUNDS.)

FOR NEARLY 20 YEARS, THE LEAGUE HAS HAS EXPERIENCE WITH AND SUPPORTED THE UTILIZATION OF SUBSIDIZED ADOPTIONS. OUR EXPERIENCE AND THAT OF MANY LOCAL AND STATE AGENCIES HAS BEEN THAT SUBSIDIZED ADOPTION HAS PROVIDED PERMANENCY FOR CHILDREN WHO WOULD OTHERWISE NOT BE ABLE TO EXPERIENCE THE SECURITY OF FAMILY LIFE.

IN A STUDY CONDUCTED BY THE LEAGUE, CHILDREN IN NEED OF PARENTS, PUBLISHED IN 1959, WE NOTED A "...SUBSIDY OF FAMILIES WHO CANNOT AFFORD TO ADOPT CHILDREN..." SHOULD BE TRIED. THE COURSE OF TIME HAS SEEN THESE CONCEPTS MOVE FROM CAUTIOUS APPROVAL BY LEADERSHIP IN THE CHILD WELFARE FIELD TO BROAD SUPPORT THROUGHOUT THE COUNTRY (47 STATES AND THE DISTRICT OF COLUMBIA PROVIDE SOME FORM OF SUBSIDIZED ADOPTION) AND FINALLY TO FEDERAL PARTICIPATION IN LAW LAST YEAR.

THE REASONS FOR THE GROWING ENDORSEMENT OF SUBSIDIZED ADOPTION ARE TWO-FOLD: IT IS HUMANE AND IT SAVE TAXPAYERS MONEY. IN SHORT, IT WORKS. IN HUMAN TERMS, THIS LEGISLATION ACHIEVES SOMETHING EVERYONE AGREES IS IMPORTANT -- A PERMANENT HOME FOR THOUSANDS OF CHILDREN. SOME HAVE MEDICAL PROBLEMS.

SOME ARE SIBLING GROUPS. SOME ARE EMOTIONALLY TROUBLED AND REQUIRE ADDITIONAL SUPPORTIVE RESOURCES. MANY ARE OLDER AND MEMBERS OF MINORITY GROUPS, SO THE SUBSIDY IS A NECESSITY.

THERE IS AN IMPORTANT COST-SAVING SIDE TO THE SUBSIDIZED ADOPTION PROGRAM. DATA FROM SELECTED STATES FOLLOW:

ILLINOIS: OF 1,868 TOTALLY ACTIVE SUBSIDIES, AN AVERAGE SAVINGS OF \$853,260 IS ANTICIPATED ANNUALLY;

MICHIGAN: OF 750 CHILDREN RECEIVING MEDICAL AND/OR SUPPORT SUBSIDIES, THE STATE ESTIMATED A SAVINGS OF \$650,000 IN FISCAL YEAR 1977;

MINNESOTA: IN A STUDY CARRIED OUT IN CONNECTION WITH A NEW SUBSIDIZED ADOPTION LAW, AN ESTIMATED ANNUAL SAVINGS OF \$2,228,000 FOR CHILDREN IN FOSTER CARE WHO COULD BE PLACED WITH A SUBSIDY WAS PROJECTED;

NEW YORK: IN FISCAL YEAR 1978, 700 CHILDREN WERE ADOPTED WITH A SUBSIDY AT AN ESTIMATED SAVINGS OF NEARLY \$1,400,000.

OUR PRIMARY REASON FOR SUPPORTING ADOPTION SUBSIDY IS THAT IT IS A GOOD WAY TO INSURE THAT THOUSANDS MORE CHILDREN WILL HAVE PERMANENT, LEGAL FAMILIES OF THEIR OWN. THEY WILL NOT BOUNCE FROM COSTLY PLACEMENT TO PLACEMENT. IF HISTORY IS ANY INDICATION, THIS PROGRAM WILL NOT BE A PRIORITY AS STATES ARE FORCED TO MAKE CHOICES WITH REDUCED FEDERAL MONEY. STATES WILL CONTINUE TO RESPOND TO CRISES, REMOVE CHILDREN FROM

ABUSIVE SITUATIONS AND FORGET ABOUT THEM AS THEY TURN THEIR ATTENTION TO THE NEXT CASE. THEY WILL NOT BE ABLE TO MOVE IN THE DIRECTION OF ADOPTION INCENTIVES.

THE TITLE IV-E ADOPTION SUBSIDY DEPENDS ON IMPLEMENTATION OF THE TOTAL SYSTEM SET UP BY THE NEW LAW INCLUDING ADEQUATE FUNDING OF TITLE IV-B, CHILD WELFARE SERVICES.

THE LEAGUE STRONGLY RECOMMENDS THAT THE CONGRESS SEPARATE P.L. 96-272 FROM THE PROPOSED SOCIAL SERVICES BLOCK GRANT AND MAINTAIN ITS UNIQUE IDENTITY AS A SYSTEM FOR REFORM OF CHILD WELFARE SERVICES. WE REQUEST THAT THIS COMMITTEE RECOMMEND \$220 MILLION TO FUND TITLE IV-B IN FY '82. IT SERVES NO PURPOSE TO PRESERVE THE LAW SYMBOLICALLY WITHOUT ADEQUATE FUNDING. IF THE LAW IS NOT FUNDED AT \$220 MILLION, THEN THE REFORMS CANNOT BE ACHIEVED AND CHILDREN CANNOT BE HELPED.

THIS COMMITTEE SHOULD ALSO BE AWARE OF THE IMPORTANCE OF TITLE XX, THE SIX YEAR OLD SOCIAL SERVICES BLOCK GRANT PROGRAM, TO THE SUCCESS OF P.L. 96-272. OF THE TOTAL TITLE XX

PROGRAM EXPENDITURES, 62 PERCENT TARGETS CHILDREN. THE ATTACHED PIE CHART SHOWS THE BREAKDOWN OF SERVICES PROVIDED WITH TITLE XX FUNDS. A FURTHER BREAKDOWN OF INDIVIDUAL SERVICES DEMONSTRATES WHY THE FOCUS OF TITLE XX IS ON CHILDREN, YOUTH AND FAMILIES.

<u>SERVICE</u>	<u>ESTIMATED NUMBER OF PEOPLE SERVED</u>
DAY CARE SERVICES FOR CHILDREN	838,884
DAY CARE SERVICES FOR ADULTS	64,211
FAMILY PLANNING	1,395,780
EDUCATION, EMPLOYMENT AND TRAINING	801,638
FAMILY COUNSELING	1,208,564
SUBSTITUTE CARE FOR CHILDREN AND YOUTH	352,006
HEALTH AND MENTAL HEALTH SERVICES	1,303,130

TITLE XX HAS ENABLED AGENCIES TO PROVIDE CARE FOR INCREASED NUMBERS OF DISADVANTAGED CHILDREN THROUGH THE PURCHASE OF SERVICE CONCEPT WHICH HAS CREATED A NEW PARTNERSHIP BETWEEN PUBLIC AGENCIES AND PRIVATE AGENCIES TO DELIVER NEEDED, HIGH QUALITY SERVICES TO CHILDREN. TITLE XX HAS BEEN CITED BY MANY AS THE MODEL FOR THE ADMINISTRATION'S BLOCK GRANT PROPOSALS. WHAT ARE THE CRITICAL FEATURES OF TITLE XX WHICH WILL ENSURE GOOD CHILD WELFARE SERVICE DELIVERY WITHIN AN EVEN LARGER SOCIAL SERVICES BLOCK GRANT?

BROAD GOALS WITH FLEXIBILITY; REQUIREMENT THAT IN EACH GEOGRAPHIC AREA OF A STATE AT LEAST ONE SERVICE MUST BE DIRECTED TO EACH OF THE GOALS; A PUBLIC REVIEW PROCESS; A STATE PLAN; REPORTING REQUIREMENTS; A 25 PERCENT MATCHING REQUIREMENT; AN EARMARK FOR CHILD DAY CARE; AND REQUIREMENTS THAT SERVICES PROVIDED WITH TITLE XX FUNDS BE REASONABLY IN ACCORD WITH RECOGNIZED STANDARDS OF NATIONAL STANDARD SETTING ORGANIZATIONS; AND A PUBLIC REVIEW (VOLUNTARY CITIZEN PARTICIPATION) PROCESS. THIS IS THE IDEAL, REPUBLICAN LEGISLATION.

IN FACT, TITLE XX GREW OUT OF CONCERNS SIMILAR TO THOSE EXPRESSED BY THE ADMINISTRATION IN PROPOSING INCREASED NUMBERS OF BLOCK GRANTS. IN ITS REPORT ON TITLE XX IN 1975, THE SENATE FINANCE COMMITTEE STATED:

THE COMMITTEE BELIEVES THAT THE STATES SHOULD HAVE THE ULTIMATE DECISION-MAKING AUTHORITY IN FASHIONING THEIR OWN SOCIAL SERVICE PROGRAMS WITHIN THE LIMITS OF FUNDING ESTABLISHED BY CONGRESS.

WHILE THE COMMITTEE BILL IS DESIGNED TO GIVE THE STATES MAXIMUM FLEXIBILITY,... THE COMMITTEE FEELS THAT THERE SHOULD BE A PUBLIC RECORD OF THE USE WHICH THE STATES MAKE OF FEDERAL SOCIAL SERVICES FUNDS.

TITLE XX HAS SUCCESSFULLY BALANCED LOCAL FLEXIBILITY WITH THE RECOGNITION THAT THE FEDERAL GOVERNMENT HAS RESPONSIBILITY FOR TAXPAYER DOLLARS.

P.L. 96-272 MADE SEVERAL CHANGES IN TITLE XX PROGRAMS. WHILE THE CHANGES DID NOT SUBSTANTIVELY ALTER THE PROGRAM, FOR THE FIRST TIME IN FIVE YEARS, FUNDING FOR TITLE XX WAS CHANGED BY STATUTE: THE NEW LAW RAISES THE FUNDING CEILING THROUGH 1985 (\$2.7 BILLION FOR FY 1980; \$2.9 BILLION FOR FY 1981; \$3 BILLION FOR FY 1982; \$3.1 BILLION FOR FY 1983; \$3.2 BILLION FOR FY 1984; AND \$3.3 BILLION FOR FY 1985). THIS WAS, AND STILL IS, CONSIDERED MINIMAL FUNDING FOR FULFILLING THE TITLE XX MANDATE.

PLACING TITLE XX (ALREADY A LARGE BLOCK GRANT) IN A LARGER BLOCK GRANT WITHOUT THESE PLANNING FEATURES AND WITH EVEN FURTHER REDUCTION OF FUNDING, WOULD FURTHER DILUTE AND POLITICIZE THE PROGRAM, WITH MORE AND MORE SERVICE CONSTITUENCIES COMPETING FOR REDUCED FUNDS.

THE CHARTS ATTACHED TO THE BACK OF OUR TESTIMONY SHOULD BY STATE THE IMPACT OF THE PROPOSED TITLE XX REDUCTION. LET US TAKE KANSAS AND LOUISIANA, FOR EXAMPLE.

KANSAS-- IN FY'81, KANSAS RECEIVED \$31,225,552 IN FEDERAL TITLE XX FUNDS. THE ADMINISTRATION PROPOSAL REDUCES KANSAS'S FUNDING BY \$7,806,388 IN FY'82. SPECIFICALLY, THIS WOULD MEAN THAT 1,900 CHILDREN FROM LOW INCOME FAMILIES WOULD LOSE DAY CARE SERVICES.

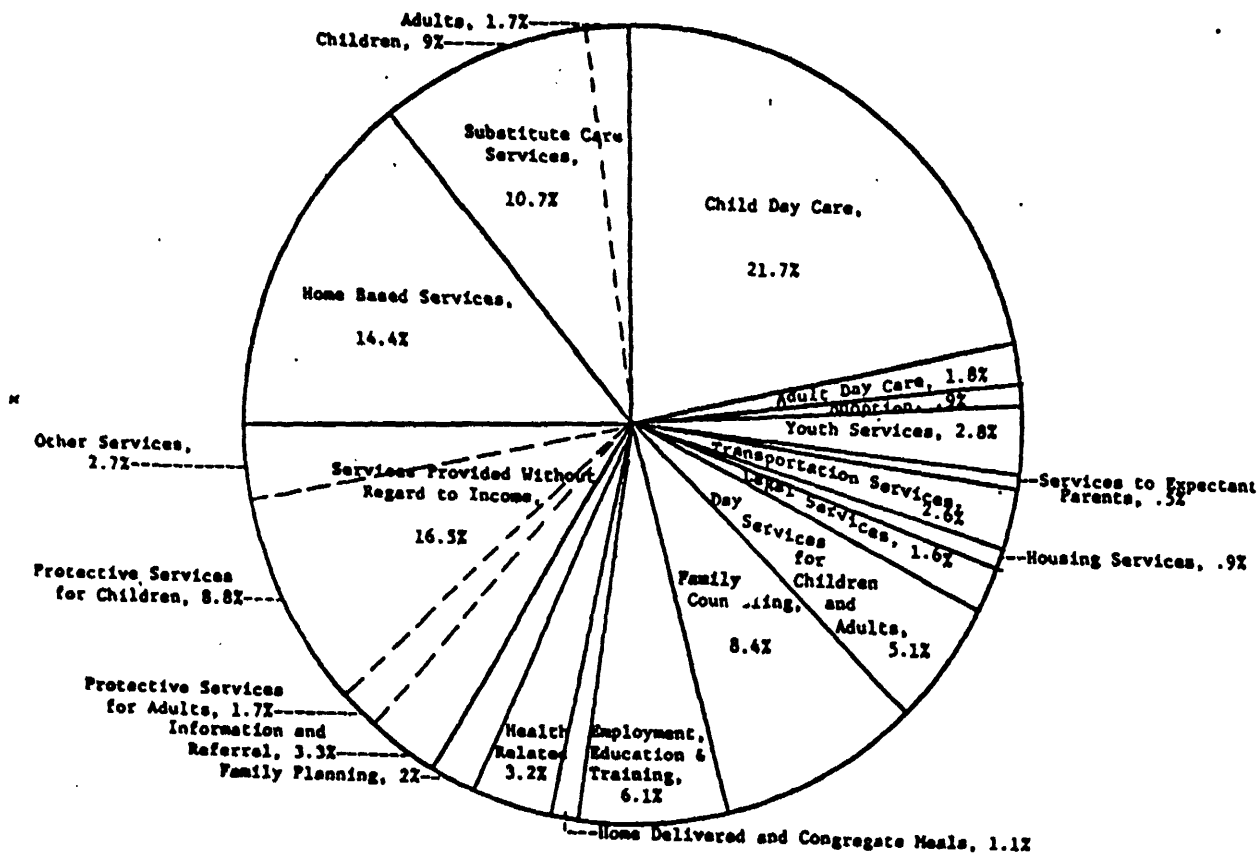
LOUISIANA -- IN FY'81, LOUISIANA RECEIVED \$52,742,989 IN FEDERAL TITLE XX FUNDS. THE ADMINISTRATION PROPOSAL REDUCES LOUISIANA'S FUNDING BY \$13,185,747. THIS MEANS 3,300 LOW-INCOME CHILDREN WOULD LOSE DAY CARE SERVICES.

CONGRESS MAY BE FORCED TO REPEAL TITLE XX, P.L. 96-272 AND TITLES IV-B AND IV-E, OR AT THE VERY LEAST, AMEND THE STATUTES AND RESCIND THE IMPORTANT FEATURES WHICH HAVE LED TO SELF-SUFFICIENCY AND COST-EFFECTIVE CHANGE FOR CHILDREN AND THEIR FAMILIES. AND THE FUNDING WILL BE SEVERELY CURTAILED. A 25 PERCENT REDUCTION OF SOCIAL WELFARE PROGRAMS WITH REMOVAL OF MAINTENANCE-OF-EFFORT WILL MEAN A TOTAL CUT OF 50 PERCENT. THOUSANDS OF NATIONAL PROGRAMS, FORCED TO REDUCE SERVICES BY 50 PERCENT WILL CLOSE. DAY CARE CENTERS WILL CLOSE AND MOTHERS WILL BE FORCED ONTO WELFARE; ABUSED CHILDREN WILL REMAIN UNPROTECTED AND UNTREATED; THE REFORM FAMILY BILL WILL LANGUISH; CHILDREN WILL REMAIN HOMELESS; SHELTERS WILL CLOSE; FAMILIES WILLING TO ADOPT CHILDREN WILL NOT BE CONNECTED WITH THESE HOMELESS CHILDREN; AND IRONICALLY, THE CRY FOR CATEGORICAL SERVICES TO PROTECT AND SERVE CHILDREN WILL BEGIN AGAIN.

WE UNDERSTAND THE NEED FOR ECONOMIZING. BUT THE ADMINISTRATION'S TWIN GOALS -- LOCAL CONTROL AND REDUCTION OF SOCIAL SERVICE FUNDING BY 25 PERCENT COLLIDE WITH TWO OTHER GOALS OF THE ADMINISTRATION -- PROVIDING A SAFETY NET FOR THE MOST NEEDY, AND SUPPORT FOR THE AMERICAN FAMILY. IN THE COLLISION, CHILDREN WILL BE VICTIMS. THEY HAVE NO VOICES, SO THEY ARE TRADITIONALLY VICTIMIZED. UNDER BLOCK GRANTS, WITH NO RESTRICTIONS, WITH A CUT IN FUNDS, THERE IS NO GUARANTEE THAT CHILDREN WILL RECEIVE ANY MONEY AT ALL. IS THIS THE INTENT OF CONGRESS? BY SHORTCHANGING CHILDREN NOW, WE SHORTCHANGE THE NEXT GENERATION -- AND WE HALT A PROCESS OF REFORM WHICH CONGRESS IN ITS WISDOM SET IN PLACE ON JUNE 13, 1980.

THANK YOU.

ESTIMATED TITLE XX EXPENDITURES, FY 79



Source: Technical Notes: Summaries and Characteristics of States' Title XX Social Services Plans for FY 1979, U.S. Department of Health, Education and Welfare, Office of the Assistant Secretary for Planning and Evaluation.

ATTACHMENT #2
STATE-BY-STATE BREAKDOWN OF IMPACT OF 25% REDUCTION
IN TITLE XX FUNDS IN:

--KANSAS
--LOUISIANA
--IOWA
--MAINE
--COLORADO
--DELAWARE
--HAWAII
--IDAHO
--MINNESOTA
--MISSOURI
--NEW JERSEY
--NEW YORK
--OKLAHOMA
--OREGON
--PENNSYLVANIA
--RHODE ISLAND
--TEXAS
--VIRGINIA

In fiscal 81, Iowa, received

\$ 38,513,287 in Federal Title XX funds. The

Reagan proposal reduces Iowa's funding

by \$ 9,628,322 in fiscal 82. If all the

programs included in your State's Title XX plan

are reduced by 25%, this means, for example:

- 2,000 aged and disabled Iowans would lose homemaker services which enables them to live outside an institution.
- 1,100 emotionally disturbed and handicapped foster care children would be denied treatment services.

In fiscal 81, Kansas, received

\$ 31,225,552 in Federal Title XX funds. The

Reagan proposal reduces Kansas's funding

by \$ 7,806,388 in fiscal 82. If all the

programs included in your State's Title XX plan

are reduced by 25%, this means, for example:

- 1,900 children from low income families would lose day care services in Kansas.
- 1,300 aged and disabled Kansans would lose homemaker services.

In fiscal 81, Louisiana received \$52,742,989

in Federal Title XX funds. The Reagan proposal reduces Louisiana's funding by \$13,185,747 in fiscal 82. If all the programs included in your State's Title XX plan are reduced by 25%, this means, for example:

1. 3,300 low income children would lose day care services in Louisiana.
2. 1,000 aged or disabled individuals would be denied home-delivered meals or meals at senior citizen centers.

In fiscal 81, Maine, received

\$ 14,508,977 in Federal Title XX funds. The

Reagan proposal reduces Maine's funding

by \$ 3,627,244 in fiscal 82. If all the

programs included in your State's Title XX plan

are reduced by 25%, this means, for example:

- 550 children from low income families in Maine would lose day care.
- Special community services programs for 320 of the mentally retarded in Maine would be eliminated.

In fiscal 81, Colorado, received
 \$ 30,507,761 in Federal Title XX funds. The
 Reagan proposal reduces Colorado's funding
 by \$ 8,876,940 in fiscal 82. If all the
 programs included in your State's Title XX plan
 are reduced by 25%, this means, for example:

- 3,700 children from low income families would lose day care in Colorado.
- 2,000 aged and disabled in Colorado would lose homemaker services.

In fiscal 81, Delaware, received
 \$ 7,753,193 in Federal Title XX funds. The
 Reagan proposal reduces Delaware's funding
 by \$ 1,938,298 in fiscal 82. If all the
 programs included in your State's Title XX plan
 are reduced by 25%, this means, for example:

- 400 children from low income families would lose day care services in Delaware.
- Services needed to respond to 300 cases of child abuse or neglect would be reduced.

In fiscal 81, Hawaii, received
 \$ 11,929,012 in Federal Title XX funds. The
 Reagan proposal reduces Hawaii's funding
 by \$ 2,982,253 in fiscal 82. If all the
 programs included in your State's Title XX plan
 are reduced by 25%, this means, for example:

- 1,400 children from low income families would lose day care in Hawaii.
- 700 aged and disabled individuals in Hawaii would lose homemaker and chore services.

In fiscal 81, Idaho, received
 \$ 11,676,335 in Federal Title XX funds. The
 Reagan proposal reduces Idaho's funding
 by \$ 2,919,084 in fiscal 82. If all the
 programs included in your State's Title XX plan
 are reduced by 25%, this means, for example:

- 175 mentally and physically handicapped individuals would lose sheltered workshop services.
- Idaho's youth rehabilitation services program would serve 1,500 fewer youth.

In fiscal 81, Minnesota, received

\$ 53,301,539 in Federal Title XX funds. The

Reagan proposal reduces Minnesota's funding

by \$ 13,325,385 in fiscal 82. If all the

programs included in your State's Title XX plan

are reduced by 25%, this means, for example:

- Services needed to respond to 1,900 cases of child abuse or neglect would be eliminated in Minnesota.
- 200 emotionally disturbed children in Minnesota would be denied treatment services.
- 1,100 children would lose day care services in Minnesota.

In fiscal 81, Missouri, received

\$ 64,632,105 in Federal Title XX funds. The

Reagan proposal reduces Missouri's funding

by \$ 16,158,026 in fiscal 82. If all the

programs included in your State's Title XX plan

are reduced by 25%, this means, for example:

- 5,800 children from low income families would lose day care services in Missouri.
- 2,300 aged and disabled individuals would lose home-delivered meals and meals in senior citizens centers.

In fiscal 81, New Jersey, received \$ 97,440,213 in Federal Title XX funds. The Reagan proposal reduces New Jersey's funding by \$ 24,360,053 in fiscal 82. If all the programs included in your State's Title XX plan are reduced by 25%, this means, for example:

- 4,900 children from low income families would lose day care services in New Jersey.
- 9,000 aged and disabled would lose homemaker/home health services to enable them to live outside an institution.

In fiscal 81, New York received \$ 236,026,873 in Federal Title XX funds. The Reagan proposal reduces New York's funding by \$ 59,006,718 in fiscal 82. If all the programs included in your State's Title XX plan are reduced by 25%, this means, for example:

1. 24,500 low income children would lose day care in New York.
2. 32,000 aged would lose senior citizens center services in New York.
3. The services necessary to respond to 29,000 cases of child abuse or neglect would be eliminated in New York.

In fiscal 81, Oklahoma, received

\$ 38,300,507 in Federal Title XX funds. The

Reagan proposal reduces Oklahoma's funding

by \$ 9,575,127 in fiscal 82. If all the

programs included in your State's Title XX plan

are reduced by 25%, this means, for example:

- 5,400 children from low income families in Oklahoma would lose day care services.
- 5,700 fewer individuals could be served under Oklahoma's "community youth services" program.

In fiscal 81, Oregon, received

\$ 32,502,236 in Federal Title XX funds. The

Reagan proposal reduces Oregon's funding

by \$ 8,125,559 in fiscal 82. If all the

programs included in your State's Title XX plan

are reduced by 25%, this means, for example:

- 750 fewer AFDC recipients each month would be served with Oregon's "Family Self Support" program which provides day care and other social services while family members are in training or employment.
- 350 aged and disabled individuals each month would lose chore services which enables them to live in their own home instead of an institution.

In fiscal 81, Pennsylvania, received
 \$ 156,260,748 in Federal Title XX funds. The.

Reagan proposal reduces Pennsylvania's funding
 by \$ 39,065,187 in fiscal 82. If all the
 programs included in your State's Title XX plan
 are reduced by 25%, this means, for example:

- 4,200 children from low income families
 in Pennsylvania would lose day care
 services.
- 6,200 aged in Pennsylvania would be denied
 services in Senior Citizens Centers.

In fiscal 81, Rhode Island, received
 \$ 12,434,366 in Federal Title XX funds. The.

Reagan proposal reduces Rhode Island's funding
 by \$ 3,108,592 in fiscal 82. If all the
 programs included in your State's Title XX plan
 are reduced by 25%, this means, for example:

- 1,000 aged or disabled in Rhode Island
 would lose homemaker services which enables
 them to live in their own home instead of an
 institution.
- 140 mentally retarded individuals in Rhode
 Island would lose vocational services.

In fiscal 81, Texas received \$173,070,415 in Federal Title XX funds. The Reagan proposal reduces Texas's funding by \$43,267,604 in fiscal 82. If all the programs included in your State's Title XX plan are reduced by 25%, this means, for example:

1. 5,600 low income children would lose day care in Texas.
2. Services needed to respond to 30,000 cases of child abuse or neglect in Texas would be eliminated.

In fiscal 81, Virginia received \$68,500,000 in Federal Title XX funds. The Reagan proposal reduces Virginia's funding by \$17,100,000 in fiscal 82. If all the programs included in your State's Title XX plan are reduced by 25%, this means, for example:

- 3,200 children from low income families in Virginia would lose day care services
- Services needed to respond to 8,300 cases of child abuse or neglect would be reduced.

The CHAIRMAN. Mr. McGarrah, I believe you are the final witness. The Director of Health and Institutions, Department of Public Policy Analysis, American Federation of State, County, and Municipal Employees.

STATEMENT OF ROBERT E. MCGARRAH, JR., DIRECTOR, HEALTH AND INSTITUTIONS, DEPARTMENT OF PUBLIC POLICY ANALYSIS, AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

Mr. MCGARRAH. Thank you, Senator Dole.

The CHAIRMAN. Welcome to the committee.

Mr. MCGARRAH. Thank you.

The CHAIRMAN. You may proceed, Mr. McGarrah.

Mr. MCGARRAH. We appreciate this opportunity to be before you today and we will be submitting additional materials. We had an extraordinary short period of time for preparing these remarks.

The CHAIRMAN. We appreciate your appearing on short notice, too.

Mr. MCGARRAH. Thank you, sir. I would like to have the opportunity to submit additional materials for the record.

The CHAIRMAN. The record will be open for that purpose.

Mr. MCGARRAH. Thank you, sir.

President Reagan deserves credit, we think, for his commitment to fighting inflation and trying to rebuild our economy, but his budget cuts, we think, are dead wrong and his tax cuts are dead wrong for America.

Rather than reduce inflation and stimulate the economy, this plan is going to fuel inflation and wreck the Federal safety net which is so vital to our people and our economy.

We would like to concentrate on the medicaid cuts because we think that is an example of a program that is clearly a safety net program. It is a program that serves the poorest, the most disabled elderly people in this society. And rather than take the responsibility for designing rational and precise changes and adjustments in this program, the President simply decided to take a \$1 billion whack out of it and dump it in the States' laps.

We think this is a really meat ax approach to it. This is an entitlement program. It serves 21 million desperately poor people. It was crafted in this committee and in the Ways and Means Committee over the past 15 years with many adjustments and amendments.

It is just absurd to hack at it in this fashion. It is a Federal/State partnership and what the Federal Government is doing, in effect, is pulling out of that partnership and sticking the States with a substantial bill.

New York is going to have to absorb \$250 million next year, according to Governor Carey.

Pennsylvania is going to lose \$70 million. These are States that have very serious economic crises going on.

The CHAIRMAN. We have one at the Federal level.

Mr. MCGARRAH. I beg your pardon?

The CHAIRMAN. We have one at the Federal level.

Mr. MCGARRAH. I am aware of that, sir, but raising revenue at the State and local level is becoming increasingly difficult as a

consequence of tax caps and spending limitations. There are, in fact, in most States constitutional requirements that they balance their budgets unlike the Federal Government.

I know there is a potential in the future for similar requirements at the Federal level, but it is not something we need to face at this time.

The States are just not prepared to deal with this increased burden.

Not only are they not prepared to deal with it on a financial basis, but their legislatures will not even be in session at the time that this cap would be finally passed through the Congress.

In fact, the National Governor's Association and the National Conference of State Legislatures have opposed the cap because they are not going to be able to come up with the kind of adjustments to their medicaid programs to even respond appropriately.

Another important point, sir, is the fact that when they calculated the savings from this cap—the \$1 billion savings—the OMB based this on preliminary estimates by the States of their medicaid spending.

These are early estimates. They are notoriously low. And, in fact, the figures have shown for the past few years that because these are so low, we can expect that the States will be stuck with maybe \$1 billion or even \$2 billion in additional costs that they would have to absorb if they are going to try to maintain their programs at current levels.

This is because of changes in their economies. In Michigan, for example, more people are going on welfare.

In fact, by 1986, the proposed cap is going to cost the States over \$5 billion a year.

This is a safety net program. I am sure that many members of the committee are aware of that. It serves over 100,000 severely and profoundly retarded people in institutions. Now, these are facilities that are only now, in many States, just coming to the levels of proper staffing and proper professional services. And to cap medicaid is going to deprive these institutions of the kind of staff and services they need.

They are going to return to the days of the snakepits. And many of them are just beginning to get up to the appropriate levels. Many of our members, 100,000 of them work in institutions for the mentally retarded under terrible conditions.

The medicaid program is vital to that whole framework of services for truly needy people.

In fact, it is clear that 44 percent of the children below the poverty line aren't even covered by medicaid; 42 percent of the elderly below the poverty line aren't even covered by medicaid.

More than 3.4 million senior citizens depend upon medicaid to meet 62 percent of their health care costs that medicare doesn't pay. That is widely recognized as a vital program for their interest.

Half of these 21 million medicaid beneficiaries are children under 21.

Again, as Ms. Edelman was saying in her testimony, these are people who depend upon this vital safety net program. And if the medicaid cap is enacted as President Reagan has proposed, it is going to be essentially dumping the program in the State's laps.

States are going to make wholesale cuts in the program that will have terribly adverse impact on these very poor people.

We think that there are areas where you could make savings and we will submit additional material for the record. One example might be the fact that currently 3 percent of adjusted gross income is deductible as medical expense deductions. This serves mainly upper income people. These aren't truly needy people. And it is very possible, we think, to make adjustments there. Perhaps, to eliminate the deduction and replace it with a nonrefundable tax credit of 25 percent of medical costs, targeting it better, would produce, according to some CBO estimates we have seen, more than \$700 million in savings.

We think that is an alternative.

The PSRO program is just beginning in many States to come into savings of some funds; 40 of them actually doing some good work now.

We have other remarks, of course, and I don't want to go on beyond the time limits here, but I want to say that we support many of the comments that were made by the children's defense fund on the Child Welfare Act. It was a landmark piece of legislation.

We oppose these AFDC cuts and many of the work requirements. We believe there are some serious problems with many of the block grants and child health proposals.

As I say, we will submit additional material for you on those points.

Thank you, sir.

The CHAIRMAN. Your entire statement will be made a part of the record. As I indicated, if you have additional information, it will be made a part of the record.

I assume—are you working with HHS and talking with people in HHS about concerns you have expressed here?

Mr. MCGARRAH. Yes, sir, we are. We are having some difficulty in getting information—all the information that we need from HHS, but we are doing the best we can.

The CHAIRMAN. Part of the problem is that, I think, in addition to the Secretary, one other person has been brought on board at the top level—

Mr. MCGARRAH. That's right.

The CHAIRMAN [continuing]. Are we going to have any of those?

For some reason, we haven't had many confirmation hearings on HHS top level staff.

I think it is fair to say that most of us on this committee, Republicans and Democrats share your concern about services to low-income Americans of whatever age and we are faced with what some would call a crisis, too, trying to restrain the growth of some of the programs, and I think I recall Secretary Schweiker's testimony and the charts showing how the program had gone up and up in cost.

I would guess that low-income Americans are affected by inflation and high interest rates, too. Probably more than middle- or upper-income Americans because there is nothing they can do about it. They can't pass it on to anyone.

I think everyone wants us to do something. It is how we finally put it together and we are only in the preliminary stages. We hope in this committee to be fair. I'm not suggesting that everything we do we will be applauded or approved or endorsed by every group, but the medicaid cap has caused a lot of concern.

I think, as I recall, Secretary Schweiker's testimony, the Governors have made a number of recommendations. I think maybe 10, and he is prepared to adopt at least 8 of those.

They believe they can save a lot of money because one of their problems was providing a service in the program is the high cost of providing the service in the present case. I think you would share that view.

If we can eliminate some of that cost and not benefits, but costs through this approach, you may be able to have some—at least we ought to give the States a chance. Maybe there are areas that we need to have some guidelines to protect certain people. We will be happy to look at those, and, again, I would assume you will be coming back to this because these are only preliminary hearings.

Mr. MCGARRAH. Yes.

The CHAIRMAN. We plan at least 2 or 3 weeks of additional hearings.

[The prepared statement of Mr. McGarrah, Jr., follows:]

STATEMENT
OF THE
AMERICAN FEDERATION OF STATE, COUNTY
AND MUNICIPAL EMPLOYEES, AFL-CIO

Mr. Chairman, Members of the Finance Committee, I am Robert E. McGarran, Jr., Public Policy Director for Health and Institutions of the American Federation of State, County and Municipal Employees. Our more than one million members work throughout the country to deliver high quality public services under increasingly difficult economic conditions. We appreciate this opportunity to present some of our views on President Reagan's budget proposals.

President Reagan rightly deserves credit for his commitment to fighting inflation and rebuilding our economy -- but his budget cuts and tax cuts are dead wrong for America. Rather than reduce inflation and stimulate the economy, the Reagan plan will fuel inflation and wreck the federal safety net which is so vital to our people and our economy.

This Administration's misguided economic policies are based on two premises which have no basis in fact. Premise number one is that the size of federal government is too big and that it consumes too large a percentage of GNP. Testifying before the House Budget Committee, Treasury Secretary Regan said that reducing federal expenditures to 20% in 1982 and 19% in 1984 was one of the major goals of the Administration. "This reduction in the role of the federal government in the economy is essential to bring about a reduction of inflation and a recovery of our economy." said Mr. Regan.

The fact of the matter is that the percentage of our Gross National Product dedicated to government spending has very little to do with inflation or productivity. Almost all the countries of Western Europe spend a greater share of their income on government, yet many of these countries are held up to us as models of productivity.

West Germany for instance, with a much larger social welfare program than ours, spends nearly ten percentage points more of its GNP on government than we do, yet it has an inflation rate half as large as ours and its productivity is the envy of the world.

The second false premise on which the Administration's misguided economic policies are based is that austere budget cuts will cut inflation. The fact of the matter is that for the last few years we have cut government spending. According to the Advisory Commission on Intergovernmental Relations, federal percapita spending has declined every year since 1978, yet the inflation rate for the last few years has risen and remained at record levels in the past two years.

As most economists have noted, there is no direct rela-

tionship between the level of government spending and inflation. Consequently, there is no economic necessity for cutting domestic spending to stop spiraling prices. The President's fight against inflation is merely a flimsy pretext for cutting programs that run contrary to the ideology of his Administration. As the originator of much of the vital safety net programs of the past 50 years, this Committee need not be bound by that ideology. We ask you to examine each program and weigh it on its own merits. If a program's benefits exceed its costs, we ask you to preserve it. If a program does not meet this test, we need new programs to meet these objectives more efficiently. But let us not use the rationale of "economic Dunkirk" to deprive the truly needy of vital income and medical care.

The President wants to cut \$1 billion out of Medicaid next year. But rather than take responsibility for cutting the real waste in Medicaid -- unnecessary surgery, excessive patient days in nursing homes and hospitals -- all ordered by America's doctors -- the President wants to shortchange the states by \$1 billion and dump the entire program in their lap with absolutely no guidance, support or time to cut this real waste. As a result, the states will either have to cut vital health services for the truly needy or assume a massive new debt for health care.

The Medicaid program is an entitlement program for more than 21 million desperately poor people. It was crafted and

revised by this Committee over the past 15 years. To hack at it with a \$1 billion cap in a hasty budget reconciliation process that was never intended to be a substitute for the deliberate authorizing process of this Committee is to mortally wound the only health care safety net for America's poor.

Medicaid is a federal-state partnership. Were the federal government to pull out of the partnership, a state like New York would be stuck with a \$300 million bill next year.

In fact, many of the states represented on this Committee would be some of the biggest losers if the cap passes. According to very conservative figures, Pennsylvania would lose more than \$70 million; New Jersey, more than \$35 million; Missouri, more than \$41 million; and Minnesota more than \$27 million.

Even worse than these figures suggest, is the very serious miscalculation made by the Office of Management and Budget, when it announced this Medicaid cap. OMB took its \$1 billion savings estimate from early state estimates of FY 1981 and FY 1982 spending. States have consistently underestimated their Medicaid spending at the beginning of each fiscal year for both budgetary and economic forecasting reasons. Consequently, the \$1 billion cap may well turn into \$2 billion loss to state and local governments -- a loss they cannot afford. Already, more than half of the states report serious financial problems with their Medicaid programs.

Some Governors have argued that they can live with federal spending cuts if they also get the flexibility they need to shape the Medicaid program to meet their specific needs. The National Governors Association has opposed the cap on the hospital portion of Medicaid, but supported it for long-term care. But what kind of flexibility is there for a Governor when the legislature he needs to approve his share of the \$1 billion cap isn't even in session and can't react in time to meet the FY 1982 federal timetable? The states will be left holding a \$1-2 billion bad debt for FY 1982.

Aware of that problem, the National Conference of State Legislatures and Medicaid officials in both New York and California have opposed the Administration's Medicaid proposal. They simply cannot make the necessary changes in their Medicaid programs in time to meet the deadline.

AFSCME categorically opposes this blatant attack on our poorest citizens. It takes little expertise to understand that the people who depend upon Medicaid as their only source of health care are truly needy. To set the record straight, Medicaid serves the aged, blind and disabled:

- More than one hundred thousand severely and profoundly retarded people in state institutions rely on Medicaid to give them the barest essentials of life. Without Medicaid, they'd be condemned to the snakepits.

- More than 3.4 million poor senior citizens depend upon Medicaid to meet the 62% of their health care costs that Medicare won't pay-Part B premiums, deductibles and nursing home care.
- Almost half of our 21 million Medicaid beneficiaries are children under 21 years. Without adequate care, their chances for productive lives, and in many cases, even survival, would be all but gone.

Yet by foisting a \$1-2 billion Medicaid debt upon the states -- ill prepared as they are to assume these huge new costs, the Reagan Administration forces a wholesale assault on this vital safety net program. Cuts in benefits, cuts in eligibility and outright denial of services are the only tools available to most states.

In fact, then Governor Reagan's own so-called Medicaid reforms in 1970-71 were replete with assaults on this safety net program. Tinged with scandal, these "reforms" produced the notorious Prepaid Health Plans (PHP's) -- so-called health maintenance organizations for the poor whose principal objectives were to maximize profits for their owners by denying services to as many Medicaid recipients as possible. Senate investigators spent months examining this Reagan initiative, and it was finally eliminated as a hopeless failure.

But there are opportunities for savings without attacking this safety net. Exhorbitant profits and waste plague the

Medicaid program. Unnecessary surgery alone is estimated to cost Medicare and Medicaid more than \$2 billion per year -- not to mention the horrible toll in needless mutilation and deaths of Medicaid recipients. Simply requiring mandatory second opinions for surgery would save nearly that amount in one year.

Another \$2-3 billion savings could come from a concerted and deliberate effort to wipe out the waste in unnecessary services, laboratory tests, x-rays and abusive practices like double billings from hospitals and doctors.

Shortsighted as they are, the President's cuts will destroy the only means we have to attack waste and abuse in Medicaid. State fraud and abuse units that now get unrestricted Medicaid funding and save more than their own costs will be decimated by the proposed cap.

At the same time that the Administration proposes a \$1-2 billion Medicaid cut, it calls for elimination of cost-effective programs. For example, PSRO's, a program delicately crafted in 1972 by this Committee will be destroyed even though at least 40, and an additional 40, have proved that they can stop waste and abuse among Medicare and Medicaid doctors and hospitals.

These are nonsense budget cuts aimed as a political weapon at the poor.

Like the Medicaid cap, the Administration's welfare and social services proposals must also be rejected. Cutting \$1 billion from the AFDC program is a misdirected and self-defeating attack on the working poor (AFDC working mothers who qualify for a reduced supplemental AFDC payment each month). These cuts will simply drive working people back on to the AFDC rolls as full recipients as they quit their jobs to gain full AFDC and Medicaid benefits.

The AFDC program is for children -- nearly 8 million of them. Nearly 20% of the 3.7 million AFDC working families receive supplemental AFDC grants. This is the group that is struggling to work itself off the welfare rolls. The proposed changes, we believe, will force many of them to give up work, and if they do, their children -- will suffer the most.

The Administration's workfare proposals completely contradict its block grant policies with little or no strings attached. Recipients would work off their welfare grants. We strongly oppose these proposals.

As a union representing working men and women, we can understand the motivation behind proposals to require able-bodied AFDC recipients to work. However, our analysis of workfare proposals shows that such programs inevitably lead to serious abuses of individuals; may well be unworkable, and could lead to increased costs to state and local governments.

Workfare also would create an irresistible temptation for public officials to substitute AFDC recipients for current civil service employees. Such substitution not only will cause deterioration in the quality of public services, but also will increase the number of employees who will be forced to work under totally substandard conditions.

The President's work program closely resembles the old federal Community Work and Training Program, that was abandoned within six years and replaced by WIN, and California's Community Work Experience Program, enacted in 1971 under then -- Governor Reagan and repealed in 1974. Both programs were considered unsuccessful. These approaches must be rejected today.

Finally, the Administration also proposes consolidating 12 social and child welfare programs into a block grant, cutting total federal spending by 25% and dumping the program on to the states.

We are convinced that a 25 percent reduction in the current level of federal funding for these programs will have a disastrous effect both on the consumers and providers of such vital services as child day care, homemaker services, protective services to children and adults, foster care and family planning. States will be forced to reduce or eliminate many of them as they struggle to establish priorities in the face of a

Child welfare services, adoption assistance, and foster care maintenance under the new Title IV-E must be maintained as separate and distinct programs. The 1980 Child Welfare Act brought long overdue reforms to a system that has encouraged family break up and long-term, costly substitute care for children. With the ink hardly dry on this law, it is now proposed to lump these crucial services along with nine other programs into the social services block grant. This will cancel out the cost effective preventive services mandated by the new law. States will continue to permit children to languish in foster care, to fail to provide the preventive services that are necessary in order to avoid removing children who are the victims of abuse and neglect from their houses, and to deny the opportunity for adoption to children with special needs.

This Committee has shown time and time again that it can deliberately attack waste and abuse, while providing the vital safety net services on which so many Americans today depend for their very lives. We urge you to reject the President's Medicaid proposals and to continue your long-standing efforts to provide needed, responsible and cost-effective services for the truly needy.

SUMMARY

The American Federation of State, County and Municipal Employees (AFSCME) opposes President Reagan's budget reductions and tax proposals. Due to time constraints in preparing this testimony, AFSCME has concentrated its attention on the Administration's Medicaid, welfare child and social services proposals. Additional information will be submitted for the record as soon as possible.

The President's Medicaid proposal must not be adopted because it:

- 1) Arbitrarily imposes spending reductions without sufficient time, guidance or support for states to do anything other than assume an additional \$1-2 billion debt.
- 2) Would totally destroy the entitlement, to health care that is vital to this safety net program for the poor.
- 3) Would destroy the federal-state partnership that has existed for Medicaid since it was enacted in 1965. Moreover, OMB Medicaid estimates are so flawed as to impose an additional \$1 billion debt on state and local governments.
- 4) Cruelly eliminates more than 650,000 people from the AFDC program, many of whom are working poor and who would have no choice but to return to complete dependence on welfare.
- 5) Imposes impossible work requirements on states and recipients.
- 6) Destroys the progress already achieved in the Child Welfare Act and eliminates vital funding for social services.

Mr. McGARRAH. Thank you, sir.

The CHAIRMAN. Thank you very much.

I guess these hearings will continue next Tuesday. We do have a hearing tomorrow morning at 9:30, a confirmation hearing on a number of nominees for the Treasury Department.

[Whereupon, at 12:15 p.m., the hearing adjourned, subject to the call of the Chair.]

SPENDING REDUCTION PROPOSALS

TUESDAY, MARCH 24, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:15 a.m., in room 2221, Dirksen Senate Office Building, Hon. Robert J. Dole (chairman of the committee) presiding.

Present: Senators Dole, Durenberger, Symms, and Grassley.

The CHAIRMAN. I think we can proceed. We will have other Senators coming and going. We have a number of committee meetings.

Our first witness is Mary Marshall, delegate, House of Delegates, Commonwealth of Virginia, on behalf of the National Conference of State Legislatures.

I want to apologize to Senator Byrd, who is off at another meeting. I am not certain he will be able to be here, but he wanted me to express his best wishes and sorry he can't be here. But he has a staff member here, a very fine staff member, you may know.

And we will be happy to hear your statement. You may proceed in any way you wish. The entire statement will be made a part of the record.

STATEMENT OF HON. MARY MARSHALL, DELEGATE, HOUSE OF DELEGATES, COMMONWEALTH OF VIRGINIA, ON BEHALF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES

Ms. MARSHALL. Mr. Chairman, thank you for the opportunity to appear and I am glad to see you here. I hope you are feeling as good as you look.

The CHAIRMAN. Feeling better.

Ms. MARSHALL. Instead of reading my testimony, let me read a summary of it and then emphasize a few points. And then if you have any questions, I'll be glad to answer them.

Let me say first that I am Delegate Mary Marshall. I am a member of the Virginia House. I am a vice-chairman of the State-Federal Assembly of the National Conference of State Legislatures, and I was formerly chairman of its Human Resources Committee.

Among the many budget issues which concern the States, medic-aid demands are our immediate attention. The medicaid policy of the National Conference of State Legislatures is that States must be given maximum flexibility in administering the program, since the States are a major contributor of the program's funding.

The willingness of the new administration to give States more authority to operate medicaid, particularly in the area of using more cost-methods of paying for health care is most welcome.

NCSL believes, however, that the additional flexibility States have long sought should be provided directly by repealing various prohibitions and restrictions contained in the Federal medicaid law itself. We cannot accept a mere broadening of the existing waiver authority, which would require States seeking to alter their medicaid programs to seek and obtain prior permission from the Federal Government.

This is a time when States are faced with the need to make major changes in their medicaid programs in order to slow the growth of the program's cost—a need which the proposed Federal spending cap would only exacerbate. Any requirement that the States must defer necessary changes until they have lined up, asked permission, and been granted a waiver from the Department of Health and Human Services is both unfair and inconsistent with the administration's proposal for regulatory relief.

The waiver approach would also dramatically increase the paperwork burden of the Federal Government at a time when the administration is holding down the number of Federal employees.

In addition, NCSL believes that the proposed cap on Federal medicaid payments is an inappropriate method of controlling the program's costs. States medicaid costs represent a far larger proportion of their budgets than Federal medicaid costs represent of the Federal budget. States, thus, have a powerful incentive to reduce the cost to the program.

Many States would suffer major adverse effects from a medicaid cap, including reductions in eligibility, reduction in services, and the shifting of cost to State, county, city, and private hospitals, as well as other health care providers.

The imposition on the States of a medicaid cap at the same time that potentially large cost savings are ignored in the larger and more inflationary medicare program is particularly inappropriate.

The great incentives States already have to reduce the cost of medicaid, the major adverse effects many States would suffer from a cap, and the need to look for appropriate savings in the medicare program, require that no such cap be imposed.

I want to emphasize again and again that medicare is a more inflationary and a more costly program than medicaid. You can do more to control costs working through that program. At least, the two have to go together.

There are four specific areas in which we want more flexibility:

We would like to have prospective reimbursement for hospitals, instead of reimbursing them after the fact.

We would like to be able to purchase from the most efficient providers.

We would like to have greater use of HMO's possible.

And, we would like to require more copayments and deductibles.

With such flexibility we can do a better job and we can do it with less money. But, we are very concerned about the waiver procedure. Virginia took a year to get a waiver on its hospice program. And that was a fairly simple program which had almost universal support.

We have an Administrative Process Act, so if we change our medicaid plan, we have to go through the public notice and public hearing process. Meantime, we would be suffering under a cap.

If we want a waiver, do we have to ask for waivers of everything at once, or can we go back 2 weeks later and say: "Sorry, we forgot this, but we wanted to include that too?" And, while Secretary Schweiker has been saying that he will be very liberal and generous in granting waivers, nevertheless, I don't think it is as simple as Governor Dalton writing him a letter and saying: "Can I have some waivers?" And the Secretary's writing back and saying: "Yes, go ahead." We are really worried about that administrative logjam and the prospect of operating under a cap with all the present machinery in place.

We think that savings can be achieved. We are quite sure they can be achieved and will be achieved, whether, in fact, the Congress directs them or not, because of our tremendous desire to save our own money.

That really is the gist of my testimony.

I have a chart—which I don't know whether or not you can see from here, but you will get a copy of—that shows the loss to the States as a result of the cap.

Virginia just finished coping with a \$30 million deficit in medic-aid. We went through some 20 proposals for reducing the cost of medicaid, almost every one of which turned out to simply shift the cost to someone else, a good deal of it to private providers and, therefore, private payors, or to city and county government.

This cap would put us right back where we were when we managed to conquer that deficit. Without the flexibility, we will have a terrible time and we will wind up shifting costs to other providers.

The CHAIRMAN. Well, I notice you mention, and I have somewhat the same feeling about the medicare program that you indicate is more costly by about \$20 billion. And, maybe that's a normal reaction if we are looking at your program; you are looking at another program. But, I think there are other areas in the medicare program that can be focused on.

In fact, I am not certain if you are—We have a little blue book. On page 70, we don't recommend, we point out a number of areas where we could save millions and millions of dollars without doing violence to the program. And you mentioned in your testimony that same—at least noted that that was an area that shouldn't be overlooked.

Do you have any specific suggestions in how we might bear the costs of medicare?

Ms. MARSHALL. No, sir; I don't. But we will be glad to supply you with some suggestions. We really have not spent much time on that particular area.

[The following material was supplied for the record.]

MEDICARE SECTION OF MEDICAID REFORM RESOLUTION ADOPTED BY THE STATE-FEDERAL ASSEMBLY OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES ON APRIL 10, 1981

MEDICARE

In conjunction with changes in the medicaid program, cost effective mechanisms to restrain medicare costs should be implemented. Medicare policies which promote inefficient utilization of health services, such as cost-plus retrospective reimbursement, should be replaced by prudent buyer and prospective reimbursement policies. In addition, the federal government should consider limiting participation by provid-

ers whose costs are excessive, imposing cost limits on certain services; and increasing recipients cost sharing. Current restrictions on enrollment in HMO's should be modified, and reimbursement for medicare enrollees in HMO's should reflect the lower cost of care in those programs.

The CHAIRMAN. Right.

Ms. MARSHALL. Because the states do not have any responsibility in the medicare program; they just suffer from the effects. [Laughter.]

The CHAIRMAN. Right. Well, our problem will be that if we are given direction to save a certain amount of money, if we can't do it with the cap and if we find we want to change that, then we will need to find it in other areas.

Ms. MARSHALL. Well, I don't think we are saying: Don't do anything.

The CHAIRMAN. No, no. I understand that.

Ms. MARSHALL. We are saying: Give us some flexibility and we can achieve a percentage reduction, and will achieve one, in fact, whether you all reduce the funds or not. Because our own budget problems are severe and we are trying to reduce expenditures. But, we could achieve more if, at least, these four proposals I presented were incorporated in the changes in the medicaid law.

The CHAIRMAN. Have you tried to estimate that if we adopted those four proposals how much it would reduce the savings?

Ms. MARSHALL. No. But, I do recall we found that we could require copayments on transportation for medical visits in Virginia and were saving something like half a million a year. That's just one State and one tiny aspect of the program.

The CHAIRMAN. Of course, the largest aspect of the medicaid program are long-term care expenses. So, I guess, we could assume that the States would look at this area to reduce their costs. And one—I don't know whether you have any—are there any competitive less expensive alternatives than nursing homes that you are aware of.

Ms. MARSHALL. Yes. We do in Virginia. We have had a pre-screening program for screening people to be admitted to nursing homes. We have had it in effect now for almost 3 years. We screen only admissions from homes, not from hospitals. But some 20 percent of the people who might be admitted to nursing homes are being maintained in their homes. We are saving in the medicaid program around a million a year.

Most of the cost of maintaining people in their own homes is being picked up under the title XX program. Now, title XX is also going to be reduced by 25 percent, which our welfare director tells me will give us the equivalent of 53 percent of what we had when title XX first went into effect, because of inflation.

That means that we may not be able to make as much use of our prescreening program as we have up to date, and that the people will be going into nursing homes instead of being maintained in their homes, unless we come up with State dollars to take care of them.

The CHAIRMAN. And you also indicate in your statement that you support the use of vouchers for medicaid recipients which would permit them to purchase private insurance. A lot of us have supported that concept in the past.

Ms. MARSHALL. Yes.

The CHAIRMAN. But we are concerned that in addition to being expensive, the coverage might be difficult to obtain. Do you have some evidence that it might not be so expensive and it might not be so difficult to obtain?

Ms. MARSHALL. No, I can't really be very helpful there. I do know that together with Marilyn Goldwater, who now chairs our human resources committee, we are working on an insurance pool, such as you have for drivers, to take care of the high risk people who aren't affiliated with a group so that you can provide health insurance for the poor. The way it has been brought to my attention most is by older women who are divorced and lose their health benefits.

The CHAIRMAN. Well, I appreciate very much your testimony and your full statement will be made a part of the record.

If you can come up with any cost saving ideas, in not just medicare but other areas that would be in our jurisdiction, I would appreciate it.

Ms. MARSHALL. Well, I am sure if you put into your new law the things that we have asked for here, there will be savings.

The CHAIRMAN. Right.

Ms. MARSHALL. We like to save our money as much as we like to save yours. [Laughter.]

The CHAIRMAN. I understand that. We don't have any to save; that's our problem. [Laughter.]

Ms. MARSHALL. That's right.

The CHAIRMAN. It's already mortgaged here.

Ms. MARSHALL. But I do want to emphasize the terrible confusion that would arise if we had the cap in place in October; and few of the Legislatures are in session; none of the rules are relaxed; and the Administrative Process Act to be gone through before we can make any changes. This would really create chaos in some places.

The CHAIRMAN. I think it is a very real problem you underscore and we need to address. And I appreciate it very much.

Ms. MARSHALL. Well, we will appreciate anything you can do. NCSL has long been a leader in saying that Federal spending should be reduced and the States should have more flexibility. In principle, we do not disagree with you at all.

The CHAIRMAN. Thank you very much.

Ms. MARSHALL. And do give Senator Byrd my regards. And I am sorry I missed him.

The CHAIRMAN. Well, I'll certainly do that. Ed will do that. [The prepared statement of Mary A. Marshall follows.]

TESTIMONY OF DELEGATE MARY A. MARSHALL, VICE CHAIRMAN, STATE-FEDERAL ASSEMBLY, NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. Chairman, members of the Committee, my name is Mary Marshall, and I am a Delegate from the 22nd District to the House of Delegates of the Commonwealth of Virginia. I serve as Vice-Chairman of the State-Federal Assembly of the National Conference of State Legislatures (NCSL), and I am speaking today on behalf of NCSL. I would like to take this opportunity to express the serious concerns which NCSL has with the Medicaid proposal submitted by the Administration.

I want to make it clear from the beginning that NCSL is pleased with much of the Administration's Medicaid proposal. For years the states have asked for more flexibility in administering the program. The NCSL policy resolution on Medicaid (Attachment A) urges in particular that "states must be given greater flexibility in developing methods for reimbursing institutional providers". We welcome the willingness of the new Administration to give states a freer hand to use more cost-

effective methods in purchasing health care. Let me assure the Chairman and the members of the Committee that state legislatures will not use any additional flexibility they gain to provide poor people with a lower quality of health care or to impose unreasonable burdens on hospitals, doctors, nursing homes, and other providers. Rather, we seek flexibility solely in order to free ourselves from the inefficient methods of purchasing health care which so far we have been compelled to use by federal law, regulation, and enforcement.

The National Conference of State Legislatures has two serious objections however, to the Administration's Medicaid proposal. Our first objection is to the way in which the Administration apparently plans to give states greater flexibility. The second objection is to the proposed across-the-board federal spending cap.

Initially, the Administration proposed to give states broad statutory flexibility to restructure their Medicaid programs without seeking permission from the Department of Health and Human Services. We have since learned that the Administration will seek instead merely to broaden the Department's existing "waiver" authority, so that states would still be prohibited from making needed changes until the Department gave its permission.

NCSL believes that the additional flexibility states have long sought should be provided directly by repealing various prohibitions and restriction contained in the federal Medicaid law itself. We cannot accept a mere broadening of the existing waiver authority which would require states seeking to alter their Medicaid programs to apply for and obtain prior permission from the federal government. Today, states are faced with the immediate need to make major changes in their Medicaid programs in order to slow the growth of the program's cost. This need would only be exacerbated by the proposed federal spending cap. Any requirement that states must defer necessary changes until they have lined up, asked permission, and been granted a waiver from the Department of Health and Human Services is both unfair to the states and inconsistent with the Administration's effort to do away with excessive regulation. The waiver approach would also dramatically increase the paperwork burden of the federal government at a time when the Administration is holding down the number of federal employees.

In addition, NCSL believes that the proposed cap on federal Medicaid payments is an inappropriate method of controlling the program's costs. Even if all states utilized the full flexibility which NCSL hopes will be made available to them, it will be impossible—without seriously depriving the poor, overburdening providers, or shifting costs to local and county government—for the states as a whole to absorb either the massive \$1 to \$2 billion loss of federal funding which would result from the 5 percent cap proposed for fiscal year 1982 or the larger reductions promised by the "interim" cap in later years.

And so I ask you: give states the tools we need to cut Medicaid costs, but do not make irrational assumptions about cutting Medicaid at a time when inflation in the health care sector exceeds 15 percent.

There are four reasons why the cap is a bad idea.

First, it is based on a false premise.

That premise is that states lack sufficient incentive to hold down the cost of Medicaid. Nothing could be further from the truth. States' Medicaid costs represent a far larger proportion of their budgets than federal Medicaid costs represent of the federal budget. States thus have a powerful incentive to reduce the cost of the program. States' incentive to hold down the cost of Medicaid is, if anything, greater than the incentive of the federal government.

Not only do states have an incentive to hold down Medicaid costs: they have acted to hold down Medicaid costs. I would urge you—as I would urge Mr. Stockman—to visit some state capitals to find out how much states have already done and how much more they are trying to do, to restrain the cost of Medicaid. I believe you will conclude that states have done far more than the federal government in recent years to bring Medicaid under control.

Let me tell you briefly about Virginia's effort to contain the cost of our Medicaid program.

We have had a Medicaid Management Information System (MMIS) from the beginning. Our system is the foundation for the MMIS systems now required in all states. We can track fraud from day one; we know how many physicians a client is seeing; and we know how many hospital days a client is taking.

We limit hospital coverage per illness, provide prospective reimbursement for nursing homes, and require co-payments for transportation.

We have had for more than two years a screening program of admission to nursing homes. About 20 percent of those screened remain at home. The services they receive are paid for from Title XX funds. Unfortunately, it now appears that it will be necessary to make more nursing home placements at additional cost to the

Medicaid program as a result of the sharp decline in "real" Title XX dollars since 1975 caused by inflation and the reduction sought by the Administration.

The effort of states to control Medicaid costs has also been a top priority in Maryland, California, Illinois, New Jersey, Michigan, Wisconsin, and many other states. (See attachment B for a summary of what states were doing before the Administration even took office.)

In short, states have both a great incentive to hold down Medicaid costs and a proven track record in restraining the program's cost. One of the major premises for the proposed Medicaid cap is thus simply not true, which is one good reason why the cap should not be imposed.

Second, the cap ignores the enormous differences among the 50 states.

As you know, each state has a different Medicaid program. This diversity in economic conditions and Medicaid program structures—not to mention the different rates of increase in local medical care costs—means that the state-by-state impact of a cap will vary widely. States with only the most basic programs, or experiencing sharp caseload growth due to economic adversity beyond their control, would be hit particularly hard. States that have already exhausted many cost containment options—reducing eligibility, services, and reimbursement rates—will face particular difficulties. Many of these states will have no choice but to shift costs to counties, cities, and the private sector, by reducing Medicaid eligibility and eliminating services. For no matter how much they are able to use more cost-effective methods of purchasing care, their cost savings will simply not be enough to make up for both the huge rate of inflation in the health care sector and a substantially lower federal payment due to the proposed cap.

The great diversity of these United States is thus another reason why a rigid, uniform, nationwide cap is unwarranted.

Third, the cap ignores the real problem with Medicaid—the excessive inflation built into our health care sector.

The unpleasant truth is that Medicaid costs a lot of money because health care in America is expensive—and getting more expensive every day. Medicaid cost increases largely reflect the huge rate of inflation in the overall health care system. While Medicaid itself contributes somewhat to this inflation, it contributes very little. Rather, it is the much larger and less cost-conscious Medicare program, other third-party reimbursement systems, and other factors which primarily drive the cost of health care skyward. To make states, through their Medicaid programs, bear the full burden of compensating for the inflation in the health care sector—which Medicaid has only a little to do with, but which Medicare and other federal policies have a great deal to do with—is both unfair to the states and hopelessly inconsistent on the part of the federal government.

I urge the members of this Committee to see the cap for what it is: a device which draws attention away from the real cause of growing Medicaid costs and which will only make it more difficult to deal with the fundamental problems of hyperinflation in the health care sector.

Fourth, the cap neglects the need of state legislators and other state decision-makers to have a reasonable amount of time to adjust to major changes in federal Medicaid policy.

Most state legislatures will have completed their budgets and adjourned by May 30, well before any major changes in Medicaid could be enacted by Congress. Approximately 40 state legislatures will be out of session by June 30, the earliest date congress decisions are likely to be known. (See Attachment C.) State law, custom, and the cost to taxpayers of special sessions restrict the ability of most state legislatures to convene in special session during the summer and fall. Thus, it may not be until January of 1982 that many state legislatures would even be able to begin their consideration of how to revise Medicaid in order to adjust to a federal spending cap. By January of 1982, states would presumably already be getting reduced federal Medicaid payments at the "capped" rate, because one-fourth of the new federal fiscal year will have already passed.

Moreover, whether state legislatures are able to convene in mid-summer or wait until early next year, they will be hesitant to revise as important, complex, and expensive a program as Medicaid overnight. We will insist upon a reasonable amount of time to restructure the program—just as the members of Congress would insist upon a reasonable amount of time to restructure comparably important programs such as Medicare or Social Security. Thus, it may not be until March or April of 1982 that some states will be able to alter their programs. By then, they will have been operating their programs and making payments under the old rules for over half of the federal fiscal year, during which payments would be coming in at the substantially reduced "capped" rate. What this means is that the entire effort to live within the cap would have to be fitted into the remaining 6 months of fiscal

year 1982. Massive cuts in eligibility and services for a 6 month period may be the only way to deal with the squeeze.

I urge Congress to apply to this situation the Golden Rule. Do unto state legislatures as you would have state legislatures do unto Congress. Give us the reasonable lead-time we need to deal with major changes in state Medicaid programs—as you would expect to have reasonable lead-time to make major changes in any major federal program.

And if you take this approach, I believe you will conclude that a spending cap—to go into effect when almost all legislatures are out of session, and months before most legislatures are scheduled to reconvene—is entirely inappropriate.

Mr. Chairman, NCSL has for several years asked that states be given the increased flexibility they need to make more rapid progress in holding down the cost of Medicaid. On behalf of NCSL, I wish to renew the states' request for flexibility, which I believe will a far more efficient tool than a cap in achieving savings—not mere cost-shifting, but real savings—in Medicaid. Specifically, I urge you to allow states to pursue the following alternatives to achieving reductions in Medicaid spending.

1. PROSPECTIVE REIMBURSEMENT

Instead of requiring that hospitals be reimbursed for inpatient services after they have performed their services on the basis of whatever costs are incurred, states should be able to use "prospective reimbursement" procedures under which service costs are fixed in advance. Should the prospective rates exceed actual charges, it should be possible to share the savings with the providers themselves, thus encouraging even lower costs and greater savings.

2. PURCHASING FROM EFFICIENT PROVIDERS

Instead of allowing all health care providers to participate in the program regardless of any history of excessive charges, states should be able to limit participation to providers whose costs fall within reasonable bounds set by the state.

3. GREATER USE OF HMO'S

Statutory barriers of Medicaid's use of HMOs and other capitation-based programs should be eliminated. Current Medicaid policy inhibits the extent of use of these potentially cost-effective systems, a result which is particularly short-sighted as it applies to tax-supported public health care facilities.

4. COPAYMENTS AND DEDUCTIBLES

States should be allowed to require income-sensitive nominal copayments and deductibles where they are now prohibited.

In addition, I strongly urge you to consider the implementation of statewide demonstrations to test the usefulness of other reforms, including:

Authorizing the provision of access to quality care through a limited number of cost-effective providers.

Authorizing the use of voucher systems for recipients to purchase care from providers or insurers of their choosing.

I would like to conclude my testimony with a request that this Committee take a hard look at the reimbursement methods used in Medicare. The cost of Medicaid is exacerbated by the tendency of certain Medicare reimbursement policies, such as after-the-fact reimbursement, to drive up the overall cost of our health care system. Moreover, it is both unfair and inconsistent to seek to hold down Medicaid costs while not addressing the most costly features of the Medicare program. Several of the cost-saving measures which I believe states should be allowed to use in running their Medicaid programs could, without in any way limiting eligibility, services, or the integrity of the Medicare program, be appropriately applied to that program, resulting in substantial savings. I understand that the Senate Budget Committee has decided in its Reconciliation Instructions to give you "the flexibility to make . . . savings in either Medicaid or Medicare . . ." I urge you to consider Medicare cost-saving options.

Thank you for giving me, and NCSL, this opportunity to speak. I will be glad to answer any questions you may have.

ATTACHMENT A—MEDICAID REFORM (JULY 1979)

(Source: Policy Resolutions of NCSL, 1980-1981)

In 1965, the public sector substantially enhanced the access to health services for millions of low income individuals through the enactment of Medicaid. While health care delivery has undoubtedly improved for many in the low income population, proper safeguards were not built in to check the inflationary effects of the tremendous influx of public dollars into the health sector.

Since the initiation of the Medicaid program, the growth in expenditures has been dramatic. In fiscal year 1966, its first year of operation, expenditures totalled \$1.6 billion; in fiscal year 1967, expenditures exceeded \$14 billion. Projections for fiscal year 1977 estimate expenditures approaching \$17 billion nationally, representing more than a ten-fold increase in just ten years! The number of Medicaid recipients also has risen tremendously over the past several years—from 9 million in fiscal year 1967 to a projected 25 million in fiscal year 1977. From 1968 through 1974, the total days of care provided to Medicaid recipients in general hospitals more than doubled. In the same period, the cost per day of care in a general hospital increased 64 percent from \$59 a day to \$97 a day. The overriding impact of such cost escalations is that Medicaid expenditures are consuming a disproportionate share of the limited state and local funds available to support other worthwhile social programs for low income individuals.

The large annual price increases in the health sector since the advent of Medicaid and Medicare are well known. What is not so commonly recognized, however, is that even before 1966, health care prices were increasing substantially faster than other sectors in the economy, leading one to conclude that inflationary forces were already at work to produce the relatively rapid rise in health care costs. In a real sense, Medicaid has been a contributing factor to the general inflation in health costs, but it is equally fair to say that Medicaid has been a victim of that inflation. As one analyst succinctly put it, "Medicaid is expensive because medical care is expensive."

Public disclosures of extensive fraud and abuse, along with serious fiscal crises in many states and local governments resulting in cutbacks in services, prompted all levels of government to search for ways to restore integrity to the Medicaid program and to check the unacceptable cost escalations. Efforts to curb fraudulent practices by providers and recipients, to ensure the proper utilization of services and to promote efficient program management are desirable and worthwhile objectives and should be implemented swiftly. However, these actions will not fully resolve the problem of inflation in health costs. The problems in the general health care system are deeply entrenched structural problems, having to do with basic incentives which contribute to the inefficient behavior of the system. And those problems are unlikely to be affected by modifications in a program which served only ten percent of the nation's population and accounts for less than eight percent of the nation's health expenditures.

Medicaid reform, therefore, should not be treated in isolation; rather, it must be approached with a sensitivity to its relation to the total medical care system. It is widely accepted that holding down prices for only one segment of the health system, i.e., Medicaid, will likely lead to undesirable distortions in the general health economy. For example, controlling reimbursement rates for Medicaid services in hospitals might result in a shifting of some costs from federally funded patients to private patients. Cost control efforts, therefore, designed to curb unreasonable increases in all health care prices would aid in holding down the Medicaid budget with fewer adverse consequences to recipients.

A flexible federal-state-local structure offers the best format for experimenting with various ways to organize, manage and deliver health services. A revised Medicaid program offering greater flexibility to the states and local governments, hopefully can serve as a useful laboratory for examining the many critical questions which must be addressed on the road to a national health care system.

Hopefully, efforts aimed at reforming the public sector's involvement in the health industry will serve as a transitional stage toward the recognition and the resolution of the many basic weaknesses that prevail in the whole health care structure.

MANAGEMENT IMPROVEMENT

Consultation with representatives of state and local governments should precede the development of Medicaid regulations. The regulations should be issued well in advance of the effective dates and the purpose and objectives of the regulations should be clearly specified.

State variations should be allowed in implementing the regulations, recognizing the differences in relative wealth and poverty and other socioeconomic factors. Criteria should be developed in light of these variations. Standards by which to evaluate state compliance with regulations must be formulated, with an emphasis on outcome objectives rather than process measures or technical requirements.

Reasonable deadlines for compliance with regulations should be agreed upon by all levels of government affected by the regulations.

With respect to the application of fiscal sanctions, efforts should be made to distinguish between willful intent not to comply and management inefficiencies. Where the latter is the problem, technical assistance should be the initial remedy with a specified time established for compliance.

Performance standards should be viewed as an essential management or information device by which an ongoing assessment of the effectiveness and efficiency of a state's Medicaid program can be made and by which areas of deficiency can be identified and corrected. Standards should not be used as a vehicle for the application of fiscal penalties.

The application of penalties should be only a measure of last resort. When program deficiencies are identified, a corrective action plan should be formulated by the state and technical assistance should be extended by HEW to help implement the plan. Only when further review indicates non-compliance should a penalty be imposed.

Penalties should be levied on a flexible basis, in accordance with the degree of non-compliance.

Positive incentives, e.g., higher matching ratios, should exist to encourage worthwhile programs.

One of the serious deficiencies in Medicaid management is the lack of comprehensive and comparable program information. HEW should work with the states to establish a common set of data describing each state Medicaid program, including information on reimbursement.

HEW should have the authority to reimburse states up to 90 percent for administrative costs. In return for the increased match, states must fulfill certain performance criteria in the administration of the program. HEW would negotiate with each state on the conditions and standards that must be met in order to receive the higher match.

The development of MMIS within every state should be a major priority of HEW. The matching ratios for development and operation of MMIS should be reconsidered in view of the disproportionate burden the costs have on predominantly low income states.

Staff to implement findings from the MMIS systems should be paid on a 75/25 percent matching basis.

The Medicaid technical assistance role of the HEW should be strengthened and upgraded and added emphasis should be placed on training federal staff onsite within the states.

HEW—in cooperation with the major state and local public interest organizations—should foster inter-state technical assistance and resource exchanges for the improvement of Medicaid management and administration.

FRAUD AND ABUSE

A comprehensive program for the detection, investigation and prevention of recipient and provider fraud within the Medicaid Program should be developed with an emphasis placed on improved coordination between Medicaid Program integrity personnel and appropriate federal, state and local law enforcement agencies.

The Social Security Act should be amended to provide that Medicaid programs have the authority and responsibility to exclude Medicaid providers with consistent patterns of "Program Abuse" from participation in the program. The language should give a program the authority to simply terminate an individual or organization as a reimbursable provider if there is significant evidence of "abuse". Such evidence could include consistently billing for substantially more expensive services per visit, or more elective surgery procedures or tests ordered per patient, etc.

The Social Security Act should be amended to allow Medicaid Programs to exclusively contract with specific providers for specified segments of the Medicaid population when a specific service is particularly subject to over-utilization (e.g., outpatient psychiatric services) and an exclusive contract approach on a capitation basis would result in the availability of services when really needed.

INSTITUTIONAL REIMBURSEMENT

States must be given greater flexibility in developing methods for reimbursing institutional providers. The concept of reasonable cost must be replaced by mechanisms that increase the state's ability reduce health costs and to function more effectively in allocating limited state resources. Such a payment mechanism could involve establishing prudent rates for certain frequent and simple procedures. A state should have the flexibility to establish standard costing criteria for determining allowable rates of reimbursement. If reimbursement technique can be used to effectively control costs without limiting availability of services, federal legislation should not prohibit their adoption by state governments.

The following reimbursement alternatives for institutions should be available to the states:

- Prospective reimbursement for hospitals;
- "Prudent Buyer" approach to hospital reimbursement;
- Limiting services to certain hospital;
- Budget ceilings for hospital expenses;
- Health maintenance organization; and
- Prospective rate-setting for nursing homes.

Medicare regulations should permit flexibility to allow Medicare reimbursement to link with alternative Medicaid reimbursement strategies.

The Department of Health, Education and Welfare should assume the lead role in establishing a common data base for use in developing a fee for each provider in type, based on information elements available to every health care program.

Section 1526 of Public Law 93-641 should be amended to allow states to receive grants to coordinate Medicaid reimbursement with other third party payors for the purpose of regulating rates.

QUALITY ASSURANCE—PSRO'S

A reassessment of the original objectives and proposed operation of PSRO's should be undertaken. And should the assessment determine that PSRP's should continue to have an active role in utilization review, their continuation should incorporate the following modifications:

Formalize and mandate state monitoring of PSRO activity (state-monitoring could be done through the surveillance and utilization review component of the Medicaid Management information System);

Provide a working process for states to appeal PSRO's decisions;

Repeal ruling giving PSRO's ultimate jurisdiction over review of medical necessity, allowing some joint determination by state and PSRO;

Allow states to continue utilization and similar reviews, maintaining federal matching payments to support them, and encourage or mandate exchange of data delivery by states and PSRO's;

Allow states to become PSRO's where no current activity is ongoing;

Encourage active cooperation and coordination between the Bureau of Quality Assurance (BOA) and Medical Services Administration (MSA).

FREEDOM OF CHOICE

The "freedom of choice" provision in the Social Security Act should be modified to enable the states to address the problem of chronic over-utilization in a manner which maintains recipient access to available services.

The Social Security Act should be amended to explicitly empower states to assign one primary care physician (or other provider) of a client's choice when there significant evidence of overutilization. Such language should allow a state to identify a number of responsible providers in the client's geographic area, from which the client would select his or her choice.

The Social Security Act should be amended to allow Medicaid programs to exclusively contract with specific providers for specified segments of the Medicaid population when certain conditions exist. Such conditions might include: (1) wherein substantial economies would be realized and clients would not be adversely affected (e.g., laboratory services) and (2) wherein a contract is needed to attract responsible providers where there is a shortage of such providers.

MEDICAID COPAYMENT

Title 19 of the Social Security Act should be amended to allow states greater flexibility in adopting cost-sharing programs in Medicaid. Such programs, however, should be sensitive to the income levels of Medicaid recipients.

PREPAID HEALTH CARE HMO'S IN MEDICAID

Federal law should encourage states to contract to provide Medicaid services with health maintenance organizations with sound standards and criteria.

Federal technical assistance and guidelines should be provided to states in contracting with HMO's.

Enforce present regulations which disallow contracts with HMO's who wish to serve only Medicaid eligibles. HMO markets must be assured to the general populations.

Modify requirements to allow states to contract on an interim time specific basis with non-federally certified HMO's who have applied for federal certification.

LONG-TERM CARE

Change restrictive Medicare/Medicaid regulations governing home care to allow coverage of chronically ill patients and payment for supportive as well as medical services.

Medicare should assume financial responsibility for the costs of the copayments and deductibles for the elderly indigents who qualify for Medicare.

All the health care costs of the elderly should be the responsibility of Medicare or of a national health insurance program.

Adjust Medicare and Medicaid regulations to allow reimbursement for those types of services which are effective in maintaining the elderly in their homes at a cost below institutionalization.

A long-term care strategy must be developed. It should be comprehensive in scope, recognizing that long-term care requires not just health services, but custodial care, shelter and social services as well. Those components of long-term care other than health should be funded through a separate mechanism other than Medicare or NHI.

ATTACHMENT B

(Source: Richard E. Merritt, Editor, "State Health Notes," Number 16, January 1981. Intergovernmental Health Policy Project, George Washington University, Washington, D.C.)

THE MEDICAID CRISIS

Controlling Medicaid costs is expected to dominate the health policy agendas of the states in 1981. In a recent survey conducted by IHPP staff, 28 states identified moderate to serious funding problems with their Medicaid budgets this year. The problem has grown so acute in some states that unless substantial supplemental appropriations are forthcoming, significant reductions in program coverage will have to occur.

The most common reasons cited for the funding problem are: (1) national economic circumstances resulting in reductions in state revenue and increases in eligibility for public assistance; (2) continued medical price inflation; (3) a substantial growth in inpatient hospital utilization; (4) the loss of general revenue sharing funds; and (5) state and local tax limitations.

Medicaid has become the single most rapidly increasing item in most state budgets. On the average, Medicaid accounts for between 10 to 15 percent of each state's general operating fund. Nationwide, Medicaid expenditures were approximately \$24 billion in fiscal year 1980—\$13 billion federal and \$11 billion state and local. Projections estimate Medicaid expenditures to reach \$27.6 billion (\$15.2 billion federal and \$12.4 billion state and local) by the end of fiscal year 1981 (September 30, 1981). While Medicaid program costs grew at a rate of 18 percent between 1978-79, state operating budgets increased on the average by only 9.3 percent. The gulf between program costs and available revenues continues to widen, prompting considerable interest on the part of state officials in viable cost containment strategies.

Two resources, recently published by the National Governors' Association's Center for Policy Research, should be of considerable assistance to policy makers in their search for ways to control Medicaid expenditures. One publication entitled "State Guide to Medicaid Cost Containment," authored by Bruce Spitz, is designed as a practical manual for state decision-makers. The guide offers a range of cost containment strategies short of restrictions on eligibility or reductions in benefits. Specific strategies are detailed within the context of six broad areas: (1) minimizing or eliminating the use of open-ended and/or provider controlled reimbursement for nursing homes, hospitals and physicians; (2) minimizing provider and recipient misuse of the programs; (3) restructuring program coverage so that care is delivered in an appropriate but least expensive setting; (4) minimizing eligibility errors; (5)

minimizing Medicaid's subsidy of other third parties; and (6) maximizing the purchasing power of the state.

A second document, "State Initiatives in Medicaid Cost Containment," provides individual state profiles of actual cost containment actions adopted since the inception of the various Medicaid programs. The profiles provide information on state initiatives related to a wide range of cost containment options, e.g., hospital reimbursement, nursing home reimbursement, utilization controls, and reducing eligibility errors. The survey results, current through July, 1980, tend to negate the widely held belief that states restrict eligibility and benefits during economically tough periods. The survey points out that "between 1978 and the late summer of 1980, the majority of Medicaid program changes reported by the states increased both coverage and eligibility."

The IHPP survey of state Medicaid programs picks up where the NGA survey leaves off. The IHPP survey found that increasingly severe fiscal pressures during recent months have caused some states to institute cutbacks in services and eligibility, while many others are giving serious consideration to doing the same. A sampling of a few states helps to illustrate the magnitude of the problem.

STATE MEDICAID COST CONTAINMENT APPROACHES

In response to a projected \$48 million shortfall in appropriations for the Medicaid program, the Tennessee Department of Public Health proposed a series of limitations on program benefits. The proposed changes included: reducing physician and dentist fees; limiting the number of inpatient hospital days to 14 and the number of outpatient visits to 6; eliminating coverage of certain prescription drugs, while establishing maximum reimbursement rates for others; and reducing nursing home reimbursement to the 50th percentile of charges for all nursing home facilities. The cutbacks were to become effective last August; however, a U.S. District Court intervened and postponed their implementation. The Court ruled that the state had failed to follow procedural requirements by not adequately consulting with the state's Medical Care Advisory Committee about the changes. The Court also declared that the advisory committee lacked appropriate consumer representation and directed that the committee be reconstituted.

The new advisory committee departed in some significant ways from the Health Department's original recommendations. For example, the committee rejected the Department's call for reductions of provider fees, as well as reductions in the number of covered inpatient hospital days and outpatient visits. The committee did concur with the proposals to eliminate certain drugs from coverage and to set maximum reimbursement limits on others. Additional recommendations include: limiting Friday and Saturday hospital admissions to emergencies; instituting co-payments on all optional services; and encouraging the state health planning agency to restrict further expansion of nursing home beds through the certificate of need process. In addition, the Governor has requested \$12.8 million in supplemental funds to help keep the program alive through the current fiscal year. The Governor notified the Speaker of the General Assembly and the Senate President that "the state Medicaid program will exhaust its appropriated dollars between March 31 and April 15. Should the General Assembly decide not to approve the supplemental appropriation, the law is clear that the state must then shut down its program."

In California, Governor Brown has directed each department to hold their budget increases to one percent over the previous year's level. Since Medi-Cal has been growing at a rate between 15 to 20 percent annually in the state, some cuts will have to be made. The size of the shortfall in California could approximate \$800 million. One much discussed strategy designed to ease the shortfall is to eliminate from further eligibility the medically indigent (MI) adult category. The MI category basically includes the "working poor"—those between 21 and 65 who do not meet any of the categorical welfare definitions and whose incomes are above the public assistance standard. This category is not recognized by Medicaid and therefore there is no federal financial participation. Elimination of the MI category would save approximately \$570 million.

While other short term cost containment strategies continue to be discussed, many public officials are focusing their attention on more long range, structural reforms. Assemblyman Art Torres, Chairman of the Special Committee on Medi-Cal Reform, recently revealed a number of recommendations designed to affect the entire health care delivery system and, hopefully, improve the Medi-Cal system in the process. Among the committee's more far-reaching suggestions are proposals designed to: (1) encourage greater open market competition through the development of organized health systems, such as, Individual Practice Associations and county based HMOs; (2) extend enrollment for recipients that choose to participate in one of the organized systems; (3) exempt hospital-based organized health systems

from certificate-of-need requirements; (4) continue health insurance coverage for up to one year for those who become unemployed; (5) create a statewide insurance pool to provide coverage for the high risks and uninsurables; (6) limit tertiary care services for Medi-Cal recipients to specific centers and (7) revamp the Medi-Cal eligibility system, making verification of eligibility similar to the process used by merchants to verify VISA eligibility, i.e., by telephone or by on-line terminal.

Maryland, a state that just six months ago claimed a surplus of \$293 million dollars, now anticipates a \$51 million shortfall in its Medicaid budget at the end of the current fiscal year (June 30). The primary reason for the shortfall relates to an unprecedented increase in hospital utilization. The number of inpatient hospital days in fiscal year 1980 was 15 percent higher than in fiscal year 1979, while the budget was based on a projected increase of less than 3 percent. In an immediate response, the state adopted several emergency cost containment regulations which are already in effect. The emergency regulations include: (1) a one day pre-operative limit on hospital inpatient days; (2) a limit of 20 days per spell of illness in inpatient hospital coverage; (3) elimination of reimbursement to acute general hospitals for administrative days for recipients pending discharge to home or to a non-medical institution; and (4) a requirement that certain surgical procedures be performed in outpatient settings unless prior approval is granted. Savings from these emergency measures are expected to approximate \$11 million. The Governor has appointed a special task force to establish priority areas for further cuts.

In Wisconsin, The Governor has directed that the Medicaid budget shall not increase more than \$106 million in state dollars during the 1981-83 budget cycle. Projections indicate, however, that if no changes are made, and if price and utilization trends remain the same, the Medicaid program would require \$174 million in additional state funds. Hence, if the Governor is to achieve his objective, some reductions will have to be made. Among the major priorities for changes suggested by the Department of Health and Social Services are to: (1) hold rate increases to both institutional and non-institutional providers to below the previous year's increases; (2) eliminate optional services such as alcohol and drug abuse treatment and outpatient psychotherapy; (3) eliminate optional outpatient services for the medically needy; (4) increase third party collections; (5) require co-payments for part of the cost of eyeglasses, drugs and dental care; (6) eliminate reimbursement under Medicaid for hospital education costs which are not directly related to patient care; (7) reimburse at the nursing home rate rather than the hospital per diem rate for days spent in a hospital while awaiting nursing home placement; and (8) reimburse ambulatory surgery at the outpatient rate regardless of where it is performed.

A recent report by the Wisconsin legislature's Ad Hoc Committee on Nursing Home Utilization identified 16 major recommendations designed to reduce inappropriate use of nursing homes in the state. Number one on the list of recommendations is a call for a two year moratorium on the issuance of certificates-of-need for the building of new nursing home beds. The report suggests that such a moratorium should foster the development of community-based care. Other key recommendations include: providing nursing homes with additional reimbursement for the costs associated with the discharge of patients to the community and the search for community-based alternatives; removing CON requirements for the development of new community-based residential facilities; prohibiting divestment of assets for the purpose of obtaining Medicaid eligibility; providing tax incentives for maintaining an elderly relative in the home; and supporting funding of respite care for elderly persons being cared for by relatives.

Mississippi anticipates a \$24.5 million (state and federal) deficit in its Medicaid program through the current fiscal year. As a result, the state's Medicaid Commission implemented a set of phased-in reductions in benefits beginning January 1, 1981. The reductions call for a limitation on inpatient hospital days to 20 per year; a limitation of physician office visits, emergency room, rural health clinics, and hospital outpatient visits to 12 per year; a limitation on payments for ancillary procedures performed in a physician's office to 12 per year; a termination of payments for ancillary diagnostic procedures on an outpatient basis after the 12 allowed visits have been exhausted; and co-payment requirements for eyeglasses, emergency ambulance, and dental services. The Commission has requested a supplemental appropriation to correct part of the deficit. However, if the supplemental is not approved, the Commission is prepared to eliminate the outpatient drug program, as well as coverage for intermediate nursing home care.

The Virginia Department of Health projects a \$68 million (\$29 million in general fund dollars) shortfall in the Medicaid program by the end of the fiscal year 1980-82 biennium. The Department has presented a set of cost containment options in priority order for consideration by the legislature. Near the top of the list is a recommendation to limit eligibility for intermediate care facilities to those with

monthly incomes below \$500. Other priority options include co-payments on transportation services, reducing hospital outpatient reimbursement to 90 percent of actual cost, and reducing coverage of the medically needy to cover only ambulatory and preventive services.

In the absence of additional funding or the implementation of proposed restrictions, the New Jersey Medicaid program would run out of money on May 1, 1981. To address a projected \$50 million Medicaid deficit, the state's Department of Human Services is ready to institute a number of programmatic cuts in early February. The proposed cuts include the elimination of most optional services such as dental care, drug benefits, and artificial limbs.

The Secretary of the Kentucky Department of Human Resources recently announced 34 recommendations designed to achieve a \$46 million savings in the state's Medicaid program by fiscal year 1983. Governor Brown is expected to sign an executive order implementing these recommendations on a phased-in basis over the next two years, beginning April 1, 1981. The most significant changes include: reducing the number of inpatient hospital days from 21 to 10; eliminating non-emergency weekend admissions; instituting reimbursement penalties for hospitals with less than a 60 percent occupancy level; setting maximum ceilings on nursing home reimbursement; reducing the maximum profits allowed in the nursing home reimbursement formula; limiting comprehensive physician visits to one per year; reducing payments for in-patient physician services; requiring recipient co-payments for all prescriptions; and reducing outreach efforts under the Early and Periodic Screening, Diagnosis and Testing Program to the minimum required by federal law. One unique idea among the proposed changes would require nursing homes to reserve at least two percent of their beds for patients being discharged from hospitals.

Minnesota faces a \$50 million shortfall in its fiscal year 1981 Medicaid budget, with projected deficits of \$100 million in each of the following two fiscal years. A series of eligibility and service restrictions will be on the legislative docket this year.

Every state agency in Iowa was forced to reduce their budget by 3.6 percent during this fiscal year. In response, the Medicaid agency has already implemented a 50-cent co-payment on prescription drugs; tightened utilization controls, particularly over emergency room treatment; and placed a greater emphasis on ambulatory surgery.

While most states have their back against the Medicaid "wall", a few states actually are considering initiatives which will either expand program coverage or costs. New York's Governor Carey, for example, recently revealed his plan to have the state assume the local governments' share for Medicaid, which will amount to approximately \$1.2 billion in fiscal year 1981. The Governor's plan would be phased-in over several years, and would be coupled with specific administrative and legislative actions to control the rate of growth in Medicaid costs. As a condition for the assumption of local costs, the Governor's plan anticipates substantial property tax relief by local jurisdictions.

The Florida legislature may be debating a proposal to expand Medicaid coverage to include many outpatient services currently financed solely by county governments. In return, counties would make increased contributions to Medicaid costs. North Carolina is considering extending Medicaid coverage to first time pregnant women.

ATTACHMENT C

1981 Legislative Session Calendar

	DEC.	JAN.	FEB.	MAR.	APR.	MAY	JUNE	JULY	AUG.	SEPT.	OCT.	NOV.	DEC.
*ALABAMA	2/3						mid-May						
*ALASKA	1/12						May						
*ARIZONA	1/12					mid-April							
*ARKANSAS	1/12												
*CALIFORNIA	12/1/80												early September
*COLORADO	1/7						early June						
*CONNECTICUT	1/7						June 3						
*DELAWARE	1/13						June 30						
*FLORIDA				4/7			June 8						
*GEORGIA	1/12				late March								
*HAWAII	1/21					mid-April							
*IDAHO	1/12				early April								
*ILLINOIS	1/14						June 30						(Fall Session probable)
*INDIANA	1/12					mid-April							
*IOWA	1/12						early May						
*KANSAS	1/15						mid-April						
*KENTUCKY													No 1980 Session
*LOUISIANA				4/20			July 13						
*MAINE	1/7						May						
*MARYLAND	1/14				April 13								
*MASSACHUSETTS	1/7												
*MICHIGAN	1/7												
*MINNESOTA	1/8					May 18							
*MISSISSIPPI	1/8				early April								
*MISSOURI	1/7						June 30						
*MONTANA	1/8					late April							
*NEBRASKA	1/7					early May							
*NEVADA	1/18					May							
*NEW HAMPSHIRE	1/7						June						
*NEW JERSEY	1/13												
*NEW MEXICO	1/20			March 21									
*NEW YORK	1/7						about July 1						(Fall Session probable)
*NORTH CAROLINA	1/14						June						
*NORTH DAKOTA	1/5				late March								
*OHIO	1/5												
*OKLAHOMA	1/8						early June						
*OREGON	1/12							early July					
*PENNSYLVANIA	1/8												
*RHODE ISLAND	1/12						May						
*SOUTH CAROLINA	1/13						July						
*SOUTH DAKOTA	1/8			March 1									
*TENNESSEE	1/13						late May						
*TEXAS	1/13						June 1						
*UTAH	1/12			March 12									
*VERMONT	1/7					April							
*VIRGINIA	1/14			mid-February									
*WASHINGTON	1/12					April 25							
*WEST VIRGINIA	1/14			2/10		April 11							
*WISCONSIN	1/13							late June					(Fall Session probable)
*WYOMING	1/13					February 27							

*These dates which are abbreviated have implications on session length.

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The CHAIRMAN. Ms. Cooper could not be here, right?

Michael Barber, supervising deputy district attorney, Sacramento County, Calif., legislative representative for the California District Attorneys' Association Family Support Council.

Mr. Barber.

Mr. BARBER. Thank you, Mr. Chairman.

The CHAIRMAN. We will be happy to hear your testimony. Your entire statement will be made a part of the record.

Senator Symms will also be present. I am going to run downstairs and introduce three—at another hearing, but I will be right back. And, I'll—

This is Mr. Barber.

Senator SYMMS. Thank you, Mr. Chairman.

The CHAIRMAN. Just ready to start. I'll be right back.

Mr. BARBER. Thank you, Mr. Chairman, Senator.

Senator SYMMS. Welcome to this committee, Mr. Barber.

Please go right ahead.

STATEMENT OF MICHAEL E. BARBER, SUPERVISING DEPUTY DISTRICT ATTORNEY, SACRAMENTO COUNTY, CALIF., LEGISLATIVE REPRESENTATIVE FOR THE CALIFORNIA DISTRICT ATTORNEYS' ASSOCIATION FAMILY SUPPORT COUNCIL

Mr. BARBER. I am, as the chairman announced, supervising deputy for the Sacramento District Attorneys' Office, Child Support Division. I am also legislative representative for the district attorneys' arm that deals with child support in California, and have been past president of that organization, and while I don't represent them here, I have spoken in the past to National URESA, and, on behalf of that organization, that being the National Child Support Organization.

The matter on which I wish to comment are the child support provisions, as set forth in the original Office of Management and Budget proposals, that were sent down here.

I understand that some of these have been changed, and will also comment on the changes as I go through my statement. I will try to be as brief as possible; leave myself open for questions.

Some of the proposals of OMB have merit; some are supported. But others are vigorously opposed.

The proposals opposed are not new. They were proposed last year by the prior administration; carefully considered by Congress and rejected, either in a Senate committee or a House committee before they saw the floor of the House that considered them in committee.

The same is not new for the ideas that we support. Either they passed both Houses, as was the case of bankruptcy reform, but died as part of a larger bill, or are totally new ideas and new concepts that are being proposed for the first time.

More specifically, we support the tax intercept, or tax offset—offset of a debt concept—repeal of the bankruptcy reform provisions that permit discharge of publicly owed child support in bankruptcy; and, cautiously, we support funding of alimony enforcement in appropriate circumstances.

We oppose taxing support payments with a 10-percent surcharge to be paid by the abandoned family and reducing incentive funding up to 50 percent.

The first point that I wish to discuss is the 10 percent fee. This proposal would take 10 percent of the funds collected for nonwelfare families and use this as an offset to cost.

It should be pointed out, in the history of this program that only last year, after repeated temporary extensions, did Congress permanently fund the nonwelfare program. Repeatedly, however, State organizations have made the point that those cases that are carried in the IV-D program, involving nonwelfare, would by and large be welfare cases but for the efforts of the child support agencies. Thus, you are treading on a very narrow line when you start taking 10 percent out of the check.

It is my understanding that this 10 percent will be applied across the board, and, therefore, point A, of my statement, should be modified in that effect.

But that also emphasizes and reemphasizes the point made in point B. After all the administrative steps are taken, the returns would not justify the cost and the impact on relatively poor families would be immense. Studies in San Diego, San Bernardino, and Salt Lake City show 90 percent, and above, of the families receiving IV-D services, but not on welfare, would be on welfare but for IV-D, or IV-D plus a combination of their income.

We have had similar experience in tracking our California cases generally. Of our nonwelfare cases, 75 percent were welfare cases at one time.

Given these statistics, it can be expected that the low-income family, who desperately needs the service, will, because of bureaucracy and threat of loss of income, take themselves out of the program until support ceases and they are on AFDC. This will be applied unevenly, because some States have a much lower threshold for leaving AFDC rolls than, say, California, Pennsylvania, or Michigan.

Some States, such as Idaho, Utah, Arizona would have people who would otherwise qualify for welfare in California and Michigan be, in fact, paying 10 percent of their child support back to the State to try to collect it.

A fee like this has been available as a program option for some time. Yet, the majority of States have rejected this option. They have rejected this option, not because of any desire to be unfair to the Federal partner, but because most States have found that such fees are unfeasible, hurting the taxpayer and the program objectives more than helping.

The second point of opposition is the 7½-percent incentive, a 50-percent cut in incentive funds. This will increase the dependence of the child support unit on administrative funding. It will take a focus away from performance and will direct it toward budgetary controls, toward limitations on collection efforts, and all the staff problems that are attendant thereto.

If you are dependent upon getting an incentive to retain your staff, your staff will be lean and hungry; your staff will be tough. And the budgetary controls that you need accountants and personnel directors for, and all that other staff personnel, to control—if you are focusing on administrative funding will be automatically taken care of by having the line program director focus his attention on trying to get as much child support as possible.

It should be noted that when the original incentive program was developed in California in 1971, that the incentive then proposed by the State, then proposed by then Governor Reagan, was in effect 37½ percent with a 75-percent administrative underwrite to the program as well. That incentive had the impact of stopping welfare in its tracks, in terms of growth. The same has been true at the Federal level.

It should be noted that right now, under the proposal that would be set forth, State government would be given an incentive to take control of the program away from the local county courthouse, where the work is really done all over the country.

It is submitted that the present incentive funding scheme on which so many long-term budget plans have been made at the local level works—works for the taxpayer; works for the Federal Government in terms of cost avoidance; works for the individual who is actually being benefited, the abandoned family. And there is a phrase of wisdom that does come from Washington that we have heard out there in California which is: If it's not broke, don't fix it. We hope you apply that to the incentive program.

We cautiously support alimony enforcement. We recognize that under the Lester decision that so-called family support orders may be created to allow people to legitimately construct their affairs to fit the tax laws and that these may create some confusion. However, it should be pointed out that certain orders are de minimus, such as a \$1 a year. Alimony enforcement is an area of contention that could result in resources being detracted from child support and that there is a sticky issue involved in terms of modification.

As a consequence, it is recommended that the discretion of the local IV-D agency to accept or reject such cases be protected by statute. This will maximize the cost benefit, and permit concentration of efforts on truly needy cases.

As to project intercept, we have had considerable experience now in California with this going into our second year. I believe that the OMB estimates on the amount that can be recovered understate, drastically, the amount that will be recovered. We have found in my own county that we have recovered more than \$880,000 in 1 year through intercepting, or offsetting, the child support owed the State with a tax refund. In the State of California last year, for a minuscule expenditure, we collected more than \$7 million.

There are some legal particulars that I have alluded to in my statement. I think that focusing on 42 U.S.C. 659 as a method of litigating the individual claims that will result would be the best way to handle some of the problems. I don't believe OMB has focused on that.

Finally, again this year, you have before you a request that the Bankruptcy Reform provisions that allow child support owed to the public to be discharged in bankruptcy be repealed.

These provisions are causing some havoc at the local level. They are causing, in the first instance, a loss of dollars. They are causing administrative readjustments that result in costly diversion of assets at the local level from support enforcement to such activity as prosecution under criminal nonsupport statutes, modification of support orders upward, based on the reduced expenses of the now

debt-free obligor, and reassignment to the custodial parent, a legal step that, in effect, avoids the whole impact of the bankruptcy but does nothing in the long run to help either the taxpayer or the custodial parent.

This is because the concept of reassignment would, in effect, undercut the trustee function, which is one of the best protections that the IV-D program gives the welfare family.

The whole concept on which this discharge is based on several misconceptions. The obligation is not a bargained for debt. To compare child support to a contract with VISA or Macy's is ludicrous.

The person discharged, in our practical experience, is not an extremely low-income individual. We find that the divorce courts are more than willing to listen to motions to modify in terms of hardship cases. We find that by-and-large bankruptcy attorneys do not take on cases involving low income individuals.

Finally, it has been suggested that to alter the Bankruptcy Reform Act is to disrupt the purpose of the act, the fresh start concept. However, if you take a good look at the act, you will find that only the creditor gets the fresh start. The debtor is often left with many assets. There are many exceptions in the act right now. And even as to creditors, there are substantial exceptions.

The present act involves arbitrary and unfair treatment of the taxpayer in this regard. It is he who steps into the breach to fulfill the absconding obligatory duty. And when the obligator is caught up with, that person goes into bankruptcy court. This suggests one more exception is in order. And that is repeal the Bankruptcy Reform Act provisions relative to this.

Thank you.

Senator SYMMS. Thank you very much, Mr. Barber.

You made the point about charging non-AFDC families for child support is rather unworkable, and making the argument that it causes a differential between them. Now, between the families that are eligible and ineligible, what new problems are in that provision proposed for determining eligibility. Why is it required in this situation?

Mr. BARBER. Well, the original OMB proposal—now, I understand that they have simply said this would apply across-the-board without an eligibility standard if they are not actually receiving AFDC. The present proposal, as I understand it, before you, is that this would—they would automatically be susceptible to the 10-percent charge. Even in that guise, you have a problem on interstate cases, trying to determine whether or not the family is on AFDC from month to month.

You have a second problem: Which State takes the 10 percent? Again, an administrative headache, a costly administrative burden.

If, in fact, the original OMB proposal, as placed before you, is still in effect then in every nonwelfare case, you would end up from month to month taking eligibility statements from individuals who might, or might not, have to come up with the 10 percent, assuming child support was collected. And, in each case, you might even be applying a separate percent. Because if, in fact, taking 10 percent would force them below AFDC, perhaps 9 percent wouldn't, 8 percent the next month, 10 percent the third month. And, I don't

know if you have been exposed to computer programing in its practical application, but I can assure you of no better way to drive a programmer nuts than try to apply something like that.

Senator SYMMS. Now, there's one argument I was going to ask you to clarify and that's on the administration's proposal that States and the Federal Government share the financing of incentive programs, payments, under the child support enforcement program.

If I understood you correctly, you made the argument that this provision will reduce the incentive that States and local municipalities have to minimize their staff. How does—

Can you explain it?

Mr. BARBER. Yes, sir. At present 15 percent of the child support saving is returned from the Federal share to the local and State jurisdiction. If, in fact, this proposal goes through that is now before the Congress, the Federal contribution will be reduced to 7½ percent.

It's argued by OMB that the State government will come with the remaining 7½ percent. But, more likely, because of provisions that were passed last year, the State government will simply put the local government on so-called administrative funding. The child support incentive program keeps staff directed at collection efforts.

We found in California, when we went exclusively on administrative funding for 1 year, instead of getting staff positions filled promptly, we had to wait in line. We had to have staff studies to see whether, over a long period of time, these positions would justify themselves. So, because of dependence on administrative funding, we had to fight a continual reluctance of county executives to try to create positions where incentive funding had been pulled back and where there was a threat that administrative funding, over the long pull, would also be pulled back. After 1 year we dropped administrative funding, went back to incentive funding and started collecting support instead of writing budget justifications.

If the incentive funding is there—that is, if we can walk in and say: Look, you give us this many more investigators; you give us this many more interviewers, secretaries, typists, and attorneys, and we will produce through the Federal incentive program that much more money for county government in the long run the taxpayer is going to be best served because in the long run you are going to see one of the prime program objectives, collecting child support, being served.

And you are not going to take up a lot of time with time and motion studies, accountants, bookkeepers, and those other people.

Senatory SYMMS. Thank you very much.

Senator Durenberger.

Senator DURENBERGER. I have nothing.

Senator SYMMS. I appreciate very much your testimony and our Chairman Dole, is leaving the room again.

[Statement follows:]

SUMMARY OF TESTIMONY OF MICHAEL E. BARBER FOR THE CALIFORNIA DISTRICT
ATTORNEY'S FAMILY SUPPORT COUNCIL

I. Background of speaker.

II. Identification of child support provisions commented on.

III. Item-by-item analysis.

A. Applicant fee of 10 percent:

1. Applicant fee of 10 percent;
2. Cases subject to surcharge would be limited;
3. The fee could impair the cost avoidance aspect of the non-welfare program; and
4. Field results suggest the concept not worth it.

B. Reducing the federal incentive to 7½ percent. This will: 1. Encourage non-productive administrative funding; and, 2. Encourage concentration of IV-D non-productive level.

C. Alimony enforcement funding:

1. Helpful in conforming IV-D program to standard divorce practice;
2. Peculiar aspects to spousal support requiring broader discretion for the local level as to cases accepted: (a) De minimus orders, (b) Problems of special defenses in alimony matters, and, (c) Definition of what is enforcement.

D. Project intercept:

1. The concept is commonly accepted debt collection method avoiding shortchanging the taxpayer.

2. Funds collected at a level far and above O.M.B. projections

3. To avoid unnecessary litigation, and for fairness, the legal activity should be related to 42 U.S.C. 659.

4. Bureaucratic reviews should be kept to a minimum.

E. Repeal the Bankruptcy Reform Act sections that permit discharge of child support:

1. The cost of discharge can be substantial;

2. Ultimately the taxpayer's defense will be an unnecessary added expense by: (a) criminal non-support prosecution, (b) post-bankruptcy modification of orders, and, (c) reassignment of support rights;

3. The concept weakens the protection of IV-D for the AFDC family.

STATEMENT OF MICHAEL E. BARBER, LEGISLATIVE REPRESENTATIVE, CALIFORNIA DISTRICT ATTORNEY'S FAMILY SUPPORT COUNCIL

Gentlemen, this statement is submitted on behalf of the District Attorneys of California, speaking through their Family Support Council.

The positions stated here are the result of the cumulative observations of the members of that organization, which includes all personnel funded under Title IV-D of the Social Security Act. The statements that follow are also drawn from my 13 years experience in enforcement of child support obligations, a range of experience that has included supervision of paternity and enforcement litigation in 30,000 cases in Sacramento County, California, lecturing and advisory work for the State and Federal Government, and lectures for public and private continuing education of the bar courses.

While some of the proposals in the Office of Management and Budget proposals have merit, and are supported, others are vigorously opposed. It is significant that the proposals opposed by the Family Support Council are not new. They were proposed last year by the prior Administration, carefully considered in Congress and to the best of my knowledge, after careful review in this Committee, never even got to the Senate floor. The same is not true for the ideas we support, either they passed both houses (as in the case of Bankruptcy Reform) but died as part of a larger bill, or they are new (i.e., alimony funding and tax intercept).

More specifically, we support the following:

1. The tax refund intercept or offset program.
2. Repeal of the Bankruptcy Reform Act provisions that permit discharge of publicly owed child support in bankruptcy.
3. Funding of alimony enforcement in appropriate circumstances.

We oppose:

1. Taxing support payments with a 10 percent surcharge to be paid by the abandoned family.

2. Reducing incentive funding by 50 percent.

I will take up each issue separately and summarize.

1. APPLICANT FEE OF 10 PERCENT

This proposal would take 10 percent of the support collected for non-welfare families and use this as an offset to cost. It would not require 10 percent if that sum would qualify the family for A.F.D.C. It is claimed this would save \$44 million. The several reasons we oppose this recommendation are as follows:

(a) The proposal would be administratively unworkable except at a cost that could exceed any sums recovered thereunder. To continually differentiate between cases

that could qualify for A.F.D.C. and those that would not would require continuing processing of financial statements from these families on a month-by-month basis.

Thus a whole new level of bureaucracy would be set up, IV-D eligibility workers. It can be anticipated that there would be a new class of crime, "IV-D" fraud, covering those who falsify income statements to avoid the 10 percent surcharge. Finally, because many state laws forbid the application of such a surcharge in interstate cases some non-support cases would have to be excluded from the system of IV-D funding, creating a further headache in the form of heretofore unnecessary cost allocation actions.

(b) It is submitted that after all the administrative steps set forth above the returns would not justify the cost because the number of cases to which the surcharge would apply would be so limited that it would apply to less than 10 percent of the total caseload. Studies in San Bernardino, San Diego, and Salt Lake City show that 90 percent and above of the families receiving non-welfare support enforcement benefits would be on A.F.D.C. but for IV-D. Seventy-five percent of the California non-welfare IV-D cases were on A.F.D.C. at one time. While not mathematically conclusive, this implies few cases would actually pay the 10 percent even assuming no fraud or error in eligibility control.

(c) Given the statistics alluded to in (b) and the administrative headaches referred to in (a), it can be expected that low income families who desperately need the service will, because of the bureaucracy and the threat of loss if income, take themselves out of the program until support ceases and they are on A.F.D.C. This will be a particular problem in those jurisdictions where A.F.D.C. grants are low. Thus families that would qualify for A.F.D.C. in Michigan, California, or Pennsylvania, even if support is paid in full, will in other states for paying 10 percent of the support received if they work through IV-D. Obviously, they will avoid IV-D until desperate. However, lapsed support payments are much harder to collect when continuity of case administration is disrupted. Thus the A.F.D.C. rolls can be expected to grow and the cost avoidance benefits of non-welfare IV-D lost by this surcharge. Then, even if IV-D made money from this surcharge, which is doubtful, the taxpayer would lose.

(d) A fee like this has been available as a program option for some time. Yet, the majority of states have rejected this option. It is submitted they have rejected this option not because of any desire to unfairly profit from the federal partner in this effort, but because most states have found that such fees are unfeasible, hurting the taxpayer and the program objectives more than helping.

2. REDUCING THE FEDERAL INCENTIVE TO 7½ PERCENT

We oppose the reduction of incentive funds from the federal level for the following reasons.

(a) This will increase the dependence of the support incentive program on the 75 percent administrative funding in the program. Such funding, unlike incentive funding is paid out without regard to whether anything is ever collected on the program. Thus the incentive to bureaucratize the program will be increased. The incentive to produce results, reduced. In California, state funding in this program has been by incentive funding since then Governor Reagan introduced the concept in 1971, except for one year. That year, the year Proposition 13 was passed, the state substituted administrative funding therefore. In that year, collections flattened out. Staff positions were not filled because there was no incentive to keep enforcement teams up to par and some risk that the administrative funding would prove in later years inadequate. Suddenly, we found much more questioning staff size and composition. The incentive fund had previously been counted on, and had, in fact, provided an automatic incentive for keeping staff size down and goal-oriented. The result was an overall loss in potential revenue. The same will be the result if the O.M.B. proposal is adopted.

(b) The fact the State Government is required to match this incentive will not change this consequence. Most of the real work in this program is done at the county level, in county court houses all over the country. Yet the program is dependent on state legislation for its structure. I may sound a bit skeptical, but where the State Legislature must now come up with a matching incentive at the state level, and where it may now keep all incentives at the state level, I cannot foresee the state match ever finding its way to the budgets of the work horses of the program, the District and County Attorneys, Friends of the Court, and other county officials. Indeed, because too many states have put the program in the hands of sometimes indifferent or unfriendly state welfare departments, I can foresee this proposal being used as a tool to encourage state administrators to take over the program under the guise of protecting the state budget. Because this would inevitably result in a weakening of the enforcement aspect of the program, in the end the

federal budget would suffer, not profit from this reduction in funding. However, the taxpayer would be the chief long-run victim of this misallocation of resources. The O.M.B. proposal was offered last year and rejected last year. It is hoped it will be rejected again.

3. ALIMONY ENFORCEMENT FUNDING

We cautiously support this concept for the reasons stated by O.M.B. However, we do not believe that the savings attributed to this activity would be significant at least from a California point of view. Nevertheless, with certain conditions, such legislation would be helpful. More specifically:

(a) We agree this would help in states where state law creates confusion or where tax attorneys under this "Lester" decision have attempted to secure an advantage for their client. However, there are disadvantages to expanding enforcement efforts in this area:

(i) Certain orders are de minimus, such as a \$1.00 per month or per year, legally keeping the subject open, but practically creating an illusory obligation that would not be worth putting into a computer.

(ii) Alimony enforcement is an area of contention that could result in resources being detracted from child support. Defenses are available in alimony cases that may not have any significance in child support, such as contemptuous conduct by the beneficiary of the alimony order. Such situations create the appearance the enforcement agency is defending contemptuous conduct, as opposed to construing it as irrelevant as would be the case in a child support matter.

(iii) A continuing problem is the lack of clarity in the program as to whether "enforcement" in non-welfare cases also includes modification. While I can anticipate some support for this in the area of child support where the beneficiary of the alimony order demands initiation of a modification upward, it can be a difficult situation unless the discretion of the IV-D agency to act is protected.

(b) Therefore, it is recommended that the discretion of the local IV-D agency to accept or reject such cases be protected by statute. In the end, this will maximize the cost benefit of such funding and permit concentrations of such efforts on the truly needy cases.

4. PROJECT INTERCEPT

We endorse the concept of project intercept, or as it might more accurately be described project setoff, since it involves setting off a debt owed by the absent parent to the taxpayer, against a debt owed by the taxpayer. Indeed, it seems more than a bit foolish, where an individual owes the government a substantial sum, that the government not require repayment of that debt to all the taxpayers before it gives the debtor any payment on the claim for refund. Indeed, to do otherwise might be termed a breach of trust by the government to all the taxpayers. Far from being unprecedented, it is my understanding that such a setoff is now provided for where the debt is one owed by a government employee to the Federal Government.

In practice, the program has been rewarding to the California taxpayer. Last year the intercept netted a return in excess of \$7,000,000 for a miniscule expenditure. It can be expected the result will be many times that if expanded to the federal level.

However, I am concerned that the O.M.B. proposal will expand the cost unnecessarily and limit the effectiveness of the intercept. The following suggestions are submitted to maximize the effectiveness of the program:

(a) It is recommended that the same standards, though not the degree of documentation, as would apply to a garnishment under 42 U.S.C. 659 be applied to the case submitted for the intercept.

(b) that the same defenses and courts as would be used to attach a garnishment under 42 U.S.C. 659 be used to resolve conflicts that will inevitably arise from this process.

(c) That it be made clear that this process also is available to non-welfare cases, as it would be if refunds were subject to garnishment.

(d) That the program be implemented with as much direct communication between the agency initiating the claim for the intercept and the Internal Revenue Service. I am concerned that a prolonged review at H.H.S. will unnecessarily delay implementation of the process of offset.

5. REPEAL THE PROVISIONS OF THE BANKRUPTCY REFORM ACT THAT PERMIT DISCHARGE OF PUBLICLY OWED CHILD SUPPORT

Although not stated in the materials available to me, it is my understanding that the O.M.B. proposals include repeal of the Bankruptcy Reform provisions that permit discharge of assigned child support. If they do not, they should. This right of

discharge is costly to the public, injurious to the A.F.D.C. family, and, ultimately illusory to the parent who is seeking the relief. Further, it has been promoted by incorrect characterizations of its consequences, the obligation in question, and its role in the bankruptcy court. Repeal will ultimately save the taxpayer a substantial sum. More specifically:

(a) The discharge provision will initially cost the taxpayer a large amount of child support due it. To date the provision has been applied with only varying emphasis around the country. However, it is my understanding that in one relatively small Michigan county, over \$225,000 was discharged in one year. Should this prove true nationwide, the results could impact the support program heavily.

(b) Administratively combatting the discharge will divert resources from support enforcement from families needing support services. This is because the discharge provision operates only on sums due at the time the bankruptcy is filed and only on sums due the public. Also, it does not impact criminal prosecution in state court, although it may prohibit probation orders that would result in reimbursement for support paid out during the period covered by the discharge. Thus, the statute encourages heretofore unnecessary litigation and attendant administrative expenses of the following nature: (i) prosecution under criminal non-support statutes; (ii) modification of support orders upward based on the reduced expenses of the now debt-free obligor; and (iii) a reassignment to the custodial parent, a practice in effect encouraged by a recent judicial decision. The benefit to the obligor then is illusory, but the cost of the program would be raised by this activity. In the end both the obligor and the taxpayer are the loser.

(c) The statute also undercuts the concept of a public trustee for support and, if reassignment concepts are instituted, would put the A.F.D.C. family in a worse position than before. This is because the assignment concept resulted in the A.F.D.C. family in effect trading an uncertain child support payment for a regular A.F.D.C. payment. Prior to IV-D in many states child support was paid directly to the family and the A.F.D.C. grant assumed the support was paid regularly. When support was not forthcoming, then the family would have to apply for a supplemental grant. The irregularity and uncertainty of this system resulted in discomfort to the family, fraud, and abuse. The temptation was always there not to report the direct payment since subsequent grants would be cut and there was no assurance the next payment would come as easily. A public trustee avoids these problems, but rather than releasing an able but unwilling parent from his obligation, the temptation will now be to scrap the public trustee.

(d) The whole concept on which this discharge is based is a result of several misconceptions.

(i) The obligation has mistakenly been analogized to a bargained for debt. Support has never been considered such. Rather, it is a statutory obligation analogous to taxes and fines. To compare it to a contract with VISA or Macy's is ludicrous.

(ii) It has been argued that the person discharged in bankruptcy is truly needy. Experience dictates otherwise. Where true misfortune has struck, the divorce courts are always open for a modification downward. Where the order was imposed on one who is in the lowest economic strata to begin with, it is so modest that it is hardly a burden and is seldom enforced except by periodic review. Rather the bankruptcy court has become the refuge of middle income parents who would prefer this method of litigating their support obligation rather than facing the judge who imposed it.

(iii) Finally, it is claimed that to alter the scheme of the Bankruptcy Reform Act is to disrupt the purpose of that Act, which is to give the debtor a fresh start. It is submitted that the whole concept of "fresh start" is illusory since there are so many exceptions to the general rule that the bankrupt's property must be used to meet his debts, that it is the creditors who have the fresh start. A true "fresh start" would not leave the bankrupt with the resources after discharge that this law does. Further, there are already multiple examples of obligations that are not discharged in bankruptcy, the most notable example being support payable to the custodial parent. The arbitrary and unfair treatment of the taxpayer in this regard, who steps into the breach to fulfill the absconding obligor's duty, and then when the obligor is caught up with, finds the matter in bankruptcy court, suggests that one more exception to fresh start is in order. That exception is one that would put the taxpayer in at least as good a position as a custodial parent who had no need for A.F.D.C. in the first place.

Senator SYMMS. Our next witness is Mr. Robert Orth, Ramsey County Commissioner from St. Paul, Minn., on behalf of the National Association of Counties.

Mr. ORTH.

Senator SYMMS. Senator Durenberger.

Senator DURENBERGER. Mr. Chairman.

Senator SYMMS. Do you want to make a comment?

Senator DURENBERGER. I just want to make a brief comment, without trying to describe for you all of Bob Orth's credentials. Just to let you know that, in my opinion, Bob Orth is a unique kind of a county commissioner. Which is not necessarily to compare him with other county commissioners that I have seen in this capacity, or to reflect adversely on any of them.

But, in terms of the role of a local government official in relating service delivery to public policy, he has demonstrated in our community and in a broader community, now, the uniqueness of the kind of people that are going into public service at the local level. And since we have oriented a lot of programs such as he will be addressing today toward counties, he has a particular capacity for telling us how to adjust public policies to the realities of the needs of people. I am pleased that NACO has decided that he would be the best person to come and address the problems associated with the budget recommendations.

Senator SYMMS. You may proceed, Mr. Orth, but please introduce your associates.

Mr. ORTH. Mr. Chairman, Senator Durenberger, I have with me Mr. Ron Gibbs, and Ms. Janet Smith from NACO's staff. I have asked them to come with me, because as Senator Durenberger knows, I am just a lowly rural Ramsey County Commissioner. I don't understand all this fiscal and political stuff, and I am just trying to do my best in getting some of our ideas across.

Mr. SYMMS. Well, Mr. Orth, let me say that: Don't consider being a county commissioner a lowly office. There are many of us here in Washington who think we spend far too much time spending money on the Capitol dome and not enough at the grassroots and county levels, so you probably are the epitome of government where it is best.

Please proceed.

STATEMENT OF ROBERT ORTH, RAMSEY COUNTY COMMISSIONER, ST. PAUL, MINN., ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES

Mr. ORTH. Thank you, Mr. Chairman.

I am happy to be here today. I am Robert Orth, and I am chairman of the Ramsey County Board of Commissioners, Ramsey County, Minn., and I am appearing today on behalf of the National Association of Counties.

I'd like to say at the outset that our organization is strongly supportive of the administration's commitment to balancing the budget as a means of achieving economic recovery. We are prepared to take our fair share of the cuts. And, in fact, over the last 2 to 3 years, I think many counties in the Nation have, in fact, taken their share of cuts from the State level. And, it is those two points that we will try to address today.

We feel that quite clearly funding for many of the programs which comprise the safety net have been cut back substantially under the President's proposals.

If the cuts are implemented, as described by the administration, our main concerns would be in the areas of the medicaid cap, the arbitrarily determined 5-percent increase in medicaid spending during fiscal year 1982, and a \$2 billion, rather than a \$1 billion cut as originally estimated; also, the block grant proposal, which we could support in concept could result in a drastic reduction in funding; the social services block, which will reduce title XX by more than 35 percent, in our opinion, and provide no special moneys for child welfare services legislation.

These are all areas, all programs, for which counties bear a significant responsibility. It is important to point out that in the last 8 to 10 years of our Federal, State and local government history, that it seems the Nation has rediscovered counties as an effective level of government. They have also rediscovered counties' abilities to levy local revenues. And in the case of the State of Minnesota, each of our 87 counties has better than 50 percent of its budget is for health and welfare programs. Therefore, when we talk about shifting programs and program control, and extending flexibility, it is—we are mindful of the cumulative effects of cuts proposed by the Reagan administration, especially in the area of human resources.

The impact on a needy, elderly person, who loses food stamp benefits due to the proposed changes must be viewed in the context of whether that person also loses energy assistance payments for escalating utility costs and, perhaps, day-care, home health service. Or, in the case of Ramsey County, literally, congregate dining and the Meals on Wheels program that Ramsey County sponsors for its senior citizens.

But let me also state the positive. The National Association of Counties accepts President Reagan's changes in unemployment insurance. Our board of directors took this position with the hope that new revenues developed from taxing unemployment benefits would continue to fund CETA title II-D public service jobs, since those jobs primarily go to individuals receiving some form of income transfer payment.

We feel that it would be the height of folly to eliminate the major program providing jobs for welfare recipients at the same time the President is endorsing a workfare program to give jobs to welfare recipients.

In health care, we accept cuts in PSRO's, health profession training, and HMO's. We also accept cuts in block grant programs. We are in Minnesota becoming quite experienced and practiced at it, because of our State administration.

However, we would ask that those cuts be commensurate with the savings which would accrue from reductions in administrative costs, and structural reforms in medicaid and medicare to reduce systemwide costs.

In addition, we are pleased that some of the President's proposals make changes in the AFDC and child support enforcement programs which NACO has long supported in our national welfare reform policy.

In the social services area, we favor block grants that leave decisions about programs—and I must stress this—to the local level, where the services are delivered.

Next, I would like to address the proposed changes in medicaid, and outline to you the county role in health care financing and service delivery.

Nationwide, the Department of Health and Human Services has estimated that in fiscal year 1980, local governments spend \$8 billion in local tax dollars. Of the 1,900 public hospital in the country, 800, or so, are county facilities. We also operate 800 nursing homes, and hundreds of county health departments and home health agencies. In some 14 states, counties contribute more than \$1 billion to the state share of medicaid.

In summary, nationally, local tax revenues support the provision of health services for many of the 26 million Americans who do not qualify for medicare or medicaid, and who have no other health insurance, as well as the many millions more with inadequate coverage—the very same individuals who last year were targeted for coverage under proposals for national health insurance.

Against this background, it can be seen that counties share the concern of this administration about the continuing, uncontrolled rise in health care costs. While the total costs of medicaid has increased fivefold since 1969, the number of beneficiaries has remained virtually constant since 1974. Income eligibility standards have not kept pace with inflation, and the value of medicaid has been eroded, even with the skyrocketing costs.

As a result, in many urban communities, such as Ramsey County, local taxes are bearing a far greater share of the burden than medicaid for the provision of health care services in public hospitals. A case in point for Ramsey County would be the fact that in our attempt to better manage our systems, we found out this year that general assistance medical care, a State program run and delivered by the counties in Minnesota, 70 percent of the cost of that program is being used not by single males under 25, but by people who receive no other form of public assistance, the working poor, the elderly, the disabled, the handicapped.

Mr. Chairman, if I may—

Senator SYMMS. Your entire statement will be made a part of our record of our hearing. It will be taken into account. So, if you want to summarize it, please go ahead.

Mr. ORTH. I was going to mention that. We have bells in rural Ramsey County, too, and I understand what they mean. So—

Senator SYMMS. What is that now?

Mr. ORTH. I said I was going to state that we have bells in rural Ramsey County, too, and I understand what they mean. So—

Senator SYMMS. Oh, I see.

Mr. ORTH. I would like to, perhaps, give you a brief overall summary.

The issues that are of utmost concern to the counties involve those proposed measures which would jeopardize our Nation's social safety net: The medicaid cap; arbitrary cut in spending for fiscal year 1982; the reduction in title XX moneys, which we feel has already been cut to the bare bones by the previous administration; and, essentially, a caution generalized over all of your very deliberate and earnest attempts to cut the cost of social services.

We would like to state that, although in concept we can agree with the Reagan administration's block grant proposals, we must

caution that that money not be skimmed off by those State governments that are presently suffering deficits which would, in fact, amount to the State using Federal moneys not to serve the people as Congress intended, but to cover their own inability to raise their revenues.

Mr. Chairman, thank you.

Senator SYMMS. Yeah. On the bottom line, Mr. Orth, when you get down to rolling in categorical grants, whether it be title XX or X, or what have you, and reducing the total dollar expenditures, do you foresee that in the future, once you get past the first year, that the problem will—if you know how many dollars you are going to get from the Federal Government on a steady basis that can be annualized and counted out into the future and you will not have as much redtape, do you anticipate that that safety net could still be maintained at the county level and not have all the forms to fill out and all the categories.

And you said one thing in your statement that you favor less earmarking; but you said you would also accept child support, I think it's title XX, when it's in the health services block.

Mr. ORTH. Mr. Chairman and Senator Durenberger, in terms of title XX, as I stated, we feel it's been cut to the bare bones. Also, I think that I would like—

Senator SYMMS. That's earmarked funds, right?

Mr. ORTH. Pardon me?

Senator SYMMS. Title XX would be earmarked funds.

Mr. ORTH. Yes. And we hope that they would remain earmarked funds not rolled into the block grant.

Senator SYMMS. Not rolled in. That's the point—That's the question I was trying to get answered.

Do you have any questions, Senator Durenberger?

Senator DURENBERGER. Yes, I do. Thank you.

Bob, I want to start with the part of your statement, I guess, that you were able to deliver—or, most of which you were able to deliver within our time limits. Pages 3, 4, and 5, and I am just going to excerpt part of this:

Local governments spent some \$8 billion in local tax dollars on health care services. Of the 1,900 public hospitals in the country, 800 or so are county facilities. . . . Nationally, local tax revenues support the provisions of health services for many of the 26 million Americans who do not qualify for medicare or medicaid . . . Many urban communities today, local taxes are bearing a far greater share of the burden than Medicaid for the provision of health care services in public hospitals. In effect, local taxpayers are forced to buy into a highly inflationary system of health care financing.

Dade County last year spent \$65 million of local taxpayers money. And in the end you say:

If we do not use the momentum of this budget crisis as an opportunity for constructive reform to reduce systemwide costs, the poor will bear the sole burden of health care cost containment, resulting in far greater long-term health and social costs.

I think that is a beautiful statement. But that was preceded by accepting a whole bunch of this administration's recommendations, including the abandonment of the only, but imperfect, system we've had going to try to control some of these health care costs, the PSRO's.

Now, we spent 3½, 3 hours and 45 minutes in here yesterday talking about PSRO's. And the only defense of the administration came from those who said: There's all kinds of voluntary cost containment out there from various providers. Why don't we let that system work?

And my view of the thing is that we had an awful lot of good testimony showing why PSRO's in some parts of the country have not worked well. I know that the PSRO, in the area that you and I are most familiar with, has worked well. It's moved beyond, you know, the publicly funded examination of medicare into the area where now the private employer system is buying in. And, wouldn't it be a more practical approach to this system to take a look at what's wrong with the Professional Standards Review Organization in some parts of the country and reform that system rather than abandoning the only form of combination cost containment and quality assurance that we have?

Don't the counties, with the statistics that you gave me and I gave back to you, have a stake in some kind of a system out there for cost containment before we get to competitive health care?

Mr. ORTH. Mr. Chairman, Senator Durenberger, I would wholly agree that we have a stake. We are concerned about the loss of the PSRO's. And about the loss of health planning, too. And we think that we are not in a position to keep it all this year; we all have to make judgments as to which way we can proceed. And, we feel that if there are services to be delivered, and professional standards to be maintained, that can be monitored in a different fashion.

Senator DURENBERGER. And what is that different fashion? NACO coming with a proposal?

Mr. ORTH. An immediate or specific one, on PSRO's no. But, again, it would be in keeping with the entire block grant theory that it would be up to State and local levels of government to monitor their systems.

Senator DURENBERGER. And what have they been able to do so far? I mean, I've got all the statistics; I got \$65 million in Dade County and I've got a variety—Is that our fault here? What are the counties doing out there, nationally, to contain health care costs? And, maybe—I don't want to belabor the point, because there are a couple of other questions I want to ask you—I just—I think it would be very helpful to all of us. I know where Senator Symms is on this issue. And I am not a defender of what's gone on in this country since Senator Bennett invented this concept. But I am doggone concerned about the whole issue of cost containment and I would just love to see NACO take another look at this.

The dollars—so-called dollar savings are really rather minuscule compared to the kind of savings we could get at if we did some genuine reforms in medicare, which the administration has said they want to do, maybe, next year. We could look realistically at some of the medicaid reforms that have been suggested. We could look at more of a Federal role for medicaid. I would appreciate it if I could either see a better statement of NACO's position on PSRO's or some alternative recommendation.

Mr. GIBBS. Mr. Chairman, if I might.

The NACO Health Steering Committee met at great length at our last legislative conference in an effort to come to grips with the

administration's proposals in the health area. There was not unanimity, I must say, on the PSRO elimination. We understand your position and we will take your concerns back to the chairman of our Health Committee and get a detailed response to your questions.

Senator DURENBERGER. Right. And it isn't just mine.

Mr. GIBBS. Yes.

Senator DURENBERGER. There were a variety of Senators in here yesterday that said: You know, let's be sure we don't throw the baby out with the bath water in this thing.

Mr. GIBBS. Our statement puts forth NACO's priority concerns in the health area. Clearly the question of medicaid cap is of much greater concern to us than the preservation of the PSRO program.

Senator DURENBERGER. Thank you.

Senator SYMMS. Thank you very much, Senator Durenberger. And thank you for testifying here. And as you might have gathered from Senator Durenberger's comments, I thought that your statement on the PSRO and HMO's was very good, I guess we have a little difference of opinion up here, but—

Senator DURENBERGER. I got that, Senator. [Laughter.]

Senator SYMMS. We thank you very much, very much for being here and being a witness.

[Statement follows.]

STATEMENT OF ROBERT ORTH, COMMISSIONER, RAMSEY COUNTY, MINN., ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES

SUMMARY

The National Association of Counties is supportive of the administration's commitment to balancing the budget as a means of achieving economic recovery. We are supportive of cuts which will reduce unnecessary and burdensome administrative costs, and which will not shift costs to local property taxpayers.

Issues of utmost concern to counties involve those proposed measures which would jeopardize our Nation's social safety net: the Medicaid cap and arbitrary cut in spending for fiscal year 1982; the proposals which would reduce by 25 percent funding for title XX and maternal and child health services; and no special funding for recently enacted child welfare services legislation.

In relation to Medicaid, we propose measures to reduce systemwide costs, which would not result in cost-shifting to local property taxpayers. Such measures include the elimination of statutory barriers to the development prepaid health care in the public sector; those which would permit states to act as prudent purchasers of services without jeopardizing access to care; implementation of prospective budgeting; and statewide demonstration projects to test such alternatives as long-term care pooling arrangements and the voucher system for the purchase of care, applied to all third-party payers.

In AFDC and child support enforcement, we support changes contained in the President's program for economic recovery but would view with caution any proposal to block grant the AFDC entitlement program. NACO recommends that title XX social services spending not be reduced, and that implementation of the new child welfare legislation not be mandated unless it is fully funded.

STATEMENT OF ROBERT ORTH, COMMISSIONER, RAMSEY COUNTY, MINN., ON BEHALF OF THE NATIONAL ASSOCIATION OF COUNTIES (NACO),¹ BEFORE THE SENATE FINANCE COMMITTEE

Thank you, Mr. Chairman, I am Robert Orth, Chairman of the Board of Commissioners of Ramsey County, Minnesota, appearing on behalf of the National Associ-

¹ NACO is the only national organization representing county government in America. Its membership includes urban, suburban, and rural counties joined together for the common purpose of strengthening county government to meet the needs of all Americans. By virtue of a county's membership, all its elected and appointed officials become participants in an organiza-

ation of Counties. We are very pleased to have this opportunity to testify before your committee on issues of such critical concern to county governments.

Let me say at the outset that our organization is strongly supportive of the administration's commitment to balancing the budget as a means of achieving economic recovery, and we are prepared to take our fair share of the cuts. The concerns we will discuss here today relate not to the proposed spending cuts per se, but to the process by which they are to be achieved. We see this process as equally important, in preserving the social safety net that the President has described.

This is indeed a unique period in our history, during which positive change can take place. We are hopeful that in our effort to achieve economic stability, we do so with the the least possible harm to those who are utterly dependent upon us through no fault of their own, for their very well-being. In short, we are hopeful, that the administration and the Congress will ensure that our Nation's social safety net does, indeed, remain intact.

Quite clearly, funding for many of the programs which comprise that safety net have been cut back substantially under the President's proposals. We will confine our remarks today to those programs which are under this committee's jurisdiction, some of which we believe will be seriously jeopardized, if cuts are implemented as previously described by the administration. They are: the Medicaid cap and the arbitrarily determined 5 percent increase in Medicaid spending during fiscal year 1982, which we understand may result in a \$2 billion, rather than \$1 billion, cut as originally estimated; the block grant proposals which could result in a drastic reduction in funding for cost-effective maternal and child health services, now under title V of the Social Security Act; the social services block which will reduce title XX by more than 25 percent and provide no special monies for child welfare services legislation.

These are all programs for which counties bear a significant responsibility. In eighteen States counties administer the AFDC, food stamp, Medicaid programs under state supervision and pay a portion of the administrative or assistance costs. For many counties, health and welfare costs account for more than 40 percent of the total county budget, which is made up entirely of property taxes. In Minnesota, for example, the counties pay 44 percent of the non-Federal administrative costs of AFDC, Medicaid and food stamps. In my own state, 50 percent of most county budgets is for welfare and health programs. Besides the federally supported programs, many counties operate general assistance and emergency assistance programs to provide "last resort" aid to needy people not eligible for Federal assistance. In other words, counties, too, are a significant factor in our national social safety net. We have a real financial stake in the programs and, therefore, have good reason to support changes that make them less costly to operate.

Within this context, we are also mindful of the cumulative effects of cuts proposed by the Reagan administration, especially in the area of human resources. The impact on a needy elderly person who loses food stamp benefits due to the proposed changes must be viewed in the context of whether that person also loses energy assistance payments for escalating utility costs and perhaps a day care or home help service under title XX needed to help her remain in her own home instead of an institution.

Let me begin with the positive. The National Association of Counties supports President Reagan's changes in unemployment insurance laws. In addition, NACo would support taxing unemployment benefits after an individual's income, including those benefits, exceeds 125 percent of the BLS lower living standard income level.

Our board of directors took these positions with the hope that the new revenues developed from taxing UI benefits would continue to fund CETA title II-D public service jobs since those jobs primarily go to individuals receiving some form of income transfer payment. We feel that it would be the height of folly to eliminate the major program providing jobs for welfare recipients at the same time the President is endorsing a "workfare" program to give jobs to welfare recipients.

NACo's basic policy position in this area is simple, we would rather pay people to work than not to work.

We are also supportive of cuts which will reduce unnecessary and burdensome administrative costs, and which will not shift costs to local property taxpayers.

In health care we accept cuts in PSRO's, health professions training, and HMO's. We also accept cuts in block granted programs, commensurate with savings which would accrue from reductions in administrative costs, and structural reforms in Medicaid and Medicare to reduce systemwide costs.

tion dedicated to the following goals: improving county governments; serving as the national spokesman for county government; acting as liaison between the Nation's counties and other levels of government; and, achieving public understanding of the role of counties in the Federal System.

In addition, we are pleased that some of the President's proposals make changes in the AFDC and child support enforcement programs which NACo has long supported in our national welfare reform policy, in which we advocate changes that would contribute to better managed programs and reduce administrative costs.

In the social services area, we favor block grants that leave decisions about programs to the local level where the services are delivered.

Next, I will address proposed changes in medicaid, and outline for you the county role in health care financing and service delivery. It is a role which is frequently misunderstood and underestimated. Nationwide, the Department of Health and Human Services has estimated that in fiscal year 1980, local governments spent some \$8 billion in local tax dollars and on health care services. Of the 1,900 public hospitals in the country, 800 or so are county facilities. We also operate 800 nursing homes, and hundreds nearly three times as much for inpatient care from the county for individuals without health insurance coverage (\$59 million) as they will from the State under medicaid. Countywide, indigent health care will cost local taxpayers \$65 million. If a medicaid cap were not imposed, and current conditions continue, the State has estimated that during fiscal year 1982, the Federal funding requirements for medicaid would actually increase 22 percent. With the proposed cap and a 5 percent increase, the State estimates Dade County would receive \$22.8 million less than currently projected, thereby increasing the county's indigent health care liability by one-third.

What is the alternative to the President's proposal, in this era of fiscal austerity? To us, the answer seems clear. Counties' social safety net is stretched to bursting. The combined impact of Federal cost-shifting for life-sustaining services to county property taxpayers could be devastating, for we have only limited taxing authority. If we do not use the momentum of this budget crisis as an opportunity for constructive reform to reduce systemwide costs, the poor will bear the sole burden of health care cost containment, resulting in far greater long-term health and social costs. This past December, our organization formed a task force of concerned county officials to address the medicaid issue. It was clear that many States were no longer able to cope with inflation in the medicaid program, and that structural reforms would have to be made, just to avoid further retrenchment. We urged the new administration to focus its attention on this issue, so that a process of program restructuring and reform could be initiated immediately. We asked for consideration of measures which would remove legislative and regulatory restrictions that currently make it impossible for States and localities to reduce program costs. In fact, the administration has stated its intention to give States increased flexibility to achieve of county health departments and home health agencies. In fact, half of all certified home health agencies are publicly operated. In addition, we administer primary care centers, mental health centers, and other community services. In some fourteen States, counties also contribute to the State share of the medicaid matching formula. That so-called "local share" amounted to over \$1 billion in fiscal 1977.

In summary, nationally, local tax revenues support the provision of health services for many of the 26 million Americans who do not qualify for medicare or medicaid, and who have no other health insurance, as well as the many millions more with inadequate coverage—the very same individuals who last year were targeted for coverage under proposals for national health insurance. Thus, counties are already providing the only social safety net available for millions of Americans who do not qualify for Federal or State assistance.

Against this background it can be seen that counties share the concern with this administration about the continuing, uncontrolled rise in health care costs. We are all familiar with the statistics documenting that uncontrolled rise. But it does bear repeating in relation to the medicaid program, that while the total costs of that program has increased more than fivefold since 1969, the number of beneficiaries has remained virtually constant since 1974. Income eligibility standards have not kept pace with inflation, and the value of medicaid has been eroded, even with the skyrocketing costs.

As a result, in many urban communities today, local taxes are bearing a far greater share of the burden than medicaid for the provision of health care services in public hospitals. In effect, local taxpayers are forced to buy into a highly inflationary system of health care financing. A case in point is Dade County (Miami), Florida, where currently, 35 cents out of every local property tax dollar pays for indigent health care. This year, the county's Jackson Memorial Hospital will receive such savings. However, it is optimistic in the extreme to assume that added flexibility can save \$1-\$2 billion in fiscal year 1982 under medicaid without jeopardizing the welfare of our citizens.

State governments have already indicated that systemwide costs cannot be reduced overnight. Such changes will take time to be formulated and implemented.

Moreover, medicaid cannot be reduced, without medicare program costs also being affected. In short, there is no way to achieve the magnitude of savings being sought under medicaid without shifting costs, and without impacting negatively upon our health care system and the people we serve.

Specifically, we ask instead for the implementation of measures which would be applied to the extent possible, across the board, to medicare and medicaid, and which would serve as the first phase of a program of health care financing reform. They are measures which place primary emphasis upon preserving client access to and quality of care, and do not involve the further imposition of cost-sharing on the elderly: We believe these measures would also go a long way to addressing the problem of provider abuse of the medicaid system:

Give States greater flexibility in setting medicaid reimbursement rates, including the ability to reimburse prospectively, with cost-savings to be shared with providers and State governments;

Enable States to act as prudent purchasers of services, in instances which would not unduly limit client choice of provider, and would not jeopardize quality or access to care;

Remove statutory barriers to the development of HMO's and other organized prepaid health systems in the public sector. We feel this minor change in the law would be of particular benefit to public hospitals, many of which face an intensifying crisis.

Provide greater State flexibility in the administration of eligibility and benefit standards, which must currently be implemented on a uniform, statewide basis;

Allow political subdivisions to provide matching funds to obtain Federal financial participation for optional services and eligibility groups not covered statewide;

Provide funding to States to develop prospective reimbursement methodologies which might also be applied to medicare, and to States and localities to plan for the development of alternatives to nursing homes and other institutional care;

Establish statewide demonstration projects to test the implementation of such concepts as the voucher system for the purchase of care, involving all third-payers; and the pooling of funds for long term care, reasonably indexed to inflation and to age specific demographic changes, with adequate controls on access to services and added flexibility for services to be reimbursed with public dollars;

Allow States to reduce regulations currently requiring services and processes in hospitals and long term care facilities to free resources to develop more efficient alternative services.

With regard to title V programs, which have been targeted for inclusion in the health services block grant, we would favor preserving a separate block grant for maternal and child health, to ensure a maximum level of funding for these cost-effective health care services.

County officials recently adopted some general policies to guide our response to the President's proposed block grant.

First, a block grant to consolidate programs must be accompanied by an absolute reduction in Federal mandates and regulations and there must be a reasonable transition period to allow States and counties to make the necessary legal adjustments and to consolidate programs, services, and funding before funding is reduced.

Second, a block grant or other spending reduction cannot serve merely to shift costs from the Federal Treasury to State and local taxpayers. NACo will vigorously oppose any such shifting.

Third, there must be a provision to assure pass-through of funds to counties that operate the programs, in order to preserve the safety net of life-sustaining services that counties must operate.

Finally, there should be no "ear marking" or mandating of specific services or programs within the block grant.

In addition to these criteria, we are concerned about the administration's assumption that proposed block grants would reduce costs by twenty five percent. If that figure is too realistic—and we have no reason to think it is—then I am forced to conclude that the effect would be to shift costs for essential social services to county governments, which President Reagan pledged not to do. Many critical services that would be affected are already "bare bones" programs at the county level, where severe funding reductions can only hurt vulnerable people whose "safety net" will be stretched too thin to protect them. Preserving this safety net of services in the face of inflation should remain a responsibility shared by the Federal Government.

In Minnesota, the Association of counties worked closely with Governor Quie to help the counties to consolidate programs and operate them under a Block Grant from the State. This Block Grant, instituted in 1979, allows counties to set local priorities and fund these priorities accordingly. The depressed economic situation, increased demand for day care, and family disintegration has created a significant increase in the need for social services. Without continued Federal and State support, counties must eliminate services to vulnerable needy people such as retarded persons, neglected children, and the elderly, or raise the county property taxes. As it is, virtually all funds are now used for direct services, since planning and reporting requirements were reduced under the Block Grant. Since the state of Minnesota is projecting a \$300 million deficit for this fiscal year, it would not be able to make up any loss of federal funds. Since county taxes increased by 2 percent in 1981 over 1980 to cover social services, it is also unlikely that the counties could cover lost federal funds. So the net result of reducing the federal funds by 25 percent in Minnesota would be to reduce services.

Many counties are in similar circumstances. In California, for example, the proposed Title XX cut would mean that \$20 million additional State and County funds would have to be found just to maintain the "in home supportive services" which keep elderly and disabled people out of nursing homes; or else, other needed services would be eliminated. Needless to say, counties don't have that kind of taxing capacity.

Since Title XX was Block Granted ten years ago, it has long since made all the savings that can be gained from consolidation, and has fallen victim to the eroding effects of inflation. We recommend that this program not be further reduced. Because of the "bare bones" nature of service delivery under existing Title XX funds, a 25 percent reduction—in fact any reduction in this funding base—can only hurt people. People who depend on a caretaker to help keep them from living in an institution. People who abuse their children and want help to become adequate parents, and the children who are the victims.

For those children, we looked forward to new federal support authorized under H.R. 3434 last year to augment the thin layer of services we provide under Title XX. Yet, NACO has taken the position that if either Title XX or the new child welfare and adoption assistance act (PL 96-272) is not fully funded, we must oppose any mandate to implement those child welfare, foster care, and adoption reforms. We would simply not be able to put those into place at the county level.

Instead, we propose that a separate Block Grant of Title XX and Titles IV-B and IV-E and child abuse be set aside with no reduction of funding. This would recognize that Title XX already is a Block Grant and as such achieved any savings that can be brought about by consolidation and administrative simplicity. It would recognize that Congress found the Nation lacking in regard to foster care and saw fit to appropriate new funds specifically to rectify the problems uncovered. And it would be consistent with the administration's desire to preserve a safety net for needy people and its pledge not to shift costs for essential services to local Governments.

With regard to AFDC, NACO supports in principle the proposed package of AFDC and child support enforcement program proposals contained in the President's program for economic recovery. Specifically, we support for AFDC:

- Counting against AFDC payments a family's earned income tax credit (eitc);
- Counting income of stepparents in determining AFDC eligibility and benefits;
- and
- Prior month budgeting.

These three processes are in effect in some States and would have minimal fiscal impact there. On prior month budgeting, however, we feel that there is no need to mandate this on the States, since the option already exists and mandating runs counter to the administration's intention to loosen federal restrictions. Another concern is that if the administration decides to implement a lengthy retrospective accounting period, such as two or three months, some costs would be shifted to counties because we would have to provide general assistance to people in need during the waiting period. This would be especially significant if a similar retrospective accounting period is also required for food stamp eligibility.

A fourth proposal that we support in concept is that of standardized work related expenses and capping the earnings disregards. This would have the effect of placing a ceiling on the income families can have and still remain eligible for welfare, as well as simplifying the eligibility processes and reducing errors. Although we may argue with specific formulas when the administration makes them available, this area is a very important one for getting a better grip on the AFDC system's credibility. NACO will examine the proposals closely to be sure that they retain or improve on the incentives for women on welfare to accept employment. For exam-

ple, it is important to continue to allow child care costs as a separate deduction, in a reasonable amount. The \$50 per month recommended by the administration is probably too low, either to ensure adequate child care or to preserve the incentive to work.

In the child support area, NACO supports charging fees for non-AFDC collections, provided that it's a flat fee-for-service, and that counties would receive fee revenues sufficient to offset the costs of collecting the fees. We support including alimony in the collections, provided that these activities also receive 75 percent Federal matching and 15 percent collection incentives. We support intercepting child support arrearages through IRS income tax returns, an idea that has been successful in California and some other State tax systems. If joint Federal-State financing of incentive payments is required, the State's share should be small enough so as not to discourage jurisdictions from cooperating in the enforcement activity; and States should be prohibited from passing on the burden of this cost to counties.

With regard to the proposed workfare mandate for AFDC, NACO supports the concept of providing work instead of welfare but finds mandating of workfare programs inconsistent with the administration's intent to deregulate programs. Any requirement to provide work slots can result in net higher costs to counties, especially those with a substantial number of recipients eligible for the workfare programs. We note that even San Diego county, the most publicized site of the pilot food stamp workfare programs, is carrying the expanded workfare pilot at a net cost to the county budget of \$335,000 for this fiscal year, a factor that simply could not be duplicated in most counties today.

Workfare in AFDC is not likely to have much deterrent effect, since the workfare recipients are mothers with young children who must rely on public assistance or employment if available. We recommend that the Social Security Act be amended to permit States and counties to develop workfare programs for AFDC parents and to experiment with different work requirements. The incentives for State and local governments to move welfare recipients into employment already exists through the long range potential for reducing costs.

Although we have not had an opportunity to review the administration's proposed block grant for AFDC, we would be extremely wary of reducing the Federal fiscal commitment to sharing of welfare costs. At our legislative conference, county officials reconfirmed our contention that the problems of poverty are national in scope and that the Federal Government should move toward primary responsibility for welfare and medicaid costs, rather than transferring additional costs to local governments.

In closing, Mr. Chairman, we understand and support the fact that health and social services programs must be made less costly where possible. However, we oppose hasty program reductions that will unduly burden the poor and the elderly in this country. We support changes that will bring about administrative efficiency and oppose modifications that will shift a disproportionate share of costs to county governments. It is critically important that State and local governments be given adequate lead time to implement any new changes in the program. As I stated earlier, county governments are the governments of last resort and will be held accountable for providing basic life sustaining services.

Thank you for the opportunity to present our views. I would be pleased to answer any questions.

NATIONAL ASSOCIATION OF COUNTIES,
Washington, D.C., April 1, 1981.

Hon. DAVID DURENBERGER,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR DURENBERGER: The following is in response to the questions and concerns you expressed during the Senate Finance Committee hearing on Tuesday, March 24th, regarding our organization's position on the proposed phase-out of PSROs, and our alternative recommendations for cost-savings.

As commissioner Bob Orth indicated, NACO has concerns about most of the budget cuts in the health and human services area. We believe many of the proposals to cut spending are short-sighted, and will result in far greater long term costs. Organizationally, we have attempted to rank our concerns across a broad spectrum of issues, and through our policy process identified which cuts we should be prepared to accept (as opposed to cuts we would support), and which cuts we would oppose. Given the intense budgetary pressures and the current political climate, this approach seems essential. Unfortunately, this places us in the position of tacitly supporting policy decisions with which we are not entirely comfortable.

We would prefer that many decisions not be made in the context of the budget process.

Given this very difficult balancing act, we feel the proposals which would force reductions in services, must be our top priority issues in the health area. In addition, our Health and Education Steering Committee decided to actively oppose the proposed phase-out of the health planning system. Although we have problems with the current health planning process, we do not believe the entire system should be dismantled before knowing what will take its place. Many of our members believe the certificate of need process has been an important deterrent to unnecessary capital spending. We also believe the local community health planning function is worth saving, where it has worked. We would like those issues to be addressed in the context of the reauthorization process next year, instead of in the context of the budget reconciliation process, this year.

We might have taken a similar position on the PSRO issue. However, we concluded that it made more sense for our organization to advocate for increased dollars for cost-effective health services—such as those under Title V—rather than to actively oppose cuts in the PSRO program, which has yielded only marginal cost-savings, at best.

We are of course keenly aware of the need to reduce health care costs and are very actively supporting system reforms to achieve that goal. Included in our testimony (enclosed) is a list of measures which would give federal, state and local governments the needed flexibility to achieve substantial savings in Medicare, as well as Medicaid. We do not present this as an all-inclusive list. However, they are measures which would reduce system-wide costs, rather than transfer costs to Medicare, or to some other third-party payer. Such measures would also obviate the need for cutbacks in essential services.

We believe strongly—as we know you do—that it is the financing mechanism itself which is the primary villain in health cost inflation. At the county level, we would like to have the ability to provide care in county prepaid health systems. Public hospitals see this as a way of dealing effectively with their intensifying fiscal crisis, by extending existing resources to augment state cost-saving efforts, and by improving the process of health delivery. However, at present, counties are essentially precluded, except through waiver, from providing prepaid health care under Medicaid. Enclosed is a copy of an amendment to the Social Security Act which would eliminate the two major statutory barriers to public sector development of organized prepaid health systems under Medicaid. As drafted, it would exempt public entities from the two provisions under Section 1093(m)(2)(A) that (i) requires services provided under Medicaid on a prepaid basis to be delivered (with some few exceptions) by a qualified HMO; and (ii) limits the proportion of Medicare/Medicaid recipients to a maximum of 50 percent of the total enrollment of a qualified HMO.

It is our understanding that the current restrictions were originated in response to abuses which occurred under private prepaid health plans, rather than under public plans. We believe the unfortunate adverse effects have been to essentially preclude the public sector from realizing what could be very substantial cost savings and service improvements attendant to prepaid health care delivery. Preliminary data from Multnomah County (Portland), Oregon, the site of Project Health, shows Medicaid savings under prepaid plans of 20 percent for the high-cost medically needy population.

I have discussed this measure with a number of individuals, including Dr. Robert Rubin at HHS, and Don Moran at OMB. Both stated it was in line with the Administration's thinking. We are hopeful that you might consider supporting this measure, in the event it is not included in the Administration's package.

We appreciate the very careful consideration you are giving these critical issues during a very difficult period. I hope we can discuss these issues again soon to continue the very hasty conversation begun last week.

Sincerely,

JANET SMITH,
Legislative Representative.

Enclosure.

AMENDMENT TO SECTION 1903(m)(2)(A) OF THE SOCIAL SECURITY ACT

Section 1903(m)(2)(A)—Except as provided in subparagraphs (B) and (C), no payment shall be made under this title to a State with respect to expenditures incurred by it for payment (determined under a prepaid capitation basis or under any other risk basis) for services provided by any entity *other than a general purpose government entity* which is responsible for the provision of inpatient hospital services and any other service described in paragraph (2), (3), (4), (5), or (7) of section 1905(a) or

for the provision of any three or more of the services described in such paragraphs unless—

(i) if the Secretary (or the State as authorized by paragraph (3)) has determined that the entity is a health maintenance organization as defined in paragraph (1); and

(ii) less than one-half of the membership of the entity consists of individuals who (1) are insured for benefits under part B of title XVIII or for benefits under both parts A and B of such title.

Senator Symms. Next I'll call Mr. Jay Angoff, on behalf of the Public Citizen's Congress Watch.

Would you please come up. Is it Angoff? Is that—

Mr. ANGOFF. Angoff.

Senator SYMMS. That's correct.

Mr. ANGOFF. Thank you, Senator Durenberger.

Senator SYMMS. Please proceed, Mr. Angoff.

STATEMENT OF JAY ANGOFF, PUBLIC CITIZEN'S CONGRESS WATCH

Mr. ANGOFF. Thank you, Mr. Chairman.

My name is Jay Angoff. I am a lawyer with Public Citizen's Congress Watch, the public interest advocacy group founded by Ralph Nader.

I am pleased to testify today on behalf of Congress Watch on the spending reduction proposals in the administration's proposals in the administration's program for economic recovery.

We share the President's concern about controlling Federal spending, and we believe that he has been given a unique opportunity to accomplish that goal with the support of the American people.

But we believe that Mr. Reagan is in danger of losing that opportunity, and losing that support, for two reasons: First, although Mr. Reagan told us in his State of the Union Address that only the programs for the truly deserving needy remain untouched, the administration left corporate welfare payments virtually intact.

The Congress Watch study attached to my testimony, entitled "The Kindest Cuts of All: Cutting Business Subsidies in Fiscal Year 1982", describes \$52 billion in corporate subsidies that could be eliminated.

Mr. Chairman, I ask that this study be made part of—

Senator SYMMS. It's a study attached here?

Mr. ANGOFF. It should—

Senator SYMMS. How big is the study?

Mr. ANGOFF. Twenty five pages.

Senator SYMMS. We will make this part of the committee file. I thank you very much.

Mr. ANGOFF. Thank you. [Laughter.]

Second, the administration has failed to even consider cutting tax expenditures, which have grown even faster than direct expenditures, and which in 1982 will amount to \$300 billion.

Mr. Chairman, tax expenditures are dollars the Government purposely does not collect in order to further certain social goals. They take the form of special exclusions, exemptions, deductions, and credits in the tax law that benefit certain classes of taxpayers. They are, thus, payments by the Federal Government made

through a reduction of taxes to a targeted group, rather than through a direct grant.

For example, if a corporation buys a machine costing \$1,000, the 10-percent investment tax credit allows it to reduce its income tax by \$100. The same result would be achieved if the corporation bought the machine for \$1,000 and the Government then sent it a \$100 check.

Many tax expenditures serve no legitimate policy goals and should be eliminated, such as the \$2.3 billion depletion allowance for independent oil companies, the \$2.9 billion deduction for intangible drilling costs for all oil companies, and the \$2 billion foreign tax credit. With the foreign tax credit, by the way, both the oil companies, who pay less tax, and the OPEC nations, who receive the more money, benefit. The only loser is the U.S. taxpayer.

While the oil industry has argued that they need these subsidies to provide incentives to explore for oil, deregulation—which will give the oil companies \$1 trillion by 1980 they otherwise would not have received, according to the Joint Tax Committee—would seem to have eliminated the need for any additional encouragement.

In addition, of course, the oil companies today are swimming in cash. Despite their claims that they need huge profits so that they can reinvest them to find more oil, Standard Oil of Ohio recently used \$1.8 billion of its profits to try to buy Kennecott Copper, and Standard of California offered \$4 billion for Amax metals.

In short, there is no rational basis for subsidizing the oil companies through percentage depletion, expensing of intangibles, and the foreign tax credit in today's environment, when deregulation has driven oil prices to OPEC monopoly levels.

Incidentally, Mr. Chairman, if we eliminated just the oil depletion allowance and the expensing of intangibles, we would be able to avoid making any cuts in food stamps, child nutrition, student assistance, aid to families with dependent children, Amtrak, the National Consumer Co-op Bank, highway safety grants, and the neighborhood self-help development program.

There are a number of other depletion allowances which other industries argued they needed because the oil companies got the percentage depletion. But, if the oil company depletion allowance were eliminated, depletion for these companies could be eliminated too. That would save an additional \$1 billion a year.

Now, there is at least another \$3.4 billion in subsidies to multinational corporations through the tax Code. For example, one of the most perverse provisions of the Internal Revenue Code is the one that allows U.S. corporations to avoid paying tax on their foreign income as long as they reinvest it abroad. This not only costs the Treasury \$500 million annually, but also actually encourages firms to invest abroad rather than in the U.S., thereby exporting needed capital and jobs that otherwise would be created at home.

And the DISC subsidy allows U.S. exporting companies to set up paper subsidiaries, called domestic international sales corporations, which can then defer indefinitely a portion of their taxes on their profits from sales to foreign countries.

Although this subsidy was supposedly designed to increase exports, it hasn't had this effect. It is merely a \$1.8 billion transfer

payment from taxpayers in general to multinational corporations. As David Garfield, the chairman of a pro-DISC lobbying group told the Washington Post in 1978: "We don't pass on DISC benefits into lower prices and increase exports. We keep it as an incentive to us. We have more profit."

Another welfare payment to multinationals is the tax credit for corporations receiving income from doing business in U.S. possessions. This mainly benefits drug companies who do business in Puerto Rico, who argue that the credit creates jobs there and, therefore, should be retained. But the Congressional Budget Office has concluded that a major effect of the exemption in the seventies has been to induce U.S. firms to shift high profit, low-labor activities to Puerto Rico, with relatively few benefits to the Puerto Rican economy.

The \$1.6 billion subsidy on industrial development bonds, or IDB's, is still another corporate subsidy that should be eliminated. The overwhelming majority of the beneficiaries of these bonds are large, established firms that don't need them. They include K-Mart, Nabisco, Burlington Industries, General Mills, Johns-Manville, and McDonald's. Country clubs have also benefited, as has Richard Viguerie, who recently got a \$7 million industrial development bond for a new computer center and office building.

I think the Washington Post summed it up very well when it said that: "IDB's are now turning local governments into bankers trying to provide tax-shelter financing for business investments that probably would occur anyway."

Now, Mr. Chairman, cutting tax expenditures will cause loud protests from the beneficiaries of these expenditures, just as cutting specific direct expenditures has caused protest from affected groups. And reasonable arguments can be made for and against certain tax expenditures, just as reasonable arguments can be made for and against certain direct grant social programs.

The point is only that tax expenditures and direct expenditures should be subjected to the same careful scrutiny.

The administration is kidding itself and the American people about cutting Federal spending if it doesn't look as critically at tax expenditures—

Senator SYMMS. All right. Would you please summarize your statement.

Mr. ANGOFF [continuing]. As it has at direct grant social programs.

Senator SYMMS. It will be a part of our record.

Mr. ANGOFF. A summary in addition to what I've just said?

Senator SYMMS. Yes. If you could just please wrap it up in about 20 seconds, or so. And then we will—there may be some questions.

Mr. ANGOFF. OK. The major point is that we can disagree about what tax expenditures should be cut and what tax expenditures should not be cut. But tax expenditures should be, at least, a subject for budget cutting along with direct expenditures.

Senator SYMMS. Thank you very much.

Are there any questions, Senator Durenberger?

Senator DURENBERGER. No.

Senator SYMMS. Senator Grassley, do you have any questions?

Senator GRASSLEY. No.

Senator SYMMS. I would just make a comment in closing. I thank you very much for testifying, but I think it is very clear, historically, that if you want more of something, you tax it less; and if you want less of something, you tax it more. A direct result of the windfall profits tax, which is nothing more than an excise tax on crude oil production at the wellhead, has caused the oil companies to look for things like Kennecott to buy that you mentioned in your testimony. That's the reason for it. It is because if profits are less in business, they go back into dividends for reinvestment for the people that are in the business of making a profit. And that's how we got where we are.

But, I thank you very much.

[Statement follows:]

STATEMENT OF JAY ANGOFF, PUBLIC CITIZEN'S CONGRESS WATCH

Mr. Chairman, my name is Jay Angoff. I am a lawyer with Public Citizen's Congress Watch, and I am pleased to testify today on behalf of Congress Watch on the spending reduction proposals in the Administration's Program for Economic Recovery.

We share Mr. Reagan's concern about controlling federal spending, and we believe that he has been given a unique opportunity to accomplish that goal with the support of the American people.

But we believe that Mr. Reagan is squandering that opportunity, and squandering that support, in two ways. First, although Mr. Reagan told us in his State of the Union Address that "only the programs for the truly deserving needy remain untouched," the Administration left corporate welfare payments virtually intact. The Congress Watch study attached to my testimony, entitled "The Kindest Cuts of All: Cutting Business Subsidies in fiscal year 1982," describes \$52 billion in corporate subsidies that could be eliminated. I ask that this study be made part of the hearing record.

Second, the Administration has failed to even consider cutting tax expenditures, which in 1982 will amount to almost \$300 billion.¹

Tax expenditures are dollars the government purposely does not collect in order to further certain social goals. They take the form of special exclusions, exemptions, deductions, and credits in the tax law that benefit certain classes of taxpayers. They are thus payments by the federal government made through a reduction of taxes to a targeted group rather than through a direct grant. For example, if a corporation buys a machine costing \$1,000, the 10 percent investment tax credit allows it to reduce its income tax by \$100. The same result would be achieved if the corporation bought the machine for \$1,000 and the government then sent it a \$100 check.

SUBSIDIES TO THE OIL INDUSTRY

Many tax expenditures serve no legitimate policy goals and should be eliminated, such as the \$2.3 billion oil depletion allowance and the \$2.9 billion deduction for intangible drilling costs. The depletion allowance—which after a half century was eliminated for the major oil companies in 1975—still allows the so-called "independents" to exclude from tax 22 percent of their income from oil production each year. The intangible drilling cost deduction allows all oil companies to deduct immediately the labor and supply costs they incur in drilling successful wells, even though virtually all other businesses must deduct their costs over the life of their investment.

In addition, oil companies are allowed to reduce their U.S. tax liability on their foreign-source income by the amount they pay in taxes on that income to foreign countries. What the oil companies and the OPEC nations call taxes, however, are often in realty royalties that should be deducted from gross income rather than credited against tax liability. Both the oil companies, who pay less tax, and the OPEC nations, who receive more money, benefit from this provision; the only loser is the U.S. taxpayer. Based on Treasury Department figures, the foreign tax credit costs U.S. taxpayers at least \$2 billion annually.

While the oil industry has argued that they need subsidies to provide incentives to explore for oil, deregulation—which will give the oil companies \$1 trillion by 1990

¹ Unless otherwise specified, all figures are from the Carter Administration's proposed budget for 1982, Special Analysis G.

that they otherwise would not have received—would seem to have eliminated the need for any additional encouragement.

In addition, of course, the oil companies today are swimming in cash. Despite their claims that they need huge profits so that they can reinvest them to find more oil. Standard Oil of Ohio recently used \$1.8 billion of its profits to try to buy Kennecott Copper, and Standard Oil of California offered \$4 billion of its profits for Amax metals.

In short, there is no rational basis for subsidizing the oil companies through percentage depletion, expensing of intangibles and the foreign tax credit in today's environment, when deregulation has driven oil prices up to OPEC monopoly levels.

OTHER DEPLETION ALLOWANCES

Corporations in many other extractive industries, in addition to independent oil companies, are allowed to deduct a percentage of their gross income as a depletion allowance. The percentage varies from 5 percent to, in most cases, 22 percent. The minerals eligible for the 22 percent depletion allowance include asbestos, bauxite (used in aluminum production), and clay, and even sand, stone and gravel get a 5 percent depletion allowance. These subsidies—which will cost \$1 billion in fiscal year 1982—were put into the Code after various extractive industries argued that if oil companies got a depletion allowance so should they. But there is no sound policy reason for retaining them. If oil depletion is eliminated, then so should all other depletion.

TAX WELFARE FOR MULTINATIONALS

Deferral

One of the most perverse provisions of the Code is the one that allows U.S. corporations to avoid paying tax on their foreign income as long as they reinvest it abroad. This not only costs the Treasury \$500 million annually, but also actually encourages firms to invest abroad rather than in the United States, thereby exporting needed capital and jobs that otherwise would be created at home.

DISC

The DISC subsidy is another ludicrous and expensive federal spending program. DISC allows U.S. exporting companies to set up paper subsidiaries, called domestic international sales corporations, which can then defer indefinitely a portion of their taxes on their profits from sales to foreign countries. Although the DISC subsidy was supposedly designed to increase exports, it has not had this effect—it is merely a \$1.8 billion transfer payment from taxpayers in general to multinational corporations. As David Garfield, chairman of a pro-DISC lobbying group, has stated: "We don't pass on DISC benefits into lower prices and increased exports. We keep it as an incentive to us. We have more profit."

Tax Credit For Possessions Corporations

Another corporate welfare payment to multinationals is the tax credit for corporations receiving income from doing business in U.S. possessions. This credit was enacted in 1921 to give U.S. firms doing business in the Philippines, which was then a U.S. possession, the same favorable tax treatment enjoyed by their British competitors. The Philippines ceased to be a United States possession in 1946; the credit therefore no longer serves its original purpose. In 1948, however, Puerto Rico enacted special tax exemption provisions and a number of multinationals built plants there; they now argue that the credit creates jobs in Puerto Rico and other U.S. possessions and therefore should be retained. But the CBO has concluded that "a major effect of the exemption in the 1970's has been to induce U.S. firms to shift high-profit, low-labor activities to Puerto Rico, with relatively few benefits to the Puerto Rican economy."

According to a June 1980 Treasury report, 55 pharmaceutical companies got 50 percent of the benefits of the credit.

INDUSTRIAL DEVELOPMENT BONDS

The \$1.6 billion spent on Industrial Development Bonds is still another corporate subsidy that should be eliminated. IDB's are tax-exempt bonds that state and local governments issue to provide low-cost financing to private firms. The overwhelming majority of the beneficiaries of these bonds are large, established firms that don't need them. They include K-Mart, Nabisco, Burlington Industries, General Mills and Johns-Manville, the asbestos giant. Country clubs have also benefited. And Richard Viguerie, the successful direct-mail fundraiser for new right Republican candidates, recently got a \$7 million IDB for a new computer center and office building. A

leading beneficiary of IDB's is McDonald's, which has received \$47.8 million worth of the bonds.

The CBO recently stated that "the widespread use of IDB's raises the question of under what circumstances for the federal government should incur revenue losses, particularly of a kind that it cannot supervise or control, to subsidize the borrowing costs of private industry." The Washington Post was more direct. IDB's, it said, "are now turning local governments into bankers trying to provide tax-shelter financing for business investments that probably would occur anyway."

IDB's are among the most wasteful corporate welfare payments and should be eliminated.

ADDITIONAL TAX SPENDING CUTS

Other tax expenditures which can and should be cut are described more fully in the attached study, "The Kindest Cuts of All." One is the treatment of ordinary income from timber and certain livestock as capital gain, thus exempting 60 percent of such income from tax. Such treatment defies common sense—hog farmers get "capital gains," for example, while chicken farmers get "ordinary income"—and its elimination would save a minimum of \$1.1 billion a year.

Another is the subsidy to wealthy individuals through the stepped-up basis given to capital gains at death, which allows appreciated property to be inherited tax-free. Congress reduced this subsidy in 1976, but then undid its good work as part of the windfall profits tax a few years later. Closing it again would save \$5.4 billion in fiscal 1982.

Many other tax expenditures can and should be eliminated or limited. The deductibility of interest on consumer credit, for example, will cost the Treasury \$6 billion in fiscal 1982. To subsidize people who buy on credit—to in effect encourage people to buy on credit rather than pay cash—makes absolutely no sense. Rather than spending still more money by excluding greater amounts of interest from tax, by eliminating the consumer credit deduction we can encourage saving, reduce inflationary demand pressures, and save billions of dollars.

The mortgage interest deduction—which will cost the Treasury a staggering \$25.3 billion in 1982—should also be significantly limited. It gives no benefit to either those people who don't own their own homes or those who do own their homes but take the standard deduction. And because it is a deduction rather than a credit, a \$1 mortgage interest deduction is worth 70 cents to a taxpayer in the top 70 percent marginal tax bracket but only 20 cents to an average working family in the 20 percent marginal bracket.

The mortgage interest deduction is so well-established that it is probably impractical to eliminate it completely. But it can certainly be restricted—say to \$10,000 in interest a year, or to only one or even two houses. Limiting it in such a manner would still allow most taxpayers who use it to take full advantage of it, while resulting in significant savings.

The deduction for charitable contributions, which will cost \$9.8 billion in 1982, also could be significantly narrowed, or at least changed to a credit.

Those interested in cutting government spending still further should turn to pp. 226-30 of Special Analysis G of the fiscal 1982 budget prepared last year by OMB, where all the tax expenditures are listed. A reasonable case can certainly be made for the elimination of billions more in tax expenditures that are found there that I have not mentioned.

CONCLUSION

Of course, cutting tax expenditures will cause loud protests from the beneficiaries of those expenditures, just as cutting specific direct expenditures has caused protests from affected groups. And reasonable arguments can be made for and against certain tax expenditures, just as reasonable arguments can be made for and against certain direct grant social programs.

The point is only that tax expenditures and direct expenditures should be subjected to the same careful scrutiny.

The administration is kidding itself and the American people about cutting federal spending if it does not look as critically at tax expenditures as it has at direct grant social programs.

Senator SYMMS. Our next witness is Mr. James Kenley, doctor, medical doctor, president of the Association of State and Territorial Health Officials.

Do you have another comment, Senator Durenberger? Excuse me.

Senator DURENBERGER. Well, I was just going to comment briefly on your conclusion. I know you were over on the House side when all of this was discussed and I was sitting over here.

But during the course of 13 weeks of hearings on the windfall profits tax, I learned a couple of things. There is a big difference between the oil companies, as many of us use that term and as I suspect the term was used by the witness, and the people that actually find oil in this country—the thousands of independent oil and gas people out there. That's one of the things I learned.

The other thing I learned is that I think, with regard to the conclusion you stated, Mr. Chairman, you may be wrong.

I recall asking the people at Exxon about the purchase of Reliance Electric and the rationale was not, you know, that we don't have adequate profits to drill oil. The rationale was that we can only spend so much time or money in the oil business—as I recall, the figure was something in the neighborhood of \$6 billion—in a particular year and we have excess profits over that and so we go into energy-related businesses.

And, you know, I don't know what position this witness is coming from on this issue, but I just want to say to you that I am concerned about the proposed acquisition of Amax; and I am concerned about the proposed acquisition of Kennecott Copper and what that's going to mean to the energy future of this country. That is not to condemn all oil companies. It is only to say that it's important to draw a distinction between some of our major oil companies in this country who are making more money than they need to perform their traditional function of exploring for oil, and so they are making themselves energy companies in the broadest sense, or mineral companies in the broadest sense. And I think that is a subject of genuine concern to the people of this country.

Senator SYMMS. Thank you very much.

Now we have Dr. James Kenley, president of the Association of State and Territorial Health Officials.

STATEMENT OF JAMES B. KENLEY, M.D., PRESIDENT, THE ASSOCIATION OF STATE AND TERRITORIAL HEALTH OFFICIALS

Dr. KENLEY. Mr. Chairman, I am James B. Kenley, physician, Commissioner of Health for the Commonwealth of Virginia. I appreciate the opportunity to appear before this committee as president of the Association of State and Territorial Health Officials and to reflect the opinions and recommendations of these health officials.

My testimony results from our meeting last week with health officers of all the States and territories, at which time we reviewed options for the future and developed resolutions for future actions. Some of these resolutions are attached to my written testimony for your records.

This verbal testimony will be limited to summarizing the major recommendations that the Association of State and Territorial Health Officials would like to convey to this committee.

First let me speak to the medical assistance program, medicaid, which is imposing increasingly severe financial burdens on States as well as on Federal Government budgets. From the limited information available to us with regard to the details of the administra-

tion's plans or proposal to cap medicaid expenditures, our association determined that it opposes such action.

We do not believe that an arbitrary cap can be placed on a program with an open entitlement. The States do not have the means to adequately control the increasing cost of medical services, nor do the States have a means to limit the number of individuals eligible to receive services. Most of the States have sought ways to control the growth and cost of medicaid services and each of the States has found the effectiveness of their actions handicapped by the lack of flexibility available to the States to determine the benefits to be made available to the various eligible groups.

More flexibility to the States is very important to enable them to manage these programs better. But even with additional flexibility, the States options for exerting leverage on health care costs is quite limited. Particularly so, if medicaid reimbursement policies are to continue to be governed by those of the medicare program.

Additionally, given the State legislature and State administrative processes, which must be followed, it would be impossible to implement any flexibility which Congress grants for this program quickly enough to realize important savings in fiscal year 1981 or 1982. Time to obtain results from changes must be considered when evaluating benefits expected from more program flexibility.

Please remember that significant reduction in Federal participation can only result in a shift of a funding burden to the States which in most cases are ill-prepared to accept any additional drain on their revenues.

In the resolution of the association with regard to medicaid, you will find specific recommendations by the States and territories in regard to proposed waivers to allow purchasing of services, goods, and supplies in more cost-effective ways, varying services in eligibility categories by local jurisdictions, and the application of cost-sharing arrangements with all categories of beneficiaries.

Further, the association supports repeal of all Federal medicaid regulations which impose a greater paperwork burden that can be shown to be cost beneficial to the program.

In general, we feel that the States must have relief from current Federal policies so as to allow the States to act as prudent purchasers of medical care for the indigents who are served by medicaid.

Certainly, if the medicaid program is to be limited by a Federal funding cap, relief must be provided from the current imposition of medicare program standards and reimbursement policies. Reasonable costs for hospital reimbursement, usual and customary fees for physicians, and other medicare requirements are inconsistent with the needs for effective administration of the medicaid program unless medicaid also is going to continue to benefit from open-ended Federal funding.

With regard to the medicare program itself, the association knows the concept of having the beneficiary, rather than the providers, exercise control of health care utilizations and costs through deductibles and coinsurance have not been successful. The beneficiaries have been unable to exercise measurable restraint over the cost of the medicare program and the elderly today are

spending more out-of-pocket money for medical care than they did before medicare went into effect.

Many of the activities taken by States to reduce medicaid program costs would have a positive effect on the medicare program if utilized. A requirement of physicians that they accept program assignment might be beneficial. Placing of an annual percentage ceiling on the rate increases in hospital payments should be considered. Elimination of the periodic interim payment to hospitals could yield benefits. Allowing State administered audit programs to substitute for fiscal intermediary hospital and nursing home cost audits may be desirable.

Other ideas are contained in the associations' resolutions on medicare and medicaid.

A resolution was made also with regard to proposals to reduce Federal support to the States for certain basic health protection programs such as certification of medical care facilities of medicare and medicaid. Assurance of the integrity of consumer products, occupational health and safety inspections, and others.

Our association recognizes that many of these programs began at State level and were subsumed under Federal mandate to guarantee minimum protection to all citizens in this country. We should welcome return of the programs to the States jurisdictional control, provided that careful consideration occurs on the continuation of the national standardization policy and adequate funding to support the States to resume the burden of these regulatory programs.

The health officials of the State concur with the concept of Federal block grants of health services which would allow the moneys available through appropriation under title V act and under the Public Health Service Act to be dispensed by the States according to the priorities within the States. Due to the economic situation within the country, more persons are going to need help in paying for health care at the time that cost for the provision of such care continues to inflate. If at the same time less Federal funding is to occur, States must have the authority to apply the available resources in areas of highest priority.

Senator SYMMS. Thank you very much, Doctor, and I failed to mention when you came in Senator Byrd extended his best wishes to you. He also has responsibilities on the Senate Armed Services Committee and was unable to be here this morning but wanted to welcome you here to the committee.

Did you have a question, Senator Grassley?

Your entire statement will be made a part of our record.

Dr. KENLEY. Thank you.

Senator GRASSLEY. Doctor, as you know, an accounting problem with the medicaid program has been the low number of physicians willing to accept patients who are on medicaid. This resistance to participation is blamed in part on the low ratio of reimbursement and mandatory assignment requirements.

The current rate of claims assignments under medicare is about 50 percent. You have suggested mandatory assignments for all claims. Don't you believe that we will begin to experience the same problem that medicaid has faced; that is, that physicians aren't willing to accept medicare patients?

Dr. KENLEY. Well, this certainly isn't true in Virginia. We have wide participation in the medicaid program throughout Virginia by physicians. We have not experienced, even during these hard times, a mass abandonment of the medicaid patient or the program in Virginia, although we have not raised our fees since 1969.

I would only offer this as consideration for this group—that is, the medicare group—at a time of crisis. I think it all depends on how we perceive our situation today and our urgency to get our country straightened out financially.

I think physicians will accept their share of the responsibility.

Senator GRASSLEY. What accounts for the success in Virginia compared with some other States, then? Does that mean that the doctors in Virginia are a little more responsibly inclined?

Dr. KENLEY. I think we have had a very responsive program in Virginia. We pay our claims very promptly. We were one of the first to be computerized. And I think we have good communication. I must admit, they are pretty much at the end of their patience as far—and tolerance—as far as our current fee schedule is concerned.

I think it's a matter of being reasonable.

Senator GRASSLEY. Thank you, Mr. Chairman. I have no further questions.

Senator SYMMS. Senator Durenberger.

Senator DURENBERGER. Thank you, Mr. Chairman.

Doctor, I think in your statement you suggested that the idea of State-run UR, utilization review, might be less costly than the present system; is that correct—more effective?

Dr. KENLEY. I didn't quite get the first part of your question, sir.

Senator DURENBERGER. You addressed yourself to the issue of utilization review and suggested that if might better be done on a State basis, might be more effective, and less costly. I am curious to know if that was your statement? Do you believe the majority of the States are currently able to perform that kind of review on all publicly financed patients or the concept of review of only medicaid patients?

Dr. KENLEY. I feel that utilization, really, should be part of the responsibilities within each hospital very much like the tissue committee and other assignments that physicians have.

In my State very early in the medicaid and medicare program when hospitals had a limited number of beds available to their physicians, they had very excellent utilization review committees that were very effective. I think they should function along those lines.

Senator DURENBERGER. Is your opinion that most States are capable of doing what you believe Virginia is able to do in terms of providing that kind of a review system?

Dr. KENLEY. I think except for long-term care. Each hospital certainly has the capability within the States to carry on good utilization review without Federal intervention or support. That's my opinion.

Senator DURENBERGER. Among the recommendations of the Governors' Association with regard to reforms—that's what it's called—in medicaid is that we consider blocking the long-term

portion of medicaid to the States. What opinion might you or your association have on that?

Dr. KENLEY. I don't believe that they specifically addressed long-term care. Can I give a personal opinion from my experience in my State?

Senator DURENBERGER. Fine; sure.

Dr. KENLEY. I am very concerned that—if you look at what has happened with the medicaid program in Virginia—we started off with a very balanced program, a very generous program to meet the needs. The long-term care portion has increased so rapidly and the inflation and the cost has been—growth has been so great, that other aspects of the program have been rather neglected.

I believe it would be wise to treat that as a different category, as a different grant aside from the medicaid program.

Senator DURENBERGER. Do you have any opinion on changes that we might be well advised to make in medicare that might make it easier for us to do some of the things that you at the State level think are appropriate with regard to medicaid?

Again, either a personal opinion if the association doesn't have one.

Dr. KENLEY. I would like the option to send you something in writing in detail. I would not want to rush into that. I do feel there are savings that we could make. I would prefer to submit it to you in writing.

Senator DURENBERGER. All right. I'd appreciate that very much and I know the chairman would also. We have a major task ahead of us in restraining our spending in the neighborhood of \$9 to \$10 billion and we are always looking for better ways than the administration might have come up with to accomplish that. So, if you have some specific suggestions, I know we'd all personally appreciate them.

Thank you very much.

The CHAIRMAN. I have no questions. I have been over making a statement on the floor, so I apologize and I think certain members here have covered the important points.

[The statement follows.]

SUMMARY STATEMENT, JAMES B. KENLEY, M.D., COMMISSIONER, VIRGINIA STATE HEALTH DEPARTMENT, ASTHO PRESIDENT

The Association of State and Territorial Health Officials (ASTHO) has adopted the enclosed series of policy statements relating to national health policy and funding. The ASTHO support of block grants for consolidated health programming and planning is a position that supports the need to set priorities in order to maintain necessary attention to the highest needs. If all present categorical programs for health were cut across the board, without any efficiencies effected by the consolidation of funding and administration, most of the programs would suffer irreparable damage. Thus, ASTHO recommends a block grant approach that would include appropriate consolidation of programs into three areas: (1) preventive health services, (2) basic health services, and (3) mental health, alcoholism, and drug abuse services. ASTHO also urges that a considered approach to block grants must include appropriate methods for allocation of funds as between Federal, State, and local levels, continuation of levels of support for ongoing categorical programs for a period of time, and provisions of accountability of states and localities.

ASTHO recommends funding of these grants at a continuation level to states and territories, but in no case at more than a 10 percent cutback in the first year, relying on savings that can be obtained from adaptations in the Federal administrative machinery.

With regard to programs coming under the direct jurisdiction of the Senate Finance Committee, namely Medicare and Medicaid, ASTHO recommends measures

that will result in substantial savings. Great reductions in Federal expenditures can be achieved if there is a greater focus of attention on cutting in the program that has the highest costs per unit of service and the least controls on rates of increases in expenditures: Medicare. ASTHO recommends specific controls to be applied to the Medicare program in order to achieve substantial savings in health care in 1982, without adversely affecting the elderly's access to needed services.

ASTHO is opposed to the President's proposal to set a limit on the Federal commitment to the Medicaid program, a proposal that would close the open-ended commitment and shift cost burdens to state and local governments, which are not in a position to absorb such funding shifts. ASTHO recognizes the need to control the ever-increasing costs associated with the Medicaid program, and in fact many states already have taken effective steps in containing the cost of Medicaid. In order that their cost containment efforts may be intensified, states must be given greater flexibility in administration of the Medicaid program, and any Federal cutbacks in Medicaid must be phased in consistent with granting the states increased flexibility in administration of the program.

NATIONAL HEALTH POLICY AND FUNDING

The Association of State and Territorial Health Officials herewith provides the attached recommendations to the President and the Congress of the United States related to national health policy and funding. These proposals are consistent with and will continue efforts such as those which have resulted in dramatic reductions in infant mortality, improvement in the quality of life, and extension of life expectancy by 20 years since the turn of the century.

1. CONSOLIDATED HEALTH PLANNING AND PROGRAMMING

Development of three block grants using the most effective provisions of previous legislation and maintaining Federal funding levels appropriate to the needs and aims of health services, disease prevention, health promotion, and cost containment.

2. STATE UTILIZATION REVIEW AND ELIMINATION OF PSRO'S

Reliance upon the States for health care utilization review with the elimination of PSROs.

3. STATE FLEXIBILITY AND FEDERAL FINANCIAL PARTICIPATION IN MEDICAID

Provision of continued levels of Federal financial participation in Medicaid, with no Federally imposed cap, but with flexibility for the States in administration so that cost containment can be intensified.

4. FEDERAL SUPPORT FOR NATIONAL HEALTH PROGRAMS

Federal financial participation at continuation levels in major national health programs and activities such as certification of health facilities for Medicaid/Medicare; Occupational Health and Safety, disposal and control of nuclear and hazardous wastes.

5. MEDICARE COST CONTAINMENT

Substantial reduction and containment of costs in Medicare which will allow continuation of Federal support for other health services.

6. CENTERS FOR DISEASE CONTROL

The Centers approach to Federal-State relations is commended and funding for activities which promote the health of the general public should be sustained.

The President and Executive Committee of ASTHO are directed to work with the President and the Congress of the United States on behalf of all of the States and Territories to further develop and refine the detail of these recommendations which express our common concerns and objectives in the best interest of the health of American people and communities.

The ASTHO recognizes that various populations served by the current categorical programs have some skepticism about the consolidation of the special grant programs, and the retention of attention to their special needs. The ASTHO support of consolidation of the grant program is a position that supports the need to set priorities, in order to maintain necessary attention to the highest needs. If all present categorical programs were cut across the board, without any efficiencies effected by the consolidation of funding and administration, then most of the pro-

grams would suffer irreparable damage. A more considered approach to reductions of federal expenditures, if such must take place, is to:

Focus attention on cutting in that program that has the highest costs per unit of service and the least controls on rates of increases in expenditures—Medicare;

Give the states more flexibility in administration of Medicaid so that continued controls on this program can be maintained;

Consolidate grant programs appropriately and give states some flexibility in administration to achieve economies but enough standards to maintain programmatic priorities.

RESOLUTION: BLOCK GRANTS FOR CONSOLIDATED HEALTH PROGRAMMING AND PLANNING

Whereas, President Reagan has proposed some thirty-five grant programs in the health, social services, education and legal assistance areas for consolidation, and

Whereas, the President has proposed that 25 percent of current Federal expenditures on these programs be cut out, and

Whereas, with respect to the health programs, these represent cost beneficial activities with proven impact on health and on access to health services, while representing a modest Federal investment when compared with the medical care programs of Medicare and Medicaid, and

Whereas, the President has proposed phasing out by 1983 grants for health planning and these funds will be necessary for states and territories to carry out effective planning for health services.

Whereas, in fiscal year 1981, the Administration proposes no further funding of the Health Incentive Grant Program, which is the model block grant program in health, and

Whereas, states are currently organized along functional lines such as health, mental health, social services, and education, now, therefore, be it

Resolved, That the Association of State and Territorial Health Officials:

1. Supports the concept of consolidated health programs and related state planning to establish priorities for these programs in the States, and recommends the following three areas for consolidation:

(1) Preventive health services, to include: Health incentive grants; risk reduction-health education; VD, TB, hypertension, immunization, flouridation, rat control, lead paint, genetic disease, SIDS, M&CH, and CCS, SSI-children; Family Planning and adolescent health;

(2) Health Services, to include: community health centers, black lung; migrant health, home health, EMS, Health Planning, RHI and UHI; and

(3) Mental health, alcoholism and drug abuse.

2. Recommends that, with respect to these consolidations for health, consideration should be given to appropriate methods for allocation of funds as between federal, state and local levels, continuation of levels of support for ongoing categorical programs for a period of time, provisions for accountability of States and Localities, concerns regarding administrative costs and overall levels of funding, and other aspects of intergovernmental process.

3. Recommends that the various models of intergovernmental relations (e.g., Title V, PHS 314(d), 315, 317), which have been used in the past with varying success, be evaluated and adapted to the proposed consolidations, including consideration of the following factors from the perspective of the states:

(a) That the Governor of each State and Territories should designate an official health agency to administer each of the block grants;

(b) Assurance that a significant proportion of all funds will be spent for local programs and services with appropriate retention of funds at the state level for those functions and activities that must be done centrally;

(c) Assurance by states & territories of accountability in regard to provisions of a state plan, performance standards, and utilization of NPHPRS (or an adaptation thereof) as the basic framework of evidence for accountability.

(d) Provision in the states for an open, public participation process in the development and implementation of plans for these services;

(e) Minimize indirect administrative costs for consolidated grants, consistent with simplification of Federal administrative requirements;

4. Provision for funding of these grants, preferably at a continuation level to states and territories, but in no case at more than 10-percent cutback in the first year, relying on savings that can be obtained from the sickness oriented programs and including savings in the Federal administrative machinery, especially appropriate consolidation of Federal Regional Office structures and savings from this being transferred to the States and territories for assistance in their administration.

RESOLUTION: PROFESSIONAL STANDARDS REVIEW ORGANIZATIONS

Whereas, PSRO's are Federally supported organizations of physicians charged with reviewing use of hospital and long-term care services under Medicare and Medicaid, and

Whereas, numerous studies of the cost effectiveness of PSRO's have demonstrated that they, in fact, raise the costs of health care at no demonstrable improvement in quality, and

Whereas, state Medicaid programs have been required to rely upon PSRO's to review utilization under their programs, even in instances where states demonstrated that their own utilization review programs were superior to that of the PSRO's, and

Whereas, many states have objected to being required to relinquish to private organizations over which they have no control, the authority to spend state money, and

Whereas, the states can carry out utilization review programs sensitive to the objectives of economy and effectiveness in Medicaid care, conserving substantial Federal and State funds, therefore, be it

Resolved, That the Association of State and Territorial Health Officials support the phasing out of the Federal PSRO program, and its replacement by state controlled utilization review, which will save much more than the direct costs of the PSRO program.

RESOLUTION: MEDICAID

Whereas, the President has proposed a \$100 million cut in fiscal year 1981 and a \$1 billion cut in fiscal year 1982 of the Medicaid Program, and

Whereas, the President has proposed setting a limit on the Federal commitment to the Medicaid Program, thus closing the end on its previous open-ended commitment, and shifting cost burdens to state and local government, and

Whereas, the President has suggested that increased flexibility will be given to the states in order to accommodate this cut and cap on Federal funds, and

Whereas, there is little specificity with respect to defining how the Administration will "cap" an entitlement program like Medicaid, e.g. what will be the base for the cap and how will it be determined?, and there is proposed to be no indexing to caseload and no indexing to medical care inflation; and

Whereas, there is nothing specific in the proposals describing how or what kind of flexibility states will be given or if such flexibility will be given before the cuts and the cap are put into place, and

Whereas, states and territories are anxious to have increased flexibility in administration of the Medicaid Program but cannot, given state legislatures and state administrative processes, act to implement such flexibility quickly enough to realize the proposed savings in fiscal 1981 or 1982, and

Whereas, the states and territories as well as the Federal Government have a continuing concern with the needy, aged, disabled, and fatherless families and children who need medical assistance, and

Whereas, the states support continued cost containment in the Medicaid Program, with sufficient flexibility to slow the rate of increase, but cannot absorb a funding shift from Federal to State and Local revenue sources,

Whereas, many States have already taken effective steps in containing the cost of Medicaid, now, therefore, be it

Resolved, That the ASTHO recommends any Federal cutbacks in Medicaid be phased-in consistent with granting the States increased flexibility in administration of the program, and be it further

Resolved, That ASTHO opposes the proposal to close the end of the Medicaid Program and thus on the poor, and further

Resolves, That States and territories immediately be given, through broad waiver authority, increased flexibility in the following areas:

A. Purchasing medical services, goods, and supplies, through authority to enter into more cost-effective and efficient arrangements with organized health systems and individual providers; regionalization of services; volume purchasing; modification of current requirements to pay reasonable costs, including methods of prospective reimbursement.

B. Flexibility to vary optional services and optional eligibility categories by local jurisdiction, thus waiving requirements for statewideness.

C. In the use of cost sharing arrangements with all categories of eligible beneficiaries.

D. In varying optional services by diagnostic category and/or beneficiary category.

E. Where cost-saving proposals are offered beneficiaries, sharing the savings associated with those proposals with the beneficiaries who participate, and be it further *Resolved*, That the ASTHO supports repeal of those Federal Medicaid regulations which demand more paperwork and administrative costs than appear to be cost-beneficial, e.g. the EPSDT Penalty Regulations.

RESOLUTION: FEDERAL-STATE REGULATORY PROGRAMS

Whereas, proposals have been made to substantially and quickly reduce Federal support to the States for certain basic health protection programs such as: control of nuclear materials use, transport and disposal; occupational health and safety; protection of the quality of foods, the safety of drugs and the integrity of consumer products; certification of medical care facilities Medicare and Medicaid; and,

Whereas, these programs confer substantial protection to the public's freedom from dangerous diseases, and to the public's pocketbook from extraordinary medical and other expenditures; and

Whereas, these programs began at the State level and were subsumed under Federal mandate to guarantee minimum protection for all citizens, and

Whereas, the States welcome a return of these programs to their jurisdiction controls with continued programmatic effectiveness for all citizens, and

Whereas, transfer of responsibilities requires a timely and well thought consideration of continued national standardization, ongoing adequate funding support and respect for procedural limitations of State governments, now, therefore, be it

Resolved, That, the ASTHO favors the principles of State operation of nationally mandated health protection programs but opposes any such Federal support reductions unless and until national policy decisions are made to support objectives and functions consistent with resources available.

RESOLUTION MEDICARE

Whereas, States have attempted to keep controls over their Medicaid programs while the Federal Government has failed to control the Medicare Program,¹ and

Whereas, many policies under Medicare, such as reasonable cost for hospital reimbursement, PSRO utilization review, standards for hospitals and nursing homes, and usual and customary fees for physicians are required to be followed by Medicaid programs and tend to exacerbate the inflationary nature of the programs, and

Whereas, Medicaid is a program that serves the poor, while Medicare serves the elderly and disabled, many of whom are not poor, and

Whereas, about 16 percent of the Medicare population is also receiving Medicaid services, and

Whereas, the Medicare Program forces the beneficiary, rather than the provider, to exercise controls on health costs through its requirements for deductibles, coinsurance, and assignments policies, and these policies have proven ineffectual and lead to the finding that the elderly today are expending more out of pocket for medical care than they did in 1965, before Medicare went into effect; and

Whereas, the elderly would have savings of significant out-of-pocket expenses for physician services if physicians were required to accept assignment,

Whereas, many of the cost control measures instituted by Medicaid programs could be applicable to Medicare, and

Whereas, these cost reductions in Medicare can be utilized as the basis to avoid proposed Federal rollbacks in other health programs; now therefore, be it

Resolved, That the ASTHO recommends that more controls be applied to the Medicare Program in order to achieve substantial savings, perhaps as much as \$2 billion in health care in 1982, without adversely affecting the elderly's access to needed services, such as:

1. Put physicians on fee schedules and require that they accept assignment.
2. Limit the rate of increase in hospital payments to 10 percent annually, otherwise modify the "reasonable cost" principles.
3. Remove hospitals from the Periodic Interim Payment system.
4. Replace PSRO with state-operated utilization review systems.
5. Replace current fiscal intermediary hospital and nursing home cost audits with state-administered audit programs.
6. contract with states to operate claims processing.

¹ In California between 1974-1978, Medicare expenditures increased 137 percent (with a case-load increase of 27 percent), while Medicaid expenditures increased 70 percent (with a case-load increase of 30 percent).

RESOLUTION: CENTERS FOR DISEASE CONTROL

Whereas, the Centers for Disease Control are and have been a most successful protector of the public's health through a close Federal-State cooperative administration of Federally funded programs, and

Whereas, the Centers for Disease Control represent an attractive economy of scale for functions, such as reference laboratory work, applied research meant to use basic research data for measured public protection, training of technical personnel for specialized public health functions, epidemic response capacity, technical information source, assignment of technical specialists to targeted geographical areas of special need, and

Whereas, the Centers for Disease Control represent a necessary national focus for health protection programs for standardized nomenclature, agreed programmatic and personnel proficiency, and other functions, and

Whereas, the States look to the Centers for Disease Control for continued coordinated and cooperative relations with the Centers as the focal point; now, therefore, be it

Resolved, That the ASTHO considers the Centers for Disease Control as an appropriate vehicle for an improved and decentralized Federal-State relationship and, further, opposed funding reductions for the Centers until their key role in support of ongoing State operations and applied research which promotes the public's health is guaranteed.

ASTHO POLICY STATEMENT ON ENVIRONMENTAL ISSUES

1. The Clear Air Act must be re-authorized.

2. Because hazardous wastes are contaminating the general environment, they have become a matter of justified anxiety for many communities in America. Dangerous fires and spills are a routine occurrence. Some of these exposures have long-range and possible genetic effects. It is important that the Administration and States launch a full-scale attack on hazardous wastes. It should support necessary concomitant human health hazard evaluations in industry and communities in order to identify practical remedial and preventive measures.

3. Because of the concern on potential hazards to human health associated with environmental problems, it is imperative that the Administration and States develop emergency response capability for environmental hazard.

4. The Federal Government should develop a qualified lead agency expert in human health hazard assessment to deal with the states on issues of the isolation of radioactive waste.

5. It is important that OSHA enforcement and consultation activities remain separate to effectively identify and solve problems. Therefore, OSHA should be strongly encouraged to develop an improved consulting role as in 7-c-1.

6. A uniform Shellfish Sanitation Regulatory Program should be established throughout the nation. The committee should continue to study the practices in all states. A National Shellfish Conference should be called in 1981.

Mr. CHAIRMAN. Our final witness is John Mallan, vice president for governmental relations, American Association of State Colleges and Universities.

You may proceed in any way you wish. Your entire statement will be made a part of the record, as though given in full.

STATEMENT OF JOHN P. MALLAN, VICE PRESIDENT FOR GOVERNMENTAL RELATIONS, AMERICAN ASSOCIATION OF STATE COLLEGES AND UNIVERSITIES

Mr. MALLAN. Thank you, Mr. Chairman. With your permission I'll turn to page 2 of my statement, which is an executive summary.

I am trying to hit at what I think is a particularly important point or two in this whole issue.

The social security student beneficiary program is a relatively little known program. I find it is not very well understood by educators and I think not by many Members of Congress, probably

excluding this committee, but, certainly, I think the average Congressman and members of the public and media.

It serves about 760,000 students at an annual cost of about \$2 billion. The income data shows that many of these people are from very low-income families, most of them from families under \$10,000 a year. About 80 percent have one or both parents who are deceased and disabled. The remaining 20 percent have one or both parents retired. There is a high proportion of black students in the program which probably reflects the earlier age of death of most blacks in the United States, both black men and black women.

There is a lot of data in here, which I will not review, which deals with the kinds of people served.

In many ways I find it very similar to the Vietnam GI bill and the Korean GI bill in the sense that it serves a population where in most cases the parents did not go to college. In many cases the parents did not finish high school. The students are making a special effort on their own. There have been studies indicating an especially high level of aspiration and motivation, unusually high retention rates in college, and relatively high grades compared to average students. In other words, the feeling we get is that this is the program that serves those who are motivated enough to rise above difficult circumstances, both economically and in many cases psychologically or socially.

As I say, it's a little known program. I have tended to stress here not the details on the program as much as the related problem that the position of the administration on this program has been that it will be replaced by the so-called Pell Grant and GSL and other student aid programs.

And, I'm sorry, but by nose is bleeding from a bad cold I have. If you will excuse me.

The Pell Grant program and the GSL program, unfortunately, cannot replace this particular program. The plan of the administration itself is to reduce this program by about \$1 billion in the fiscal year 1982. That they believe, according to Secretary Bell's testimony, will take only \$56 million in additional Pell Grant moneys to make up the difference as required under the Pell Grant formulas. In other words, students will lose about \$1 billion which will not be replaced.

I believe this, plus other reductions proposed in Pell and GSL simply mean that it's very unlikely that those who lose money under this program may make it up through other forms of student aid.

There is one additional problem, which I think is important, other than that, is the timing. The high school seniors, hundreds of thousands of them, who are planning for college this fall do not know, in most cases, that this is going to happen. They have not been informed; I don't think their parents have been informed; high school counselors are not aware of this; and I think generally the community out there is not aware of the degree of seriousness of this problem.

I think if this program is going to be ended—I am very—

The CHAIRMAN. We had a couple of nurses on our staff, maybe—[Laughter.]

Mr. MALLAN. I may add that this is the most absurd situation I've ever been in, sir.

The CHAIRMAN. Well, I—

Mr. MALLAN. And I will close in just a minute.

The CHAIRMAN. Right. I don't want to—

Mr. MALLAN. But, in any case, I simply want to make a point that I do not see that this program can be replaced by the available Federal student aid program and other aids available.

I think with your permission, Senator, I will adjourn at this point. If I can talk to your committee's staff at some later time. But, other than that—

The CHAIRMAN. I really think you should and I will not propound any questions. If we have any, we will submit them in writing. I think the immediate concern is to somehow stop the nosebleed.

Mr. MALLAN. You will perhaps remember me as a witness, but this is not the way I would prefer that you remember me.

Thank you.

The CHAIRMAN. Your entire statement will be made a part of the record. Maybe Sheila and Lillian can give you some help here.

Mr. MALLAN. Thanks again.

[The statement follows.]

STATEMENT BY DR. JOHN P. MALLAN, VICE PRESIDENT FOR GOVERNMENTAL RELATIONS, AMERICAN ASSOCIATION OF STATE COLLEGES AND UNIVERSITIES

EXECUTIVE SUMMARY

The Social Security Student Beneficiary program serves about 760,000 students at a cost of about \$2 billion a year. A great many are very needy, with very low family incomes, with one or both parents deceased or disabled. About 20 percent are black, probably reflecting the lower life expectancy of blacks. The benefit is an earned benefit, paid for over a lifetime.

A point which must be emphasized is that in no way can other federal student aid make up the loss of these funds. The administration estimates that it will save \$1 billion in fiscal year 1982 by phasing out this program, but will add on \$56 million to the Pell Grant program to pick up the difference. In other words, students will lose about \$1 billion.

The administration's massive proposed cuts in the Pell Grant (BEOG) and Guaranteed Student Loan (GSL) programs would make it impossible to replace these Social Security funds for needy students. Proposed needs analysis changes in the Pell program will eliminate as estimated 600,000 students from that program, about 400,000 at public colleges and 200,000 at private colleges.

Further, a \$750 "self-help" provision is really a device to greatly reduce the grants of thousands of students at public colleges only (not private colleges) with family incomes between \$8,000 and \$15,000 or higher.

Student aid experts believe that proposed administration changes in the GSL program may keep some 1 to 3 million students (of a possible 4 million) from borrowing at all. Many who can borrow will be left with a \$20,000 debt for a \$10,000 loan. Thus, student grants and loans can in no way replace losses in the Social Security program.

TESTIMONY ON SOCIAL SECURITY STUDENT BENEFICIARY PROGRAM

The American Association of State Colleges and Universities (AASCU), an association of 341 state colleges enrolling about 2,400,000 students, is very concerned about the administration proposal to phase out the Social Security student beneficiary program, beginning in the fiscal year 1981. In other words, beginning in the academic year 1981-1982, no further students would receive benefits under this program. In 3 more years, the program would come completely to an end.

The administration has taken the position that this program is "inappropriate," and that low- and middle-income students who no longer received this aid would be eligible for federal student aid assistance "tailored to their educational costs and needs."

It is our position that the latter statement is incorrect—that the Social Security Student program provides far more aid; to needy low- and middle-income students than they would receive under the other federal student aid programs, even if these programs were adequately funded. Since there are also major administration proposals to phase down and possibly eliminate several other student aid programs, there is even less reason to believe that students' needs could be met in this fashion.

We believe that we can be most helpful to this subcommittee if we try to deal with the following six issues:

1. Who benefits from this program—what kinds of students, by family income, type of institution attended and race?
2. Who benefits geographically?
3. Can other aid substitute for this program?
4. This program is an earned benefit.
5. Possible reductions in this program, if absolutely necessary for budgetary reasons.
6. The need for better data on the program and the effect of reducing or eliminating it.

1. Who benefits from the program?

Data attached below shows that in the month of June, 1980 (the latest available month) a total of 760,000 students aged 18 to 21 received a total of about \$169,803,000 under this program. Earlier surveys showed that about 20 percent of these students are high school students. So far, administration recommendations do not make it plain whether they wish to end payments for high school students aged 18, too. They of course are not eligible for other federal aid and in many cases are not in a position to provide help to their families.

About 7 percent of these students attend technical or vocational schools, about 18 percent 2-year colleges, and about 54 percent 4-year colleges and universities. About 29 percent of those in college attend private colleges, a figure which is higher than that for all college students.

One study made by the Social Security Administration indicated that these students, like most of those who have attended college on the G.I. Bill, are especially highly motivated, more likely than other students to complete their programs, and usually work as well as carrying student loans to pay their way. Their difficult family circumstances probably account for their special drive to get an education, in the same way that many veterans have been especially highly motivated to go to college because of their experience.

About 80 percent of these students have one or both parents deceased or disabled.—This is an important statistic in itself. It shows that most students come from families not only in need but faced with substantial personal problems in raising and educating children. In many cases the mother is the head of the household, and, as we know, such households have considerably lower incomes, on the average, than those households headed by men. The remaining 20 percent are the children of retired workers.

A recent survey by GAO found that about 71 percent of these families had incomes under \$15,000 per year.—Twenty-nine percent had incomes under \$6,000, and 53 percent had incomes under \$8,000. Eighty-four percent had incomes under \$20,000. Thus, by any standard, the great majority are needy, and in many cases very needy. It is almost a miracle that so many children are able to attend college at all under these circumstances.

A disproportionate number of these families are black, particularly among those with disabled workers. A 1976 study found that about 20 percent of these students were black, compared to about 11 percent of blacks in the general population or the college population. The program is clearly of great help to minority students from low-income families. It is also our understanding that both black men and black women die at a considerably earlier age than those for their white counterparts, because of less adequate medical care and other factors, which may help account for the large percentage of black students. Data for Hispanic students are not available, but we suspect that they are disproportionately represented, too.

Many students are from blue collar or working-class families.—One study showed that about 48 percent of these students came from blue collar families (craft, foremen, operators, and laborers) compared to 20 percent of the general college student population. Many also came from lower-education families—35 percent from families in which the father had not completed high school, as compared to 20 percent of the general population. Again, the Social Security program, like the three G.I. Bills since World War II, has been an important means of educational and economic mobility for a generally disadvantaged population.

2. Who benefits geographically?

Attached to this testimony is an analysis of beneficiaries by state for the month of June, 1980, the latest month available. Data for the fiscal year 1980 is comparable. As would be expected, the large states have large numbers of beneficiaries—New York in that month had about 74,000 students who received about \$17 million; California, about 76,000, receiving about \$17 million; Texas, about 31,000, receiving almost \$20 million.

But even in somewhat smaller states there are many beneficiaries. In Connecticut, for example, 10,000 students received about \$2.4 million, and in Missouri, over 13,000 received about \$3 million.

We are also attempting to obtain data for all counties represented by members of the Subcommittee on Social Security, and selected members of the full Ways and Means Committee. Data by Congressional district is not available, but county figures give an approximate idea of the value of this program to each Congressional district.

There is no question that this program has a major impact in terms of the numbers served, the families which benefit, and the amounts of aid, in every state and county in the United States. It has been an almost "invisible" program because benefits flow as part of general Social Security aid and because colleges in many cases are not aware of the importance of this program to their students.

3. Can other federal aid substitute for this program?

The answer, very simple, is that it cannot. Benefits under this program are based on general Social Security formulas which determine the aid which a family receives. Benefits under the Pell Grant (BEOG) program are based on very different criteria, including family, cost of attendance, size of family, and complicated formulas relating to such factors as whether a student lives on or off campus. (Students living off campus receive considerably less aid; an effort was made in the 1980 law to change this for many students, but the administration may propose continuing this practice.) Further, Pell Grant aid in any case is limited to not more than half of cost (unless maximum grants rise far beyond what is anticipated for the next few years), so that low-income students in any case get far less Pell Grant aid than they need to attend any college.

Even if the Pell Grant program were fully funded under the law as amended in 1980, its benefits would be far less than students receive under Social Security. But what is more significant is that the administration is also proposing major reductions in Pell Grants for most students. It is estimated that, if their proposals are accepted, many students may get only half what they would otherwise receive and others would receive no aid at all. For example, a student with a family income of about \$20,000 at a \$3,400 public college might get about \$400-\$500 next year rather \$800-\$1,000.

Proposed changes in the Guaranteed Student Loan program might make it impossible for many students to borrow at all, according to student aid experts. And the other, much smaller programs may be cut back or at least not increased. All of this is happening at a time when college costs at both public and private institutions are rising fast, and there is no way the states and colleges can take up the losses if federal student aid is reduced.

Here are a few examples which show that other student aid could not make up the elimination of the Social Security program. They are taken from 1979 testimony by the American Council on Education and other associations (including AASCU) before this subcommittee. While some of the numbers would have to be adjusted to allow for changes in the programs, the general picture is the same.

These examples assume full funding of Pell Grants to meet need. At reduced levels, as proposed for fiscal year 1981 and fiscal year 1982, students would often receive much smaller Pell awards.

For example: a working widow with one child in college and one at home earns \$6,000 a year. Social Security educational benefits are designed to supplement this income to \$8,300 to help meet family expenses while the student is in college. The student in this situation might also be eligible for an \$1,700 Pell Grant. If the social security benefit were removed from this family, income would be reduced by \$2,300 but the student's Pell Grant would only be increased by \$100—leaving a deficit of \$2,200.

A second example: the combined income of a working wife and a husband who has retired is \$12,000. Their son is ready for college and qualifies for \$2,300 from social security and a \$1,000 Pell Grant. Without the social security benefits, his Pell Grant would increase only \$250, leaving him a net loss of \$2,050.

Finally, a working wife is supporting her disabled husband and two children on \$18,000 per year. A daughter enrolled in college qualifies for a \$800 Pell Grant in

addition to her social security benefit of \$2,300. If she were not entitled to social security benefits, her Pell Grant would increase to \$1,020, leaving a net loss of \$2,080.

In summary, it is not true that families affected by the loss of social security educational benefits would have their needs met by existing student aid programs. On the contrary: they would have their resources greatly depleted—critically depleted, in the case of most beneficiary families' ability to meet the costs of postsecondary education.

The effect of these Social Security reductions would also create a much greater demand for Pell Grants as well as other student aid. If the administration simultaneously reduces Pell aid and makes it impossible for many students to receive GSL loans, these students will be effectively cut off from almost all aid. There have also been proposals to phase out the National Direct Student loan program, and the future of other federal aid programs is unclear.

It must also be emphasized that all of this is happening very suddenly. We are talking about aid to students now in high school, planning to attend college in the fall, and trying now to make final plans based on how much student aid they may receive. If Social Security aid is suddenly eliminated this spring, and other programs cut, there will be great uncertainty. Neither students, parents, high school counsellors, or college aid offices may be able to tell students until late summer or fall how much aid they can hope to receive from what programs.

It could be argued that if some reduction is justified in this program it should be phased in over time, so that at least other federal programs might be adjusted, and students and colleges would have some lead time to see what other resources might be found. The current timetable would not allow for such planning—nor for state governments to consider what actions they might take to help meet the situation in the fall.

If Congress has not yet received many letters about this issue, it is probably because this program is not well understood, even by those who benefit from it, and because it has received less attention from the media and even the college community than many others which have been the subject of public discussion. Within the next few months, however, the volume of criticism will certainly rise.

4. *Social Security is an earned benefit*

As this subcommittee knows, this is an earned benefit—a form of insurance—like other Social Security benefits. All workers covered and taxed by Social Security are provided for, to the extent that in the case of death, disability or retirement their children will have some opportunity to complete high school and attend college.

5. *Possible reductions in the program*

A principal criticism of this program is that, unlike the Pell Grant aid, it is not completely needs-based. However, a program in which 84 percent of the beneficiaries come from family incomes under \$20,000, and 71 percent from families under \$15,000, is very close to being needs-based even if it were not an insurance program based on family contributions.

If, however, some sort of compromise is absolutely necessary for budgetary reasons, student aid specialists could assist the subcommittee in developing ways to prevent unnecessary duplication between the program and other student aid, or to base aid more directly on need.

AASCU and other groups are already working with student aid experts on possible reductions which might be made in the Pell Grant and guaranteed Student Loan program, if absolutely necessary. Some reductions might be worked out which would result in savings without simply destroying these programs.

Here are two possible ways to reduce the costs of the Social Security aid program:

(a) *Count all Social Security student aid as student aid rather than family income, in awarding Pell Grants.*—Under present law, it is counted as family income, which means in effect that for families with incomes below \$25,000 only 14 percent of SSA benefits are counted against Pell Grant awards. If it were counted as student aid, each dollar of Social Security aid would mean one less dollar for Pell Grants—so that there would be no duplication or overlap between the two programs.

(b) *It might also be possible, although difficult, to apply some form of needs test for Social Security student aid.*—Social Security as a whole has never been needs-based, on the grounds that it is an earned benefit and that the great majority of those receiving it are needy in any case. However, a needs test could be devised, perhaps based on family income, size of family, and number of students in postsecondary education at any one time. This would enable the federal government to reduce or even eliminate the awards for the relatively small percentage of families not considered needy. It would, however, add to paperwork and administrative costs, which would offset part of the savings.

If the subcommittee wishes to explore those or other approaches, we would be glad to arrange for student aid specialists, familiar with these programs and with needs analysis systems, to sit down with your staff.

6. The need for better data

As we have said, there is a need for better data about this program, before Congress or the administration considers doing away with it. At present, many colleges do not have records on which students receive this aid, nor how much they receive. Such records are kept by the Social Security Administration, which simply asks the college to certify that the students are attending college full-time. Checks go directly to the student or the family.

We believe that Social Security should make such information available to the colleges, and should also publish annual reports to the Congress on the number of beneficiaries, the amounts they receive, their average family income, and other relevant statistics. In this way, Congress and the public could determine much more readily how valuable the program is and what the effect would be of ending it.

In conclusion, we appreciate this opportunity to testify on this very important program which benefits a great many needy students.

APPENDIX I.—STUDENTS RECEIVING SOCIAL SECURITY AID BY STATE, JUNE 1980

State	Student recipients	Amount received
Total U.S.	760,199	\$169,803,000
Alabama	15,517	3,188,000
Alaska	613	138,000
Arizona	7,378	1,708,000
Arkansas	7,046	1,377,000
California	76,720	17,600,000
Colorado	7,451	1,770,000
Connecticut	10,134	2,475,000
Delaware	2,058	483,000
District of Columbia	2,799	536,000
Florida	30,471	6,881,000
Georgia	19,725	4,077,000
Hawaii	2,954	634,000
Idaho	2,229	535,000
Illinois	35,864	8,501,000
Indiana	14,077	3,475,000
Iowa	7,721	1,813,000
Kansas	5,155	1,246,000
Kentucky	9,602	2,111,000
Louisiana	12,110	2,458,000
Maine	3,775	788,000
Maryland	13,052	2,987,000
Massachusetts	20,589	4,627,000
Michigan	34,459	8,353,000
Minnesota	14,640	3,350,000
Mississippi	10,304	1,819,000
Missouri	13,709	3,147,000
Montana	3,039	717,000
Nebraska	4,212	966,000
Nevada	1,446	354,000
New Hampshire	2,426	570,000
New Jersey	27,936	6,621,000
New Mexico	3,697	751,000
New York	74,687	17,071,000
North Carolina	22,803	4,720,000
North Dakota	2,239	483,000
Ohio	36,013	8,537,000
Oklahoma	6,157	1,401,000
Oregon	7,882	1,934,000
Pennsylvania	38,317	9,040,000
Rhode Island	3,431	770,000
South Carolina	12,523	2,479,000
South Dakota	2,082	447,000
Tennessee	14,130	3,053,000

APPENDIX I.—STUDENTS RECEIVING SOCIAL SECURITY AID BY STATE, JUNE 1980—Continued

State	Student recipients	Amount received
Texas	31,041	6,824,000
Utah	2,862	692,000
Vermont	1,558	349,000
Virginia	18,824	4,028,000
Washington	13,665	3,322,000
West Virginia	6,726	1,460,000
Wisconsin	15,344	3,631,000
Wyoming	812	201,000
American Samoa	112	10,000
Guam	112	17,000
Puerto Rico	18,213	2,071,000
Virgin Islands	260	42,000
Abroad	7,498	1,165,000

Source: Social Security Administration.

The CHAIRMAN. Our staff is most helpful.

I think that is the final witness. That's sort of a—We don't normally end our hearings this way. But, we thank Mr. Mallon for even attempting to make his statement and I think he raises some points that we are going to have to address in this committee. But it gets back to the same bottom line question. Nobody, of course, wants any of their programs to be tampered with. Or, if so, only slightly. I'm not certain. If everyone is accurate, then I guess the alternative is to continue high inflation, and high interest, and high unemployment and no economic recovery in this country.

So, I hope those who haven't testified, who may have been listening, understand the responsibility that we have and I don't think of it as making a sacrifice. I think everybody is going to have a chance to make a contribution to economic recovery.

Our next hearing will be tomorrow morning. What time is it, at 10 o'clock?

At 10 o'clock tomorrow morning. Then we will stand recessed until that time.

[Whereupon, at 11:45 a.m., the hearing was adjourned, to reconvene at 10 a.m., on Wednesday, March 25, 1981.]

SPENDING REDUCTION PROPOSALS

WEDNESDAY, MARCH 25, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10:08 a.m., in room 2221, Dirksen Senate Office Building, Hon. Robert J. Dole (chairman of the committee) presiding.

Present: Senators Dole, Packwood, Heinz, Grassley, Long, Bentzen, and Bradley.

[The committee press release follows:]

(Press release, Mar. 16, 1981, U.S. Senate, Committee on Finance)

LABOR SECRETARY DONOVAN TO TESTIFY ON MARCH 25, 1981

The Honorable Robert J. Dole (R., Kans.), Chairman of the Committee on Finance, today announced that Labor Secretary Raymond J. Donovan will testify on the Administration's spending reduction proposals on March 25, 1981, rather than on March 18, 1981 as previously announced.

The hearing will begin at 10 a.m. in Room 2221 of the Dirksen Senate Office Building.

The CHAIRMAN. I think we will have to begin.

The Senators, Mr. Secretary, come and go during the morning hour here and certain other Senators will be here, but I know your time is valuable, and you probably have other—do you have a time you must leave?

Secretary DONOVAN. I would like to leave by 11 or 11:15 if that is possible.

The CHAIRMAN. OK.

So, we will go ahead and proceed and we can make that known to other members as they arrive.

You may proceed.

So, the record will indicate, the first witness is the Secretary of Labor, Raymond J. Donovan.

Your entire statement will be made a part of the record and you can proceed in any way you wish, Mr. Secretary.

We are very pleased to have you before the Finance Committee; we look forward to hearing you.

STATEMENT OF RAYMOND J. DONOVAN, SECRETARY OF LABOR

Secretary DONOVAN. Thank you, Mr. Chairman.

I do have some prepared remarks. I am especially pleased to have the opportunity to appear before you today, however briefly, to discuss some of the aspects of President Reagan's program for revitalizing the economy and the importance of this program for the American working man and woman.

(349)

Since my two associates, Mr. Lewis, and Mr. Berrington will be describing to you the details of those aspects of President Reagan's program before this committee today, I would like to use my time to establish the context in which I hope you will consider our specific proposals.

The CHAIRMAN. I was wondering at this point, for the record, if you could identify those on your right and those on your left?

Secretary DONOVAN. This is Mr. Berrington, Mr. Lewis, Mr. Weathford, and Jim Van Erden, who is our actuarial expert.

It is an understanding that the decade of the 1970's was an extremely difficult period for the average American worker.

These 10 years were plagued by repeated economic recessions and slow growth resulting in high levels of unemployment. These high levels of unemployment were accompanied by an acceleration in inflation and high taxes, which steadily eroded the purchasing power of worker's wages, their savings, and their retirement incomes.

Further, many workers found their jobs increasingly threatened by the inability of American industries to meet foreign competition.

The country was gripped by a sense of frustration and fearful of our inability to cope with the enormous problems besetting the Nation.

It is with this backdrop that President Reagan developed his program for revitalizing the national economy. This revitalization program is the cornerstone of the administration's domestic economic policy.

I cannot stress enough the importance of this program for the American worker.

Without such a revitalization we are locked into a bleak world of continued high unemployment and inflation which has had a devastating impact on the American worker.

I would like to note that this administration disagrees with the Congressional Budget Office projections. These projections held the unemployment rate at 7.8 percent through 1984, substantially higher than nearly any major forecast public or private.

Simultaneously inflation was held at high levels. This administration believes that inflation and unemployment can be attacked simultaneously.

It does not agree with the economic assumptions upon which the CBO projections were based. It is our belief that spending cuts, coupled with tax cuts, will produce both economic growth and reduced inflationary pressures. By providing incentives for the private sector to grow and insuring that adequate capital is available for such revitalization, the economy will be placed on a sound economic path.

Thus, the proposed spending cuts will not produce higher unemployment if the second part of the President's program, the tax cuts, are enacted.

As you know, the President's program calls for four key elements. Specifically, it calls for significant reduction in the growth of Federal expenditures, a 3-year tax reduction of 30 percent in individual income tax rates, accompanied by modifications in depreciation schedules that will provide incentives for revitalizing

plant and equipment, an extensive program of regulatory reform aimed at reducing the unnecessary regulatory burden and, finally, a stable monetary policy.

These four elements must be viewed as an integrated whole. The four elements comprise a complementary and integrated program for national economic recovery.

We recognize that the program is dramatic and will influence the lives of many individuals.

The scope of the program, however, is tailored to the need for dramatic action that is required to place the economy back on a sound economic path of strong noninflationary growth.

First and foremost, the program is designed to break the inflationary psychology that pervades the economy. The key factor underlying this inflationary psychology is the rapid increase in the growth of Federal expenditures.

These must be brought under control since failure here will doom the entire program.

Second, the program is designed to revitalize the industrial base of the economy and thereby stimulate growth.

It is this growth that will lead to the jobs and real wage gains for the American worker for which the American worker has hungered.

Revitalization itself will be achieved primarily through new investment in capital goods which American workers must have in order to work efficiently and to meet the challenge of foreign competition.

To achieve this needed investment, the President's tax policy complements the budget reform proposals by encouraging individuals and companies to increase savings and investments.

These tax policies are further reinforced by the program of regulatory reform aimed at reducing or eliminating unnecessary regulations which only add to the cost of production, thereby constraining the economy's ability to grow.

The stakes in achieving the President's program are high. Failure to achieve a revitalized economy, points to a bleak outlook for the American worker. It is for this reason that we all must make every effort to insure the success of the President's program.

Thank you for the opportunity to discuss these matters, Mr. Chairman, and with your permission, I would like to turn the floor to my associates to explain certain proposals we are making to further the President's overall program.

Mr. Lewis.

[The prepared statement of Hon. Raymond J. Donovan and his answers to questions asked by Senator Moynihan follows:]

STATEMENT OF THE SECRETARY OF LABOR, RAYMOND J. DONOVAN

Mr. Chairman and members of the committee, I am especially pleased to have the opportunity to appear before you today, however briefly, to discuss some aspects of President Reagan's program of revitalizing the economy and the importance of this program for the American working man and woman.

Since my two associates, Mr. Lewis and Mr. Berrington, will be describing to you the details of those aspects of President Reagan's program before this Committee today, I would like to use my time to establish the context in which I hope you will consider our specific proposals.

It is an understatement that the decade of the 1970's was an extremely difficult period for the average American worker. These 10 years were plagued by repeated economic recessions and slow growth resulting in high levels of unemployment.

These high levels of unemployment were accompanied by an acceleration in inflation and high taxes which steadily eroded the purchasing power of workers' wages, their savings and retirement incomes.

Further, many workers found their jobs increasingly threatened by the inability of American industries to meet foreign competition. The country was gripped by a sense of frustration and fearful of our inability to cope with the enormous problems besetting the nation.

It is with this backdrop that President Reagan developed his program for revitalizing the national economy. This revitalization program is the cornerstone of the Administration's domestic economic policy. I cannot stress enough the importance of this program for the American worker. Without such a revitalization, we are locked into the bleak world of continued high unemployment and inflation which has had a devastating impact on the American worker.

I would like to note that this Administration disagrees with the Congressional Budget Office projections. Those projections held the unemployment rate at 7.8 percent through 1984—substantially higher than nearly any major forecast public or private. Simultaneously inflation was held at high levels. This Administration believes that inflation and unemployment can be attacked simultaneously. It does not agree with the economic assumptions upon which the CBO projections were based. It is our belief that spending cuts, coupled with tax cuts, will produce both economic growth and reduced inflationary pressures. By providing incentives for the private sector to grow, and ensuring that adequate capital is available for such revitalization, the economy will be placed on a sound economic path. Thus, the proposed spending cuts will not produce higher unemployment if the second part of the President's program, the tax cuts, are enacted.

As you know, the President's program calls for four key elements. Specifically, it calls for:

Significant reduction in the growth of Federal expenditures,

A 3-year tax reduction of 30 percent in individual income tax rates, accompanied by modifications in depreciation schedules that will provide incentives for revitalizing plant and equipment,

An extensive program of regulatory reform aimed at reducing the unnecessary regulatory burden, and finally,

A stable monetary policy.

These four elements must be viewed as an integrated whole. The four elements comprise a complementary and integrated program for national economic recovery. We recognize that the program is dramatic and will influence the lives of many individuals. The scope of the program, however, is tailored to the need for dramatic action that is required to place the economy back on a sound economic path of strong non-inflationary growth.

First and foremost, the program is designed to break the inflationary psychology that pervades the economy. The key factor underlying this inflationary psychology is the rapid increase in the growth of Federal expenditures. These must be brought under control since failure here will doom the entire program.

Secondly, the program is designed to revitalize the industrial base of the economy and thereby stimulate growth. It is this growth that will lead to the jobs and real wage gains for which the American worker has hungered. Revitalization itself will be achieved primarily through new investment in capital goods which American workers must have in order to work efficiently and to meet the challenge of foreign competition. To achieve this needed investment, the President's tax policy complements the budget reform proposals by encouraging individuals and companies to increase savings and investment.

These tax policies are further reinforced by the program of regulatory reform aimed at reducing or eliminating unnecessary regulations which only add to the costs of production, thereby constraining the economy's ability to grow.

The stakes in achieving the President's program are high. Failure to achieve a revitalized economy, points to a bleak outlook for the American worker. It is for this reason that we all must make every effort to insure the success of the President's program.

Thank you for this opportunity to discuss these matters with you, Mr. Chairman. With your permission, I would now like to turn the floor over to my associates to explain certain key proposals we are making to further the President's overall program.

RAYMOND J. DONOVAN, SECRETARY, U.S. DEPARTMENT OF LABOR, RESPONDING TO
QUESTIONS FROM SENATOR MOYNIHAN

Question 1. I realize that CETA is not under this Committee's jurisdiction, as I realize that AFDC is not the concern of the Labor Department. But the two programs are quite obviously connected: AFDC seeks to provide the dependent with enough income to meet minimal needs, and CETA, by virtue of its emphasis on job training and on-the-job development of marketable skills, seeks to end dependence.

No one wishes to encourage dependence. But how can the Administration's proposal to cut the programs that provide the dependent with jobs and skills result in anything but increased dependence?

I speak with special reference to CETA public sector employment. 20 percent of CETA public service employment (PSE) employees nationwide were on AFCE or the General Assistance programs run by the states until they obtained a CETA PSE job. 67 percent of CETA PSE workers come from households with incomes below the poverty line. 86 percent come from families the federal government terms "economically disadvantaged."

Where are these workers to find jobs? The vast majority live in center cities, which have a nationwide unemployment rate of 8.2 percent. Among center city minorities, the unemployment rate is 14.2 percent.

Are we relegating these workers to welfare? This question takes on a new dimension when considered in light of the proposed changes in AFDC. For 14 years, AFDC has embodied the principle that welfare recipients who are able to work should have an economic incentive to work. An "earned income deduction" was built into the AFDC program so that welfare recipients can work and retain both their AFDC benefit and a significant portion of their earnings. The Administration proposes changes that would all but eliminate this incentive. This is ironic, to say the least, for the Administration in other pronouncements appears committed to the proposition that welfare recipients must work. Another of the proposed "reforms" would reinstitute the practice, suspended since 1968, of requiring welfare recipients (except those with very young children) to engage in non-paying community service in return for their monthly check.

The Administration is proposing, then, to eliminate CETA public service jobs that train the poor, making them better suited to the job market, to reduce substantially the economic incentive to hold a paying job while on welfare, and to predicate receipt of a welfare check on performance of non-paying work. Work that cannot contribute to employability because it is not combined with training.

How are we to view these changes except as consigning the ill-educated, the ill-trained and the poor to permanent dependency? What steps will the Department of Labor, under your direction, take to avert this?

Answer 1. The Department of Labor is undertaking a reemployment effort for Public Service Employment participants. Under this effort every possible action is being taken to assure that every participant phased out of PSE jobs under CETA is directly assisted in finding full-time unsubsidized employment or, where needed, obtaining additional training to increase their employability. Specifically, the following steps are being taken to help the 300,000 persons obtain appropriate job or training opportunities:

The services of the U.S. Chamber of Commerce and its affiliates, the National Governors Association, the associations representing city mayors and county executives, the National Alliance of Business, major community based organizations, and other special interest groups are being asked to link participants with available jobs.

Each prime sponsor is being required to formally notify the local Job Service office of the name and expected phaseout date of each participant. The Job Service will review the work history and occupational skills of the participants and refer them to available job opportunities. The prime sponsor and the Job Service will work together to ensure that those who need further training or other services will be referred to appropriate organizations.

Vacant positions in the Private Sector Initiative Program (funded under Title VII of CETA) and other CETA programs will, to the extent possible, be made available to these participants.

Through this reemployment effort, we anticipate that a great many PSE participants affected by the phaseout of the program will be either placed in an unsubsidized job, in training opportunities, or will receive some other positive outcome. Those PSE participants who are not placed in employment or training opportunities will be eligible to receive unemployment compensation while they are seeking work, and the Department has asked the Congress to allow funds to be set aside to cover the costs of unemployment compensation for these participants.

The Work Incentive (WIN) program, which is jointly administered by the Department of Labor and the Department of Health and Human Services, has as its mandate placing welfare (AFDC) recipients into jobs and training opportunities and providing them with necessary supportive services. In fiscal year 1980, almost 280,000 WIN registrants entered unsubsidized employment. Welfare grant reductions of over \$632 million were reported by States for these individuals, on an annualized basis. As you are aware, the Administration's budget calls for continued funding of the WIN program at current levels in fiscal year 1982.

The WIN program does have about 20,000 participants on suspense to CETA PSE programs. WIN has made a commitment to place as many of these individuals as possible in private sector employment or in other work or training opportunities.

Question 2. The Administration has set aside \$245 million for unemployment compensation for laid-off CETA public service workers. Your Department estimates that 200,000 of the 307,000 workers to be laid off will file unemployment claims. Your Department also estimates that laid-off CETA workers will spend, over average 20 weeks on unemployment insurance, and will collect, on average, \$90 weekly.

Thus the Department's estimate is that unemployment insurance for laid-off CETA PSE workers will cost \$360 million, but it is only providing \$245 million with which to pay it. As you know, Congress last year made prime sponsors—in other words, the states and localities for which CETA workers performed services—responsible for paying CETA workers the difference between the proper amount of their unemployment check and the sum provided by the federal government. In this case, state and localities will be responsible for about \$115 million in unemployment compensation.

I think this unduly burdens states and localities, especially in light of the dramatic decreases in federal funds flowing to them. It is bad enough that their CETA job slots are being terminated. Why should the federal government force states and localities to bear a great financial burden in the process?

Answer 2. In fact the federal government is paying the entire cost of unemployment insurance for PSE workers, but through two different mechanisms. The first is the Federal Unemployment Benefits and Allowances (FUBA) account, which had paid 100 percent of these costs up until December 5, 1980, when the Omnibus Reconciliation Act of 1980 took effect. That act specified that FUBA would be liable for only those benefits attributable to PSE wages earned prior to December 5. The prime sponsors are liable for all other benefits. Funds for this are provided through CETA. The \$245 million cited in the question refers to this portion of the benefits paid and covers the entire estimated liability of the prime sponsors from the effective date of the Reconciliation Act of 1980 until all PSE workers have exhausted benefits.

The CHAIRMAN. Your entire statement, Mr. Lewis, will be made a part of the record, which indicates that you are the Administrator of the Unemployment Insurance Service, Employment Training Administration, U.S. Department of Labor.

STATEMENT OF WILLIAM B. LEWIS, ADMINISTRATOR, UNEMPLOYMENT INSURANCE SERVICE, EMPLOYMENT AND TRAINING ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. LEWIS. Mr. Chairman, I thank you for entering the statement in the record.

We appreciate the opportunity to discuss the President's proposals for unemployment compensation amendments and for changes in trade adjustment assistance.

I would like to highlight some of the points in the prepared statement, which I think are key to the proposals.

While the administration's economic revitalization program that the Secretary referred to is taking hold, the unemployment compensation system is a major protection against wage loss for unemployed workers.

The system now covers 97 percent of persons working for wages and salaries in the United States.

During the current fiscal year, 1981, we estimate that for regular and extended unemployment compensation about 10 million indi-

viduals will receive about \$20 billion in benefits at an average weekly amount of about \$101.

We are proposing a general tightening of requirements that we believe will strengthen this basic program. We estimate that with our legislative proposals, the unemployment compensation system will pay out over \$16.5 billion in benefits to about 9.6 million workers in fiscal year 1982.

Specifically, the administration's proposals would change the extended benefit provisions as follows: We would eliminate the national trigger, which at present causes benefits to be paid in many States with very low unemployment rates.

Second, we would change the State trigger rates to more accurately reflect changes that have taken place in the national economy, raising the trigger level from 4 percent to 5 percent insured unemployment rate with the State option being raised from 5 percent to 6 percent.

Third, we would require that in order to qualify for extended benefits an individual must have had 20 weeks of work or a reasonable equivalent in the base period.

Fourth, we would eliminate the use of extended benefit claims in our formula for computing trigger rates.

We are also proposing that the regular State unemployment compensation laws be modified to tighten the requirement to search for suitable work after receiving benefits for 3 months.

We would also propose that unemployment compensation for ex-servicemembers would be modified to eliminate benefits to individuals who leave the service voluntarily or who are discharged for cause.

These changes, while leaving a multibillion dollar program in place for wage loss protection, will result in an estimated savings of \$565 million in the current fiscal year; \$1.44 billion in fiscal year 1982, and a little over a billion dollars in 1983.

Mr. Chairman, I would like to turn now to the trade adjustment assistance proposals.

The administration believes that we've strayed from the original intent of trade adjustment assistance. We are proposing that working with the Congress, we can refocus on that objective. We see that objective as one of adjusting to changes in the labor market. In this case, changes related to foreign competition.

We want to get the experienced worker who is permanently displaced by imports back to work so that U.S. industry can take advantage of skilled workers with established work habits.

As you know, the present Trade Act of 1974 provides that for workers adversely affected by imports, there are TRA cash benefits for up to 52 weeks, up to a maximum weekly benefit equal to the average weekly wage in manufacturing, which presently is \$289.

It also provides employability services, including job search allowances, relocation allowances, and job training.

The administration is proposing to amend these provisions effective October 1, 1981, so that eligibility for TRA benefits would be limited to weeks of unemployment beginning after the certification date.

Also, cash benefits would be paid only after exhausting UI benefits for a total duration of 52 weeks, including all unemployment insurance.

The weekly benefit amount would be changed to equal that paid under regular State unemployment insurance laws.

Thus, Mr. Chairman, with these proposals, the trade adjustment program would be tied to the unemployment insurance program.

These are several significant reasons for our making these proposals.

First, outlays have increased from \$89 million in 1974 to \$1.6 billion in 1980, and an estimated \$2.7 billion this year.

We are confident that fiscal year 1982 outlays could be reduced to \$350 million.

Second, there is a need to remove disincentives for adjusting to changing labor market conditions and a need to provide incentives to do so, where possible.

The present high net wage loss replacement in the trade program, we believe, is a disincentive to adjust to a new career or location.

Third, trade benefits should be focused on those who are unemployed for long periods and need to make a permanent adjustment rather than compensate for a temporary adjustment.

Studies have shown that two-thirds of the Trade Act beneficiaries return to their original employer.

We believe that the basic unemployment compensation system is adequate protection for those who are temporarily out of work.

Fourth, we believe there is a need to establish equity in benefit amounts for people who are out of work and seeking work regardless of whether the cause is foreign competition or other reasons having to do with economic conditions at home.

Thank you very much, Mr. Chairman.

I would be happy later to answer any questions you might have.

The CHAIRMAN. I think before that, we will hear Mr. Berrington and we can ask the panel questions.

Mr. BERRINGTON. Thank you, Mr. Chairman.

The CHAIRMAN. He is the Deputy Assistant Secretary for Employment Standards.

Mr. LEWIS. That is correct.

STATEMENT OF CRAIG A. BERRINGTON, DEPUTY ASSISTANT SECRETARY FOR EMPLOYMENT STANDARDS, U.S. DEPARTMENT OF LABOR

Mr. BERRINGTON. I would like to make a few general comments on the black lung program.

The black lung benefits program was established to compensate miners and their families for the debilitating effects of black lung disease.

We understand the plight of victims of black lung disease and share the humane concerns that led to the adoption of this program.

The welfare of miners who are disabled by black lung disease, and of their families, must be protected. The administration will not propose anything that would deprive any miner who is disabled from qualifying for benefits.

We believe, however, that the prudent administration of the trust fund requires that steps be taken to make the fund solvent.

The black lung disability trust fund was established in 1978 to finance the payment of black lung benefits.

The major source of revenue for the fund is from a tonnage tax paid by the coal operators. The present production tax is 50 cents per ton on underground coal and 25 cents per ton for surface-mined coal. The present rate structure is insufficient to finance the program, and massive loans are now needed from the Federal Treasury to keep the program going.

At the end of fiscal year 1980, the fund owed the U.S. Treasury \$956 million. It is projected that this debt will reach about \$1.5 billion by the end of fiscal year 1981.

With no change in the law, the only manner in which sufficient revenues can be obtained to meet the trust fund obligations is through continued reliance on loans from the U.S. Treasury with no end in sight in the foreseeable future.

Mr. Chairman, the situation clearly runs counter to the intended purposes of the black lung disability trust fund, which was to make it an industry financed program. It was also the intent of the Congress that the fund be fully financed through coal tax revenue.

Provision for repayable loans from the U.S. Treasury was to cover startup funding and to meet acute problems. Loan provisions were not designed as a long-term mechanism to cover deficiencies in revenues.

Due to the difficulty which miners and their survivors had in obtaining medical evidence needed to establish proof of disability, the evidentiary standards were substantially revised in 1978 to shift some of the burden of proof from claimants.

This, it can be argued, was needed to expedite the adjudication of claims for a large number of miners whose medical histories were scanty.

Most miners with a long history of respiratory ailments are now receiving benefits. We believe that this need has largely passed for some of these presumptions that we have had in the past.

Medical technology has become available in geographic areas of the country with a high concentration of coal miners. Thus, it is easier to establish whether an individual has black lung disease.

More importantly, much work has been done to improve the health and safety conditions in the mines in order to reduce the incidence of black lung in the future. We need to amend the program's evidentiary requirements to take into account these developments.

I am, again, emphasizing that the proposals that we are developing would in no way harm coal miners who are totally disabled by black lung disease, but they will insure that claims are based on sufficient proof that disability from black lung disease justify approval.

Thank you.

The CHAIRMAN. In your statement, in addition to black lung, I think you discussed the FECA program.

Mr. BERRINGTON. Yes. Would you like some discussion on that?

The CHAIRMAN. Yes. I think we have—we certainly have an interest in that. That is another program that has sort of gotten out of hand.

Mr. BERRINGTON. I'd be glad to discuss that.

The FECA program provides workers' compensation benefits, as you know, to Federal employees and their survivors for job-related injuries.

Changes in the law in 1974 have resulted in substantially increased utilization of FECA benefits by Federal employees.

FECA, as presently constituted, provides positive incentives to employees to file questionable claims, or claims for very minor injuries. There are few inducements for workers to return to work or participate in vocational rehabilitation programs as soon as they are medically able to do so.

In addition, the existing law compensates a larger proportion of the lost income of high-paid workers due to injury than lower-paid workers. This inequitable situation is the outgrowth of a compensation system that allows an increasingly larger proportion of workers to receive more in FECA benefits than they had in take-home pay when they were not injured.

The overhaul of the FECA program is long overdue. The present level of benefits provided under the program certainly cannot be justified at a time when all sectors of the economy are being asked to make sacrifices to restore the economic health of the Nation.

The increased employee use of FECA system has attracted increasingly harsh criticism. Over the past decade, the number of injury reports filed under FECA has increased from 121,000 in fiscal year 1970 to 217,000 in fiscal year 1980.

This increased use has resulted in an alarming rate of growth and benefit expenditures, from \$151 million in 1970 to \$785 million in 1980, to a projected billion dollars in 1982.

This excludes the estimated \$65 to \$75 million paid out annually by agencies during the 45-day continuation-of-pay period.

These large increases in reported injuries bear no relationship to the size of the Federal civilian work force, which has remained fairly stable, or to the increased emphasis placed on Government safety programs.

The reforms already announced as part of the President's economic recovery plan will go a long way toward restoring credibility to the FECA program by eliminating overcompensation while at the same time providing adequate income to deserving claimants.

These reforms would do four basic things. They would increase the compensation rate to 80 percent of gross pay and make that amount subject to Federal taxation, which under current law it isn't.

Second, it would reinstate the 3-day waiting period, which involves coinsurance principles, before the continuation of pay benefits begin. We believe this provision will reduce the filing of claims which are not justified.

The other reforms would reduce the compensation rate paid during the 45-day continuation-of-pay period 80 percent of full salary and would integrate the FECA and Federal retirement systems so that individuals, at retirement age, would move from workers' compensation into a Federal retirement system.

We believe that these reforms and others which are presently under consideration will restore a more equitable balance between the competing objectives of providing adequate income to disabled workers and their families, while at the same time providing incentives for workers to return to work as soon as they are medically able to do so.

I want to assure the committee that the proposed changes in the black lung and FECA programs will not result in a denial of valid claims.

The Department looks forward, of course, to working closely with the committee and with others on these important matters.

Thank you.

The CHAIRMAN. I might just say for the benefit of Senator Long, we just heard Secretary Donovan and Mr. Lewis and Mr. Berrington.

We are just starting questions.

I have to say first of all that I've had more opportunities in the last few weeks to watch a lot of television than I've had in the past and I note that in almost every newscast that, of course, there should be focus on what the budget cuts will do, but with reference to black lung, I think there was an almost maybe unintentional projection by some of the media that indicates you are going to take away black lung benefits.

Is that in the proposal? Are you going to take anyone's benefits away?

Secretary DONOVAN. No, not at all.

Mr. Chairman, because of the march on Washington, there was a lot more heat than light on this subject. The number of \$400 million that was quoted by Mr. Church is really the deficit that we see developing this year and pointing out that in our studies and in the proposal that is underway, the administration views that as a significant gap that has to be closed, and we are addressing that.

The obvious way to address it is to look at increasing coal taxes. There is no desire on our part to disallow claimants who are presently on the rolls but we do have a hemorrhage situation and administratively it has to be addressed. So, we are looking to protect the solvency of the fund rather than even consider doing away with anyone's benefits, or the program itself. The taxpayers have paid \$1 billion into the trust fund via loans advanced from the U.S. Treasury.

The interest penalty rate being charged liable coal mine operators is ludicrous. It is 6 percent. We want to make the black lung program fiscally sound and administratively tighter.

The CHAIRMAN. I don't think anyone would quarrel with that, but I think there is a tendency maybe to highlight some of those who may have to be impacted, but I think that statement indicates that anybody who is receiving benefits will continue to receive benefits.

I happened to watch a program you don't have jurisdiction of the other evening, on one of the networks, talking about student loans. You would think we were abolishing the program. Here is a program that has grown in the last 10 years from \$500-some million to nearly \$6 billion and there are areas where it can be tightened up without any adverse impact on needy students.

I think we need to—the administration needs to and I am certain you are making the effort, wherever possible, to articulate the positive. I mean, the alternatives are double-digit inflation and double-digit interest rates and continued high unemployment and I would hope that sooner or later we can come to grips with all the problems and get back to past rates as nearly as we can.

We have been told that if we eliminate the national trigger that we are going to hurt some cities. I think the one that is called to my attention is El Paso where the uninsured unemployment rate is about 10 percent, but located in a State with a very low aggregate employment.

I guess my question is: are there reliable unemployment statistics for individual metropolitan areas upon which a locality-by-locality unemployment compensation figure could be based?

Secretary DONOVAN. This is a problem that is recognized by us. Mr. Lewis will address it.

Mr. LEWIS. Mr. Chairman, in our view area triggers would not be administratively feasible certainly at this time and in the near future. We do not have data that would allow us to publish accurate trigger rates in the frequency that would be required to manage the program.

Moreover, we would be concerned about the impact on public understanding of the program. If we had labor market-type triggers, there would be a question of eligibility being on a plant basis versus a place of residence. There would be people living close together drawing benefits while their neighbors are not.

We believe it would not be administratively feasible. There is a high risk of overpayments in that area.

The CHAIRMAN. What about the administration's proposals to eliminate unemployment compensation for military personnel who voluntarily leave the service?

How will that affect reenlistment in the Armed Forces?

Secretary DONOVAN. I will take a crack at that and then turn it to Mr. Lewis.

The CHAIRMAN. It seems we have a financial incentive to leave the military.

Secretary DONOVAN. Logically, that would seem so, Senator. There are studies, as in any hot issue, which would indicate that it is not a disincentive. I am persuaded, with the limited knowledge I have, that it has to be a disincentive and if service personnel voluntarily leave, just as in the private sector if someone voluntarily leaves employment, they are denied unemployment benefits.

I think logic is on our side. I don't know that the studies are so specific that you could really pin down the incentive to leave the service.

Overall in our programs, we are looking to build incentive and to limit the disincentives.

Do you have any more specifics?

Mr. LEWIS. I wouldn't want to add to that.

The CHAIRMAN. I guess the general question is that we are in a period of very high unemployment right now and I guess some would say, well, is this the appropriate time to tighten up the unemployment compensation program in this period of high unemployment?

I don't know when we are going to tighten it up if we don't tighten up sometime, but is this the appropriate time in a period of high unemployment to tighten up the program?

Secretary DONOVAN. I would think so. At least from a budgetary view, yes, but from a practical point of view, the disincentives that are in there are shocking. The statistics at the Labor Department were 2,100,000 jobs at our employment agencies last year that were not filled.

So, there is a disincentive somewhere in that people are not seeking those jobs. I think in time of economic crisis like now, it may be the best time to do it.

The CHAIRMAN. My time has expired and under our early bird procedure, Senator Heinz will be next, but I want, before we do that if we might, if it is all right with Senator Long, if we might meet in executive session to consider the nomination of Norman B. Ture to be Under Secretary of the Treasury, and the nomination of Beryl Sprinkel to be Under Secretary of the Treasury for Monetary Affairs.

We had hearings on both of these men last Friday. We have records from the Office of Government Ethics for each of these nominees which reveal no potential ethical problems or conflict of interest.

The reviews by the FBI and our committee counsel likewise have posed no problems in those areas.

The nominees appear to be eminently qualified. I would like to move that we report their nominations favorably unless there is some objection.

Mr. LONG. I have no objection. In fact, I second the motion, Mr. Chairman.

The CHAIRMAN. The motion is made and seconded to report the nominations. We will poll those who are not here.

Any objection?

[No response.]

The CHAIRMAN. Thank you.

Senator Heinz.

Senator HEINZ. Thank you, Mr. Chairman.

Let me say to you, Mr. Secretary, that I think overall you have, with respect to the unemployment compensation program, addressed many of the problems that I see with the program.

I don't agree with everything you have done, but I, for example, I support the elimination of the national trigger, so that extended benefits are really targeted to those areas by unemployment the most.

I do have some questions for you. I come from a relatively high unemployment State, so the question may be somewhat obvious to you.

I am concerned about the combined effect of the administration's proposal to change the way in which the insured unemployment rate is calculated together with the additional proposal to raise both the mandatory and optional State triggers to 5 and 6 percent respectively.

Might this not result, if you will, in an overtargeting of extended benefits to the point where they might not be paid in States where unemployment is, in fact, quite high?

Secretary DONOVAN. I am going to ask Mr. Lewis to address that; I really don't know.

Mr. LEWIS. Mr. Heinz, I think it is true that a number of States that are now triggered on would not be triggered on with our proposals.

On the other hand, I think our belief would be that raising the trigger levels would be consistent with some structural changes in the work force that have occurred and, most likely, make the triggering on more comparable to what existed some years ago when extended benefit triggers were initiated.

Senator HEINZ. Is that your full statement on that?

Mr. LEWIS. At this point, yes.

Senator HEINZ. Let me ask you another question then. It is addressed to either of you.

Now, the administration is requiring the States after 13 weeks to impose a suitable work test.

Mr. LEWIS. That's correct.

Senator HEINZ. Now, that seems to me, since it is State money you are talking about, to really violate the principle of State's rights.

How can that possibly be consistent with the administration's overall philosophy?

Secretary DONOVAN. Well, philosophically, I know what you are saying and I agree with it. That troubled me too.

Mr. LEWIS. I think, Mr. Heinz, first of all, there have been Federal standards in the unemployment insurance program since its inception. In fact, there was a standard enacted by the Congress in the 1974 amendments and amended last year on pension offset. So, the idea of across-the-board requirements required by the Congress is nothing new.

Second, with this particular—

Senator HEINZ. That is true, but scarcely a reason for us to do things. If we did all the things that weren't new, I think we could really create some even worse problems that we've got.

Mr. LEWIS. Second, this provision we recognize is an abrupt change and it is pretty far reaching and it is one which, we hope, if approved by the Congress would speed the reemployment of unemployed persons. We, therefore, thought that there should be equitable administration across State lines, as well as within a State.

Senator HEINZ. Why shouldn't that be left to the States though?

Mr. LEWIS. It is a judgment call.

Senator HEINZ. My final concern is, in a sense, what is not contained in the administration's proposal? I am talking about the absence of any mechanism that would insure that State unemployment compensation systems, which, by the way, collectively owe the Federal Government some \$5 billion as of December 31, a mechanism which would encourage them to remain solvent and that outstanding debt is repaid in a manner that is not unduly disruptive of State economies, thereby really causing more joblessness from which the debt results.

I see I am about to run out of time, and I need to give you some background before I can really get into this question with you, so I am going to reserve what little balance of my time remains and come back to you later.

The CHAIRMAN. I think Senator Long may have a question.

Senator LONG. Senator Moynihan would have been here, but he missed his airplane connection and he just wanted to ask this question. He said here: I have a transcript of your Department's Unemployment Insurance Administrator William Lewis' testimony before Ways and Means on trade, March 11, 1981.

He says, that the administration is planning to propose amendments that the Trade Adjustment Act "will be able to have a bill drafted by the middle of next week."

He adds: "There are several policy issues that are still unresolved within the Administration."

What are the policy issues that you haven't resolved yet? Will they, in any way, alter the level of budget cuts you propose? Will they eliminate even more TAA, trade adjustment assistance recipients?

That was his question.

Mr. LEWIS. Senator Long, I was obviously inaccurate when I made that statement on the 11th, because our bill is still not forwarded to the Congress and we believe it will be there shortly.

There were several policy issues involving four or five agencies, as you would appreciate. We do not anticipate that the \$350 million mark that we have used will be changed for fiscal year 1982. We are still going with that number.

Some of the issues involved: How long a claimant would have to use up his or her benefits, and the like.

Senator HEINZ. When do you expect to have something up here—your recommendations?

Mr. LEWIS. Well, having been inaccurate once before on that, I hesitate.

Senator HEINZ. Well, we can agree that you are not accurate then, I mean, you so stated, but what is your guess now?

Mr. LEWIS. I will go on the record, within 2 weeks, Senator.

Senator HEINZ. Thank you very much, sir.

The CHAIRMAN. Does OMB have a cap?

Mr. LEWIS. It is that, plus just the work load itself, Senator.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. Thank you, Mr. Chairman.

I have one short question. Last year the Senate passed a provision which would allow States to opt into the extended benefit program at insured unemployment rates higher than the current optional rate. This was not among the changes being proposed by the administration and my question is: Does the administration have any objection to such a change?

Mr. LEWIS. I believe, sir, that we are proposing a state option at 6 percent. I would have to check with my colleague to see if the option is for higher, I don't recall.

Senator GRASSLEY. OK.

Mr. LEWIS. But we are raising that State option—we're proposing that.

The CHAIRMAN. Do you have other comments on that?

Mr. LEWIS. Your question would be: Could a State opt at 7 percent rather than 6 percent? I'm not sure of that.

Senator GRASSLEY. Well, I wasn't a Member of the Senate, but my research has indicated that the administration this year has

not taken a position on the change this committee proposed last year. I am trying to determine whether or not the administration has any objection to allowing States to opt into the extended benefit program at unemployment rates higher than the optional rate proposed by the administration.

Mr. LEWIS. We would have to look at that specific proposal.

Senator GRASSLEY. OK. Then would you please answer on the record then?

Mr. VAN ERDEN. Mr. Grassley, we have proposed a change in the trigger rates. You raise the levels, as Mr. Lewis said, that's part of the President's package.

There were several different alternative triggers last year and, you know, we will be glad to take a look at it and analyze it, but we are proposing an increase in the State trigger rate at this time.

Senator GRASSLEY. Well, I will wait until you have had a chance to study more explicitly my question, and if that does answer it, then I will have to do some more checking on just exactly what the Senate did last time.

That is all the questions I have, Mr. Chairman.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. No questions.

The CHAIRMAN. Let's see, Senator Symms was here, but I don't see him.

I have a number of questions that I will submit in writing. I am interested in the black lung trust fund. Will you be recommending additional taxes on producers to make up that deficit?

Secretary DONOVAN. Yes, we will, Mr. Chairman.

The CHAIRMAN. That will be forthcoming too? Will all these come to us in a package, or will it come at different times?

Secretary DONOVAN. I am not certain. Hopefully, as a package.

The CHAIRMAN. But you are working on specific tax increases which will place the burden where we thought it was originally on the producer—

Secretary DONOVAN. That is exactly what we're doing.

The CHAIRMAN [continuing]. Not on the Federal Government?

Secretary DONOVAN. That is correct.

The CHAIRMAN. We don't have any money.

Secretary DONOVAN. We see it as an industry and labor problem.

The CHAIRMAN. Have you had a chance to look at the contract of the United Mine Workers?

Secretary DONOVAN. I know the highlights of it. There are many portions of it that are not even public at this stage. It is at a very sensitive stage.

The CHAIRMAN. Have you had an opportunity to conclude whether or not it is inflationary?

Secretary DONOVAN. Well, when you think of 36 percent over 3 years, that would be your initial reaction, but I would just remind everybody of the obvious that workers today, in real spendable dollars, are further behind than they were 6 years ago.

You have to view the entire package and it is fairly complicated as to the pension provisions, Mr. Chairman. And I would really like not to comment on it too strongly because it is at a sensitive stage right now.

The CHAIRMAN. Senator Heinz, do you have additional questions?

Senator HEINZ. Thank you, Mr. Chairman.

I think what I will do to save the committee's time is to ask Secretary Donovan and his staff to respond to this later after the hearing, but I want to point out that there is something that you haven't addressed in your unemployment compensation plan, and that is that there is no plan submitted by the administration to encourage States, which are going more and more heavily into debt with you, interest free, to reform their systems and get on a pay-as-you-go basis.

Senator Boren and I have introduced a bill, S. 507, that has very strong incentives, both carrots and sticks, for States to reform; imposes an interest charge on consequent borrowings, but is a quid pro quo for the benefit of the States and freezes the escalation of the employment FUTA tax credit which kind of evaporates at three-tenths of a percent, or so, each year.

I would like you to take a careful look, Mr. Secretary, at this proposal. It seems to me that there is something in it for everybody.

What is in it for you is sounder State systems, meaning less borrowing.

What is in it for the States is that if they meet the terms of the proposal, they will get relief from this flat rated increase in the penalty tax rate. They will be able to—they will not be subjected to what starts out as the double then triple then quintuple taxation of existing jobs.

Clearly, that puts them at an economic disadvantage. It drives still more jobs out of the State. More unemployment benefits are paid and the cycle is just unending.

We allow, also, the States to pay back the Federal Government at some reasonable rate out of the State trust fund, thereby allowing them to adjust the way the tax—their unemployment compensation tax is apportioned between high and low unemployment rate employers. And it is going to become quite a problem, I think, for all of us, because even though right now my State of Pennsylvania has the dubious distinction of leading everybody in the amount of money we owe the Federal Government, \$1.5 billion, we are soon going to be in third place right behind Illinois and Michigan, which are going to zoom past us in the very near future.

I hope you will look at S. 507, which we have introduced, and I hope you can support it.

My last question, if I may, on the trade adjustment assistance. Mr. Secretary, just let me ask you a philosophical question: To the extent that this country pursues a free trade policy, which I assume you do support, we obviously accelerate economic change and create temporary victims. These victims tend to be in the Northeast and in the Midwest, such as Pennsylvania, New Jersey, New York, and Detroit, Mich.

Wouldn't you agree that a policy to facilitate adjustment for those unemployed goes hand in hand with a free trade policy?

Secretary DONOVAN. Yes, but I believe that the disincentives, again, were on maintenance of income rather than on training and relocation, recognizing that it is a cultural shock to move from Sheboygan to Houston. Only \$8 million was in that program for retraining and relocation.

Senator HEINZ. It is sometimes a cultural shock to go from Philadelphia to Newark. It always is.

Secretary DONOVAN. Newark is much nicer. [Laughter.]

Yes, philosophically, I agree. It gets difficult, you know, when you try to determine who has been affected even under the present law.

Senator HEINZ. Two questions. What are you proposing on retraining in the more literal sense of the term "readjustment?" What is the administration's proposal there?

Secretary DONOVAN. The proposal being studied is to substantially increase the training and the relocation end from its present level. That is a meaningful contribution to help solve this terrible problem.

Senator HEINZ. Will you have that proposal to us before we take up what you have actually proposed?

Mr. LEWIS. I don't understand.

Senator HEINZ. You said you are studying a proposal. You also made some proposals to the Congress on unemployment—on trade adjustment assistance.

Will you send us your proposal before we have to act on what you have already proposed?

Mr. LEWIS. Mr. Heinz, we would be able to tell the Congress how much money would be available for training and relocation assistance at the time we come up with the bill.

Senator HEINZ. All right.

Mr. Chairman, if I may just proceed with one additional question.

The CHAIRMAN. Sure.

Senator HEINZ. Mr. Secretary, you have indicated qualified support for the trade adjustment assistance program. You've said you've recognized that when Government takes certain actions in the free trade area, particularly when our allies—our friends and allies allegedly, are subsidizing dumping and doing other things that we are sometimes a little slow on the uptake to adjust to around here. Let me remind you that almost any action taken under our countervailing duty or antidumping law takes 6 months or more to get just an injury finding on, let alone duties imposed.

The way I understand—I've got the following question: Let's assume someone is laid off in the steel industry by reason of the French or the British dumping, which they are doing now. Everybody knows and understands that they are selling below their cost.

You go on, under the administration's proposal, unemployment benefits for 26 weeks. My State is 26 weeks. Then you hit, assuming that various triggers are on, you hit the extended benefit program which carries with it a requirement for suitable work under present law. At which point the steelworker presumably goes to—if he can find an opening—McDonald hamburger stand and starts slinging hamburger patties at the minimum wage.

At what point is he ever eligible for trade adjustment assistance after that? He is slinging hamburgers; he has got a job; he is no longer eligible for adjustment assistance, it seems to me, at week 39 or whenever the so-called extended benefits would cease. I mean, what happens to him?

He doesn't get any trade adjustment assistance as far as I can see. He is not even eligible for any retraining even though, Lord knows, he's slingin' hamburgers and maybe if the steel mill in Youngstown, for example, isn't going to reopen, he ought to be trained to do something better than sling hamburgers.

Secretary DONOVAN. That is not the proposal, as we see it. The TAA benefits would begin right after his unemployment compensation has run out.

Senator HEINZ. But he loses his unemployment compensation benefits and his rights to it, as I understand it, the moment he takes suitable work. He may have been earning \$12 an hour, or \$10 an hour, and all of a sudden he's earning \$3.50 or whatever it is, and he is no longer eligible; isn't that right?

Secretary DONOVAN. His training, as I understand it, can begin long before that; is that right, Mr. Lewis?

Senator HEINZ. It can, but nobody ever certifies anybody for 6 months.

Mr. LEWIS. Mr. Heinz, in the extreme case that you've cited, the result that you indicate could theoretically occur. With the Omnibus Reconciliation Act Amendments that were enacted December 5, it is now an extended benefit program requirement that those individuals who are deemed to not have good prospects for reemployment are subject to a different work search requirement and ultimately if there were no other job at all in the area, then the unemployed steelworker possibly would have to take the McDonald's job that you referred to.

On the other hand, the way we believe the program would be operationalized effective April 1, would be that the local employment security agency offices would nevertheless attempt to make the best possible match between the unemployed person and the job openings available.

Senator HEINZ. Yes, but it seems——

Mr. LEWIS. And while it may not be at the same wage rate or in the same occupation——

Senator HEINZ [continuing]. I understand all that, but what I am trying to point out is that it seems to me that what the administration has done, wittingly, or unwittingly, is to eliminate the trade adjustment assistance program for the unemployed steelworker I have just described.

Mr. VAN ERDEN. Mr. Heinz.

Senator HEINZ. I would like to know if that is true or not?

Mr. VAN ERDEN. I don't think that is true, Mr. Heinz, because a large portion of the workers, who are presently receiving trade benefits are also covered under a supplementary unemployment benefit program. This includes almost all the autoworkers, as well as the steelworkers.

Under the 20 weeks of work—or the suitability of work requirement, the claimant is not required to take a job which pays less than his SUB benefits, and his SUB benefits are substantially higher than the minimum wage. So, for the majority of the people covered presently under the trade program, this provision would have very little impact.

Senator HEINZ. I hope you are right.

Mr. VAN ERDEN. I believe I am, sir.

Senator HEINZ. As long as SUB holds out, which it doesn't always. I mean, it just depends on how much money is in that fund.

Mr. VAN ERDEN. That's true, but most of these SUB programs right now are paying benefits at various stages of—

Senator HEINZ. My time has expired. Thank you.

The CHAIRMAN. Senator Bentsen.

Senator BENTSEN. Let me follow up on that interesting line of questioning.

You talk about workers not being required to take a job below the SUB benefit level. Could you give me a feel for what we are talking about percentagewise as a SUB benefit level compared to a salary? What are those variables?

Mr. VAN ERDEN. Yes, sir. I think the present SUB agreements require the payment to be at 95 percent of the take-home pay minus \$12.50. So, it is pretty close to a level of take-home pay that the individual worker has now.

Senator BENTSEN. 95 percent?

Mr. VAN ERDEN. Of the take-home pay, minus \$12.50.

Senator BENTSEN. Minus \$12.50.

And I suppose the eligibility period for SUB benefits also varies? Can you give me some feel for that?

Mr. VAN ERDEN. As I understand it, it is as long as he is eligible for unemployment insurance, he would get SUB benefits, or trade.

Senator BENTSEN. Mr. Secretary, turning to the administration's proposals for the economy designed to get inflation under control and hold unemployment at a minimum, the whole Nation certainly shares those objectives. We wish you well. But, as you cut back on CETA and you bite into II-D and into VI which deals particularly with people with low skills, you are going to have some, at least temporary, dislocation and unemployment.

Has the administration reviewed some of the reforms that this committee has supported utilizing tax benefits to get the private sector more involved in job creation—jobs that are productive and meaningful, not dead end jobs?

Secretary DONOVAN. Yes. We see that in the past that this is one of the hopeful lights. I think the tax benefit has not been used sufficiently in the past.

Senator BENTSEN. The targeted jobs credit was not publicized and has been underutilized, I believe. We passed it in this committee and I was the coauthor.

Secretary DONOVAN. But for those corporations who I have spoken to on this subject, they felt it was extremely complicated, a lot of redtape. It is being addressed and those public sector people who will be laid off between now and September 30, we are looking to the private sector and to industry to try to soften and cushion this blow.

We recognize that, that it is a blow.

Senator BENTSEN. Well, how quickly do you think you will be out with better regulations that will enable industry to utilize the benefits of the tax incentive? Will you publicize the revisions and try to enable employers to take advantage of it in a reasonable period of time?

Mr. WEATHFORD. Senator Bentsen, I might add to what the Secretary said that that program, as you know, expires at the end of this calendar year. Over the period of time that we've had it in operation, there have been some 400,000 certifications made during that period.

One of the findings that comes out of our evaluation of it is that in many cases the law provides for employers to receive the tax credit for people that were hired ahead of the certification. In other words, it would be a question now as to whether the employer—

Senator BENTSEN. They would have hired them anyway?

Mr. WEATHFORD. That is correct.

Senator BENTSEN. You always have that argument.

Mr. WEATHFORD. Yes, I understand that, and I think at the front end of the program that number was more than Congress expected and certainly we expected, but as we have tried to redirect the program to insure that it is being used for hiring people that would not otherwise be hired, we found a substantial reduction in that.

Some of our recent studies indicate that maybe one out of four of them, whereas it used to be maybe three out of four of them were—I mean, had previously been hired.

We have to come before the Senate within the next 10 days to testify on that, and currently we are trying to bring together the administration's position on No. 1, whether to extend the program, whether we support that.

Second, whether we should ask you, or recommend that you change it to eliminate these retroactive certifications.

Senator HEINZ. Would the Senator from Texas yield for some information?

Senator BENTSEN. Yes. I would be pleased to.

Senator HEINZ. Our Subcommittee on Economic Growth and Employment is having a hearing a week from Friday on April 3, where the Department of Labor will be testifying. We are hopeful—I know they are hopeful that they will have their position pulled together.

Senator BENTSEN. Good.

Mr. WEATHFORD. I think—

Senator BENTSEN. It was some time ago that I helped get the targeted jobs credit into the law. The Treasury opposed me on it. They gave it no publicity, and came up with such a set of regulations that businessmen just backed away from it, as the Secretary has just reaffirmed.

Mr. WEATHFORD. Well, sir, I think we have made the effort to reduce it substantially.

Senator BENTSEN. We should either do away with it, or redirect it to make the program work effectively.

Mr. WEATHFORD. I might also add that of the certifications that have been taken, the bulk of them have been with small employers and not with the large corporations in the country.

Primarily, the focus of the publicity was to the large employers, and as we found it working, we found it to work better in those communities where we deal with smaller types of employers.

Basically, Senator Bentsen, that is where the hiring has been going on in most of the places.

Senator BENTSEN. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. No questions, Mr. Chairman.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Just one question.

One of the things I hope you will look at in the target jobs tax credit is with respect to the CETA workers that are being laid off under II-D and VI whether it wouldn't make sense to give them much more rapid eligibility. If someone is being laid off, as a number of CETA workers are in Philadelphia next week, it would take 6 months to be eligible for the targeted jobs tax cut assuming, and I don't prejudge your decision, but if we decide to extend it, wouldn't it make sense to make the people who are presumably hard to employ eligible more rapidly?

Secretary DONOVAN. Yes, but I think the more positive thing, or an equally positive thing is to give them some priority in our existing training program. To give them the skills to make them that more attractive to hire.

Senator HEINZ. Mr. Chairman, I do have a followup on my previous question although you don't need to take time to answer it now, because you may not have a policy decision that you can answer it, but my question was in regard to giving States the option to have yet a higher trigger rate for extended benefits.

So, if you have an easy answer to that, I would like to have the answer, but if you can't, then I would like to have it in writing.

Mr. LEWIS. We will answer it for the record, Senator.

[The information follows:]

BERT LEWIS, ADMINISTRATOR, UNEMPLOYMENT INSURANCE SERVICE, EMPLOYMENT AND TRAINING ADMINISTRATION, DEPARTMENT OF LABOR, RESPONDING TO A QUESTION FROM SENATOR CHARLES GRASSLEY

Question. The Administration proposes that the present 4 and 5 percent State triggers for extended benefits be raised to 5 and 6 percent, respectively. I understand this is a straight 6 percent. Although I was not a member at the time, I recall that the Senate approved an alternative trigger that would have permitted a State to opt for a higher trigger. Does the Administration have any objection to such an alternative?

Answer. As you know, there are two provisions in the Federal law relating to the State triggers: (1) a requirement which all State laws must include, and (2) an alternative, which States may opt to adopt as well.

First, the requirements—that extended benefits must be paid in a State with an insured unemployment rate of 4 percent and which is at least 20 percent higher than the rate in the State in the two previous years. We propose that this 4 percent be changed to 5 percent.

Second, and relating specifically to your question—a State may, at its own option, waive the 20 percent factor and pay extended benefits regardless of the rate in previous years if its rate is 5 percent or higher. We propose that this 5 percent be raised to 6 percent.

The proposal which passed the Senate last year would have set the rate at which the 20 percent of 2 previous years experience could be waived, at State option, at 5 percent or higher. At that time, the sponsors of the change in the option suggested that some States would probably prefer a 5.5 or 6 percent rate. We believe the administration recommendation of a State waiver option of 6 percent would meet this objective. We believe it would be desirable at this time to adopt the 6 percent option and review the experience of the States with that rate when it has been in effect for a few years.

The CHAIRMAN. I want to thank, Mr. Secretary, you and members of your staff.

I have a number of questions on Trade Assistance Act, the calculation of weekly benefit amount; recalculation of benefits for subsequent separations; calculations for partial benefits; retroactive payment of TRA; employer notification of payments, a number of questions. I think it would help us in making a decision.

I will submit those for the record, because some are technical and some will need research, and I appreciate very much—we've gotten you out 10 after 11, which is about on time.

Secretary DONOVAN. I appreciate it.

Thank you, Mr. Chairman.

[The prepared statements of Messrs. William B. Lewis and Craig A. Berrington follow:]

STATEMENT BY WILLIAM B. LEWIS, ADMINISTRATOR, UNEMPLOYMENT INSURANCE SERVICE, EMPLOYMENT AND TRAINING ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. Chairman and members of the committee, I am pleased to have this opportunity to appear before you today to discuss the role of the unemployment compensation system in President Reagan's program of revitalizing the economy and the importance of the program for the working men and women of our Nation.

The President's economic revitalization program is the cornerstone of the Administration's domestic economic policy. We must contain the growth of Federal expenditures to break the inflationary psychology that pervades the economy. And we intend to revitalize the industrial base of the economy and stimulate growth in real jobs in the private sector. While these changes are taking hold, the unemployment compensation system, providing cash benefits promptly to unemployed workers, is the keystone of protection for them and their households.

The Federal-State Unemployment Compensation Program now affords major protection against wage loss to 97 percent of all persons working for salaries and wages in this Nation—some 87 million workers.

During fiscal year 1981 we estimate that for regular and extended unemployment compensation: Benefits in the amount of \$20.1 billion will be paid to 10.1 million individuals at an average weekly benefit of \$101.

Similarly, for fiscal year 1982, we expect that: Benefits will be paid in the amount of \$18.1 billion to 9.6 million workers at an average weekly benefit of \$107.

We propose a general tightening of requirements that will continue this much needed protection and strengthen its basic insurance concept. We propose to target extended benefits to areas where high unemployment justifies Federal participation in paying the costs of these benefits, and to assure that extended benefits are paid only to workers with significant work force attachment. We would require that State laws assure that workers who have already drawn benefits for three months broaden their search for work. And we would change the requirements for ex-servicemembers to require that they are unemployed due to no fault of their own. Specifically, we recommend:

For extended benefits.—Eliminate the national trigger, which at present causes benefits to be paid in many States with very low unemployment rates.

Change the State trigger rates to more accurately reflect the changes that have taken place in our national economy.

Require that in order to qualify, an individual must have had 20 weeks of work, or a reasonable equivalent, in a 52-week base period.

Eliminate the use of extended benefit claims for computation of trigger rates.

In the regular State unemployment compensation laws.—Tighten the requirement to search for suitable work after an individual has received benefits for 3 months.

Unemployment compensation for ex-servicemembers.—Eliminate payment of benefits to individuals who have left the service voluntarily or were discharged for cause.

These changes, which we believe will strengthen this multibillion dollar safety net for unemployed workers, will also provide savings that will contribute to the President's Budget Reform Plan:

For fiscal year 1981: \$565 million.

For fiscal year 1982: \$1.443 billion.

For fiscal year 1983: \$1.005 billion.

Mr. Chairman, I would now like to turn my attention to the trade readjustment assistance program which has been paying similar, but higher, weekly allowances to

workers whose separations or reductions in work weeks are attributable to adverse competition from exports.

The Trade Adjustment Assistance program was designed to help workers who are unemployed as a result of foreign competition. The present program combines income support, retraining, and relocation assistance to provide displaced workers with the resources they need to adapt to changing conditions. In the past four years, however, the program has been distorted relative to its original intent resulting in escalating costs.

Trade Readjustment Allowances (TRA) paid to workers certified to be unemployed due to increased imports have grown from \$89 million in fiscal year 1974 to \$1.6 billion in fiscal year 1980. Current estimates are that fiscal year 1981 payments will reach \$2.7 billion. This recent explosion of costs simply cannot be justified in light of either the program's intended purposes, its accomplishments, or our national priorities.

The rapid escalation in costs is attributable to several factors, mainly: (1) the recent decline in the auto industry coupled with rising imports; (2) substantial liberalization of the certification standards and qualification requirements under the 1974 Trade Act, relative to those under the original Trade Expansion Act of 1962; (3) excessively long durations of benefit eligibility (up to two years), and high net wage replacement rates approximating 100 percent of previous take-home pay for many recipients, which provide a significant work disincentive; and (4) no distinction between indefinite and temporary layoffs, resulting in the majority of payments going to workers on temporary layoff.

Under the Administration's proposal, workers would be required to exhaust their unemployment compensation benefits before receiving trade readjustment allowances. Under current law they can receive both benefits simultaneously. This change will integrate the TAA program with the regular unemployment compensation (UI) system. Benefits will be the same as the worker's weekly benefit amount under the State UI law. The maximum duration of both UI and TRA benefits combined would be 52 weeks. All workers certified for TRA would continue to be eligible for retraining and special job search and relocation allowances.

The effect of these changes would be to shift the emphasis of this program back to its original purpose—assisting workers in their return to employment. These changes are proposed to become effective on October 1, 1981, and are expected to result in a fiscal year 1982 saving of \$1.15 billion.

The proposed changes are based on a study of the first years of program experience and recommendations by the General Accounting Office and supported by findings of a second, independent study (Survey of Trade Adjustment Assistance Recipients: December 1979). Both studies found that more than two-thirds of the workers who received TRA had returned to their original employers after a temporary spell of unemployment. In many cases these benefits, which are meant to help the worker over a period of unemployment, were paid in a lump sum after the worker had returned to his or her old job, or had taken a new one. The studies also found that the workers most in need of assistance were those who remained unemployed for a lengthy period and did not return to their original employer.

By limiting trade readjustment allowances to those who have exhausted their unemployment compensation, the program would be refocused on those whom it was originally intended to serve. Assistance would be targeted to workers who have not been called back to work by their former employers after an extended period of time, and who, because foreign competition has hurt their industry, are in need of retraining, longer-term income assistance, and/or relocation assistance. The proposed change would also greatly reduce the number of lump sum payments of retroactive benefits to those who have already returned to work.

Under this proposal there would be a 52-week limit on the total duration of compensation, both unemployment and trade. This change helps to make the TAA program an integral component of the unemployment compensation system, with trade readjustment allowances being paid directly after unemployed benefits are exhausted.

Making the amount of trade readjustment allowances equal to the level of unemployment compensation is principally a matter of equity. The present program, under which some workers are paid trade readjustment allowances far in excess of the unemployment compensation paid to their neighbors, simply is inequitable. In the auto industry, moreover, the present computation method has shifted benefit costs from industry-financed supplemental unemployment benefits (SUB) funds to the Federal treasury, since the SUB funds pay only the difference between the amount of unemployment compensation and the SUB fund income guarantee (up to 95 percent of wages). Thus, many workers do not receive more income because of trade readjustment allowances. In fact, SUB funds require recipients of retroactive

trade adjustment allowances to repay the SUB fund for overlapping SUB payments made for the same weeks for which they received trade readjustment allowances. This proposal would remedy this situation.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or members of the Committee may have.

**STATEMENT OF CRAIG A. BERRINGTON, DEPUTY ASSISTANT SECRETARY FOR
EMPLOYMENT STANDARDS, U.S. DEPARTMENT OF LABOR**

Mr. Chairman and members of the committee, I appreciate today to discuss the impact of the Administration's plan for Economic Recovery on programs administered by the Employment Standards Administration.

There will be significant spending reductions in Employment Standards Administration programs as in other Department of Labor programs. These reductions were not proposed on a hit-or-miss basis, but were developed in accordance with the specific guidelines set forth in the Administration's Plan for Economic Recovery. First, I will discuss the Black Lung Program.

BLACK LUNG PROGRAM

The Black Lung Benefits program was established to compensate miners and their families for the debilitating effects of black lung disease. We understand the plight of victims of black lung disease and share the humane concerns that led to the adoption of this program. The welfare of miners who are disabled by black lung disease, and of their families, must be protected. The Administration is not proposing anything that would deprive any miner who is disabled by black lung from qualifying for benefits.

We believe that the prudent administration of the Trust Fund requires that steps be taken to make this fund solvent. The Black Lung Disability Trust Fund was established in 1978 to finance the payment of black lung benefits. The major source of revenue for the Black Lung Disability Fund is from a tonnage tax on coal paid by the coal operators. The present production tax of 50 cents per ton of underground coal and 25 cents per ton for surface-mined coal is insufficient to finance the program, and massive deficits are being financed by loans (with interest) from the U.S. Treasury. At the end of Fiscal Year 1980, the fund owed the Treasury \$956 million. It is projected that this debt will reach about \$1.5 billion by the end of this fiscal year (1981). With no change in law, the only manner in which sufficient revenues can be obtained to meet Trust Fund obligations is through continued reliance on loans from the U.S. Treasury.

Mr. Chairman, this situation clearly runs counter to the intended purpose of the Black Lung Disability Trust Fund which was to make it an industry-financed program. It was also the intent of the Congress that the Fund be fully financed through coal tax revenue. The provision for repayable loans from the U.S. Treasury was to cover start-up funding and to meet acute problems. The loan provisions were not designed as a long-term mechanism to cover deficiencies in revenues.

Due to the difficulty which miners and their survivors had in obtaining the medical evidence needed to establish proof of disability, the evidentiary standards were substantially revised in 1978 to shift some of the burden of proof from claimants. This was needed to expedite the adjudication of claims for the large number of miners whose medical histories were scanty. Most miners with a long history of respiratory ailments are now receiving benefits. We believe that this need has largely passed.

Medical technology has become available in geographic areas of the country with high concentrations of coal miners. Thus it is easier to establish whether an individual has black lung disease. More importantly, much work has been done to improve the health and safety conditions in the mines in order to reduce the incidence of black lung in the future. We need to amend the program's evidentiary requirements to take into account these developments.

Let me again emphasize that these proposals will in no way harm coal miners who are totally disabled by black lung disease, but they will ensure that claims are based on sufficient proof of disability from black lung disease to justify approval.

FEDERAL EMPLOYEES' COMPENSATION ACT (FECA)

The Federal Employees' Compensation Act (FECA) provides workers' compensation benefits to Federal employees or their survivors for job-related injuries or deaths. Changes in the law in 1974 have resulted in substantially increased utilization of FECA benefits by Federal employees. The FECA, as presently constituted, provides positive incentives to employees to file questionable claims or claims for

very minor injuries. There are few inducements for workers to return to work or participate in vocational rehabilitation programs as soon as they are medically able to do so. In addition, the existing law compensates a larger proportion of the lost income of high-paid workers due to injury than lower-paid workers. This inequitable situation is the outgrowth of a compensation system that allows an increasingly larger proportion of workers to receive more in FECA benefits than earned take-home pay.

The overhaul of the FECA program is long overdue. The present level of benefits provided under the program certainly cannot be justified at a time when all sectors of the economy are being asked to make sacrifices to restore the economic health of this Nation. The increased employee use of the FECA system has attracted increasingly harsh criticism. Over the past decade, the number of injury reports filed under the FECA has increased from 121,000 in Fiscal Year 1970 to 217,000 in Fiscal Year 1980. This increased use has resulted in an alarming rate of growth in benefit expenditures, from \$151 million in 1970 to \$785 million in 1980, to a projected \$1 billion in 1982. This excludes the estimated \$65-\$75 million paid out annually by agencies during the 45-day continuation-of-pay period (COP). These large increases in reported injuries bear no relationship to the size of the Federal civilian workforce or the increased emphasis placed on Government safety programs.

The reforms already announced as part of the President's Economy Recovery Plan will go a long way toward restoring credibility to the FECA program by eliminating overcompensation while at the same time providing adequate income to deserving claimants. These reforms would increase the compensation rate to 80 percent of gross pay and make that amount subject to Federal taxation, reinstate the 3-day waiting period before continuation-of-pay benefits begin, reduce the compensation rate paid during the 45-day continuation-of-pay period from 100 percent to 80 percent of full salary, and integrate the FECA and Federal retirement systems. We believe that these reforms, and others which are presently under consideration, will restore a more equitable balance between the competing objectives of providing adequate income to disabled workers and their families while at the same time providing positive incentives for workers to return to work as soon as they are medically able to do so.

Mr. Chairman, I want to assure the Committee that the proposed changes in the black lung and FECA programs will not result in the denial of valid claims. The Department looks forward to working closely with your Committee on these and other important matters. I will now be happy to answer any questions you may have.

The CHAIRMAN. Our next witness is Mr. Roy Ash, a former director of the Office of Management and Budget. He is the current chairman of the Budget Committee of the Business Roundtable.

Senator BRADLEY. Mr. Chairman, I just missed the Secretary of Labor and I would like to have your permission to submit some questions for him for the record and get those responses.

The CHAIRMAN. Right. We'll be happy to do that and, in fact, I think a number of us have made the same request because there were a number of technical questions we thought they might not be able to answer.

So, we would be happy to accommodate the Senator and if the answers are not satisfactory, we will have them back before the committee.

Senator BRADLEY. I thank you, Mr. Chairman, very much.

The CHAIRMAN. Mr. Ash.

STATEMENT OF ROY L. ASH, ON BEHALF OF THE BUSINESS ROUNDTABLE

Mr. ASH. Thank you, Mr. Chairman. I am here today representing the Business Roundtable, which, as you know, is an organization comprised of approximately 200 corporate members, who together provide many billions of dollars of capital and a number of millions of jobs that make up a significant part of this Nation's economy.

I will provide a summary statement and then submit myself to any questions you or other members of this committee may have.

Notwithstanding the problems that some of its members have with certain specifics of the President's program, the Roundtable, as a responsible business organization, supports the President in seeking an outcome best for the country as a whole. The American people are coming to see the relevance to their own lives of the very disturbing economic facts of our present times, ones that are becoming so vividly evident to all of us. And they want something done by the administration and by this Congress.

The Roundtable, in addition to reiterating the strong conviction that individual and business taxes should be reduced significantly, and should be reduced quickly, as proposed by the President, also specifically supports the 10-5-3 concept of capital cost recovery, effective January 1, 1981.

It supports the two-track approach to the tax cuts proposed by the President and will, at the appropriate time, offer second track suggestions.

The Roundtable believes that the level of spending reductions proposed by the President are appropriate and are achievable.

Less Government expenditures reduce tax burdens on individuals and on business. Lower taxes not only increase savings available for investment, but can make the employment of investment and venture more attractive, thus inducing more of it.

No matter which series of numbers concerning Federal expenditures that we, together, might examine, it is obvious that the exponential growth rate of the last few decades can't continue without an inevitable big bang at the end.

The Business Roundtable is prepared, as a body, to accept its share of the so-called loss in business subsidies in order to get our economy on the right track once again.

The President's recommendations, taken together, form a bold attempt to come to grips with the problems of inflation, taxation, Government regulation. As we see it, the program offers balance, concern for the disadvantaged, and hope for a revitalization of our economy. We support the President's programs.

As to those elements of it that come specifically under the jurisdiction of this committee, the Roundtable has a position on social security. But, as to unemployment and trade adjustment assistance, it has not developed an official position, but a number of its members have exchanged views in regard to these programs. As there may be any questions in regard to these, I am prepared to answer for myself and those other individual members of the Roundtable with whom I have discussed such matters.

Mr. Chairman, that is the summary of the statement that I will submit for the record and then be prepared to answer any questions that you may have.

The CHAIRMAN. Well, thank you, Mr. Ash. And, you are, of course, no stranger to congressional committees. The entire statement will be made a part of the record.

I note on page 5, which will be, of course, noted in the record that you have outlined some of the areas where business will also be impacted. And I think that is important, because there seems to be a strong feeling that perhaps that's not the case. That we have

isolated only lower income Americans and they will suffer all the pain in the program. So there may be other areas by the time this committee and other committees complete their work that might also impact on business.

I think it's necessary that it be a balanced approach. You have indicated the same. If it is perceived by the American people to be anything other than a balanced approach, then I think we will have great difficulty in enacting the President's package; do you agree with that?

Mr. ASH. I certainly do. And it is a fact, even though the public may not know it as well as they know the effect of the President's proposals on other programs. It is a fact that business, itself, is going to have to pay its share of this kind of a program.

But, the Roundtable, as an organization, supports the program in its entirety, including the fact that members of the Roundtable are going to suffer their own adverse effects.

The CHAIRMAN. You also indicated that you support the two-track approach on tax reduction. I think many of us in the committee are wondering about how realistic that may be because there is a tendency to not wait for the second bus. If you see one going through, you may want to board that one. If you have an amendment, you may not want to wait, particularly since there has been no indication by the administration how we would finance a second reduction. Now, maybe they have other cuts in mind, or offsets, but that's a matter, I guess, that we will have to determine after the House acts.

Mr. ASH. We will leave to those of you that are expert in the politics of all of this, the matter of tracks and how they would be pursued. But, we do believe it is important to get on with the kind of tax reductions that are proposed in the President's simple, clean, clear first track program.

The CHAIRMAN. Do you subscribe to everything in his tax reduction package, the individual rate cuts as well as the business side?

Mr. ASH. We do. In fact, we see in the individual rate cuts a substantial effect on business itself. First, as we all know, by far the greatest number of the businesses in the country are small business. And in most of those cases, those small businesses are taxed under the individual tax rates. They are not incorporated. Therefore, the underlying base of the business structure of this country will be improved by the kind of tax cuts that pertain to individuals.

There are a number of other advantages, as well. Those very individuals—in their capacity as investors will, with a tax rate reduction, have a greater propensity to save and to otherwise make funds available for expansion and increased productivity of our economy.

So, the tax cuts as they apply to individuals, as we see it, are an integral part of not only the President's program but of any program that has at its goal improving the basic productivity and workings of the country's economy.

The CHAIRMAN. I think there are some reservations, not only among Members of Congress in both parties, but economists and others—it may be because we haven't tried the President's approach—on whether, because of the individual cut, a reduction of

10 percent of the marginal rates for 3 years, if, in fact, the taxpayer would invest or save that money? If not, there's fairly strong evidence that the cut could be inflationary.

I don't know whether the Roundtable has done any projections, or estimates, or surveys, or not?

Mr. ASH. We have some thoughts that we have developed in that regard.

First, the tax cuts for individuals, as proposed by the President, are, at least for the first 2 of the 3 years, almost exactly equal in amount to the combined effect of bracket creep and social security tax increases.

So, in that sense, there is no net amount of new spending power put in the hands of the public.

We also believe that there is evidence—there is not necessarily proof, because who knows what the future will hold—but, certainly, there is evidence that in past times, when similar actions have taken place, a fair amount of the reductions of individual taxes, have gone to savings in one form or other, keeping in mind that savings are made when individuals pay down debt. There is a very high level of individual debt outstanding at the moment. And there is reason to believe that some of the tax savings will go to pay down individual and personal debt, which is exactly the same as savings.

So a combination of debt reduction, and savings has seemed to follow this kind of tax reduction. The fact that, on the other side, there are taxes that are going up, through bracket creep and social security, leads us to believe that this 10-10-10 proposal would not have the effect of being inflationary.

The CHAIRMAN. Senator Grassley, I've got to leave for a minute or two, could you preside, and then Senator Bradley follow you?

Senator GRASSLEY. I'll only be here for another 7 minutes.

The CHAIRMAN. All right. I'll be back by then. Just take a seat.

Senator GRASSLEY. Well, is it my turn or your—

Mr. ASH. You are the chairman.

Senator GRASSLEY. Thank you. [Laughter.]

Mr. Ash, I want to say that those of us who are supporting the budget reductions appreciate organizations like the Business Roundtable for supporting the program, and accepting the cuts in subsidies to business, as well as supporting cuts and subsidies for other people as well.

Now, I suppose that somebody outside of the business community might laugh and say: Well, that's to be expected, they can afford it. But, you know that it is not a necessary characteristic, even of businesses, to want reductions. A subsidy is a subsidy, and people who receive subsidies want to maintain them.

But, I want you to know that, at least from this side of the aisle, I think most of us appreciate the position you have taken. I do have a question, because you have suggested in your testimony here seven or eight specific areas where there will be some subsidies cut. When a subsidy is cut, I assume that is going to create capital problems for industry and business, and so I want to know whether you believe that if the administration's proposals accomplish their stated goals of revitalizing our economy, that there will be sufficient capital in the private sector to enable businesses

which have taken advantage of various programs in the past to maintain their activities.

Mr. ASH. The Roundtable has considered exactly that question, as a number of its members came face to face with the need to, up the advantage under the present program. And the unanimous view of its members is that such a program as proposed by the President in the long run—and not necessarily too long a run, but at least once it gets over the initial trauma at the beginning—will have substantial positive effect on the development of the economy; the benefit of which will accrue not only to those businesses who may have to give up their subsidies in the beginning, but will accrue to all the citizens of this country.

This is a program, as we see it, that, if enacted in its entirety including regulations and everything else, will substantially revitalize the whole of the economic base of the country for all of those who participate in it—which means everybody in this country.

Senator GRASSLEY. My second question probably refers to that portion of your comment where there is the implication that there might be short-term problems. Which, if any, activities—and I know the Business Roundtable represents a broad array of them—that have enjoyed Government support in the past might not be able to compete successfully for funds in the private sector?

Mr. ASH. Well, of course, the whole matter of export-import loans and loan guarantees is a problem that has been identified. And I must reiterate, that having identified it and see it as a problem, nevertheless, the Roundtable supports the President's program which includes reduction of export-import loans and subsidies.

But in that particular case, a reasonable calculation is that for every \$1 billion of exports foregone by not having the form of subsidy now provided, there are about 40,000 jobs that are at stake.

Now, the Business Roundtable, its members, and business in general does not support export-import loans and guarantees for themselves, so much as the fact that foreign countries are providing similar support to its industry and that if we are to be competitive in selling into foreign markets, we need to provide the kind of support that governments of other countries provide their industries. We would prefer that those governments not provide subsidies. But to the extent that they do, we feel that we should consider maintenance of those 40,000 jobs per billion dollars by doing the same thing.

Nevertheless, the Roundtable supports the President's program, and will just have to fight it out with one hand tied behind its back; but it is prepared to do so. We do think it would be incumbent upon this Government to put even greater pressure than it has on foreign governments to reduce, or eliminate, the kind of subsidies they provide to their industry.

Senator GRASSLEY. Mr. Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. ASH. I'd like to go back to your statement and to what you have said in response to Senator Dole. You have managed large enterprises in your career; you have most recently been associated with a major corporation. And, in your capacity as an executive for a major corporation, you had to make projections of what you thought the cost of money would be the following year. I'm curious.

What would you recommend to your former corporation? What do you expect the cost of money to be if you are going into the corporate bond market to get financing in the next year or so?

Mr. ASH. I would have to preface an answer by saying: The projections made for this last year didn't turn out to be true—any projections I, or virtually anybody else made. In fact, the kind of policies that have come to be known as stop-and-go policies of the last year have made it very difficult to make projections of any sort, whether it be interest rates, or anything else, that bear upon the economy.

If the Congress supports the President's program as submitted, or approximately as submitted, and, in doing so, sends out a signal to the whole of the economy that it can expect a consistent set of actions and policies out of Government over the next few years, then I think those expectations can lead to a gradually reducing rate of interest. Because, in fact, those who make such investment decisions can say that the Government now is engaged in a course of action that is more predictable than it has been in the past.

The very predictability, and particularly predictability in the direction of the President's proposal, I would think would suggest to the financial markets, whether it be borrowers or lenders, that the inflation element that is now built into all of their calculations, and negotiations, will be going down and down and down. And, therefore, interest rates should go down with it.

That to me—

Senator BRADLEY. And that doesn't happen overnight?

Mr. ASH. It doesn't happen overnight. It is, on the otherhand, a signal of things to come over the long-run. And interest rates, particularly for long-term securities, are based on expectations for that longer term—

Senator BRADLEY. Do you think that the 8.9 percent cost of money that the administration estimates for the 1982 budget is reasonable?

Mr. ASH. Well, I have no reason to believe that it is not reasonable. But one only need look at earlier forecasts and ones in which I have taken part and others, it's very difficult for anybody to forecast, particularly to a 10th of a percentage point, what interest rates are likely to be.

Senator BRADLEY. If it is higher than that, of course, it will cost the Government more money, won't it?

Mr. ASH. Clearly, it will cost the Government more money if the interest rates are higher.

Senator BRADLEY. Money to pay for financing debt.

Mr. ASH. That's the way it goes.

Senator BRADLEY. Now, the argument that a major share of the tax cuts will be saved has been disputed. Others say that, it won't be saved, but rather will be spent, as Senator Dole at least, has suggested. Your response to his question was: Well, people aren't going to have any more real money anyway, because they are going to have tax increases with bracket creep and with social security tax. They are not going to have any real money—any more money in their pocket, any real new additional money. Why do you think their behavior is going to change and they are going to save so much more?

Mr. ASH. Because, among other things, if the whole of the President's program is enacted, investment opportunities will look a little better than they may have in the past. In the past one wondered whether to invest in anything, especially to invest in common stocks of companies.

Senator BRADLEY. So you are saying that the income earner of \$20,000 who thinks he has \$200 more in his pocket, now will choose to invest in a common stock instead of spending the money as he did last year, to buy food, take a vacation, or other things like that?

Mr. ASH. I am not saying that any one thing will happen. In fact the economy is made up of the aggregate of millions of decisions.

Senator BRADLEY. But, you don't have the slightest bit of doubt; you believe that people really are going to save this money and that we won't have an inflationary response?

Mr. ASH. They are not going to save all of it. We are talking about the margin, what happens at the margin. First, there won't be a lot of margin, because taxes—

Senator BRADLEY. When you—let me just ask—when you were the head of OMB did you use the word "on the margin"?

Mr. ASH. Probably that wasn't governmentese at the time. But, certainly, it's one that economists and business people use all the time.

Senator BRADLEY. That shows you how rhetoric has pervaded our discussions.

Mr. ASH. It has moved into Government from the world of private enterprise.

Senator BRADLEY. I am curious, as well, when you said that bracket creep and social security tax cuts in the next year and a half would offset the tax cut. What did you assume the inflation rate would be?

Mr. ASH. I assumed the inflation rate would be not much different than it is right now, and one should put in a margin even for that of a plus or minus a percent or more.

Senator BRADLEY. You assumed that the inflation rate would not be much different than it is now.

Mr. ASH. It should be down a bit for the next couple of years.

Senator BRADLEY. Well, the administration's budget assumption indicates that it is going to drop by about 2 points in each year—2 to 3 points.

Mr. ASH. Well, that's within the margin of possibility.

Senator BRADLEY. It's supposed to be 7.2 percent by the fourth quarter of 1982.

Mr. ASH. But if you take the whole of that 2-year period, as it may move from where it is to 7.2 or more or less, the average during that time would still be pretty close to 9, 8½, or something. And it's really hard to fine tune beyond that. For any calculations that we might make now, or that if we look back in retrospect that were made in earlier times, nobody gets closer than that.

Senator BRADLEY. Let's say that, indeed, you are going to have lower inflation not higher inflation.

Mr. ASH. Right.

Senator BRADLEY. With lower inflation there is less pushing of people into the higher brackets.

Mr. ASH. Correct.

Senator BRADLEY. So, if the program succeeds, the bracket creep won't be as bad. Add to that the fact that you actually are cutting rates. Formerly bracket creep might have pushed people into higher and higher brackets, but under the tax cut proposal we would have a new lower top level. You still stand by the statement that you think it's a wash?

Mr. ASH. Sure. There are other elements as well. The expanded tax base that, presumably, will come from a revived economy also bear upon Government's total revenue, regardless of rates. So all of these factors together, lead to the conclusion that we have less risk of inflation by going the 10-10-10 route than the risk that is inherent in continuing on the route we are now on.

Senator BRADLEY. Well, let me say, Mr. Ash, as one person who wants the same objectives as you do, I am not as sanguine as you are about how this is going to work. And I'm going to be very anxious to talk to those people who, making \$20,000 and \$25,000 these days still decide to save instead of consume. And my guess is that if I had my way, I'd like to be a little more sure that they are going to save.

The thing I don't understand from many members of the business community is this kind of analysis. Arthur Burns certainly doesn't share it. He didn't last weekend at a conference. Many other people who were partners of yours, in your years in Government, don't share these expectations about this budget's impact on the economy. And, in some sense, I agree with Arthur Burns more than I agree with David Stockman. And I think that when you find people of the stature of Arthur Burns raising big red flags, you should slow down and at least look. And, as one Senator, that's what I am doing.

It's striking to me, when you get into the assumptions of the budget how many business people have not stopped to look at the assumptions and the probabilities that they will be realized, and are pushing ahead, very forcefully, with the complete endorsement of every last dot of the "i's" in the program.

I hope that we won't have a situation 6 months or a year from now, when the Business Roundtable and I will be back with another plan, having forgotten that they endorsed this plan.

You know that advertisement, "You asked for it, you got it"? If the administration's assumptions are wrong and Arthur Burns is right, that might be exactly what the business community will be faced with.

And, not only am I trying to wait until my distinguished colleague gets back here but I am trying to convey a message to you that as one Senator, I have some real doubts about the program, as you can imagine. And, as a veteran of the budget wars, I assume that you are factoring in things like: The program won't actually be the way it's proposed, but we've got to make a strong effort at the beginning and convey to the public that this is really all or nothing. You know, its like the person that starts to lose his hair and goes to a doctor—maybe not a doctor, maybe a specialist—and asks him what he needs for his hair, and he says: Well, you do the following 14 things—you use this lotion, that powder, this massage. You do it every day. And if you do those 14 things in the order I

have given you, your hair will grow. But, if you do the powder before the lotion, or the lotion after the powder, or don't do it on Monday, Wednesday, and Friday, but on Thursday and Tuesday, I can't be responsible; your hair won't grow and I am not responsible.

That's the message you and the administration are giving us. You have 14 remedies; you got 14 specific steps to make our hair grow, and if we don't follow them, you can't be responsible.

So, I know that Senator Dole is surprised to come into the hearing room and hear us discussing how to grow hair. [Laughter.]

The CHAIRMAN. Yes, indeed.

Senator BRADLEY. I didn't want to ask him about a telephone call or whatever was——

I've enjoyed this opportunity to speak at——

Mr. ASH. If I may, I would like to make a couple of observations—that relate to that which you have said.

First, as we all know, as a matter of practical experience, every program undertaken by the Government is not underwritten with a Lloyds of London insurance policy that it will come out exactly as forecast. Every program has a risk. I think I am merely saying there is a greater risk of staying on the course we are now—for which we can almost predict its outcome—than the risk of taking a course that has been proposed and has reasonably good logic behind it. So, I am talking about relative risks, rather than absolutely guaranteeing this is going to grow hair and that is not going to grow hair. There are probabilities at work in both cases when talking about relative risk.

Another one, since you introduced it that way, at a time when Arthur Burns and I were both in the administration, we didn't agree on a lot of things even at that time. And I think in retrospect, it will turn out that the positions that I held had their share of being correct versus the ones that he held. But history will have to make an analysis of which was the greater cause of earlier inflation, monetary policy or fiscal policy. And, I would say that monetary policy had its share along with fiscal policy.

Senator BRADLEY. May I just ask one other question?

Maybe you don't remember the numbers—I wouldn't expect you to—but, just by chance, if you do, the period 1965-69 was a time where we really did mobilize our defense resources. Many people trace the inflation that we are experiencing today to that period, when Lyndon Johnson tried to have guns and butter, but didn't finance it. Do you know offhand the defense expenditures during those 4 years? If you don't, let me suggest the numbers were significant. But the defense expenditures that this budget contemplates are two to three times the amount, in real terms, that we expended in 1965-69. Why do you feel that this won't engender the same kind of inflationary response as it did in 1965-69, when we had in more unused capacity than we do now in those sectors of our economy that will be called upon to support defense?

I mean, why are we now immune from this kind of inflation pressure?

Mr. ASH. As you observe, I don't remember all of the numbers. On the other hand, I would think a calculation would not show that the defense expenditures now in real terms, are two to three

times what they were then. In the years 1960-68, for which I do happen to have some numbers that generally embrace the period that you have identified. Defense expenditures declined by 40 percent on a constant dollar basis from what they were at an earlier time.

Senator BRADLEY. Well, but don't take 1960. The war didn't really get going until 1965-66. That's when we started to mobilize.

Mr. ASH. That's right.

Senator BRADLEY. 1965-69 was when we mobilized.

Mr. ASH. Then we began to reduce them later in that period and by the end of 1968, they came back to the mid-1950 levels in real terms, even after paying the considerably higher costs of the All-Volunteer Force. And one has to take into account the mix of defense expenditures, which in the early 1960's were largely for material and now go largely for labor. It is a totally different mix.

I don't really think—

Senator BRADLEY. So, you are saying—

Mr. ASH. That today real defense expenditures are no higher than they were at those times. I am sure that they must be lower in real terms, although I wish I had the numbers in front of me to show so.

Senator BRADLEY. But if you had a second glance at the numbers and there was a real increase, the only explanation you can offer for why that wouldn't generate inflation now is that it is now primarily channeled into manpower as opposed to—

Mr. ASH. No. That was just a side observation. At that time, if one looks back to that guns and butter era, the problem—

Senator BRADLEY. And I am not saying this as a defense budget issue or a comparative regime issue—

Mr. ASH. Sure.

Senator BRADLEY. I am asking it as an economic issue.

Mr. ASH. Wasn't the issue then that we attempted to finance both guns and butter with deficits rather than with taxation?

Senator BRADLEY. Yes.

Mr. ASH. And that became the issue. It's how we financed the cost not necessarily the levels. But we did have a war to finance. We have had earlier wars to finance.

Senator BRADLEY. Right. Exactly, and that's my precise point. If you are expanding your defense expenditure because of a threat to the country and you have to—you recognize you have to finance that defense expenditure, one of the things you don't do is also reduce taxes during the same period.

Just as economic logic, isn't that consistent?

Mr. ASH. That's one of the ways. You may also finance it by reducing other forms of expenditure.

Senator BRADLEY. Yes, that's true.

Mr. ASH. That's another way to finance it.

The real issue to me, as far as fiscal policies in a macroeconomic sense are concerned, is only secondarily a deficit level. Now, that sounds almost heretical to say that deficits are secondary. The question is: To what are they secondary?

They are secondary to the level of Government expenditures vis-a-vis the scale of the whole GNP. Moving our expenditures from 18 to 19 to 20 to 22, almost to 23 percent of GNP, is a much more

consequential matter to the economy than the deficits level at the margin. I'm sure—

Senator BRADLEY. But, wait a minute. The deficit at the margin? I understand what taxes are at the margin.

Mr. ASH. The \$50-billion deficit.

Senator BRADLEY. What is deficit at the margin?

Mr. ASH. Well, the \$50-billion deficit, while it is a horrendously large number as against a \$600 billion total spending level, is secondary to the fact that it's \$600 billion in the first place. I would be much more satisfied with a \$50 billion deficit if we had a \$400 billion expenditure level than with no deficit at a \$800 billion expenditure level. The real key issue in a macroeconomic sense is the level of expenditures vis-a-vis the scale of the economy rather than that small amount of spending that may be a deficit in any one year. The deficit tends to be more transitory, year to year. But is nowhere nearly as—

Senator BRADLEY. Yes.

Mr. ASH. But is nowhere nearly as harmful to the whole of the economy as a governmental spending level that moves its way up from 18 percent of GNP to 19, 21, 22, 23. And that's at the Federal level. And when you add on top of that State and local government, you've got 35 and more.

That's really what we should have our eye on. I—

Senator BRADLEY. Wait. Does the last statement you made say we should have our eye on the consolidated Government budget?

Mr. ASH. And the Federal Government's contribution to it, both of them together. In effect, we are changing the nature of our economy and of our society when governmental expenditures account for such a big part of GNP. To me, the real fiscal story of this country, is more than deficits, horrendous as they are, at their \$50 billion, more or less, level.

So, while deficits are significant, they are not as significant as something else that bears not only on the economy, but bears upon the whole social structure of the country.

Senator BRADLEY. Thank you very much, Mr. Ash.

Mr. CHAIRMAN. I have no further questions. We appreciate very much your statement and your response to the questions, some of which I missed. But, we will probably be seeing you again. Thank you.

Mr. ASH. Thank you, Mr. Chairman.

[The prepared statement of Mr. Roy L. Ash follows:]

STATEMENT OF ROY L. ASH ON BEHALF OF THE BUSINESS ROUNDTABLE

SUMMARY OF PRINCIPAL POINTS

Notwithstanding the problems some of its members have with certain specifics of the President's program, the Roundtable, as a responsible business organization, supports the President in seeking an outcome best for the country as a whole. The American people see the relevance to their own lives of the economic facts that are becoming so vividly evident; they want something new done.

In addition to reiterating the strong conviction that individual and business taxes should be reduced significantly and quickly—as proposed by the President—The Roundtable:

Specifically supports the 10-5-3 concept of capital cost recovery, effective January 1, 1981;

Supports the "two track" approach to the tax cuts proposed by the President and, at the appropriate time, will offer second track suggestions; and

Believes that the level of spending reductions proposed by the President are appropriate and achievable.

Less government expenditures reduce tax burdens—on individuals and business. Lower taxes not only increase savings available for investment but can make the employment of investment and venture more attractive, thus inducing more of it.

No matter which series of numbers concerning federal spending that you examine, it's obvious that the exponential growth rate of the last few decades can't continue without an inevitable "big bang" at the end.

The Business Roundtable is prepared, as a body, to accept its share of the "so-called" loss in business subsidies in order to get our economy on the right track once again.

The President's recommendations taken together, form a bold attempt to come to grips with the problems of inflation, taxation and government regulation. The program offers balance, concern for the disadvantaged and hope for a revitalization of our economy. We support it.

My name is Roy L. Ash and I represent The Business Roundtable. The Roundtable is an organization comprised of approximately two hundred corporate members who, together, provide many billions of dollars of capital and a number of millions of jobs that make up a significant part of this nation's economy.

The Roundtable, recognizing as it does that the deliberations you are engaged in at this time can be described properly as a watershed in the course of our country's history, appreciates your allowing me to appear before this Committee on its behalf.

Notwithstanding the problems some of its members have with certain specifics of the President's program, the Roundtable, as a responsible business organization, supports the President in seeking an outcome best for the country as a whole, and recognizes the importance of this Committee's deliberations through the next few months in achieving what I consider to be our common objective—"America's Economic Recovery".

That outcome, as the President has proposed and you are considering, requires:

Substantial, across-the-board, reductions in planned federal spending levels for the years immediately ahead.

A commitment to restrained spending growth into the future, accompanied by effective spending control processes to meet that commitment.

Significant reductions in the tax burdens of individuals and businesses in ways that free more resources for savings and investment—the necessary ingredients to our regaining world leadership in the business arena.

Surcease of the debilitating regulatory excesses that are impairing industry's ability to meet our country's needs for efficient production and growing employment.

Substantial action on all of these, along with consistent monetary policies, can turn the tide. We can begin the long and hard road back toward lowered inflation, higher productivity, enhanced international competitiveness, economic growth, increased job opportunities, a higher standard of living, and quality of life for all Americans, including an increased ability to provide for those—through no fault of their own—unable to participate in the mainstream of the economic system which we advocate.

I don't intend to recite the considerable statistical evidence that supports the need for the kinds of dramatic actions the President proposes. The whole country has heard the evidence and is beginning to understand "common sense" economics like it never has before. The American people see the relevance to their own lives of the economic facts that are becoming so vividly evident; they want something new done. This Congress has the awesome task of rethinking the whole American economy and determining how to respond to the people.

Because of the scope of this Committee's responsibilities, I will not dwell on regulatory policy or monetary policy as they relate to the revival of our economy. And because of the scope of my own responsibilities representing the Roundtable, I intend to concentrate especially on federal spending—its reduction and control. But let me make some summary points about taxation, which represent the Roundtable's considered views but can best be amplified by others.

In addition to reiterating the strong conviction that individual and business taxes should be reduced significantly and quickly—as proposed by the President—The Roundtable:

Specifically supports the 10-5-3 concept of capital cost recovery, effective January 1, 1981.

Supports the "two track" approach to the tax cut proposed by the President and, at the appropriate time, will offer second track suggestions.

Believes that the level of spending reductions proposed by the President are appropriate and achievable.

As to federal expenditure reductions—or I should more properly say, slowing the growth of federal expenditures—business has a very strong interest—for its shareholders, for its employees, and for its customers.

Less government expenditures reduce tax burdens—on individuals and business. Lower taxes not only increase savings available for investment but can make the employment of investment and venture capital more attractive, thus inducing more of it. Capital, simply, goes where expectations of return justify it.

The employment of that capital adds jobs, makes industry more productive, and allows distribution of the resultant benefits to consumers, employees and shareholders alike.

Business also is vitally interested in federal expenditures because of their effect on existing capital markets. "Crowding out", to finance increasing government deficits, denies capital for private productive investment, especially for smaller businesses. For capital that is obtained, government competition for money raises interest costs. Interest costs, like all other costs, are largely passed on in the prices of products and services sold. The consumer ultimately pays.

In discussing government spending, again there's no need to recite the statistics you know so well. For no matter which series of numbers concerning federal spending that you examine, its obvious that the exponential growth rate of the last few decades can't continue without an inevitable "big bang" at the end. Nobody will be the winner at the moment. And we're getting closer.

In 1975, following my own not very successful efforts to help rein in spending, an article I had written was published which contained the observation that "if we continue on the present [spending] course the producers of the flow of goods and services in the year 2000 will keep considerably less than one-half of its value for their efforts—they will become the slaves; the rest will be paid over to government which in turn will pass most of it along to transfer payment beneficiaries". "Obviously," the article went on, "if such a condition comes to pass, not only will we have changed the economics of the country, but also, by breaking the relationship between effort and reward, its social system as well."

Almost a quarter of that twenty-five year forecast period has passed. We are on the ominous course projected. Not only are transfer payments growing but so are other government expenditures, including those where business is seen as beneficiary. As a part of a balanced program of cuts, no expenditure should escape close scrutiny at this time.

Let me identify some of the programs that are generally regarded as aiding business, even as they also aid others. They are:

Export-import loans and loan guarantees—We believe their reduction could be a negative factor for this country's competitiveness in world markets and for the creation of jobs that flow from a high level of exports.

- Synthetic fuels,
- Rail subsidies,
- Airline subsidies,
- Postal subsidies,
- The space program, and
- Airport and waterway user fees.

The Business Roundtable is prepared, as a body, to accept its share of the "so-called" loss in business subsidies in order to get our economy on the right track once again. We're confident that this Committee goes along with us in achieving this goal.

We cannot afford to back off that approach; we cannot afford to arbitrarily exempt from consideration any budget item. And, particularly, we must keep in mind the President's scale of cuts. Anything less is too little. If we can't do enough at this time, and don't do enough, it's a signal that we never will be able to—that we will gallop on to that day of economic and social collapse.

So, those few comments encapsulate the Roundtable's views of the present imperative need for federal expenditure reduction. But, even after wrestling with the challenge of the moment, spending will go on. And we can be back in the condition in which we now find ourselves unless we give attention to the processes by which government spending is managed year in and year out.

The Budget Committee of The Business Roundtable has considered the spending control processes now employed within government and will recommend to OMB and the House and Senate Budget Committees procedural improvements in the budget process.

In summary, on behalf of The Business Roundtable, it is clear that some industries will be affected adversely by some aspects of the President's program, and I'm certain that you will be hearing from them. But The Roundtable also recognizes that the natural tendency for any segment of society to favor cutting government

expenditures in sectors other than its own is self-defeating and would scuttle the whole program. The President's recommendations, taken together, form a bold attempt to come to grips with the problems of inflation, taxation and government regulation. The program offers balance, concern for the disadvantaged and hope for a revitalization of our economy. We support it.

The CHAIRMAN. Mr. Richard W. Rahn, vice president and chief economist, Chamber of Commerce of the United States will be our next witness.

You may proceed. I had hoped you might be able to summarize it.

Mr. RAHN. I'll summarize it very quickly, Mr. Chairman, given the lateness of the hour.

The CHAIRMAN. It's just me and you now.

STATEMENT OF RICHARD W. RAHN, VICE PRESIDENT AND CHIEF ECONOMIST, CHAMBER OF COMMERCE OF THE UNITED STATES; ACCOMPANIED BY ERIC J. OXFELD, EMPLOYEE BENEFITS ATTORNEY AND KENNETH D. SIMONSON, TAX ECONOMIST, TAX POLICY CENTER

Mr. RAHN. I wish I had been up here when Mr. Bradley was here on the effect of inflation on tax cuts, which is one of my favorite subjects.

I am Richard W. Rahn, vice president and chief economist of the Chamber of Commerce of the United States. I am accompanied here today by Mr. Ken Simonson, our tax economist on my left, and Mr. Eric Oxfeld, our employee benefits attorney on my right.

On behalf of our 112,000 businesses, local and State chambers and association members, I welcome this opportunity to testify on those spending reductions proposed by the administration that are before this committee.

The U.S. Chamber has endorsed the President's program for economic recovery in its entirety. I believe its adoption will quickly produce higher real economic growth, less inflation and unemployment, and a better standard of living for all Americans. The best protection Americans have from economic hardship is that provided by a dynamic, growing economy.

We cannot afford to wait much longer to change economic directions. Congress should move quickly to reduce spending and taxes, to reform the regulatory process, and support a more stable and moderate monetary policy. Tax reductions will provide the incentives for the private sector to work, save, and invest. Monetary restraint will assure that gains in nominal income from higher levels of employment and investment are not eaten up by inflation. Spending cuts will free up resources and keep the deficit down, so that business can finance new investment without excessive competition for funds from the Federal Government.

The growth in Federal spending must be curtailed. Federal spending has grown far more rapidly than gross national product in the last 20 years, rising from roughly 18 percent of GNP in the early 1960's to 23 percent of GNP in fiscal 1981. As a result, the Federal Government now competes more heavily with the private sector for scarce capital, labor, and resources. Many private firms and individuals are crowded out by this competition, thus hurting private initiative, job creation, and productivity.

Our written statement, which we would like to enter into the record in its entirety, contains a detailed description of our reasons for supporting the President's program in its entirety.

One thing I would like to note is that it has been asserted that the tax reductions, particularly the Kemp-Roth individual rates are inflationary. I believe that it is totally fallacious and that, if anything, they would be deflationary.

We have recently commissioned a study by Mathematical Policy Research. They have provided us some preliminary data this morning indicating that approximately two-thirds of the rate reduction would be saved. Even if that figure is too high, we still believe there is absolutely no reason to believe that the rate reduction would be inflationary.

In addition, this morning I would like to note that the President's economic assumptions and forecast has been under attack. At our U.S. Chamber Forecast Center, we have analyzed the program; we have made an economic forecast based upon the assumption that Congress will pass the spending restraint, reduce the taxes, engage in regulatory restraint and, hopefully, the Federal will engage in a more consistent monetary policy within their growth targets. If that comes about, we believe the President's forecast is most realistic.

We find the CBO's criticism of the Reagan forecasts substantially without merit, particularly in light of CBO's own forecasting record, which we have analyzed.

Recent CBO forecasts have—the error range in a recent CBO forecast show that the Reagan administration forecast are well within the CBO average error since 1977. In fact, if you look at the 1977, subsequently forecast from CBO in their 1-year forecast, you will find that they have guessed wrong on the change in GNP an average of 59.8 percent. Their error on the change in the CPI has averaged 30 percent; and for the unemployment rate, 5.1 percent. That's only for the 1-year forecast. If you go out 2 and 3 years, you find CBO is even more incorrect. And hence, sir, I don't think they are the agency that ought to be criticizing the probabilities of the Reagan administration's forecast coming out correctly. We all know economic forecasting is far from precise. But, we at the chamber believe the administration is on the right track; the forecasts are credible; and I would encourage the Congress to enact the program as quickly as possible.

Thank you, sir.

The CHAIRMAN. There have been some considerable criticisms of the Reagan economic package because of its impact on social programs, not only unemployment insurance, trade adjustment and others, but, CETA programs, food stamps, LITT programs, school lunches, a great deal of criticism of the cuts in those areas.

Has the chamber made any analysis of the cuts in social programs? You say you endorse the package, I assume that means you have taken a look at these?

Mr. RAHN. We have gone through the programs, the program cuts, and our various issue managers have looked at each one of those—a number of spending programs the chamber has supported in the past. But, we realize that the Government needs to cut back and so our board in late February unanimously endorsed all those

spending cutbacks. We find that with most of those social programs that you have tremendous duplication. For instance, in something like child nutrition, we find there are families which are benefiting from four different child nutrition programs. And when you are cutting back a program, it does not mean that you are eliminating people who have real needs.

The CHAIRMAN. I think the answer to some of those who advocate those programs and believe we ought to take a look at tax expenditures for business, in effect they say, it's welfare subsidizing business interests. I think we are going to have a very real debate within this committee on some of the issues at the appropriate time.

But, it's hard to believe that the chamber of commerce would agree with us on everything that the President recommended. That's more than he can expect from Congress.

Mr. RAHN. Well, if we—I suppose if each one of us was making up the ideal economic recovery program, we'd come out a little bit differently. But, we felt the overriding concern at this time was to get the Nation's economy back in the track and the President's program was the—it seemed to us the single best way. It was a reasonable compromise. And, it's not that every member of the chamber agrees with every item, specific line item in it. But they feel that the benefits so clearly outweigh any possible negatives that again we urge you to move full speed ahead in enacting this program.

The CHAIRMAN. Do you have in your statement—I haven't read it all—any additional cuts that were not in the Reagan package?

Mr. RAHN. We have been identifying a number of additional cuts and, Eric, do you want to comment on that?

Mr. OXFELD. Well, there are several in the unemployment compensation program that we think can go beyond what has been recommended and we will be glad to—since they are a technical detail to submit them for the record and to the staff as well.

The CHAIRMAN. All right. We would like to have some more flexibility. We understand we will have some direction, or some guidance, or whatever, from the Budget Committee. But it seems to me there may be other areas that haven't been properly identified where we can make savings. We may not want to go as far as the administration did in some areas. We may want to find others that are not recommended by the administration.

Mr. RAHN. There's a lot of little things that we think can be taken out of the Federal budget.

Mr. CHAIRMAN. That means that we didn't go far enough in some areas.

Mr. OXFELD. Senator, if you look just at the unemployment compensation program, studies by the National Commission on Unemployment Compensation found that in some areas at least as much as a third of all the unemployment benefits paid out are improper payments. Since the projected benefit payout for 1981 is in excess of \$22 billion, I would suggest that the committee might be able to find some additional cuts in the way of reducing fraud and abuse within the program as a way of achieving very large additional savings.

The CHAIRMAN. We have an interest in that and I know Senator Boren, who is not here this morning, has a great deal of expertise in that area, having been a Governor of a State and having made a number of reforms that did impact on those who needed the assistance, and saved the State a great deal of money.

So, anything we might have that would be helpful, we would appreciate.

I thank you very much. And as I have indicated, the entire statement will be part of the record.

[The prepared statement of Dr. Richard Rahn follows:]

STATEMENT OF RICHARD W. RAHN, CHAMBER OF COMMERCE OF THE UNITED STATES

I am Richard W. Rahn, Vice-President and Chief Economist of the Chamber of Commerce of the United States. On behalf of our 112,000 business, local and state chamber and association members, I welcome this opportunity to testify on those spending reductions proposed by the Administration that are before this Committee.

The U.S. Chamber has endorsed the President's program for economic recovery in its entirety. I believe its adoption will quickly produce higher real economic growth, less inflation and unemployment, and a better standard of living for all Americans. The best protection Americans have from economic hardship is that provided by a dynamic, growing economy.

We cannot afford to wait much longer to change economic direction. Congress should move quickly to reduce spending and taxes, to reform the regulatory process, and to support a more stable and moderate monetary policy. Tax reductions will provide the incentive for the private sector to work, save, and invest. Monetary restraint will assure that gains in nominal income from higher levels of employment and investment are not eaten up by inflation. Spending cuts will free up resources and keep the deficit down, so that business can finance new investment without excessive competition for funds from the federal government.

The growth of federal spending must be curtailed. Federal spending has grown far more rapidly than gross national product (GNP) in the last 20 years, rising from roughly 18 percent of GNP in the early 1960's to 23 percent in fiscal 1981. As a result, the federal government now competes more heavily with the private sector for scarce capital, labor, and resources. Many private firms and individuals are "crowded out" by this competition, thus hurting private initiative, job creation, and productivity.

A NEW ECONOMIC DIRECTION

I am keenly aware of the difficult choices facing this Committee with regard to spending reductions. The Administration's proposed spending cuts have been carefully chosen so as not to leave any individual without essential benefits, and they should be enacted. However, the best protection for all individuals is a healthy, growing economy. Our goal must be to increase real per capita incomes for all Americans. To assure that we reach that goal, disincentives to work, save, and invest must be reduced. Those disincentives include: (1) excessive and duplicative benefits which can be trimmed in a rational manner by implementing the spending reductions before this Committee; (2) punitive tax rates and excessively long recovery periods for investment in fixed capital, both of which this Committee can alleviate by approving the President's individual and business tax reduction proposals; (3) onerous regulatory burdens; and (4) too rapid and too volatile expansion of the money supply.

Balancing the budget is not the principal rationale for reducing federal outlays. While I believe that adoption of the Administration's program would result in a balanced budget by 1984, it is more important to reduce federal competition with the private sector for scarce resources, and to improve the efficiency of government by eliminating waste and duplication in programs.

Supply-oriented tax reductions are as essential as spending cuts to achieving economic recovery. In fact, immediate supply-oriented tax cuts will contribute significantly to improved efficiency of government spending and to an eventual budget balance, because reductions in marginal individual income tax rates and in the tax bias against fixed investment by business will lead to higher levels of investment, employment, and output. The increased economic growth that has historically resulted from these types of tax reductions can work in the 1980's to reduce the demand for higher government spending as well, particularly in transfer payment

programs such as unemployment compensation, trade adjustment assistance, and welfare. Stimulating economic growth through tax reduction decreases the dependence of large numbers of people on the federal government as they enter the private economy. A supply-oriented tax reduction is thus essential if the growth of government outlays is to be permanently reduced.

Tax reductions would not discriminate against the poor. In fact, lower income individuals historically have always benefited the most from supply-oriented tax relief, because they have the most to gain from the additional job opportunities such relief engenders. In addition, the individual rate cuts in the Administration's package distribute tax relief in strict proportion to the share of total taxes paid by each income class. Thus, these cuts are not biased toward either poor or rich.

Nor would these supply-oriented tax cuts be inflationary, as some have charged. Inflation is not caused by tax cuts, it is caused by excessive growth in the money supply which results in too much money chasing too few goods. These supply-oriented tax cuts will result in a reduction in the cost of goods so that less money is needed to buy the same goods, a deflationary outcome. Stable and moderate growth of the money supply will assure that inflationary pressure diminishes.

The latest Chamber forecast shows a rapid and sustained improvement in real output, inflation and unemployment rates, beginning later this year and continuing through the end of the forecast (1983). Like the Administration's forecast, the Chamber's forecast assumes major supply-oriented tax relief for businesses and individuals being adopted this year, a substantial slowdown in the growth of federal spending beginning next quarter, and adherence by the Federal Reserve Board to its new monetary growth targets. The Chamber's forecast results corroborate the reasonableness of the Administration's predictions.

The proposed spending reductions before this Committee actually form a continuum with the tax reductions. Transfer payments such as unemployment compensation and trade adjustment assistance amount to a subsidy for not working, and thus are an implicit tax on labor income. For instance, trade adjustment assistance pays 70 percent of the worker's prior gross earnings in many cases. When a worker has a choice of receiving tax-free transfer payments without incurring any out-of-pocket costs, or of giving up leisure, paying work-related expenses, and hefty marginal tax rates on earnings, it is easy to see how the transfer payment may become just as much a tax on working as the direct income tax is. By reducing both the income tax rates and selective transfer payments, Congress can go far toward encouraging an increase in both the supply and demand for labor. Productivity gains are likely to come about because more experienced and productive workers, who face higher marginal tax rates and higher benefits, will be encouraged to return to work more quickly. At the same time, the business tax reductions will increase employers' demand for workers and enable them to use workers more productively.

While I support the President's entire economic package, I would like to comment particularly on the following areas of spending reduction proposals under this Committee's jurisdiction: social security, unemployment compensation, trade adjustment assistance, and health care.

SOCIAL SECURITY

Summary

Adverse economic conditions threaten the financial survival of the Social Security system. Throughout the 70's high levels of inflation and unemployment in combination with lagging productivity and lagging real wage growth have forced a draw down of Social Security trust funds to the point that, unless effective action is taken by Congress this year, the old age and survivors trust fund will be out of money early in 1982. Should that happen, the Social Security Administration will be unable to issue monthly checks to aged retirees, their survivors and dependents. Hence, it is imperative that Congress act this year to resolve this very serious human service and cash flow problem.

This crisis can be met without increasing taxes or resorting to the improper remedy of general revenue financing by taking the following steps:

(1) Put into effect accounting and administrative changes to redistribute existing revenues in a manner designed to postpone exhausting of Social Security trust funds.

(2) Eliminate certain unearned Social Security benefits, including student benefits and the minimum benefit, as recommended by President Reagan. We also suggest that the current method of providing cost of living increases be modified in order to end unintended escalation of benefits.

(3) Require all federal, state, and local government employees to participate in Social Security.

This three part package, if enacted, will overcome the impending cash shortfall, eliminate present inequities and make a major contribution toward meeting the critical long term financing problems that are expected to confront Social Security in the next century. Our proposals require neither inflationary tax increases nor additional federal spending, and are, therefore, totally consistent with the President's program for economic recovery—a program that the U.S. Chamber has committed itself to support in its entirety.

The Problem

Social Security faces serious financial problems. In the short run, it is primarily a question of assuring that trust funds are not depleted before outlays can be reduced and revenues increased. In the long term, the demographic pattern will cause Social Security outlays to far exceed our anticipated ability to collect revenues.

The underlying cause for both the short and long range problems is the poor performance of the nation's economy, high levels of inflation and unemployment in combination with lagging productivity, and slow real wage growth. If unchecked, the ability of Social Security and all retirement programs to meet their obligations will be threatened.

This is one of the reasons it is necessary to adopt policies which can restore strength to our economy. If we can rebuild and revitalize America's economy, we will have taken the most important step toward saving Social Security and restoring people's confidence in this important retirement program.

The short-term problem will appear early next year when the old age and survivors insurance trust fund (OASI) is depleted. When that occurs the Social Security Administration will be unable to issue monthly checks to retired workers, their dependents and survivors. No such cash flow problem is expected for either the Disability Insurance (DI) or Hospital Insurance (HI) trust fund, although each could be in jeopardy in the event of a severe and protracted recession.

The long-term financial problem is of a much greater magnitude. Although estimates vary, all agree that benefits will exceed payroll tax collections over the next 75 years. The 1980 Trustees report estimates that the combined deficit for the OASI and DI trust funds may average 1.52 percent of payroll. In other words, the average payroll tax rate would have to be 1.52 percent more than is now scheduled by law, as the table below shows.

ESTIMATED LONG-RUN SURPLUS OR DEFICIT OF OASDI TRUST FUNDS

[percent]

	Average scheduled tax rates	Average estimated expenditures	Surplus or Deficit (-)
25-year estimate.....	11.85	10.66	+ 1.19
75-year estimate.....	12.22	13.74	- 1.52

Source: Social Security Board of Trustees.

Since this estimate does not include the HI trust fund projections, the actual deficit may be higher. Former chief Social Security Actuary Haeworth Robertson calculates this deficit to be about 4.39 percent and warns that it could be much higher if pessimistic assumptions are used.

Although the long-term problems are critical, they are not immediate and solid solutions can be developed in sufficient time to fully meet expected benefit demands. However, postponing decisions on this problem beyond the first half of this decade will make the task that much more difficult.

Chamber Recommendations

Last month, the U.S. Chamber's Board of Directors adopted a comprehensive set of recommendations designed to (1) resolve the short-term financial shortfall of the OASI trust fund, (2) restore public confidence in Social Security, and (3) place Social Security on a sound financial basis for the foreseeable future. Many of these recommendations and the underlying rationale are set forth below.

(1) *Recommendations on accounting and administrative changes.*—Several accounting and administrative changes, if implemented, would provide a partial solution to the short-term problem. Should economic conditions prove to be better than anticipated, then these steps alone might suffice.

Interfund borrowing.—One of the more promising and least disruptive steps is temporary interfund borrowing. It offers a simple method of insuring against any one trust fund running short of funds because of unexpected economic events. Just

four years ago, the Carter Administration estimated that, at the beginning of 1982, the OASI and HI trust fund assets would equal 30 percent and 47 percent of yearly outgo, respectively. The Reagan Administration now predicts these assets to be 13 percent and 61 percent respectively. Thus, the OASI fund has declined beyond expectations despite a temporary allocation of DI revenues into that fund. HI, on the other hand, has been increasing its assets beyond expectations and could act as a temporary loan source to the OASI fund.

The interfund borrowing proposal would work as follows: Each trust fund could borrow from another whenever its balance falls below 25 percent of its estimated outlays for the preceding 12 months. When the borrowing fund's assets reached 30 percent of its outlays, all of its income beyond that needed to maintain the 30-percent level would be transferred to the lending fund until the loan is repaid with interest.

This simple procedure is an acceptable way to solve the temporary shortfall of the OASI trust fund and to give the social security program the necessary flexibility to meet future financial emergencies. Should Congress wish to pursue this alternative, we recommend it do so on a pilot test basis, and in conjunction with our recommendation on reallocation (below).

Reallocation of Revenues.—Another alternative is simply to reallocate the income among the three trust funds. The 96th Congress adopted a measure of this sort as Public Law 96-403 in which a portion of the 1980 and 1981 DI revenues were transferred to the OASI fund. The 97th Congress may choose to repeat this step.

While this proposal would overcome the anticipated shortfall in the OASI trust fund, it does not offer the flexibility of interfund borrowing. However, it does maintain the separate identities of the three trust funds and Congressional control over the funds—factors that many believe are quite important.

Other Accounting Changes.—There is a variety of other cost saving accounting changes which we also recommend. Specifically, we concur with the General Accounting Office recommendation that the Department of Health and Human Services (DHHS) should require States to make FICA deposits on the same basis as required of private sector employers. Public Law 96-265 required States to make FICA deposits within 3 days of the close of the monthly pay period. If States were to make semimonthly deposits beginning next year, the trust funds could earn about \$339 million more in interest during fiscal years 1982-85.

We also recommend that Social Security benefits be rounded to the nearest 10¢ rather than up to the next 10¢ as is currently done. If this change were to be adopted, savings would total about \$80 million per year.

(2) *Recommendations on benefit modifications.*—Several options are available for modifying Social Security benefits in a manner designed to curb their future growth. The basic issue raised here is whether the "core" retirement benefits ought to be modified or whether reductions should be limited to the so-called "welfare" elements of Social Security. We believe that both modifications should be made.

Retirement benefits.—Each June, Social Security benefits are raised by a percentage amount equal to the increase in the Consumer Price Index (CPI) provided that (1) the CPI increase exceeded 3 percent and (2) Congress has not enacted a benefit increase during the preceding year.

Since the adoption of this cost of living adjustment (COLA), Social Security has emerged as the outstanding example of the hidden perils of indexation. In this instance, there are two shortcomings. First, the index (CPI) itself is flawed in several ways, the most notable of which is its housing component. This has resulted in an overstatement of the actual increase in the cost of living. Second, even an improved CPI greatly overstates pure inflation, because by design it measures all changes in the cost of living, both those caused by excessive monetary growth and those due to short supply. Third, earnings on which Social Security taxes depend have not kept pace with inflation. With benefits now pegged to the CPI and taxes pegged to wages, a gap between the two has opened up and is expected to increase again this year when benefits are scheduled to rise by 12.4 percent while wages during the same period rise by 9.8 percent.

Through automatic indexation, to 100 percent of changes in the CPI, Congress has unintentionally been transferring, in the past few years, income from the employed to Social Security recipients. Changing the benefit formula to correct this distortion is an urgently needed reform. A variety of proposals is now under consideration by the Chamber.

Student benefits.—Presidents Ford, Carter and Reagan recommended phasing out Social Security benefits for adult students, defined as full-time students between the ages of 18 and 22. When this entitlement was created in 1965, there were two limited federal scholarship programs providing only \$284 million. Today, there are six major federal scholarship programs which provide over \$7 billion in assistance

per year. Clearly, there is no longer a need for a student's Social Security benefit. We therefore recommend this benefit be phased out at a savings of \$7 billion by 1986.

Minimum benefit.—We endorse the elimination of the “minimum benefit” provision of Social Security as recommended by the President. Designed originally to assure an adequate retirement for workers with low wage histories, this benefit has become obsolete and inequitable.

Today the Supplemental Security Income (SSI) program serves this function very efficiently. Indeed, the main effect of the minimum benefit for these people is to offset, dollar for dollar, the SSI benefit that they would have been entitled to if they were not also receiving the minimum benefit.

Ironically, the main beneficiaries of the minimum benefit are not the elderly poor, but rather those with relatively short work histories in covered employment, most notably federal employees. For them, the benefit is four times their covered wages, and approximately 100 times the amount of their taxes. Such retirees, of course, also enjoy federal pensions averaging about \$11,000 per year. Some have working spouses earning, on the average, \$15,000 per year. Clearly, this windfall is unjust and should be curbed immediately with a resultant savings to Social Security of \$5.8 billion by 1986.

Retirement Age.—The entitlement age for Social Security benefits should be gradually raised by three years to accommodate the longer life expectancies in the next century. Both full and early retirement ages should be increased beginning in the year 2000.

(3) *Recommendations on universal coverage.*—It is necessary that we begin immediately to mandate the inclusion of all federal employees and those state and local government employees not now participating in Social Security. This step would provide a temporary windfall of revenues to the trust funds at a time when added revenues are desperately needed to avoid insolvency. Moreover, it would end the withdrawals from Social Security now being undertaken by a number of state and local government employees which are eroding the tax base of Social Security and further threatening its solvency.

Ninety percent of the American workforce is covered by Social Security, but about 7,000,000 workers, mostly federal, state and local government employees, are not. Nonetheless, about 70 percent of the “uncovered” employees finally qualify for Social Security benefits as a result of working in covered employment at some time in their career. As a rule, such employees qualify for benefits which are about two-thirds of the amount they would have earned if their full career had been in covered employment. Yet, on the average, they pay less than one-third of what career-long covered employees pay in Social Security taxes.

If mandatory universal coverage were effective January 1982, over \$99 billion in additional revenues could be expected by 1987. That is nearly 8 percent of the projected trust fund outlays for that period, based on CBO's January 1981 economic assumptions.

We do not propose raiding the retirement trust funds for federal, state and local government employees. Those funds belong to these employees and must be used exclusively to pay promised retirement benefits to both present and future beneficiaries. We do propose, however, that all working Americans should have Social Security as their base line pension. Where employer-provided pensions are available, these should be supplemental to and integrated with Social Security just as they are now by the majority of private and public sector pensions including some federal plans.

Most Americans are incredulous when they first learn that, after 44 years of Social Security, neither Members of Congress nor federal employees have ever paid Social Security taxes on their federal compensation.

Common sense and fairness suggest that reasonable comparability between public employee and private sector employee compensations and pensions is essential, and that Social Security coverage should be universal. If our elected representatives—federal, state and local—fail to achieve these objectives within a reasonable time span, the resulting discontent will weaken the public confidence in and support for, financing OASDI and the separate federal employee retirement system and other public sector pensions.

Financing

It would be a serious mistake either to raise Social Security taxes or tap general revenues for meeting the short-term crisis confronting Social Security. Either course of action would seriously undermine the President's program for economic recovery. Moreover, as we have demonstrated, neither course of action is necessary.

We are equally opposed to offering an income tax credit against Social Security taxes. We see it as an improper and unwise use of tax dollars and as a back door

method of introducing general revenue financing to a program which for four decades has been self-supporting.

Conclusion

If the above recommendations are enacted, it will not be necessary to increase the scheduled tax rates or to supplement current revenues by the infusion of general revenue funds. The accounting changes will, by themselves postpone the exhaustion of the OASI trust fund. The savings from the proposed benefit modifications—which we project to be roughly \$50 billion by 1987—plus an increase of \$99 billion in revenues resulting from universal coverage will return Social Security to a healthy financial basis. Rather than a \$40-\$60 billion deficit as now predicted, it would enjoy a \$88-\$108 billion surplus by 1987.

Our commitment as employers to the principles of Social Security, and the commitment of Congress as a responsible trustee for the retirement security of elderly Americans, should cause employers and the Congress to work together for the enactment of the realistic program we are advocating to save and strengthen Social Security.

UNEMPLOYMENT COMPENSATION—SUMMARY

As the major spokesman for the business community, the U.S. Chamber has had a long standing interest in, concern about, and support for the unemployment compensation system. Unemployment insurance is designed to serve the needs of involuntarily jobless workers by providing cash assistance during periods of temporary unemployment. Ninety-seven percent of American workers are covered by the UC program. Benefits are financed by employer payroll taxes.

The UC program has been an overwhelming success and has functioned well in both good and bad times. In recent years, however, serious financial difficulties have developed. High unemployment, coupled with federally-mandated extensions of benefit duration, are rapidly depleting the Unemployment Trust Fund. The strain has been aggravated in some states by ad hoc increases in amount of benefits without corresponding increases in funding. Moreover, improper benefit payments and fraud are estimated to run as high as a third of benefits paid out.

Swift enactment of the President's Program for Economic Recovery, in its entirety, is the single most important action that Congress can take to restore the solvency of the UC program. A healthy economy will curb inflation and expand employment opportunities, lessening the need for UC as a safety net.

As federal budget reductions, the proposed changes in the UC program (see Appendix A) will contribute to national economic recovery. Most importantly, however, they are good for the UC program and constitute a modest step toward long overdue reform of the federal unemployment compensation laws.

We strongly urge this Committee to approve the following four UC changes included in the Administrations Program for Economic Recovery.

I. Targeting Unemployment Insurance Extended Benefits on States with High Unemployment.

Congress enacted a permanent program of Extended Benefits (EB) in 1970. EB provides up to 13 additional weeks of benefits, financed equally from state and federal employer payroll taxes, for persons who have exhausted their regular benefits (normally 26 weeks). Extended Benefits become payable in a state whenever the national insured unemployment rate (IUR) or the IUR within a state reaches a specified level, often referred to as a "trigger." The Extended Benefits program remains activated as long as the average IUR remains at or above the trigger level, but no less than 13 weeks.

EB was intended for people in states experiencing emergency levels of unemployment, but as presently constituted, the EB program often provides extra benefits for persons in states where job vacancies remain unfilled due to a lack of applicants. The Administration's proposal will return the EB program to its intended purpose of extending duration only in states where such an extension is warranted. The proposal, which is expected to save nearly \$3 billion over the next six years, has four elements:

A. Eliminate the national trigger for Extended Benefits.

B. Raise the basic state trigger to 5 percent insured unemployment rate (IUR) plus 20 percent higher than the preceding 2 years (presently 4 percent IUR plus 20 percent higher); raise the optional state trigger to 6 percent IUR (presently 5 percent IUR).

C. Require 20 weeks' attachment to the labor force to qualify for Extended Benefits.

D. Exclude Extended Benefits claims from calculating the IUR for Extended Benefits trigger purposes.

EB is activated nationwide when the seasonally adjusted insured unemployment rate nationwide reaches 4.5 percent or more for three months. Under this national trigger, every state is required to pay Extended Benefits, including those that have low unemployment rates. Providing extra benefits in such circumstances discourages claimants from accepting employment, aggravating an already tight job market. Eliminating the national trigger will insure that EB is payable only in states where extra assistance truly is needed.

EB is also activated by a state trigger, independent of national IUR. The basic state trigger is 4 percent statewide IUR if the unemployment rate has increased 20 percent or more over the preceding two years. Alternatively, a state may elect to pay EB when the statewide IUR reaches 5 percent, even though unemployment has increased less than 20 percent (all but 15 states use the alternative trigger). The state trigger rates, however, are inflexible, and neither formula represents emergency levels of unemployment necessitating a federally subsidized extension of duration. Raising the basic state trigger to 5 percent-plus-20 percent-higher—and the alternative trigger to 6 percent—would help make EB payable only when it is actually needed.

Requiring 20 weeks' (or equivalent) attachment to the labor force as a prerequisite for EB eligibility will help prevent the anomaly of paying benefits for a longer time than a claimant actually worked. All states use some measurement of recent previous work as a criterion for benefit eligibility. In some states, however, the qualifying requirements are relatively liberal—allowing those who have little connection to the workforce to receive up to 9 months of benefits. Under this proposal, the states will continue to have responsibility for determining eligibility for regular benefits, but a claimant who has worked less than 20 weeks will be ineligible for Extended Benefits.

Calculating the IUR for EB trigger purposes based only on claims for regular benefits will end an inequity caused by the present practice of counting regular and EB claims. An Extended Benefits period lasts indefinitely while the IUR remains at or above the trigger level; counting EB claims inflates the IUR, prolonging the EB period. As a result, extra weeks of benefits are payable after the need to extend duration has passed. Moreover, in two states with the same rate of insured unemployment, exclusive of EB claims, extended benefits might be payable for many months in one state and not at all in the other, because claims for extended benefits in the first state inflate the state IUR. As a result, employers in the second state help to finance one-half of the extended benefits in the first state even though their laid-off employees, faced with the same tight job market, were not eligible for extended benefits. The Department of Labor attempted to correct this inequity in 1980 by revising its regulations, but the action was reversed by a federal court on the ground that the change required congressional action. This proposal does exactly what the court said Congress must do.

II. Stopping Unemployment Insurance Payments to People Who Will Not Take Other Jobs

Under current law, claimants who refuse to accept "suitable work" are disqualified from receiving unemployment benefits. Suitable work, however, usually is defined as a job similar to the claimant's previous employment. That definition is appropriate for the initial period of unemployment, when the claimant has a reasonable expectation of being recalled. But subsidizing a career-oriented prolonged job search merely discourages workers from adjusting to permanent changes in employment patterns. Present law allows workers to draw up to half a year of benefits while searching for their customary work, needlessly running up program costs to pay benefits to persons who could be working.

A number of states presently have requirements that define suitable work more stringently as the period of unemployment lengthens. The U.S. Chamber strongly supports this concept, and the states should be encouraged to strengthen these provisions. Too often, available jobs go unfilled because tax-free unemployment benefits are more attractive.

A federal law that takes effect April 1st denies further benefits to persons out of work 6 months who refuse to accept a job that pays at least minimum wage or the amount of their weekly benefits. The Administration proposal, which is projected to save more than \$1 billion over the next 6 years, would cut off benefits after 3 rather than 6 months. Full benefits would be payable when there are no jobs, but after a reasonable search period claimants who refuse employment will no longer be subsidized. The U.S. Chamber supports the philosophy behind the Administration proposal. We prefer that it be implemented through voluntary state action rather than federal legislation.

III. Elimination of Unemployment Compensation for Those Who Voluntarily Quit Military Service

UCX is a special federal program that provides unemployment benefits for former members of the armed services. The present law, however, permits payment of benefits to persons who voluntarily leave the military by refusing offers of reenlistment. Unemployment compensation was never intended for persons who leave their jobs voluntarily. The Administration proposal to deny benefits to persons refusing reenlistment would restore this basic principle to the UCX program. This program change is projected to save nearly \$1 billion over the next 6 years.

IV. Eliminating Trade Adjustment Assistance Payments to People Already Receiving Unemployment Insurance Benefits

Although 97 percent of American workers are covered by the regular unemployment compensation program, a number also are eligible for supplementary benefits under approximately 20 separate federal programs serving limited constituencies. These special programs typically pay higher weekly benefits, and for a longer duration, than regular unemployment compensation.

The largest and best known special program is Trade Adjustment Assistance, which is expected to pay out \$2.7 billion in 1981, more than the whole UC program paid out in 1970! Trade benefits are available for claimants laid off from jobs in industries certified to be in decline because of foreign competition.

Experience with the Trade program reveals that the added benefits are superfluous at best and, at worst, prolong the duration of unemployment. In fact, the General Accounting Office (GAO) has documented that most employees return to work long before their benefits are received. Moreover, it is inequitable to pay higher benefits, and longer, because lay-offs are due to foreign rather than domestic competition.

The Administration has projected savings of more than \$3 billion over the next 6 years by making the following changes in the Trade program: (1) reduce weekly Trade benefits to the same amount payable as unemployment compensation, (2) pay Trade benefits only to persons who exhaust unemployment compensation, and (3) limit the combined duration of unemployment and Trade benefits to 52 weeks. These modest changes will reduce the work disincentives in the current Trade program and take some pressure off the Unemployment Trust Fund.

Additional Recommendations

The Administration's Program for Economic Recovery offers some relief for the unemployment compensation program by reviving the national economy and making some permanent improvements in the federal UC laws. The U.S. Chamber strongly urges Congress to act swiftly in approving the entire package.

Lasting reform of the UC program, however, will require changes in both federal and state laws. A short list of problems requiring legislative attention would include the following:

- Using interest-free federal loans to pay state-legislated benefit increases, rather than raising state UC taxes
- Inattention to fraud and abuse
- Excessive socialization of UC costs, as opposed to experience rating
- Benefits for strikers and persons who leave their jobs voluntarily
- Low return on state funds in the Unemployment Trust Fund
- Maldistribution of administrative costs

Two additional proposals have been made for budget savings involving the unemployment compensation program. The Chamber believes these are unwise.

Taxation of Benefits

The first is a recommendation by the House Committee on Ways and Means to raise an estimated \$1 billion by greater income taxation of unemployment benefits. Taxation is proposed as an added incentive for unemployed workers to go back to work. The U.S. Chamber advocates getting the unemployed to take jobs, but we think that there are better ways to achieve that goal than by taxing benefits, and we fear that the taxation proposals advanced to date would be counter-productive.

At present unemployment benefits are taxed when benefits plus other income exceed \$20,000 for a single worker, \$25,000 if married. The provision for taxation, which was added to the Internal Revenue Code in 1978, has been in effect for only a short time. We are unaware of any studies that show what impact the tax has had on the length of the job search by claimants.

Taxing benefits based on prior earnings violates the principle that UC is an entitlement which provides partial compensation for loss of earnings as a matter of right, regardless of other sources of income.

Since benefits are funded by taxes, taxing benefits amounts to taxing taxes. UC is funded by employer payroll taxes, and many economists argue that workers bear part or all of the tax burden through lower wages. Subjecting UC benefits to taxation, therefore, could be considered double taxation: the payroll tax, which effectively reduces the worker's net-of-tax wage, plus the income tax.

Taxing benefits adds another burden to the family already hindered by loss of earnings due to unemployment, since benefits normally replace half or less of normal income.

Federal Benefit Standards

Another budget savings proposed by the Senate Budget Committee would be a federal law requiring 20 weeks of employment as a qualification for 26 weeks of regular state UC benefits.

We oppose this proposal as offered in the form of federal legislation because it represents a federal benefit standard, but we urge our membership to support state legislation to accomplish this objective.

The Chamber opposes federal legislation to achieve this action by the state because it is a major departure from the basic federal-state unemployment compensation relationship, in which important decisions on how to raise funds and how to pay out these funds in benefits have been reserved to the states.

Thus far, with few exceptions, Congress has not disturbed the basic federal-state relationship characterizing the unemployment compensation system. It has rejected numerous proposals to federalize completely or to remake state programs through the use of federally-dictated standards. In doing this, Congress reaffirmed the validity of the original decision that a better unemployment compensation system can be had through the flexibility of the federal-state arrangement than through a uniform, federally managed or controlled system.

We see no need for federal benefit standards. Our opposition applies equally to all forms, including those generally viewed as favorable to the interests of employers. We are convinced of the superiority of state judgments on important matters such as the amount and duration of benefits, conditions of benefit qualification, and related matters. If there are problems with the judgments made by these states, then the proper forum for their resolution is within that state, not the Congress.

HEALTH CARE

The U.S. Chamber fully supports the Administration's spending reduction proposals regarding health care. Of the proposals under this Committee's jurisdiction, we especially support the proposed cap on the federal contribution to the medicaid program and the plan to consolidate 27 basic health service programs into a single block grant. These changes will improve the efficiency and flexibility of health care funding without depriving anyone of needed care. We also support the proposed phasing out of federal subsidies for professional standards review organizations, health maintenance organizations, and health service agencies.

CONCLUSION

Congress must move swiftly to adopt the President's recommended reductions in taxes and federal spending, and must support efforts to ease regulatory burdens and maintain steady slow monetary growth. These actions will pay off in greater investment, employment, output growth, and lower inflation. With higher employment and economic growth, the demand for transfer payments will drop sharply. Once these changes are adopted, Congress should address a variety of other problems affecting Social Security, unemployment compensation, and health care.

The CHAIRMAN. Perhaps you can get together with some of our staff at the appropriate time and go over the list. I think you know our staff.

Mr. RAHN. Yes. We'll be happy to.

Thank you, sir.

The CHAIRMAN. Thank you.

We will stand in recess until 10 o'clock tomorrow morning.

[Whereupon, at 12 noon, the hearing adjourned subject to the call of the Chair.]