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PRESIDENT'S FISCAL YEAR 1988 BUDGET PROPOSALS

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

FEBRUARY 18, 1987

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PRESIDENT'S FISCAL YEAR 1988 BUDGET PROPOSALS

WEDNESDAY, FEBRUARY 18, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 10:00 a.m. in Room SD-219, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (chairman) presiding.

Present: Senators Bentsen, Baucus, Mitchell, Riegle, Rockefeller, Packwood, Danforth, Chafee, Heinz, Wallop, and Durenberger.

[The press release announcing the hearing and the prepared written statements of Senators Bentsen, Mitchell, and Rockefeller follows:]

[Press Release]

CHAIRMAN BENTSEN ANNOUNCES HEARING ON THE PRESIDENT'S FISCAL YEAR 1988 BUDGET PROPOSALS UNDER THE JURISDICTION OF THE COMMITTEE ON FINANCE

WASHINGTON, DC.—Senator Lloyd Bentsen (D., Texas), Chairman, announced today that the Senate Finance Committee will hold a hearing on February 18, 1987 to review the President's fiscal year 1988 budget proposals for programs within the jurisdiction of the committee.

The witness for the hearing will be James C. Miller III, Director, Office of Management and Budget.

"The President's Budget includes more than $7 billion in fiscal year 1988 spending reductions in programs under the Committee's jurisdiction," Bentsen said.

"This hearing will give members of the committee an opportunity to consider the President's proposals, and to determine whether they are the best method of achieving our budget goals."

The hearing will begin at 10 a.m. on Wednesday, February 18, 1987 in room SD-215 of the Dirksen Senate Office Building.

Remarks By
Senator Lloyd Bentsen
Senate Finance Committee
Wednesday February 18, 1987

Let me, first, congratulate you and the OMB, Mr. Miller, for getting out the budget under such a tough deadline.

It's quite a challenge to put together the annual blueprint of the President's priorities under any circumstances. But when you add in the early deadline set by Gramm-Rudman-Hollings this year, it is quite amazing that you were able to deliver the budget on time.

Having said that, let me move on to offer some criticism

I support Gramm-Rudman-Hollings as the most effective mechanism anyone has come up with for reducing our huge federal budget deficits.

I am convinced, though, that this legislation will work only if Congress and the Administration lay aside partisan posturing and come together to make it work.

The Administration -- notably you, Mr. Director -- has refused to sit down and work with Congress to reduce these deficits and that causes me some concern.

Your attitude has been: "We've offered our budget. We've met the targets set by Gramm-Rudman-Hollings. Until Congress comes up with it's own budget, we've nothing to talk about."

One problem with this attitude is that I don't believe you've met the deficit targets of Gramm-Rudman-Hollings, Mr. Director. And I don't think an6 of us will meet them until you're willing to sit down with Congress and hammer out an agreement.

Certainly, the non-partisan Congressional Budget Office reports that your budget for fiscal 1987 failed to meet the deficit targets. And again this year

CBO reports that for fiscal 1988 your budget falls anywhere from $27 billion to $32 billion short of the target.

I would also note the recent tacit admission by a prominent member of your own Administration that the new budget fails to meet the deficit target. Chairman Beryl Sprinkel of the Council of Economic Advisers admitted that a combination of hard work and "smoke and mirrors" were used to get the budget down to the target.

So I would urge you, Mr. Director, to stop challenging Congress to match what the Administration has done. The challenge is clearly to exceed that and we can do it best if we're working together.

As to specifics, I certainly agree with statements in the budget that we can get better value for our health dollar. However, I have some reservations about priorities.

The Administration's $1.2 billion Medicaid savings in fy 1988 isn't necessarily unreasonable. But, achieving those savings through an across-the-board cap may be inequitable.

In states like Texas, which have traditionally taken a conservative posture by limiting eligibility and containing cost growth, the cap proposal would effectively lock the state into covering no more than 27 percent of the poor -- although the national average is nerly 50 percent.

I am concerned about the effect this proposal would have on states with high unemployment, where many families have lost their medical insurance.

I also note that the cap proposal would make it difficult for Texas and other states to adopt the new optional Medicaid coverages for pregnant women and children approved by the President in last year's reconciliation bill.

Congress has rejected this cap proposal for the last four years and I would be interested to learn of any new information or change in the situation that justifies your proposing it again this year.

I also look forward to hearing details of your proposal to reform Medicare payments to radiologists, anesthesiologists and patholgists. It's certainly generated a lot of attention. I understand that OMB was very involved in developing this proposal and I'd like to hear more about the underlying reasons and what your long-term policy goals may be in this area.

Finally, I hope we'll be able to hear some of the details of your proposal for the PPS update factor for Medicare hospital payments. For example, have you given any thought to adjustment of update to narrow the gap between urban/rural payment rates?

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OPENING STATEMENT OF SENATOR GEORGE MITCHELL
FULL FINANCE COMMITTEE HEARING ON THE BUDGET

The 1988 Medicare and Medicaid budget proposals submitted by the Administration are, with few exceptions, unimaginative and inequitable. Once again, the budget proposes virtually nothing to address the growing concern about access and quality of care. Once again, there is cost shifting to beneficiaries, the states, providers, and the public, with minimal recognition of the burdens that might result.

It is disturbing that many of the proposals are identical to those that previously have been rejected by the Senate while under Republican control. The resubmission of the proposal to cap Medicaid with no adjustment for inflation or increases in the population served, is especially disturbing. At a time when the population of the uninsured poor and older persons needing long term care is growing, the Administration's budget would place the entire burden of future increases on the states.

The proposal to limit hospital payments seems to have been made with no analysis of the cumulative impact of either the previous cuts in Medicare hospital payments, or for that matter, of the interaction of the present proposals.

The proposal to end direct medical education support for hospital costs of nursing and allied health education comes at a time when most hospitals, and especially those in rural areas, are already experiencing a critical shortage in nursing and technical support. Would the Administration have us simply turn our backs on the health care needs of rural America?

In the past six years, Congress and the Administration have focused, and appropriately so, on cost containment. This effort must continue, to insure that Medicare and Medicaid are prudent purchasers of health care services. However, we must also renew our determination to insure access and quality for our citizens who depend on these programs. To do otherwise would abrogate our responsibility to the American people.

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OPENING STATEMENT
FINANCE HEARING ON THE ADMINISTRATION'S FY'88 BUDGET PROPOSAL
SENATOR JOHN D. ROCKEFELLER IV
February 18, 1987

Mr. Chairman, I appreciate Mr. Miller's willingness to appear before the Finance Committee in order to explain and discuss the President's FY 1988 budget plan. I hope today will provide the OMB Director with the opportunity to shed some light on his budget's various provisions and on the questions that many of us have about its economic assumptions, its recommended revenue increases, and its impact on the federal deficit.

Though this hearing is intended to focus on the spending and revenue areas in the Finance Committee's jurisdiction, I must make a brief comment on the President's budget overall. I just don't understand how the President can make the eloquent plea for restoring this nation's competitiveness he issued in his State of the Union address at the very same time he is proposing a $6 billion cut in education. Of the $19 billion in spending reductions contained in the Administration's budget, one-third are slated to come out of programs to assist low-income Americans -- these very same programs make up only one-ninth of the federal budget. Why should deficit reduction continue to be targeted at those who can least afford the burden?

I'm deeply concerned about the priorities reflected in this budget. I know I shouldn't be surprised -- having been here for two years, I've become quite familiar with proposals to eliminate economic development programs, cut back on health care coverage for the elderly and poor, slash student financial aid, and target such vulnerable groups as black lung victims.

But this year, I felt especially disappointed that the Administration did not decide to develop a proposal that might be seriously considered as a starting point in the budget process.

With Gramm-Rudman in place, and the strong consensus it represents that the federal deficit must be reduced each year, I would think that the President and OMB would work with Congress in this process.

For example, not only does the Administration's budget contain many proposals which have been repeatedly and overwhelmingly rejected by Congress in the past, we hear that the President has rejected the suggestion from my colleagues on both sides of the aisle for a so-called "summit" to attempt to negotiate a budget for FY 1988. The name might give the wrong signals, but that should not be the reason to reject this good-faith offer to sit down and pursue an agreement.

Today, I hope to hear more about the Administration's rationale for eliminating almost 4000 employees in the Social Security Administration, for reducing Medicare by over $5 billion, and by cutting over $1 billion in Medicaid. I see grave implications in reductions of this size, at a time when my constituents report longer and longer delays in the processing of Social Security applications and appeals, rural hospitals in financial trouble partly as a result of lower Medicare payments, and a short-fall of Medicaid funds that forces the state to deny coverage to low-income families without health insurance.

In the past weeks, I've already expressed strong opposition to many parts of this budget. But I'm here to consider areas where I still have questions. Knowing that my distinguished colleagues will do the same, I encourage OMB Director Miller to take our views seriously as well -- and to suggest to the President that it is time to work together on a budget that fulfills our obligations to those who deserve assistance and that makes sense for the future of our country.

The CHAIRMAN. The committee will come to order. We are very pleased to have the Director with us this morning. I understand he has had a touch of the flu, and I am sure that means the questioning will all go easy on you, Mr. Director.

Mr. MILLER. Thank you, sir.

The CHAIRMAN. I am not sure of that at all. But, first, let me congratulate you on meeting this budget deadline. That has been a tough one. I think it is a challenge always to put together a blueprint of priorities of a President. It is difficult under any circumstances. But then to put on the time limits of Gramm-Rudman, I think it is quite amazing that you have been able to deliver that budget on time.

Now having said that, let me tell you some of the things that concern me.

I support Gramm-Rudman-Hollings as the most effective mechanism anyone has been able to come up with thus far in trying to reduce those huge Federal budget deficits. I am convinced though that that legislation will work only if Congress and the administration lay aside partisan posturing and come together to make it work.

The administration, and notably you, Mr. Director, I think have refused to sit down and work with the Congress to reduce those deficits and that causes me a lot of concern. But I have seen thus far your attitude has been, we've offered our budget. We have met the targets set by Gramm-Rudman-Hollings. Until Congress comes up with its own budget we have nothing to talk about.

I really don't think that is the case. I think if we sit down and reason together that we would come closer to reaching a consensus. I have seen us to do that time and time again in this committee with Secretaries of Treasury, working on tax legislation, but we are pretty far apart, but finally developed a consensus. I am hopeful we are going to be able to do that on trade.

One of the problems I think this time is that I don't believe that the administration has met the targets of Gramm-Rudman-Hollings. And I don't think any of us are going to meet them. I don't think this Congress is going to meet them unless we can work together to hammer out an agreement. There are going to be some politically difficult things to do and each side is going to try to escape blame for them. But if we sit down and work together, perhaps we can share that responsibility and achieve some of those objectives that I think are awfully important for our country.

Certainly that budget that you presented fell short. The CBO reports that your budget falls short anywhere from $27 billion to $32 billion.

I also saw a recent tacit admission by a prominent member of your own administration that the budget fails to meet that deficit target. Chairman Beryl W. Sprinkel, of the Council of Economic Advisers, admitted that a combination of hard work and smoke and mirrors were used to get the budget down to the target.

I have spent years in the private sector managing a public company. If I had used some of the estimates and some of the things we do here in the Congress, and I think that the Administration does, in presenting a budget, I think I would have been hauled before the SEC.

Now as to the specifics, I certainly agree with the statements in the budget that we can get a better value for our health dollar, however, I agree with one of yours on the specifics. I think we can get a better value for our health dollar. I do have some reservations about the priorities.

The administration's $1.2 billion Medicaid savings in fiscal year 1988, that is not unnecessarily unreasonable, but achieving those savings through an across the board cap may be inequitable. Let me give you an example.

We have states like Texas, which have traditionally taken a very conservative posture by limiting eligibility and trying to contain cost growth. That cap would effectively lock that state into covering no more than 27 percent of the poor, although the national average is nearly 50 percent. And that concerns me. I am concerned about the effect on states with high unemployment where many families have lost their medical insurance. I also note that the cap would make it difficult for Texas and other states to adopt a new optional Medicaid coverages for pregnant women and children that was approved by the President in last year's reconciliation bill, a measure which has been of great concern to me and which I worked at to try to see if we can't do something to alleviate the problem of low weight birth babies and some of the price that we pay in handicapped children, things that I think could be alleviated at a cost that is certainly a bargain when you think of the results.

Congress has rejected this cap proposal for the last four years, and I would be interested to learn of any new information or any change in the situation that justifies your proposing it again.

I also look forward to hearing details of your proposal to reform Medicare payments to radiologists, pathologists, who have certainly generated a lot of attention.

I understand that OMB was very involved in developing this proposal. I would like to hear more about the underlying reasons of what your long-term goals may be in this area.

And, finally, I hope we will be able to hear some of the details of your proposal for the PPS update factor for Medicare hospital payments. For example, have you given any thought to the adjustment of update to narrow the gap between the urban-rural payment rates?

Each of us deals in our own experiences, but I have problems with rural hospitals closing all over Texas. And I know in some of those areas it is critical to them. It is the only service that is available. So I have concern on that one too, Mr. Director. And I would like to now yield to my distinguished colleague, Senator Packwood.

Senator PACKWOOD. Mr. Chairman, I have no opening statement.

The CHAIRMAN. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman, I do.

The 1988 Medicare and Medicaid budget proposals submitted by the administration are, with few exceptions, unimaginative and inequitable. Once again, the budget proposes virtually nothing to address the growing concern about access to care and quality of care. Once again, there is cost shifting to beneficiaries, to the states, providers, and the public with little or no recognition of the burdens that may result.

It is especially disturbing that many of the proposals are identifiable to those previously rejected by the Senate, as the chairman noted, over the past four years even while under Republican control. I, too, look forward to an explanation as to what has occurred between last year and this that would lead the administration to believe that those proposals rejected over and over again should now be accepted.

The resubmission of the proposal to cap Medicaid with no adjustment for inflation, or increases in the population served, is especially disturbing. At a time when a number of the uninsured poor and older persons needing long-term care is growing, the budget proposal would place the entire burden of future increases on the states.

The proposal to limit hospital payments seems to have been made with no analysis of the cumulative impact of the previous cuts in Medicare hospital payments or, for that matter, of the interaction of the current proposals.

The proposal to end direct medical education support for hospital costs of nursing and allied health education comes at a time when most hospitals, and especially those in rural areas, are already experiencing a critical shortage in nursing and technical support personnel.

Would the administration have us simply turn our backs on the health care needs of rural Americans? In the past 6 years, Congress and the administration have focused on cost containment, and appropriately so. That effort must continue to insure that Medicare and Medicaid are prudent purchasers of health care services.

However, we must also renew our determination to insure access and quality care for our citizens who depend on these programs. To do otherwise, we would fail to meet our responsibility to the American people.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Durenberger.

Senator DURENBERGER. Mr. Chairman, thank you very much.

The Director may get the impression that the tough part of the recommendations that he has made are in the health care because I think the three of us are going to, if not sing the same song, at least emphasize the same point. And I would say, Mr. Director, it is because we have all been here for the last 6 years trying to play the same tune with the administration in terms of the important changes that are taking place in the marketplace. Yet we are having to deal with the impact on access and quality of the recommendations for reductions in the growth and the reimbursement system.

I would just add by way of definition to the comments that the chairman of this committee made, which I really appreciate. He says "an across-the-board cap may be inequitable." An across-the-board cap is inequitable. He knows it. He is just too nice a guy. He says it may be. The reality is whether it is the difference between a more conservative practice in a rural area versus a more liberal practice traditionally in an urban area. You cut them the same. It hurts the conservative practice more, and discourages people.

If you take the typical state—and we all, I think, represent fairly typical states here in the Senate, as opposed to the House in the way the DRG system works. I mean, you know everything there is to know about regulation and deregulation. You have a DRG system with urban rates and rural rates, and the urban rate is paid to hospitals in an SMSA. And downtown, they are surviving. The Parkland in Dallas, a big public hospital, they are just sort of barely hanging on. And some of the other larger public hospitals in core cities with a high percentage of elderly and poverty, are hanging on with this rate.

In the suburbs though, I would guess, of Houston or Dallas or the Twin Cities, hospitals are making out like bandits. And then you get out into the rural areas, and the growing cities in the rural areas that happen to be SMSAs are doing real well. But the other parts of the rural area—most of Maine I would guess, the smaller hospitals in Maine—are again, sort of hanging on by their finger nails.

And so when George Mitchell says "unimaginative or inequitable" I think what he is saying is that it is time that, when we approach the DRG increase, if there is any way with the talent that might be available to us elsewhere in other departments, we could find some savings—because there are going to be profits out there. We know that if we could find some way to change that urban-rural distinction, as an example, so that instead of taking money from the downtown hospitals as well as the suburban hospitals to give to all rurals, we might find some other distinction. We depend on you or other sources in the executive branch to come up with those recommendations. The same thing holds true, just for your information, with regard to the administration's new PHPO, the Private Health Plan Option, which is a new name for the competitive medical plan. As they push that out into the rural areas, what they have done is cost base the AAPCC county by county resulting in incredible inequities there.

So, again, if you want to try to save some money—and I think this committee, as the chairman said, is willing to be helpful—we need a little more creativity, a little more imagination, a little more help from the Administration on the way that reimbursement system works. So that is again a contribution to try to be helpful to the process.

Thank you, Mr. Chairman.

The CHAIRMAN. I am going to limit the opening statements to just those Senators who are here because we will have a number of others coming.

Senator Riegle, did you have an opening statement?

Senator RIEGLE. Thank you, Mr. Chairman. I will be very brief. Some of us have had the opportunity to see the Budget Director in other committees—certainly the Budget Committee—but from the vantage point of the Finance Committee, it seems to me there are several things implicit in your budget proposal that I would hope you would address directly here today in maybe your opening comments. It seems to me you are saying that the Administration's view is that it is not practical, to make further spending cuts, at least beyond what is in the submission. And you do have $22 billion worth of revenue in the 1988 budget proposal. And so that, to me, is a very striking fact because it seems to me the Administration, after its own budget appraisal, has said that we cannot get to the Gramm-Rudman targets with your spending cuts, we've got to have revenue. You've laid out $22 billion worth of revenue. And we will have to see whether that is sufficient.

But there is a related question and it is really an unspoken question and perhaps an unspoken agenda for this committee, and that is, if the numbers are off, the CBO and others have suggested that the assumptions alone are off, and if, in fact, your other premise is right, we can't make spending cuts deeper than those you have already proposed, then we may find ourselves as a committee asked to come up with additional revenue. That the gist of sheer requirements of the law under Gramm-Rudman may push that duty upon us. And if so, I think we need to hear from you today where that additional revenue might come from if it has to be found in order to meet the law, the Gramm-Rudman-Hollings law.

So I would like your thoughts today on an oil import fee, on any fee on imported goods that might come into this country, on the federal telephone tax, cigarette excise taxes, alcohol taxes, or anything else that might fall into that category, which would not be across the board tax increases on taxpayers generally, but some way to get additional revenue.

The other point I will just make is this. I am sure you have seen these full-page ads that have been running in newspapers—this one was in the Washington Post on January 6—in which a coalition of people, groups across the country, headed by the American Association of Retired Persons, but including other health care provider and professional groups, are saying we can't afford any more cuts in Medicare and Medicaid, which, of course, there are very substantial ones recommended in this budget. The headline on this piece is to the effect, during the past five years more than $30 billion has been cut from Medicare and Medicaid. Now the Administration wants to cut $50 billion more. Isn't it time we started defending the home front?

I think it is significant when groups of this size and consequence, non-partisan groups, and those that obviously cover the whole political spectrum, are coming forward with this kind of urgent appeal in the form of full-page advertisements in the newspaper. I think it indicates that we are not going to be able to go out and wring a lot of money out of these programs, such as you are suggesting here. So that relates to my earlier point, and that is, if we don't get some measure of saving or deficit reduction out of those kinds of very substantial cuts you are proposing in health care programs, then how do we make that up? And I would like to hear your suggestions specifically. I don't think that the administration should just hide out on this issue of where we are going to get the money, if money is needed to meet the Gramm-Rudman targets.

And my final point would be this, Mr. Chairman, and that is, if you look beyond 1988, the administration's budget proposal does not attempt to meet the Gramm-Rudman targets. There is no effort whatsoever to meet them. And, frankly, I don't think that is sufficient. If, in effect, you think the law ought to be repealed because you can't meet it, then you ought to come out and move to repeal it. And otherwise, I think the proposals ought to show how we get to the balanced budget, even if it is in the next administration in 1991, which the law requires.

So I would hope we might hear something on that as well.

The CHAIRMAN. Thank you very much, Senator Riegle.

Senator Heinz, do you have any comments?

Senator HEINZ. Just briefly, Mr. Chairman.

I hope, Mr. Miller, that you do get a chance to say something sometime this morning. And I am sure we can all find much to criticize in the administration's budget. No two people are ever going to submit the same budget. So I would take the criticism we give you with something of a grain of salt. But the part that I hope you will take seriously is the realism of the economic assumptions in the budget. Because if the administration is overly optimistic on economic growth, and there are a lot of private sector forecasters who, by their forecast, are saying that you are, then the surest way for the administration to bring about something that you say you don't want, which is a big tax increase, or even a medium size tax increase, or as I understand the administration, any tax increase, is to put us in the kind of box where suddenly we find there is a 20 or 30 billion dollar hole in the budget as we approach whatever targets have been set because of economic assumptions. And if we are put in that kind of box, there is at least a 50-50 chance—maybe better—that what you don't want, which is a tax increase, is going to result.

Now having said that, there is one other area I want to just make a comment about, and that is that for the last five years this committee has done a lot of cutting. We have saved a lot of money. Of course, we have never raised taxes. Increased user fees maybe, but never raised taxes. Someone will have to explain to me what the difference between a user fee and a tax is, but that is another issue.

We have and this Congress has cut from the Medicare program over the last six years some $40 billion. And I note that one of the proposals that you have come in to say to this committee where we can save money for you is a number of changes to reduce reimbursements to providers in Medicare. And it almost seems to me that every time the OMB gets in some kind of a tight budget box, and the computer flashes, you know, cut, cut, cut someone down at OMB says "where is the Medicare button?" And immediately pushes it in response to the flashing red.

And I would hope that we just don't continue to pick on the Medicare Program. There are some problems with that program that some of the pressure we put on it has created. The premature or early discharge of patients which we tried to do something about in the last bill that we passed and the President signed is one example.

But I just hope that we will not decide that it is the senior citizens who ought to be the main vehicle for trying to come into compliance with Gramm-Rudman.

The CHAIRMAN. Thank you, Senator Heinz.

Gentlemen, if you would keep your comments short because we want to hear from this witness. Senator Rockefeller.

Senator ROCKEFELLER. I have no comments. I will put my statement in the record, Mr. Chairman.

The CHAIRMAN. Bless you. [Laughter.]

Senator Chafee.

Senator CHAFEE. I would like to see what the witness has to say, Mr. Chairman.

The CHAIRMAN. Good for you.

Mr. Director, we are very pleased to have you. And if you would proceed, please.

STATEMENT OF HON. JAMES C. MILLER III, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. MILLER. Thank you, Mr. Chairman. I will proceed however you like. I thought maybe I might just respond, or review my notes here from the comments that were made and the statements that were made and respond very briefly if I could to some of the issues that were raised before I get into my statement.

Mr. Chairman, I think it is correct to say, as you have, that we in the Administration believe that we ought to see some other more concrete ideas from those who have criticized the President's budget. Certainly there have been discussions here from Senator Durenberger and others about some other alternative ways of reaching some of these savings, of changing the incentives in order to realize lower costs. We are certainly open to those kinds of ideas, and look forward to a specific proposal in this area and in others.

We do believe that we have met the Gramm-Rudman-Hollings targets. I understand that CBO will not price out the President's budget, will not have their final analysis until later this week. We believe that, based on some discussions we have had with them in trying to give them more information about our methodology and our estimates, that CBO may move a little closer to our own figures.

I am glad to hear you say that we believe that we can get better health for our dollar. You point out, or make the argument that a Medicaid cap would be inequitable. We surely will be able to work with you.

Of course, what we propose is essentially this Medicaid $1 billion cap be spread proportionately over the states according to the sharing formula, and we believe that that would be equitable; however, we would certainly be open to alternative ways of going about achieving those savings.

I will talk a little about the RAPs proposal in a few minutes, and if I don't respond there, Mr. Chairman, please let me know and I will give some more details.

Senator Mitchell suggests that the proposals are neither imaginative nor equitable. Again, we look forward to receipt of different ideas, suggestions of different ideas, perhaps more imaginative ideas, and in the minds of some, perhaps more equitable ideas. We think that what we have forwarded meets both of those criteria and we look forward to discussing it with you.

It is not surprising, I think, Senator, that many of the proposals contained in this budget have been asked for before. We continue to believe that they are the best to take, and for the reasons that are articulated in the President's budget.

With respect to the urban-rural split, I notice this has been a bone of contention in the Congress for a long time, and I am not suggesting that we have the latest word on what that split should be. Basically, it is an attempt to differentiate between higher cost hospitals and lower cost hospitals. But we can certainly work on that split.

We do have, as Senator Riegle points out, $22 billion in revenve. This is a recognition, I think, that the combination of revenue increases and cost reductions is the appropriate way to go about achieving Gramm-Rudman-Hollings targets.

With respect to sources of additional revenue, Senator Riegle, we could not accept an oil import tax, nor a fee, an overall fee on imports. With respect to cigarette and alcohol excise taxes, we do not at this time have any particular feel that those amounts presently in law are too low. We have no plans to ask for an increase in these taxes.

With respect to the telephone excise tax, we have opposed an extension of the telephone excise tax.

Why do we continue to propose cuts in Medicare and Medicaid? Well, we have a real problem, and that is that we spend a much larger proportion of our gross national product on health care than other developed nations, and, moreover, the rate of increase as a proportion of gross national product for health care is much higher in this country than it is in other developed countries. And it is not explained in demographics and it is not explained on quality of care.

As you know, we have a higher infant mortality here than in other developed countries. We don't seem to have any greater longevity. So we must be doing something wrong. We must be not controlling our costs as we should.

With respect to our not meeting the Gramm-Rudman targets in the out years, two things about that, in response to Senator Riegle. First, partly this is an artifact of our completing the budget a month early. It takes more work to meet the out year targets than we had available.

Second, we do not believe the law reads to require us to meet the out year targets. And bear in mind that the out year target differences are on the order of $20 billion. So we don't think that that is an insurmountable task by any means.

Senator Heinz, you have raised the question of the realism of our economic—could I just go back? On the question of cuts in Medicare, I would just emphasize that both Medicare and Medicaid expenditures will go up under the President's budget. Medicare was at, we estimate, $78 billion, 158 million for 1987, and that rises to $82 billion, 907 million in fiscal year 1988. So there is a substantial increase, even under the President's budget.

With respect to Medicaid, there is a slight increase from $26 billion, 700 million, to $26 billion, 864 million.

With respect to the economic sumptions, if I can find a piece of paper here right quickly, I would just—let me emphasize, as we all know, that predictions, projections, forecasts are not so exact that we are able to nail them very frequently. There are some that have lower estimates than we have, some that have higher estimates than we have. Although it is not on exactly the same basis that we have it in our budget because we are fourth quarter over fourth quarter where this data is year by year.

I would point out that the lastest issue of Blue Chip, published February 10—and I am quoting—indicates that there is an upward shift in the 1988 forecast in terms of real growth, which is at 3.4 percent, slightly above OMB's projection and are well above what they call the green logo band.

So I don't think we should make too much of this data, but I think it is an indication that——

Senator PACKWOOD. What is the green logo band?

Mr. MILLER. Let me read you the definition.

Yellow logo signals, low economic growth between zero and 2.9 percent; red logo warns that GNP for the year may drop below zero percent growth. Green logo means the economy is expanding above long-range growth potential of 3 percent. So it is above the so-called green logo band.

Let me respond to——

Senator HEINZ. Can I just follow up?

Mr. MILLER. Yes.

Senator HEINZ. Your definition of green is expanding above the long-range growth potential. So the green band is above average growth.

Mr. MILLER. It is not only above average growth, it is above what they characterize as the long-range potential. I was quoting when I quoted the phrase "well above the green logo band." I was quoting from the Blue Chip publication in response to Senator Packwood's question. I just gave you the definition, their definition of "green, yellow and red logo bands."

Again on the question of picking Medicare for savings, that is a substantial portion of the budget. It has been expanding at very fast rates. Medical costs in this country is expanding at many times the increase in the Consumer Price Index. And as you know, we propose not only a cap on Medicaid, but that in subsequent years the federal government's portion of Medicare expenditures would be tied to the medical price index, the medical's consumer price index, which, as you also know, tends to run at a good deal higher rate than the consumer, ordinary consumer price index-you.

If I could now, Mr. Chairman, go into my prepared statement.

The CHAIRMAN. Yes. Please do.

Mr. MILLER. It is an honor, of course, to have this opportunity to discuss with you the President's budget. As you know, it proposes a further reduction in the deficit while maintaining federal support for the core functions of government. The budget meets the Gramm-Rudman-Hollings target, deficit target of $108 billion in fiscal year 1988, and a reduction of $65 billion in fiscal year 1988, following a reduction of $48 billion in fiscal year 1987.

And could I just mention? I was pushing some numbers around last evening. I think we need to bear in mind that outlays have expanded under the President's budget, even under the President's budget by a good deal, and the amount of expansion in outlays is understated because there is about a $6 billion increase in offsetting receipts under current services. So the expansion, as I indicate, is a good deal more than is indicated.

Of the $842.4 billion in revenues for fiscal year 1987—that is the President's policy budget—we ought to add about $36.4 billion in offsetting receipts, that by counting budgeting convention, appear on the outlay section of the budget is negative outlays, and that would give you an idea really of what total revenues are. And that turns out to be $878 billion.

So spending, which is recorded at a billion, 15 million—excuse me, a trillion, 15.6 billion, you add the 36.4 billion dollars to that, you get a trillion, 52 billion, which is a more accurate representation of total outlays, in dollars greater than the fiscal year 1987 figure. And you get a trillion, $66.3 billion outlay, or spending figure, which is $14.3 billion over the spending figure that is recorded in the President's budget and the point here is to compare—contrast real spending, in other words, will go up $14.3 billion under the President's budget rather than the $8.7 billion that might be derived.

So a point I want to make of all this is that basically under current services you have got growth in revenues in the President's budget will outpace the growth in outlay by about $23.1 billion.

So the deficit reduction package from $173 billion to $108 billion really is comprised of three component parts. One is the growth that we will experience—we anticipate experiencing from 1987 to 1988; the revenues outpacing the increase in outlays, and that will save about $23.1 billion, and then we have the revenue increases, which are about $22.4 billion. And then we have the outlay reductions, including the $1.3 billion savings in outlays because of the lower interest expense with the lower debt to carry.

And so in a sense they are sort of tri-equal parts: Increased growth; increased revenues, vis-a-vis the current services; and, finally, decreased outlays.

This budget avoids increasing the nation's tax burden and reflects the bipartisan concensus to protect social security. It provides a 3-percent real increase for Defense above the 1987 appropriated level, and it reforms or terminates an assortment of programs leading to savings of $19 billion in fiscal year 1988.

And as a share of gross national product, the deficit decline is dramatic, from a total of 5.3 percent of gross national product in fiscal year 1986 to just 2.3 percent in fiscal year 1988.

And, importantly, if these targets are met, it means the deficit will be more than cut in half in just 2 years, from $221 billion in fiscal year 1986 to $108 billion in fiscal year 1988.

Now under the President's budget, outlays increase by $9 billion without taking into consideration the offsetting receipts. And as I indicated to you, it increases by a good deal more, if you take into consideration the offsetting receipts.

Now the President's budget does contain deficit savings of $42.4 billion. Programmatic reforms account for only $18.7 billion of these savings. And as I indicated, the rest comes from increased revenue or reduced interest expense.

Now critics have latched onto the revenue figure as evidence the President has broken his promise not to raise taxes. They say the only question for fiscal year 1988 is just how big a tax increase there is going to be, not for whether there will be one.

Now the argument appears to be based, to me, on an unusual definition of taxes, anything that raises government revenue. But this is not the way we view a tax or how or where tax should be appropriately defined.

First, the budget distinguishes between increased receipts, which total $6.1 billion, and increases in offsetting collections, which total $16.3 billion. Offset in collections are payments of a business type or marked oriented nature, and about $13 billion of the total stems from the sales of government assets. No one should confuse an asset sale, whether a government loan or a railroad, with a tax.

Certainly the purchasers won't. They expect to receive something of value they might later resell if appropriate.

Furthermore, there is no element of compulsion in these transactions as there is with a tax. You don't have to purchase a government asset if you don't want to.

Another distinction is that an asset sale pares down the size of government. And since many of our privatization efforts are accompanied by an end to wasteful subsidies, and the long-run spending goes down as well. Asset sales are one-shot revenue increases, whereas, tax increases are designed to increase the revenue stream permanently.

The remaining $3.2 billion in offsetting collections comes from user fees which also, in my judgment, clearly are not taxes, although they do constitute a permanent increase in the revenue stream. A user fee is a direct charge for a specific benefit received. Like an asset sale but unlike a tax, a user fee does not involve compulsion. One characteristic of user fees is that they reveal how much government programs are really worth to direct recipients in a most direct and meaningful way possible. And one of the strongest arguments that a government program is worthwhile occurs when the user fee covers cost. The reverse is also true, and that is one reason that beneficiaries, some beneficiaries, oppose user fees.

And, finally, the budget incorporates increased receipts of $6.1 billion. Now do these revenues constitute a broken promise that the President will not raise taxes? Not at all.

First of all, more than a third of the extra receipts, $2.4 billion, is due to tighter enforcement of existing tax laws; more money to the IRS for processing—for enforcing the tax laws.

Collecting more of taxes already owed the government is not a tax increase. Several of the reforms giving rise to increased receipts are very much like user charges, but by convention show up in the receipts portion of the government's ledger. It has long been accepted that the federal excise tax on gasoline and diesel fuel and other highway excise taxes are, in essence, a user fee on the consumption of federally-supported highways. Indeed, the monies collected are deposited in a trust fund explicitly for that purpose.

The budget proposes to repeal the partial exemption from excise taxes on gasoline and diesel fuel produced from gasohol and certain alcohol fuels, and repeal the exemptions from these and other highway excise levies provided to private bus operators.

The budget also proposes to end the present free ride afforded state and local governments who now pay no tax, but like every other user, derive benefits from using federally-assisted roadways.

The repeal of these exemptions increases receipts to the Highway Trust Fund by $800 million.

The vast majority of employees of state and local governments from Medicare coverage under existing laws and regulations. And rather than propose excluding those few from not paying for Medicare, excluding those few who do not pay Medicare, an initiative that I have no doubt would generate serious opposition, we propose that existing employees, like new employees under current law, make appropriate payments to Medicaid. The increased receipts, we estimate, would be on the order of $1.6 billion.

Now, likewise, many workers whose current job is not covered under Social Security would be eligible for benefits because their spouse's earning record or short periods of work in covered employment. The proposed extension of Social Security coverage to the inactive duty earnings of armed forces Reservists, certain students, and agricultural workers children ages 18 to 21 employed by their parents, and spouses employed by the other spouse increases receipts by $.3 billion.

We also propose that employers pay the Social Security payroll tax on total cash tips rather than reduce the benefits provided to such employees.

Under current law, employers generally pay the Social Security payroll tax on the amount of tips considered to be wages under the Federal Minimum Wage Law, even though the tax liability of their employees is based on the total amount of cash tips.

Benefits also are based on the total amount of cash tips. This proposal would eliminate the cross subsidy from other employers, and would increase receipts by $.2 billion.

Two trust funds, those paying victims of black lung disease and rail industry pensions, presently are not sound in an actuarial sense. Therefore, the administration proposes to increase the user charge contribution by a half billion dollars. Similarly, to insure sound financing of the railroad unemployment benefits, the railroad sickness and unemployment insurance fund is deeply in debt to the financially ailing rail pension fund. The budget renews the administration's proposal to extend Federal-State unemployment insurance program to the rail industry. This increases receipts by one-tenth of a billion dollars.

Many of the remaining issues, which increase receipts by two-tenths of a billion dollars, can be explained by similar logic. These include technical corrections, et cetera, and I will not dwell on these.

So now you be the judge. Do these revenues constitute a tax increase? The answer, I submit, is a definite no.

Now let's address now the health care reforms in the budget.

As a nation, we simply cannot afford health costs that rise at four times the rate of the general inflation. Americans spent $425 billion on health care in fiscal year 1985; 10.7 percent of our gross national product. Per capita, we spend more on health care than any other nation on earth: 28 percent more than in Canada; 52 percent more than in West Germany; and 100 percent more than in Japan. We must find ways to find high quality health care at prices we can afford.

As you all know, federal spending on health care is growing far more rapidly than inflation and the aging of our population combined. Approximately 52 million of the Nation's poor, elderly and disabled will have their health care needs met through these programs in fiscal year 1988, an increase of five million, or 11 percent above the fiscal year 1980 levels. These programs are expected to aid approximately one in every five Americans in fiscal year 1988.

In contrast, over the same fiscal year 1980 to 1988 period, Medicare and Medicaid increased spending by 117 percent, more than double. In the first half of the 1980's, Medicare expenditures increased an average of 12.4 percent a year. Only Defense spending, 11.9 percent, and interest costs, 15 percent, grew at comparable rates.

Again, I want to emphasize that Medicare grew at about the same rate as did Defense spending and also interest expense. Even with the recent success in restraining health care inflation, under current law, Medicare outlays are projected to escalate by 10 percent annually through fiscal year 1992, more than twice the projected average Consumer Price Index, the rate of growth and the numbers of beneficiaries combined.

So the rate of growth and medical care expenses is estimated to be twice the sum of a Consumer Price Index, and the growth and the numbers, rate of growth and the numbers of beneficiaries.

The President's budget proposes to slow this rate of growth to 8 percent a year, a rate faster than last year's growth, through proposals designed to contain cost and to increase the efficiency of health care delivery. Even so, under this budget, Medicare spending will be $104 billion by fiscal year 1992, more than two and one-half times the amount spent in fiscal year 1981.

I realize that before this committee calls have been made for cutting Medicare, and there have been cuts of Medicare from current services, but bear in mind that there has been a tremendous increase in total Medicare spending over the period the President has been in office.

Medicare and Medicaid spending will continue to grow as a share of the President's budget from 9.2 percent in fiscal year 1981, to 11 percent in fiscal year 1986, and to 13 percent in fiscal year 1992.

Excluding interest costs and spending on Social Security and Defense, under this budget, Medicare's proportion of the federal budget will double, from 12.4 percent in fiscal year 1981 to 25.4 percent in fiscal year 1992. As a proportion of that part of the budget, excluding Social Security and Defense, it will more than double.

The CHAIRMAN. And did you say interest charges?

Mr. MILLER. And interest charges. Yes, sir. Spending on Social Security and Defense and interest charges, yes, sir.

Our proposals can only be said to provide cuts from what I believe to be an unreasonable level characterized by runaway growth.

As you know, through various reforms, the administration and Congress have been successful in controlling hospital expenditures, which grew by only 2 percent between fiscal year 1985 and fiscal year 1986, after almost doubling between fiscal year 1980 and fiscal year 1985.

Hospitals responded to the implementation of the prospective payment system by becoming more economical and providing care for their patients. At the same time, hospitals posted profits, and according to the Commission on Professional and Hospital Activities, high quality medical care has been maintained.

Specifically, this Commission found that the PPS did not change the quality of care delivered to either Medicare or non-Medicare patients.

The administration's goals remain very much the same as in fiscal year 1981. The administration intends to promote competition, capitation, and other reforms that rely on private markets to stimulate health care service efficiency and enhance the quality of care.

As part of this effort, we plan to increase the choices for beneficiaries and providers alike.

We want to build on our modest success in restraining hospital payments. We want to begin changing the inflationary incentives of physician payments, and we want to insure the quality of care.

For example, we are proposing to expand opportunities for Medicare beneficiaries to enroll in a wider range of private health benefits organizations.

We want to establish a series of demonstration projects to explore ways that Medicare can benefit from innovative private sector arrangements. These projects will create negotiated provider agreements for physician services delivered outside the hospital. By standing by our goal to change the inflationary incentives of open ended cost reimbursement of hospital capital, we will phase capital into the PPS system, into the rates over the next 10 years.

As specified by Congress, our phase in will remain budget neutral to the congressionally set levels for fiscal year 1988 and fiscal year 1989. I believe that was in the reconciliation of last year.

We propose to restore the authority of the Secretary of Health and Human Services to update payments under which perspective payment system these rates are set.

As you know, this authority was suspended for fiscal year 1988 by the Fiscal Year 1987 Reconciliation Act.

Under our proposal, using the most current information available, PPS update would be set in an amount necessary for the efficient and effective delivery of medically appropriate high quality care. For planning purposes, as you know, it was a 2.5 percent place hold in the fiscal year 1988 budget.

The President's budget also included a proposal to increase modestly payments made by current Medicare beneficiaries. Specifically, we would index for inflation the present $75.00 deductible a beneficiary pays before Medicare coverage for physician services begins. Our proposed increase to $77, a $2 increase, for fiscal year 1988 is clearly warranted. As you know, it remains at closing in its fiscal year 1982 level, which, in real terms, is less than half the deductible in place 20 years ago.

Beneficiary income, Social Security, already is inflation-indexed, and it is proper, we believe, for Medicare deductible to be inflation-indexed as well.

We also propose to increase the supplementary medical insurance premium for new enrollees only. Current enrollees would continue to pay 25 percent of cost, even though when SMI began, the premium coverage was 50 percent of cost. We propose that a new enrollee pay 35 percent of the cost. We believe that new enrollees can easily afford the modest increase in premiums.

Many realize a higher standard of living, once retired, and Social Security benefits for new enrollees are higher than ever.

As indicated earlier, we also propose that coverage of Medicare be extended to current as well as new state and local employees.

As mentioned earlier, under current law, many state and local employees become eligible for Medicare on the basis of spouse participation or short work periods, even though they have not contributed their fair share to the Hospital Insurance Trust Fund. Our proposal also insvre Medicare coverage to state and local employees who now have no opportunity to enroll.

Controlling physician costs has proven to be one of our most difficult challenges. Despite the vigorous efforts of Congress and the administration, Federal expenditures for physicians grew by 15.7 percent annually between fiscal year 1980 and fiscal year 1985. Again, under Medicare, physician expenditures increased at an annual rate of 15.7 percent.

During the fiscal year 1986 congressional freeze on physician charges, spending on physician services grew 8.5 percent, while the number of beneficiaries grew by only 2 percent, and hospital admissions actually declined by 2 percent.

Absent any fundamental reform of physician payment rules, spending for physicians is projected to grow 12.5 percent annually in fiscal year 1987 and beyond.

The fee for service reimbursement system used to pay physicians so far has been immune from the government's best efforts to control costs. Numerous privately and privately funded studies have shown that from the standpoint of Medicare, fee for service reimbursement is inherently inflationary, rewards the minority of physicians who provide medically unnecessary services, and thereby penalized the majority of doctors whose primary interest is patient care.

We propose to reform Medicare's payment mechanism for radiologists, anesthesiologist and pathologists by having Medicare pay the average area price for hospital-based physician services. The area price would be determined by using actual physician billing information and calculating the average amount paid for each physician's service. By paying an average price for each physician-practice area, variations in costs reflecting different patterns of medical practice will be retained.

Now our proposal would encourage hospital-based doctors to make a bias-free decision whether to return to the traditional relationships that existed prior to the imposition of Medicare rules. So RAP's physicians, before the imposition of Medicare rules, a vast majority, worked for hospitals. Before creation of the split, most hospital-based physicians were billed through the hospital or were on salary rather than bill on a fee for service basis.

The administration's proposal does not change current Medicare assignment rules. All physicians, including RAP's, will continue to be able to bill beneficiaries above Medicare's reasonable charges. Doctor-patient relationships will not be altered. Hospital-based doctors will continue to provide their services directly to patients or in conjunction with other doctors.

Quality of care will not be affected. I cannot believe a doctor on salary performs his or her work less diligently than he or she would if reimbursed on a fee for service basis.

Medicaid has grown at an annual rate of 10 percent since 1980. We have two strategies to slow the rate of increase in federal and state Medicaid expenditures.

The two proposals consistent with prior budgets are to reduce federal expenditures by reducing federal assistance to states from Medicaid, to through the cap. We've discussed and reduced the 50 percent special matches for administrative expenditures. A new feature in this year's budget, one that holds much promise, would provide to the states financial incentives to place Medicaid recipients in capitation. States would receive an enriched federal matching rate for the first three years of each new capitation project. In return, the state would systematically reduce its Medicaid expenditures over the three years to 95 percent of what it would have spent under fee for service.

The CHAIRMAN. Mr. Director.

Mr. MILLER. Yes, sir.

The CHAIRMAN. Your testimony is extensive and detailed, and, frankly, very valuable.

Mr. MILLER. Yes, sir.

The CHAIRMAN. But we have a problem with time limitations where a number of questions come to mind as you present this testimony and as we try to read through it. And I would urge you to try to summarize.

Mr. MILLER. Well, Mr. Chairman, as you can see, I touch on the remainder of the Medicare-Medicaid proposals. We talk about some of our reforms under welfare, allowing the AFDC families to receive funds so that they can, rather than just using these funds for—the job funds for employment during the summer, they can use funds for employment year round for AFDC families.

We do eliminate WIN, but we throw it into a new program with an acronym GROW. And I go into some detail about how these various programs will work.

I apologize for the length of my testimony, but, Mr. Chairman, there has been some, I think, lack of appreciation about the specifics, the details of the President's budget, and are focused unduly on some of the overall aggregate cost figures, and sometimes on specific programmatic figures, which might cast some doubt on the integrity of the President's budget. And it is one which I do believe is very vital, is very thought out and cohesive.

I also at the end mentioned some of the President's competitive initiatives. We will be sending up the legislation tomorrow with the details. I know that a lot of the details are of interest to this committee and Jim Baker, in particular, and I, look forward to working with you on this.

I just left the leadership breakfast this morning where there was frank and candid discussion about this package, and an agreement that we will all work together to try to fashion a package that will make us proud, and we will continue the economic expansion we have been experiencing over these past several years.

I will stop there, Mr. Chairman.

The CHAIRMAN. Mr. Director, the detail of your testimony is going to be, I think, very helpful to us and I am appreciative of that.

But one of the things that it brings to mind, as I think of the catastrophic coverage, for which I have been interested in, and others of this committee, for a long time, advocating that kind of improvement. I understand the administration's proposal will be coming up to the Hill.

Mr. MILLER. We anticipate its coming up tomorrow.

The CHAIRMAN. Tomorrow. Good.

One of the things that concerns me is your very comment about the increase in the cost of Medicare and health care cost, and they are accelerating beyond the CPI. So as you look to the premium, and as Dr. Bowen was testifying, we are talking about a premium of around $5.00, you looked to future years and you get a concern as to what happens to that with what you have just told me in the growth and the cost of medical care.

Do you anticipate that that premium is going to be indexed? If so, is it going to be to medical costs or what will it be related to?

Mr. MILLER. We recognize that it would increase over time. If I am not mistaken, the legislation calls for it to be, the premium to be rated on experience and estimates of cost increases. And so there would be some indexation. We believe that the $4.92 or the $59 a year figure is appropriate, based on what the actuaries at HHS have computed.

The CHAIRMAN. My concern is if it is going up faster than the CPI, and you could have Social Security checks that would in no way match the increase in that premium. And I was trying to determine how you would relate the two and how you compensate for the two.

Mr. MILLER. Well, I think that without question your point is well taken. If in fact that the increase in the CPI, which drives the increase, as you know, for Social Security is a good deal less than the medical CPI, then it is likely that the increase, percenta in-crease in the premium, that portion that is put in Part B for catastrophic, would outpace the increase in Social Security.

The CHAIRMAN. Another question concerns me is on the child welfare services program, one that we had focused on, children that had been abandoned or neglected but that might otherwise need some protection. And a particular objective in recent years is getting those children out of inappropriate foster care and into permanent homes.

Fifteen years ago that was authorized, the program was. It was raised to $266 million. It has never been funded at that level. And despite the budgetary constraints, Congress has been able to provide some modest increases in this program.

In this year's budget, the President is proposing to cut the current fiscal year funding for this program about 10 percent, and then to merge its funding for future years into a conglomeration of programs serving not only children but other routes, such as the aged and the disabled.

Now is this proposal simply a budget cut or is it based on the Administration's analysis of the importance and effectiveness of the child welfare services program? I have such a long interest in this, frankly, and it concerns me. These kids don't vote. And I think an investment in these children is one of the best things we can do for the future of our country.

Mr. MILLER. Well, I don't contest that. The FY88 level for child welfare services is not a budget cut, but an attempt to increase program flexibility. It is based on an analysis of the programs. I mean, one of the jobs of a controller or an OMB finance officer of the state or any other government it seems to me is to analyze programs periodically and find out ways in which they can deliver the same services for lower costs.

You have got your budget person, examiner, and they are going to find opportunities for, again, achieving the same benefits—they have measured it; it is the best judgment they have—at lower costs.

Institutionally, that is a major job we have. And so these changes in many of these very sensitive programs reflect our assessment that the same benefits could be delivered at lower costs.

The CHAIRMAN. Well, I hope that is right.

The other one I get concerned about is the difference between OMB and CBO, the disagreement as to the aggregate tax revenues that the economy will produce in fiscal year 1988. It is about a $9 billion difference in the two projections. That is a lot of money. It is more than the entire tax increase proposed by the President in the budget.

What I am wondering about is the extent to which the administration can assure us that those revenues are going to actually flow into this Treasury. We have had some rosy projections over the last several years, and you understand why I begin to question them.

Mr. MILLER. Well, yes, sir. We believe that the estimates we have are well grounded. We would be glad to defend them in detail. CBO differs with us on some areas. The one most nagging difficult area for me is that they assumed that we will pay advanced efficiency payments in agriculture. It is not a question of whether farmers will be paid, but when and in what installments. Whereas, we have complete discretion not to do that, under existing law, and have said that we would not. But, nevertheless, CBO counts $4.5 billion, I think it is, as in the base line for fiscal year 1987.

There are some technical differences. The difference between OMB and CBO in the total reflect about $10 billion or more is reflected in the differences in our assumptions about the growth rates. We assume 3.2 percent fourth quarter over fourth quarter for calendar year 1987, and they assume 3.0 percent for fiscal year 1980—excuse me, calendar year 1988. We assume 3.7 percent and CBO assumes 2.9 percent.

Those differences, and the accompanying differences in rates of inflation, unemployment, et cetera, lead to about a 10 to 12 billion dollar difference in our base line. We are hopeful that we can come to some better agreement, a closer agreement on those numbers.

Could I just mention, Mr. Chairman, before you move on that even though we anticipate getting this package to you tomorrow on catastrophic, the drafting is not final, and there are at least considerations being given to some kind of hold harmless provision that would say that the increase in the premium would not exceed, say, the rate of increase in Social Security. But I will have to give you that information tomorrow.

The CHAIRMAN. And you are addressing the very question.

Mr. MILLER. Your earlier question.

The CHAIRMAN. Yes. All right.

We have had quite a number of Senators here who have been quite interested in your testimony but have had other commitments. And I note the early bird list of those that are remaining. Senators Rockefeller, Danforth, and Wallop. Senator Rockefeller, please proceed.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Director, you mentioned earlier the increase in the total amount being spent on Mēdicaid and Medicare, and then you referred to the fact that other countries in Europe were spending much less than we were with respect to those, which, in a sense, seem to case a judgment as to how we should determine our—in some sense how we should determine our national policy.

Did you also mean that there are more older people that we are spending more per capita than we were in previous years or simply more in bulk?

Mr. MILLER. Well, we have the figures cut in many different ways. The numbers that I was giving you on Medicare and Medicaid expenditures are in bulk as proportionate, and the measure that I was using in contrasting the U.S.A. and other developed countries was a proportion of gross national product. Many countries have lower disposable income per capita of gross national product per capita. And so it would magnify the difference between the absolute expenditures per person in the US and these foreign governments.

I did not necessarily mean that we ought to set as our goal the average of other developed countries, industrial countries, but I think when the disparities are so significant, I think it raises a question of what are—it suggests that we are doing something wrong, when the evidence on longevity, on infant mortality and other indices of health appear to be no higher for us in the United States. I think it is something we have to come to grips with.

Senator ROCKEFELLER. In the cuts that are made overall within the President's budget, $6 billion come out of education, approximately, and one-third of the cuts come out of programs which affect low income Americans, or, in fact, the nation's poor, whereas, that expenditure reflects, in fact, only about one-ninth of the total federal budget.

Is there a lesson or an irony or a philosophy in that?

Mr. MILLER. Senator, what we have done in education has been an approach that is controversial I know, and I think in many cases not thoroughly understood. But let me say, first, I am a person that believes a lot in education. And I know you are too. The Senator and I share having our daughters at the same school.

Senator ROCKEFELLER. Which means we can both afford to pay it. [Laughter.]

Mr. MILLER. Speak for yourself, Senator. [Laughter.]

But let me say, the savings that we have in the education area are all net. There are some programs that are expanded and some that are reduced in scope. The main criticism has been in the area of secondary school education, the amount of funding there, in fact, is $2.4 billion that we are suggesting saving.

Now, in our experience and our way of thinking, the real problem with children not being able to go to college is that they cannot use their own human capital as collateral. Economists, social scientists, not that he would necessarily agree with me, but I'm sorry that Senator Moynihan is not here. He has a wonderful piece in the latest issue of Public Interest. I don't agree in all dimensions, but it is a great piece.

But people have identified that you just simply cannot use your own human capital. And just as an anecdote, I mean, when I was a kid beginning college, I went into my local bank and said to the president of the bank—got in to see him—I would like to borrow some money to go to college. And I told him why. And he said, well, Jimmie, I know you are a fine boy. You sacked groceries down at the grocery store, and all of that, and I know your family for a long time. But, you see, we can't lend you any money, you see. You don't have any collateral.

Now it is appropriate for the government, I think, to step in, be the institution that provides that kind of collateral, but not necessarily come in and finance directly the education for the child.

And so what we are proposing to do is to move from direct grants to guaranteed loans; also to expand some of the income to contingent loan programs. People will say, well, people who borrow money to go to school, when they come out they are burdened. They can't pay it back. And they would discriminate against low paying jobs that may be very useful socially, like school teachers and so forth.

Well, under this program, they can have a longer time to pay the money back. But the investment in education is a very useful one. I mean, it is one that the private rate of return is very high.

And so I think it does make sense for the person who chooses to go on to college, who reaps the substantial rewards in later life because of the higher income and better knowledge, and so forth, to be the one to pay it back rather than to burden the general taxpayer, who might not have children or who may have sent their own children through school or maybe choose a different kind of schooling for their children.

Senator ROCKEFELLER. Is there a philosophical difference in terms of national public policy if the general taxpayer is excused from that what I understand the President to see as a fundamental national commitment, in fact, perhaps the most fundamental national commitment in terms of competitiveness? Are there people to be excused from that responsibility if it is national policy?

Mr. MILLER. We do. I mean, we continue the pell grant program and other special grant programs at a smaller scale and identifying specially low income people for that kind of support. There are other aspects of the President's competitiveness training program. Of course, you know we have a $1,980,000,000 proposal for training and education of people who are out of work who need to change their jobs, to acquire new job skills.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. Senator Danforth.

Senator DANFORTH. Thank you, Mr. Chairman.

Mr. Miller, according to the Congressional Budget Office, in order to reach the Gramm-Rudman target we would have to reduce the base line, the present spending levels, by $61 billion. But according to OMB, we would have to reduce it, I think, by $42 billion. Is that right?

Mr. MILLER. Yes, sir. I speak to the $42 billion.

Senator DANFORTH. Yes.

So I guess the first thing we are going to do, and I happen to be on the Budget Committee, along with some other members of this committee, is to decide what baseline we are going to use. My guess is that we will probably use CBO. I think we usually use CBO, don't we?

Mr. MILLER. Well, I think, according to Gramm-Rudman-Hollings, the Budget Act, that is the baseline you would have to use.

Senator DANFORTH. So we have to use it?

Mr. MILLER. Right.

Senator DANFORTH. All right.

So you start with $169 billion, and we have to then reduce that by $61 billion to get to the Gramm-Rudman-Hollings number. Now, there was an article in the morning paper indicating that some members of the House, including I think one Republican, thought that it is just not realistic to get to Gramm-Rudman-Hollings. Do you think that, given the fact that we are starting with a $169 billion baseline, going to $108 billion, it is unrealistic? Do you think we should give up on Gramm-Rudman-Hollings?

Mr. MILLER. No, sir. I think you can move to 108. We have a difference of opinion, as you pointed out, on the baseline. We believe a $42 billion deficit reduction package would get us down to the 108. We are satisfied with that.

I understand you have a technical problem, that according to Gramm-Rudman-Hollings, you are bound by the CBO figures.

Senator DANFORTH. We have got to come up with $61 billion. Do you think we should forget it?

Mr. MILLER. No. I think you should try.

Senator DANFORTH. You think we should try to get it?

Mr. MILLER. Yes.

Senator DANFORTH. All right.

Now I want you to explain where I am wrong in my reasoning. We have to come up with $61 billion and a tax increase is off limits. Right?

Mr. MILLER. Yes.

Senator DANFORTH. The President would veto it if we passed it and I don't see anybody clamoring for a tax increase around here. So we move over to the spending side. And we have to pay interest on the national debt. Right?

Mr. MILLER. Oh, yes.

Senator DANFORTH. That is right off the top. So that is——

Mr. MILLER. 139.

Senator DANFORTH. That is about 13 percent of the budget?

Mr. MILLER. Yes, sir.

Senator DANFORTH. So that is off limits. Right?

Mr. MILLER. Uh huh.

Senator DANFORTH. So then Social Security is about 20 percent?

Mr. MILLER. 217.

Senator DANFORTH. So that is about 20 percent of the budget, I think.

Mr. MILLER. Yes.

Senator DANFORTH. That is off limits. Correct?

Mr. MILLER. Yes.

Senator DANFORTH. So there we are up to 33 percent of the budget, which is the spending side, which is off limits. With respect to national defense, the President has asked for a 3 percent increase. Certainly the President wouldn't want us to go below the present real spending on Defense. Let's suppose for the third straight year we were to freeze Defense, but that we didn't want to go below it, so we took real cuts in defenses off the table. That is 27 percent of spending?

Mr. MILLER. Well I think it is 286 in VA. About that.

Senator DANFORTH. I think it is 27 percent. So now we are up to 61 percent of federal spending that is off the table. I am told that about 8 or 9 percent of federal spending is contractually obligated —that is, we have committed ourselves to spend the money. I guess we can renege on our contractual obligations, but we really shouldn't. If we are contracturally obligated, we should commit ourselves to meet those obligations, don't you think?

Mr. MILLER. Well, it all depends. If it is something we should get out of, we should get out of it. But I grant your point.

Senator DANFORTH. A breach of a contract?

Mr. MILLER. Well, it surely could be done.

Senator DANFORTH. It probably could. If you think we should breach, if that is the position of the Administration, that we should breach contracts, I would like to get a list of those contracts we should breach.

Mr. MILLER. Oh, we breach them from time to time, depending on the performance.

Senator DANFORTH. Well, I am told that around something like 9 percent of the total budget, 8 or 9 percent of the total budget is contractually committed.

Mr. MILLER. Subject to check. I take your point.

Senator DANFORTH. So we are up to about 70 percent, 68, 69 percent—call it 69 percent—of the spending side——

Mr. MILLER. Uh huh.

Senator DANFORTH [continuing]. Where we are not going to make any cuts. Right?

Mr. MILLER. Right.

Senator DANFORTH. Now, if we get to Gramm-Rudman, this means that we are going to have to cut the remaining 31 percent of the budget by a grand total of $61 billion, which would mean, I am told, an average of 18 percent. How are we going to do that? That is my simple question.

Mr. MILLER. Well, first of all, on the $42 billion deficit reduction, you are talking about 61 billion; we are talking about 42 billion. Of the $42 billion deficit reduction package in the President's budget——

Senator DANFORTH. $61 billion is the number we have to work with.

Mr. MILLER. Well, I have to tell you.

Senator DANFORTH. It is the law.

Mr. MILLER. I have to tell you, of the $42 billion deficit reduction, 22 billion of that is revenue. Only $19 billion is cuts. And that cut is coming out of a base of $416 billion, which are all the entitlement programs, health, all the non-health entitlement programs, all the discretionary programs, not including, as you take off interest, Social Security, Defense. Everything else, about $416 billion. As you said, approximately $90 billion is contracted. I will accept that for purposes of argument. So what you are doing is getting $19 billion out of that $416 billion. And that is, first, less than 2 percent of the total trillion dollar budget and it is about 4 and a half percent——

Senator DANFORTH. How much do you have in revenues?

Mr. MILLER. $22 billion.

Senator DANFORTH. All right.

But it is $61 billion then less 22. So that would be 39. Right?

Mr. MILLER. Right.

Senator DANFORTH. So now you have got it down to a $39 billion problem out of about $400 billion. Right?

Mr. MILLER. Right.

Senator DANFORTH. About a 10-percent cut.

Mr. MILLER. Well, first of all, you said $61 billion out of $318 billion base. That is using your numbers, and that is about 19 percent.

Now, since we have already got $22 billion in revenue in the President's budget, you subtract that from 61, you get $39 billion. So $39 billion divided by 318 is about a 12-percent reduction.

Now, I didn't say that all of the additional meeting of the Gramm-Rudman-Hollings target had to come out of outlay reductions. I think there would be some possibilities under those circumstances of finding some additional revenue that we could agree upon. I don't want to volunteer it right now. I mean, if somebody asked me to do it, I don't have that in my hip pocket. It is something I think we might discuss.

I certainly would disagree with your assumption that we freeze Defense. As you know, Senator, the Defense budget authority has come down two successive years in real terms. In fact, under the President's budget, it will be 2 years before we get back to the peak of what it was in fiscal year 1985.

But it is not an easy task, but it is not an insurmountable task it seems to me.

Senator DANFORTH. Well, let me just make an assertion, Mr. Chairman, and then that is the end of it.

If we adopt the CBO baseline numbers, if we do no worse than freeze Defense, if we rule Social Security off limits, and if we pay interest on the national debt, I would submit that as a political matter anything is possible mathematically. As a political matter, it will be very difficult to reach the Gramm-Rudman-Hollings target. Do you disagree?

Mr. MILLER. Yes, sir, I do.

We had the same situation last year. I came in and it was a $144 billion target, and we had a deficit estimate of $220 billion, and we had a $20 sequester, which brought it down to 208. And then we had $5 billion reduction of rescissions and deferrals, which brought it down to 203, as I recollect. And then it escalated back up to 221.

Now, actually the difference between 203 and 221, you know, the $18 or $19 billion difference there, when you are talking about $1 trillion roughly in outlays and revenue, it is not that big a margin there. It is about less than 2 percent.

And there are some reasons why it escalated back up. But the argument was it is impossible to get down to 144. Well, as you know, we didn't get down to 144. We got down, for purposes of Gramm-Rudman-Hollings, to estimating it at the beginning of the fiscal year, or the end of the old fiscal year, at coming in below 154, the 154 target, which most people look at really as the target, because it is only when you go over the $10 billion margin of error that you get the sequester.

And so by the time then under the——

Senator DANFORTH. The margin of error has become the target.

Mr. MILLER. The margin of error becomes the target. Then under the Gradison baseline rules, the way we had to estimate, we estimated below 154, when if we were free of those shackles, would have estimated about 164. So we are looking at the $173 billion estimate now that is predicated on a deterioration of about $10 billion from the estimate that we made last October.

Senator DANFORTH. Mr. Chairman, thank you for your forebearance.

The CHAIRMAN. That is an interesting exchange.

Mr. MILLER. Could I just mention, Mr. Chairman, that I think the thing to bear in mind here is to continue on this discipline. I mean, if we give up on the $108 billion target, we don't have the discipline.

I mean, if I had to bet right now, I am not going to bet that we would have a $108 billion estimate this time next year for the fiscal year 1988. But I do know it would probably be somewhat higher. But I do feel strongly that if we give up on the $108 billion target, the number that I would estimate a year from now would be much higher than the number that I will estimate if we stick with it.

Senator DANFORTH. Let me just say that I hasten to agree with that comment, Mr. Miller. I think we have to stick with it, too.

The CHAIRMAN. Senator Wallop.

Senator WALLOP. Thank you, Mr. Chairman.

It might be a buck or two less than the completed contract. I don't know.

The CHAIRMAN. Now, let's—that could take the rest of the morning.

Senator WALLOP. Director Miller, I would just like to comment on an earlier response you gave to Senator Durenberger, that the PPS system is not damaging rural hospitals. And you said there are some high-cost hospitals and some low-cost hospitals. But there are some states, like mine, which are so sparsely populated that necessarily we are either going to have hospital care or we are not going to have hospital care. We will have to go to Colorado or Montana or Utah for hospital care. So it is necessary for us to accommodate the reality of America, not the statistics of America.

Mr. MILLER. Well, statistics, if they are measured accurately, do reflect the reality.

Senator WALLOP. They don't when you try to put one blanket across this country and have everybody fit underneath it. There is grass under there; we are getting cold. I mean, it is just not possible for some rural hospitals in a state sparsely populated, as like Wyoming, to come in under a statistical balance that suits the rest of America, because we don't have population centers that can reduce the overall cost of delivery care on a statistical basis. It is not within our reach with a population of 480,000 people.

I hope that we can find some means to adjust the formula to that kind of reality or we won't have hospital care in a state which doesn't have transportation. It would be an incredible burden to our people.

Mr. MILLER. Senator, I think that the first thing you focus on is overall. Hospitals are not hurting. I mean, hospitals do very well.

Senator WALLOP. I understand that.

Mr. MILLER. Now, the question then is how do you control these costs and distinguish among various categories?

Senator WALLOP. Thats my question.

Mr. MILLER. I am certainly open to trying to find things to——

Senator WALLOP. That's why I asked the question. As long as we can realize that—we probably have a couple of hospitals in Wyoming that are not hurt. We have a bunch that are.

Mr. MILLER. Right.

Senator WALLOP. And it is just going to be beyond their reach just simply because they don't serve a large enough population to be able to deliver any kind of health care but emergency, based on current reimbursement trends.

Secretary Bowen's catastrophic health insurance initiative is argued to being budget neutral. So the first question is, is it your opinion that this proposal would have no budget impact?

Mr. MILLER. Yes.

Senator WALLOP. If it is neutral, does this include the possibility of coverage of all catastrophic medical needs?

Mr. MILLER. No; well, what it does very precisely is cover only extended—excuse me, only a catastrophic event, a kind of a onetime event. It does not cover nursing homes.

Senator WALLOP. Does it cover liver transplants?

Mr. MILLER. I would presume so for a person that is eligible for Medicare. Again, not the younger population. Although there are some people that are young that qualify for Medicare, but they are very small in proportion.

Senator WALLOP. I don't foresee any possibility whatsoever that Secretary Bowens' Catastrophic Health Insurance Initiative would be budget neutral. However well intended people may be, I just cannot imagine projecting the kind of medical demands that people make when medical aid is available on that kind of basis.

Mr. MILLER. Well, again, the actuaries on the basis of the eligibility pool, under Dr. Bowen's plan, the Administration's plan, the actuaries estimate that it would be budget neutral from the standpoint that the premiums, the $4.92 a month, would cover all the outlays under this program.

Senator WALLOP. Well, without pending to cause him exactly that much, let me suggest what I understood Dr. Bowen to say, was that they had not considered yet how to report to any cost containment provisions.

Mr. MILLER. Pardon?

Senator WALLOP. HHS has not yet considered how it contained cost. If that is the case, it doesn't matter what actuaries say. And I have been told, or at least I have been reading in the newspaper, that OMB's first year projection cost us $6.20 rather than the $4.92, or whatever it is, and that it will probably reach over $12 in several years time. Is there any truth in those reports?

Mr. MILLER. Oh, I wouldn't, Senator, want to comment specifically on the estimates we gave the President.

Senator WALLOP. Well, I can understand that. But our problem is that if we buy this package, we are going to have to pay for it some day. And we need, at least as specifically as we can or as realistically as we can, to project the kind of cost it is going to put either on the budget or the rate payer.

Mr. MILLER. Oh, yes.

Well, again, the details will be out tomorrow. And, you know, we are working out the last bit right now. But basically the idea is that it will be budget neutral. It will be self-financing. It will be part of Part B. If it turns out that you are correct by your implication that liver transplants are included—and, again, that is a very complicated thing—and it does turn out to be very numerous, and very costly, and the premiums do not cover cost, the premiums would be raised. That is the basic view.

Senator WALLOP. Well, Mr. Chairman, I would just suggest that if they are not covered to begin with they will be covered subsequently just simply because the political pressure will be there to do so. And I think we had better proceed very much one step at a time now.

The CHAIRMAN. Thank you, Senator Wallop. Senator Mitchell.

Senator MITCHELL. Mr. Miller, I am concerned that the Administration has failed to include funding for peer review organizations to carry out the congressional mandate to focus on quality of care and to extend peer review to help maintenance organizations. Do you have an explanation for that?

Mr. MILLER. I don't. A document that I hope reached each member was fiscal year 1988 assertions versus facts. On page 9, it indicates Medicare peer review organizations receive $176 million in fiscal year 1988.

Senator MITCHELL. That is right. But the fact is that in recent legislation we have increased their mandate and required more extensive activities which will require greater funding than previously.

Mr. MILLER. Right.

Senator MITCHELL. If you want to take a look at that and get back to me, that is fine.

Mr. MILLER. Yes. Those are not included, and we may have a request from HHS later.

Senator MITCHELL. I believe you will. And I think it is something to which you will really have to address your attention.

On this question of catastrophic, Secretary Bowen's plan assumes that $2,000 out of pocket in catastrophic, which is clearly the case for persons whose income is $10,000 a year. Do you think it is catastrophic for persons with income of $250,000 a year to have $2,000 out of pocket medical expenses?

Mr. MILLER. I see the drift of your point, Senator. No, we have called this catastrophic proposal, but would not means test it.

Senator MITCHELL. Not at all in any way?

Mr. MILLER. No. We believe it is a stand alone insurance policy.

Senator MITCHELL. Do you oppose——

Mr. MILLER. We have been reluctant to means test any of the Medicare.

Senator MITCHELL. Are you opposed to that in any way, either through taxation, through sliding scale deductibles, through co-payments, through some form? Is the administration opposed to that?

Mr. MILLER. Yes, we are opposed to it.

Senator MITCHELL. I think that ultimately our side is going to have to rethink that. And it is something that I think you folks would look into. I really honestly believe that.

Now let me ask you one thing about this Medicare tax thing. I am sorry I did not hear your whole statement. I had to go to another meeting. But while I was here you spent a great deal of time defending the administration's position that it is not raising taxes, and distinguishing between user fees, and sale of assets, and general taxes. But on the Medicare requirement for participation of State and local employees, in fact, the average employee now making $23,000 would be required to pay $334.00 a year in new Medicare taxes, which is almost twice as much as any tax reduction that person received under the much-heralded Tax Reform Act of last year. For those 5 million persons, isn't that a tax increase?

Mr. MILLER. No. Well, the point is that they are right now receiving benefits to which they have, arguably or not, due to them, because of spouse employment or because of earlier employment. We estimate three-quarters of state and local current employees will have access to Medicare without having had paid for it. So they are now getting—this would remedy the unwarranted subsidy that they are presently receiving.

Senator MITCHELL. But under current law, a person who works a number of quarters is entitled to full Medicare coverage. Why is that an unwarranted subsidy? Is there something wrong with the law then?

Mr. MILLER. No. No.

Senator MITCHELL. Well, what you are saying then is that someone who works the minimum number of quarters after public employment receives an unwarranted subsidy.

Mr. MILLER. But you don't have people continuing on in employment and not paying the Medicare tax, as you have in the situation I just described.

Keep in mind, of course, in reconciliation, I guess it was last year, maybe a year before, last year we polled all new employees in the Medicare system.

Senator MITCHELL. I understand that. And we thought we ended it there. Well, do you deny that for the 25 percent who don't ever go on Medicare—you just said three-quarters—that this isn't that a tax?

Mr. MILLER. Well, again, we have a system here in which user fees are not always paid in direct proportion to their use. I mean, that is an imperfection in the way we go about federally providing goods and services. It is not more inequitable for them than it is for anybody else who would fail to use Medicare.

Senator MITCHELL. But in your long explanation earlier you distinguished user fees from general tax primarily on the ground of compulsion as opposed to voluntarism. And you said a user fee is voluntary. There is no compulsion involved. That is your own testimony here today. Now what you are telling us, is that a Medicare tax imposed on people who don't want it and who are compelled to pay is not a tax but is a user fee. That directly contradicts what you said just a little while ago in your opening statement.

Mr. MILLER. Well, Senator, I don't think it is really in terms of principle a repudiation or contradiction of what I said.

Senator MITCHELL. Didn't you say that in your opening statement?

Mr. MILLER. Well, my statement speaks for itself. I just said one aspect of the ordinary user fee is that it does not involve compulsion. But then I went on to describe this particular instance of state and local employees' also uses of highways as being like a user fee.

The CHAIRMAN. Go ahead, Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman. I have some more questions. Well, I will just say you are right, your statement does speak for itself. And the two statements you made are directly contradictory. You did not describe it as one factor, you described it as the principle distinction between user fees and taxes. And now you have something here which is compulsory, and you are saying it is not a tax, it is a user fee. It is a tax. That is what it is.

I think you spend so much time trying to say you are not imposing a tax that you lose sight of the objective.

And the other point I just want to make—this is not a question—but that in economic effect, in the transfer of funds from individual citizens to the government, a user fee is indistinguishable from a tax. They are made distinguishable on the grounds you suggest, and appropriately so, but in economic effect, in taking money from private citizens and transferring it to the government for public purposes, they are indistinguishable. They have the same economic effect.

Mr. MILLER. Well it depends on the incidents. It depends on who pays them as to whether they—what the effect is. They both affect the budget deficit, which I think is the point that I am trying to raise.

Senator MITCHELL. That is right.

Now I wonder if you would submit to us—and I don't think this is a kind of question you can respond to now spontaneously—a statement demonstrating that the Administration has considered the interactions, the total effect of the various proposals in terms of hospital reimbursement, that is, the fixed increase of 1.5 percent, the cuts in indirect and direct medical education, and the capital reimbursement performed, each of them explained independent. But they have a cumulative effect that I would like to see you more carefully analyze. I wonder if we could get that at your convenience for the committee, a written statement on that.

Mr. MILLER. I will be glad to.

[The information was not available at press time:]

Senator MITCHELL. Thank you.

I would just like to talk about the Medicaid cap.

Mr. MILLER. I think I found the part of my testimony. Since I went pretty quickly, there were cases where I didn't necessarily read exactly the words printed here, but it is subject to check. I think at one point I was discussing the offsetting receipts, and I said no one would confuse an asset sale with a tax, et cetera. Furthermore, there's no element of compulsion in these transactions as there was with taxes. And I am talking there about asset sales. And later on, I say that like an asset sale but unlike a tax, a user fee does not involve compulsion.

Senator MITCHELL. Well that is the statement you made right there.

Mr. MILLER. And then I said, "Several of the reforms giving rise to increased receipts to $6.1 billion are very much like user charges but, by convention, show up in the receipts." So I mean maybe we are splitting hairs but I don't think we do.

Senator MITCHELL. Yes.

Well, we can just agree to disagree, I think. That is the best way to leave that.

I would like to just ask now, if I may, Mr. Chairman, one more.

The CHAIRMAN. Yes.

Senator MITCHELL. Thank you.

On the Medicaid cap. The situation is clear. The number of elderly persons is continuing to increase, as you know. Although Medicaid is a program for the poor and disabled, its expenditures have increasingly gone toward long-term care. Although elderly make up 20 percent of the eligible persons under Medicaid, expenditures for that 20 percent consume 80 percent of the program's cost.

What conceivable justification can there be for the proposed cap? It has been rejected previously. I just don't know if there is any rational argument for it, except if you want to say it doesn't make any difference what the realities are, we have just got to stop spending.

Mr. MILLER. No. Again, keep in mind that even under the President's budget, Medicaid expenditures will increase. We are proposing a number of initiatives that we believe that where states can control costs better. But keep in mind that we have sharing. If the state wants to add to their Medicare portfolio, they can do so.

What we are talking about, again, is trying to hold something down to something—costs down to something approaching the increase in just the medical CPI. And that is what we would do after this $1 billion cap, is index Medicaid to the medical CPI, which, as you know, is increasing at a much faster rate than the CPI generally.

What has happened is that these costs are escalating far more than can be explained in demographics.

Senator MITCHELL. I have gone over my time, so I will defer to Senator Baucus and I will come back after.

Senator BAUCUS. Senator Mitchell, why don't you continue.

Senator MITCHELL. Oh, all right.

Senator BAUCUS. You might as well finish up here.

Senator MITCHELL. Anybody who has ever tried a lawsuit or have been married knows the last word is the best word. [Laughter.]

I just want to say that I do appreciate the spirit you expressed of wanting to work with us. A very, very difficult area. The fact is that Secretary Bowen's proposal deals with what is the small part of the problem. That is what is incredible about the furor that it has aroused in the divisions within the Administration.

Over 80 percent of the problem is long-term care. The acute care costs, which are the subject of the Secretary's, and now the President's, catastrophic proposal comprise less than 20 percent of the total cost. So we are really addressing a very small part of it. It is easy to make the case for the need. It is very hard to see our way clear to figure on how to pay for it. That, I think, requires a great deal of thought, innovation and cooperation, and we hope we will be getting it from the administration. It is a very tough area, but a very important and necessary one. And the problem is, of course, going to grow. We are all familiar with the statistics, the demographics of the situation as the need will grow dramatically in future years.

Mr. MILLER. Could I just say that the President has asked the Treasury Department to look at some possibilities along these lines for these extra areas. But I guess a distinction, as we all know, that we are going to grow old. We don't all know that we will have the kind of catastrophic demand that is covered under the Administration's proposal, so arguably. And for that reason, we ought to be putting aside for our care when we do get up in years.

Senator MITCHELL. But the trouble is, Mr. Director, that the costs are so overwhelming that they are simply beyond the reach of the vast majority of American families, even with the best of intentions and the best planning. I mean, it is just unpredictable; $20,000, $25,000 a year eats up—the savings of the average working family in this country simply many persons do not have the means to set aside enough to do that. That is the reality; it is a very difficult problem. I appreciate what you said.

Mr. MILLER. Yes.

Well that is one reason, again, to take in private insurance, that is, to provide in the event that that were to happen. You know, there is no free lunch. I mean, that money has to come from somewhere.

Senator MITCHELL. Yes.

Well, I thank you very much, Mr. Director. Thank you, Senator Baucus.

Senator BAUCUS. Mr. Director, assuming we have to come up in the Congress with $30 billion additional to reach the CBO target, and, further, assuming that the Administration and the Congress cannot agree on $30 billion additional of cuts in expenditures—I say $30 billion additional because, as you know, that is the CBO analysis—what kinds of revenues might we look at? I know you are going to be somewhat reluctant to give us specifics here at this point.

Mr. MILLER. Right.

Senator BAUCUS. But still, so we are making the best use of our time, what areas perhaps are not too low? That is, what taxes perhaps are too low right now? What about the cigarette tax, for example? Is it your position that the cigarette tax today is too low or not too low? What about the cigarette tax?

Mr. MILLER. I started to say something like we ought to meet on the Funk and Wagnall's back porch or something. We have talked about that. It is not the appropriate time for us to be, I think, talking in great detail about this.

First, as guidance, Senator, I would encourage you to read my statement where I distinguish the kinds, conceptualized, distinguish the kinds of revenue that are in the President's budget from a tax increase, and that would provide at least some conceptual guidance for the kinds of things that we would look that I think the President would accept as not being a tax increase, but we perhaps could discuss in greater detail.

Specifically on your question of a cigarette tax, I think at one point I distinguished between an excise tax for which there are negative externalities, including cigarette and alcohol, and for which there are no obvious negative externalities, for example, a telephone tax and an excise tax. We don't see any reason for the telephone excise tax. There is, arguably, a reason for a cigarette tax and an alcohol tax.

I did not mean to imply surely the next step, and that is the present tax is too low. I have seen no analysis; I have done no analysis that suggest to me at this point that the cigarette tax is too low or that the alcohol tax is too low. And for that reason, I would oppose it at this point.

Senator BAUCUS. Essentially, the kinds of taxes where there are negative externalities.

Mr. MILLER. Externalities. Social costs associated with them.

Senator BAUCUS. Right.

Mr. MILLER. Costs beyond the person who purchased it.

Senator BAUCUS. That is the category that the Administration would be not more interested in but at least less resistant.

Mr. MILLER. Well, what we would do is perform analyses to see whether we got the level correct.

Senator BAUCUS. What other kinds of taxes where there are negative externalities, besides alcohol and cigarettes?

Mr. MILLER. Following up on yesterday's Wall Street Journal, don't use the T word. I just don't think it would be productive for me to sit down and speculate about particular taxes, but just to refer to the guidance that is contained in my testimony about conceptually the kinds of things that—kinds of revenues that do not classify, in our judgment, as an ordinary tax, the kind of thing the President has steadfastly opposed. Obviously an asset sale is not a tax. And any additional assets for speeding up the sales of certain assets that we would not all accept but endorse.

Senator BAUCUS. Turning to the administration's proposal on catastrophic health insurance in Medicare and cost to enrollees. As I understand it you are proposing that new enrollees in Medicare begin paying a monthly premium equal to 35 percent of the program cost. Is that correct?

Mr. MILLER. Yes. You know, it was a 50-50 split sometime ago when it was set up, and that has deteriorated.

Senator BAUCUS. What would 35 percent translate into, say, the monthly cost to a new enrollee?

Mr. MILLER. That is a 40-percent increase. I mean, it is 10 divided by .35, I guess.

Senator BAUCUS. In dollar terms, what would that be?

Mr. MILLER. Seven dollars a month.

Senator BAUCUS. Thirty-five percent would be a $7 a month increase.

Mr. MILLER. Yes.

Senator BAUCUS. Is that 35 percent?

Mr. MILLER. Well, it goes from 25 to 35, so it would be 10 divided by .25, and that is roughly a 40-percent increase, $7 a month.

Senator BAUCUS. What would then the total cost be to the elderly for the catastrophic proposal that the Administration is enacting?

Mr. MILLER. Our estimate is $4.92.

Senator BAUCUS. I mean, total, everything. I am an enrollee. I am a senior citizen. What am I going to be paying, total, for my Medicare bill, including catastrophic?

Mr. MILLER. About $27, which would be about a $10.00 increase per month——

Senator BAUCUS. $27.00.

Mr. MILLER [continuing]. Over the $17.50 that exists now.

Senator BAUCUS. $27 a month. Right? Is that correct?

Mr. MILLER. Something like that.

Senator BAUCUS. And these, both the catastrophic and the other premium, would be indexed at what, the CPI? There is a special index.

Mr. MILLER. Well, the Part B catastrophic would be indexed, would vary according to the risk—to experience with the risk. And the other Medicare premium would be indexed to the cost. And that would depend on the definition of benefits, subject to change.

Senator BAUCUS. And you also said, if I understand it, earlier today that the premium cost increase would be at a rate faster than Social Security.

Mr. MILLER. Well, if we have the same experience in the next several years that we have had in the past, namely, that the medical CPI goes up faster than the CPI which drives Social Security COLA, you would need to get some—there would be conceivably reasons why it wouldn't, depending on the experience of the incidence of catastrophic illness in the population. Assuming that didn't change, then you would probably have the risk—the Part B premium for catastrophic going up at a higher percentage rate than the percentage increase in the Social Security.

But let me just stress the details of that. I mean, we are looking at a possibility of a provision. I just don't want to say. It will be up tomorrow.

Senator BAUCUS. Well, my concern is that, frankly, since any catastrophic legislation may be enacted won't be enacted for another year or two, and cranked into the medical index premium increases, that that $27 figure you gave me is not going to be $27. It is going to be a bit higher by the time this takes effect. And since these premiums are going up at a rate faster, at least from historical evidence, than the Social Security COLA, I was wondering if it behooves us to find some supplemental way to pay for catastrophic, that is, in addition to tacking on an additional monthly premium payment.

Mr. MILLER. Well, the answer, Senator, in our view, is no. I mean, it needs to be budget neutral, and it needs to be self-sustaining.

Keep in mind again that since we had Medicare put in place, the split has gone from 50-50 to 75 percent federal general taxpayer share, 25 percent share for the enrollees. And Social Security benefits have risen at a much higher rate than these programs.

Senator BAUCUS. What about means testing catastrophic? I hear a lot of people around the country at town meetings, lunches, whatever, more and more are beginning to talk about some kind of means testing. They point out that a lot of seniors are not very well off, but a lot of seniors are very well off. And if we have this big budget crunch, you know, just a general sense of fairness and equity implies that we look seriously at some kind of a way to accommodate that.

Mr. MILLER. We have opposed means testing of Medicare. Let me just say, when you have concerns about the poor, you provide for them much more efficiently through direct income distribution programs. We view Medicare as an insurance program.. And we would not expect to differentiate that program, or means test that program any more than you would expect to means test your going in and purchasing something at a hardware store. A poor person pays the same as the richer person. If that is a problem for the poor person, then we can redistribute income to them. But to have the goods and services that they purchase skewed by means testing is not a good way of going.

Senator BAUCUS. A lot of good Republican doctors tell me they would like to change that a little bit.

My time is up, and I thank you very much, Mr. Director.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Miller, I was not here, and I understand that Senator Mitchell might have touched on this. I am concerned about the cap on the Medicaid.

Mr. MILLER. Uh huh.

Senator CHAFEE. This is, as you know, the only federal program which currently helps the elderly or the disabled in need of long-term care, plus it is the only program to provide comprehensive health care to the poor. And even without a cap, it is only covering a fraction of those. And with a cap, of course, the number it could cover would be far less.

I find it very difficult to understand your rationale for capping the Medicaid.

Mr. MILLER. Well, Senator, I have in my testimony some explanation for our rationale, some summary of our rationale.

Basically a program that costs have gone up very rapidly. We are providing in the budget some incentives for states to be more efficient in their employment of these Medicaid funds, and we believe that even with a cap that there will be no deterioration in the benefits given. We are talking about a fairly large program, to begin with.

Senator CHAFEE. Well, I mean, I do not agree with you because when you have the state paying a substantial share—at least 50 percent in most instances—there is an incentive, obviously, on the state to watch those expenses.

Mr. MILLER. Well, again, roughly speaking, very roughly, states and the federal government share 50-50. Actually the Federal Government shares more than 50-50. And two things to keep in mind. One, Medicaid budget outlays will increase under the President's proposal. Two, the billion dollar saving is only 4 percent of the Fed's part, which would be 2 percent of the total, roughly speaking.

Senator CHAFEE. Uh huh.

Mr. MILLER. Or a little bit more than 2 percent total. And we believe that there are savings from capitation. We are encouraging states to move in the direction of capitation. We believe there are other kinds of savings that states can engage in that would reduce the rate of increase in Medicaid outlays that are thrust upon taxpayers, federal taxpayers, and not diminish the services to Medicaid recipients.

Senator CHAFEE. Let me ask you one other question and then I want to get to a broad point.

I have proposed doubling the cigarette excise tax from 16 to 32 cents. Now I have done that primarily for health reasons and not for revenue reasons. However, the revenue is hardly negligible. I think that the cost to the Federal Government of smoking go way beyond the cost, as calculated under Medicare. I mean, the smoking affects the budget of the Veterans Administration, for example. Smoking affects the private insurance plans, which are made more expensive because of the health problems of smokers covered by private insurance. And then, those increased expenses, those increased insurance primiums are deductible and thus the Federal Government loses out on revenue.

So I think that the argument is easily sustained that the cost to the U.S. Government of cigarette smoking is way beyond the 16 cents a pack that you currently receive.

You said you have no rationale to believe that the tax isn't enough. Now I don't know what is enough. But the statistics show that the tax is something like 50 percent of what it was 20 years ago, because of the inflation factor. So if it was enough then, then it is inadequate now, presumably. And I would like to see you endorse that cigarette excise tax. What would it take to persuade you?

Mr. MILLER. The kind of analysis that would really show that the social costs are much greater.

Senator CHAFEE. Oh, you would find that persuasive?

Mr. MILLER. Yes.

Senator CHAFEE. Well, I think we could do that. In other words, if you were convinced that the cost to the U.S. Government of smoking was greater than the revenue that is brought in by 16 cents a pack, you would find that a telling figure?

Mr. MILLER. No. No. I didn't say that. I said I think that if you found that the external cost, you calculate an appropriate X-sized theme on a negative extremality and you have to go through a lot of stuff. And it doesn't matter. It is not just the matter of whether it cost the Federal Government this much. You don't say how much would it cost the Federal Government? Then you raise that amount of revenue. It is more complicated than that.

Senator CHAFEE. What would be other factors besides the cost to the Federal Government?

Mr. MILLER. It is marginal cost, not average cost, for one thing. It is a complicated analysis. I would be glad though to look at whatever you and your staff would put together.

Senator CHAFEE. Finally, I want to ask a question about the point you made throughout your statement that the United States is spending more on health care than any other industrial nation and doing worst. Was it in your statement that you talked about the high infant mortality, for example?

Mr. MILLER. Yes.

Senator CHAFEE. I believe that is a national disgrace.

Why do you think health care expenses in the United States are so high? It goes way beyond controlling the cost of Medicare or Medicaid, as you suggest. What is wrong in our system?

Mr. MILLER. Infant mortality. Senator, you are probably more versant with the literature on this than I am. The question I have is that we, first of all, do not, we in this country, despite a lot of talk about it, do not put as much a high premium on our own personal health as do many—do citizens in many other industrialized countries. Our diets are not as proper. And I can speak from experience on that.

Senator CHAFEE. Are you suggesting that the average Englishman smokes less, drinks less, exercises more than the average American? Is that a factor?

Mr. MILLER. A factor. In addition to that, of course, we have a very high incidence of teenage pregnancies, of women who do not take as good care of themselves and do not have as good care provided to them during the pregnancy months. And this is, as you know, a major explanatory variable in infant mortality.

Senator CHAFEE. Well, I just find it extremely discouraging that we don't have proper prenatal care under our health care system. Yet we are spending these billions of dollars. We spend more, as you say, than any other industrial nation. Something is wrong somewhere and I am curious to know where. Do you have any further suggestions?

Mr. MILLER. Well, I have a number of suggestions in the testimony and, of course, in the documents accompanying the budget. One of the great difficulties, of course, is that the incentives built in to the Medicaid payment system do not always adhere to the efficiency of the provision of these medical services and lead to excessive costs and to excessive procedures. One of the problems we have in this country, frankly, is the tort system, the insurance liability that is placed on physicians. One reason we have overprescribing of procedures is because of the fear of that. You know that better than I do, and that is something the President has proposed that the Congress deal with.

So it is very complicated. I don't mean in any way to suggest that there are a couple of keys to unlock the door to Nevada. It is something we need to work on in many directions.

Senator CHAFEE. Thank you, Mr. Chairman. Thank you, Mr. Miller.

Mr. MILLER. Thank you.

Senator BAUCUS. Mr. Miller, I have just one question here. Are you familiar with the Stark-Gradison catastrophic bill? Essentially, they are trying to find a way to take away the burdens from the poor; trying to find a way to finance catastrophic care for the elderly. And essentially, as I understand it, they propose for Part A a $500 deductible and a thousand dollar deductible under Part B, and they finance it by saying that all the elderly whose incomes qualify them high enough so that they have to pay income taxes, would have their adjusted gross income raised $1800.00. So, therefore, those wealthier Americans would be paying higher taxes to help finance catastrophic insurance.

Mr. MILLER. That looks like a T word to me.

Senator BAUCUS. And particularly of Part B. How is that?

Mr. MILLER. I said that is looking like a T word to me in tax words.

Senator BAUCUS. Would the administration oppose that?

Mr. MILLER. I think so.

Senator BAUCUS. Would you recommend a veto if Congress were to pass it such a bill?

Mr. MILLER. Senator, I profess a great deal of ignorance on this particular proposal. I have heard your characterization of it. And I would have to evaluate before I could tell you whether even I would recommend it to the President, that he veto it or accept it.

Senator BAUCUS. I encourage the present administration to look at something along these lines and keep an open mind on all this. And, frankly, I think all this talk about a T word or not a T word is counterproductive.

Let me just give you an analogy. And that is on the trade bill. I have noticed this year that the administration is less prone to label anything that the Democratic Congress—the Democratic House and now the Democratic Senate—comes up with to try and curb our trade deficits as protectionism.

Last year, whatever we came up with, the Democratic side said they won't fight the administration. It is protectionism. And, frankly, it led to a little complication and neither side got very far on it. And I think the trade deficit is big enough a problem but we need some more cooperation.

I notice this year that the administration is much less proned to label everything that comes up here as protectionism. That is, any trade bill or any provisions in the trade bill as protectionism. They are much, much less likely to do so and I think that is very helpful.

So I hope that we can try to find ways to get the budget deficit reduced, you know, that the administration doesn't automatically label any constructive, legitimate way to try to solve the problem as "taxes" and, therefore, you will oppose it.

I just encourage you to be more constructive and more helpful because the fact of the matter is we are all in this boat together, the both ends of Pennsylvania Avenue.

Mr. MILLER. Sure.

Senator BAUCUS. So if we are going to get the budget deficit reduced, as in the case of the democratic process—democratic with a small "d"—it is compromise, give and take. But we have to work together.

Mr. MILLER. Well, Senator, your point is well taken. The T word business is somewhat of an inside joke. But you and I both know—well, maybe you don't know—but let me just tell you my perspective. The reason that we are having this colloquy about whether the inclusion of current state and local employees in the Medicare is taxed or whether the user fee on poultry and inspection is a tax or not is because when the President's budget came out and had more than half of the deficit reduction program in revenue, there were people who said it is a tax, it is a tax, it is a tax. And, therefore, the President is going to accept a tax increase. And I am saying that is not true. And so I have been spending a lot of time trying to explain that what the President's revenue package does not qualify for what he strenuously opposed as a tax increase.

And on your point about working together, I think, you know, you are absolutely correct. We are in the boat together and we need to work things out.

We would like to see, however, what is on the other side. I have an old saying, and I don't just apply it to this situation; it applies to many situations. It is easier to write a book review than it is to write a book. And we have written a book and then we have had some reviews. And now we would like to see that other side, the other book, and then we will sit down and talk about how it ought to be fit together.

Senator BAUCUS. Thank you very much.

Mr. MILLER. Thank you, Senator.

Senator BAUCUS. The hearing is adjourned.

(Whereupon, at 12:14 p.m., the hearing was concluded.)

[The prepared written statement of Mr. Miller follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D C 20503

PREPARED STATEMENT

of

JAMES C. MILLER III

DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

before the

COMMITTEE ON FINANCE

U.S. SENATE

WASHINGTON, D.C.

FEBRUARY 18, 1987

Mr. Chairman and Members of the Committee: It's an honor to have this opportunity to discuss with you the President's budget for FY 1988.

As you know, the President's budget proposes a further reduction in the deficit while maintaining Federal support for the core functions of Government. Specifically, the budget:

-- Meets the Gramm-Rudman-Hollings FY 1988 deficit limit of $108 billion -- a reduction of $65 billion in FY 1988, following a reduction of $48 billion in FY 1987;

-- Avoids increasing the Nation's tax burden;

-- Reflects the bipartisan consensus to protect social security;

-- Provides 3 percent real growth (above the FY 1987 appropriated level) in funding for national defense; and

-- Reforms, reduces, or terminates an assortment of programs, saving taxpayers $19 billion in FY 1988 alone.

As a share of gross national product (GNP), the deficit decline is dramatic -- from a total of 5.3 percent of GNP in FY 1986 to just 2.3 percent in FY 1988. In absolute amount, the deficit is more than cut in half in just two years -- from $221 billion in FY 1986 to $108 billion in FY 1988.

Under the President's budget, outlays increase by $9 billion -- from $1,016 billion in FY 1987 to $1,024 billion in FY 1988. Adjusted for inflation, spending actually declines in real terms.

The $9 billion increase in outlays reflects the net impact of: (a) an increase of $2 billion for net interest payments; (b) an increase of $11 billion for social security benefits; (c) an increase of $15 billion for national defense; (d) an increase of $1 billion for major medical programs; and (e) a net decrease of $21 billion for other Federal spending. This decrease in outlays for other programs reflects the net impact of $13 billion in increased revenues from asset sales, privatization initiatives, and user fees, as well as a wide variety of programmatic increases and decreases.

Revenue Increases

The President's FY 1988 budget contains deficit savings of $42.4 billion. Programmatic reforms account for only $18.7 billion of these savings; the rest come from increased revenue of $22.4 billion and lower interest expense of $1.3 billion.

Critics have latched onto the revenue figure as evidence the President has broken his promise not to raise taxes. They say the only question for FY 1988 is just how big a tax increase there's going to be, not whether there will be one. Their argument appears to be based on an unusual definition of a tax -- anything that raises Government revenue. That is not how the Administration defines taxes, nor does this view comply with the usual definition.

First, the budget distinguishes between increases in receipts, which total $6.1 billion, and increases in offsetting collections, which total $16.3 billion. Offsetting collections are payments of a "business-type or market-oriented nature," and about $13.0 billion of the total stems from the sale of Government assets. No one should confuse an asset sale, whether a Government loan or a railroad, with a tax. Certainly, the purchasers won't. They expect to receive something of value they might later resell if appropriate. Furthermore, there is no element of compulsion in these transactions, as there is with taxes. You don't have to purchase a government asset if you don't want to.

Another distinction is that an asset sale pares down the size of government. And since many of our privatization efforts are accompanied by an end to wasteful subsidies, in the long run spending goes down as well. Asset sales are "one-shot" revenue increases, whereas tax increases are designed to increase the revenue stream permanently.

The remaining $3.2 billion in offsetting collections comes from user fees, which also clearly are not taxes, although they do constitute a permanent increase in the revenue stream. A user fee is a direct charge for a specific benefit received. Like an asset sale, but unlike a tax, a user fee does not involve compulsion. One characteristic of user fees is that they reveal how much government programs are really worth to direct recipients in the most direct and meaningful way possible. One of the strongest arguments that a government program is worthwhile occurs when it has a user fee and the fee covers costs. The reverse is also true, and that is one reason some beneficiaries oppose user fees.

Finally, the budget incorporates increased receipts of $6.1 billion. Do these revenues reflect a broken promise not to raise taxes? Not at all. First, more than a third of the extra receipts -- $2.4 billion -- is due to tighter enforcement of existing tax laws. Collecting more of the taxes already owed the Government is not a tax increase.

Several of the reforms giving rise to increased receipts are very much like user charges, but by convention show up in the receipts portion of the Government's ledger. It has long been accepted that the Federal excise taxes on gasoline and diesel fuel, and other highway excise taxes, are in essence a user fee for consumption of Federally-supported roadways. Indeed, the monies collected are deposited in a trust fund for that purpose. The budget proposes to repeal the partial exemptions from excise taxes on gasoline and diesel fuel produced from gasohol and certain alcohol fuels, and repeal the exemptions from these and other highway excise levies provided private bus operators. The budget also proposes to end the present free ride afforded State and local governments -- who now pay no tax but like every other user derive benefits from using Federally-assisted roadways. The repeal of these exemptions increases receipts to the highway trust fund by $0.8 billion.

The vast majority of employees of State and local governments benefit from Medicare coverage under existing laws and regulations. Rather than propose excluding those few not paying for Medicare -- an initiative that surely would generate howls of opposition -- we propose that existing employees, like new employees under current law, contribute appropriate payments to Medicare. This increases receipts by $1.6 billion.

Likewise, many workers whose current job is not covered under social security (OASDHI) will be eligible for benefits because of their spouse's earnings record or short periods of work in covered employment. The proposed extension of social security coverage to the inactive duty earnings of Armed Forces reservists, certain students and agricultural workers, children aged 18-21 employed by their parents, and spouses employed by the other spouse increases receipts by $0.3 billion.

We also propose that employers pay the social security payroll tax on total cash tips -- rather than reduce the benefits provided to such employees. Under current law employers generally pay the social security payroll tax on the amount of tips considered to be wages under the Federal minimum wage law, even though the tax liability of their employees is based on the total amount of cash tips. Benefits also are based on the total amount of cash tips. This proposal would eliminate the cross subsidy from other employers and would increase receipts by $0.2 billion.

Two trust funds -- those paying victims of "black lung disease" and rail industry pensions -- presently are not sound in an actuarial sense. Therefore, the Administration proposes to increase the "user charge" contribution -- by $0.5 billion. Similarly, to ensure sound financing of railroad unemployment benefits -- the Railroad Sickness and Unemployment Insurance Fund is deeply in debt to the financially ailing rail pension fund -- the budget renews the Administration's proposal to extend the Federal/State unemployment insurance program to the railroad industry. This increases receipts by $0.1 billion.

Many of the remaining measures, which increase receipts by a net $0.2 billion, can be explained by similar logic. These include:

-- The correction of a technical deficiency in the existing ad valorem tax on imports, which exempts imports with American-made components. This will ensure than the costs of services provided by the U.S. Customs Service are borne by the users of these services.

-- The initiation of rail sector financing of a portion of windfall benefits, which will reduce the annual subsidy of some $1,100 per employee to about

$820 in a sector with annual average wages of some $40,000 per rail worker.

-- An increase in the D.C. government employer contribution to civil service retirement as necessary to cover the full cost of the program.

-- Increases in existing fees to recover 50 percent of Nuclear Regulatory Commission and Federal Emergency Management Administration costs for regulating nuclear power plants.

Now, you be the judge. Do these revenue proposals constitute a tax increase? The answer, I submit, is a definite no.

Health Care Reforms

As a nation, we simply cannot afford health costs that rise at four times the rate of general inflation. Americans spent $425 billion on health care in FY 1985 -- 10.7 percent of our gross national product. Per capita, we spend more on health care than any other nation on earth -- 28 percent more than Canada, 52 percent more than West Germany, and 100 percent more than Japan. We must find ways to provide high-quality health care at prices people can afford.

As you all know, Federal spending on health care is growing far more rapidly than inflation and the aging of our population combined. Approximately 52 million of the Nation's poor, elderly, and disabled will have their health care needs met through these programs in FY 1988 -- an increase of 5 million people, or 11 percent, above FY 1980 levels. These programs are expected to aid approximately one in every five Americans in FY 1988. In contrast, over the same FY 1980 to FY 1988 period, Medicare and Medicaid spending increased by 117 percent.

In the first half of the 1980s, Medicare expenditures increased an average of 12.4 percent a year. Only defense spending (11.9 percent) and interest costs (15 percent) grew at comparable rates. Even with the recent success in restraining health care inflation, under current law Medicare outlays are projected to escalate by 10 percent annually through FY 1992, more than twice the projected average Consumer Price Index and rate of growth in the numbers of beneficiaries combined.

The President's budget proposes to slow this growth rate to 8 percent a year -- a rate faster than last year's growth -- through proposals designed to contain costs and to increase the efficiency of health care delivery. Even so, under this budget Medicare spending will be $104 billion by FY 1992 -- more than two-and-one-half times the amount spent in FY 1981.

Medicare and Medicaid spending will continue to grow as a share of the President's budget -- from 9.2 percent in FY 1981, to 11 percent in FY 1986, and to 13 percent by FY 1992. Excluding interest costs and spending on social security and defense, under this budget Medicare's proportion of the Federal budget will double -- from 12.4 percent in FY 1981 to 25.4 percent in FY 1992. Our proposals can only be said to provide "cuts" from which I believe to be an imaginary, unsustainable baseline characterized by runaway growth.

As you know, through various reforms the Administration and Congress have been successful in controlling hospital expenditures -- which grew by only 2 percent between FY 1985 and FY 1986, after almost doubling between FY 1980 and FY 1985. Hospitals responded to the implementation of the prospective payment system (PPS) by becoming more economical in providing care for their patients. At the same time, hospitals posted profits, and, according to the Commission on Professional and Hospital Activities (CPHA), high-quality medical care has been maintained. Specifically, CPHA found that PPS did not change the quality of care delivered to either Medicare or non-Medicare patients.

In part because of and, in part, despite of, the facts I just mentioned, the Administration's goals remain very much the same as FY 1981. The Administration intends to promote competition, capitation, and other reforms that rely on private markets to stimulate health care service efficiency and enhance the quality of care. As part of this effort, we plan to increase choices for beneficiaries and providers alike.

We want to build on our modest success in restraining hospital payments, we want to begin changing the inflationary incentives of physician payments, and we want to <u>ensure the quality of care</u>.

For example, we are proposing to expand opportunities for Medicare beneficiaries to enroll in a wider range of private health benefits organizations. We want to establish a series of demonstration projects to explore ways that Medicare can benefit from innovative private sector arrangements. These projects will create negotiated provider agreements for physician services delivered outside the hospital.

Standing by our goal to change the inflationary incentives of open-ended cost reimbursement of hospital capital, we will phase capital into the prospective payment system rates over the next 10 years. As specified by Congress, our phase-in will remain "budget neutral" to the Congressionally-set levels for FY 1988 and FY 1989.

We propose to restore the authority of the Secretary of Health and Human Services to update payments under the prospective payment system; as you know, this authority was suspended for FY 1988 by the FY 1987 Reconciliation Act. Under our proposal, using the most current information available, the PPS update would be set at an amount necessary for the efficient and effective delivery of medically-appropriate, high-quality care. For planning purposes, average hospital payments are projected to increase 2.5 percent in FY 1988.

The President's budget also includes a proposal to increase modestly payments made by current Medicare beneficiaries. Specifically, we would index for inflation the present $75 deductible a beneficiary pays before Medicare coverage for physician services begins. Our proposed increase to $77 for FY 1988 is clearly warranted. The deductible currently remains frozen at its FY 1982 level, which in real terms is less than half the deductible in effect 20 years ago. Beneficiary income -- social security -- already is inflation indexed; it is proper for the Medicare deductible to be inflation indexed as well.

We also propose to increase the supplementary medical insurance (SMI) premium for new enrollees only. Current enrollees would continue to pay 25 percent of costs, even though when SMI began the premium covered 50 percent of costs. We propose that new enrollees pay 35 percent of costs. We believe that new enrollees can easily afford this modest increase in premiums. Many realize a higher standard of living once retired, and social security benefits for new enrollees are higher than ever.

As indicated earlier, we also propose that coverage of Medicare be extended to current (as well as new) State and local employees. As mentioned earlier, under current law many State and local employees become eligible for Medicare on the basis of spouse participation or short work periods even though they have not contributed their fair share to the Hospital Insurance Trust Fund. Our proposal also assures Medicare coverage to State and local employees who now have no opportunity to enroll.

Controlling physician costs has proven to be one of our most difficult challenges. Despite the vigorous efforts of

Congress and the Administration, Federal expenditures for physicians grew by 15.7 percent annually between FY 1980 and FY 1985. During the FY 1986 Congressional freeze on physician charges, spending on physician services grew 8.5 percent, while the number of beneficiaries grew by only 2 percent and hospital admissions actually declined by 2 percent. Absent any fundamental reform of physician payment rules, spending for physicians is projected to grow 12.5 percent annually in FY 1987 and beyond.

The fee-for-service reimbursement system used to pay physicians so far has been immune to the government's best efforts to control costs. Numerous privately and publicly funded studies have shown that from the standpoint of Medicare, fee-for-service reimbursement is inherently inflationary, rewards the minority of physicians who provide medically unnecessary services, and thereby penalizes the majority of doctors whose primary interest is patient care.

We propose to reform Medicare's payment mechanism for radiologists, anethesiologists, and pathologists (RAPs) by having Medicare pay an average area price for hospital-based physician services. The area price will be determined by using actual physician billing information and calculating the average amount paid for each physician service. By paying an average price for each physician practice area, variations in costs reflecting different patterns of medical practice will be retained.

Our proposal will encourage hospital-based doctors to make a bias-free decision whether to return to the traditional relationships that existed prior to the imposition of Medicare rules. Before the creation of Medicare's split billing rules in FY 1965, most hospital-based physicians billed through the hospital or were on salary, rather than billed on a fee-for-service basis. The Administration's proposal does not change current Medicare assignment rules. All physicians, including RAPs, will continue to be able to bill beneficiaries above Medicare's "reasonable charges". Doctor-patient relationships will not be altered. Hospital-based doctors will continue to provide their services directly to patients or in conjunction with other doctors. And quality of care will not be affected. I cannot believe a doctor on salary performs his or her work less diligently than he or she would if reimbursed by fee for service.

Medicaid has grown at an annual rate of 10 percent since 1980. We have two strategies to slow the rate of increase in Federal and State medicaid expenditures. Two proposals consistent with prior budgets are to reduce

Federal expenditures by reducing Federal assistance to States for Medicaid through the cap and reduced -- to 50 percent -- special matches for administrative expenditures. A new feature in this year's budget, and one that holds much promise, would provide to the States financial incentives to place Medicaid recipients in capitation. States would receive an enriched Federal matching rate for the first three years of each new capitation project. In return the State would systematically reduce its Medicaid expenditures over the three years to 95 percent of what it would have spent under fee-for-service. States with excessive Medicaid costs could opt for capitation because it provides low-income residents with guaranteed access to medical care. Capitation can contribute to higher quality care because it would end sporadic, disjointed, and inappropriate care.

In summary, we think these proposals are solid, realistic, and very much needed. We're carefully changing the perverse incentives that contribute to progressively inefficient service delivery and unsustainable Federal spending. To obtain these goals, true reforms are necessary. We in the Administration look forward to working with you in Congress toward this end.

Before leaving the topic of health care reforms, Mr.Chairman, allow me to comment briefly on the difference between the Congressional Budget Office (CBO) and Office of Management and Budget (OMB) estimates of the Medicare baseline. As you know, CBO's preliminary FY 1988 baseline for Medicare is $5.4 billion higher than the Administration's estimate. CBO projects that Medicare spending will increase by over 14 percent in FY 1988, following increases of 7 percent in FY 1986 and and 4 percent in FY 1987. The Administration believes that such extraordinary growth will not occur and that the OMB estimate, based upon the advice of the Medicare actuaries, is far more realistic. Let me explain.

The OMB versus CBO difference results in large part from three factors:

-- CBO's different assumptions from the Medicare actuary about bill processing times under provisions of the Omnibus Budget Reconciliation Act of 1986 increases the baseline by $1.4 billion.

-- The Treasury data on FY 1986 spending used by CBO yielded estimates $1.0 billion higher than the more recent data that the Medicare actuary received from the Medicare intermediaries.

-- CBO's overall projected Hospital Insurance Fund growth rate is higher than the Administration's projection, contributing over $1.5 billion to the higher CBO Medicare estimate.

For obvious reasons, we look forward to seeing CBO's final appraisal of the President's budget in this area.

Welfare Reforms

Because I know the Committee is interested in welfare issues, I want to draw to your attention two interrelated proposals in the budget that deal with the population receiving Aid to Families with Dependent Children (AFDC). Both of these proposals are based on landmark research that shows that those most likely to stay on the AFDC rolls for a long time are young, unmarried mothers with young children. Both our proposals are designed to prevent welfare dependency and increase the self-sufficiency of AFDC recipients.

The first proposal is for a new program in AFDC: Greater Opportunities through Work. "GROW" is the acronym. This proposal will give States substantial flexibility to structure programs of work-related activities designed to prevent and reduce welfare dependency. It will replace current authorities for the Work Incentives program (WIN), WIN demonstrations, community work experience programs, grant diversion, and employment search with a single authority.

Under GROW:

-- The Federal law that exempts mothers with children under age six from participation in work-related activities will be eliminated. This change will mean that those recipients most likely to stay on the rolls for a long time no longer will be exempt from activities designed to increase self-sufficiency.

-- Teenage AFDC recipients who have not completed high school will be able to meet participation requirements by staying in or returning to school. Older recipients will be able to participate in a variety of activities, including job search, work experience, remedial education, training under the Job Training Partnership Act (JTPA), time-limited training directed at immediate employment, and other State-designed activities approved by the Secretary of Health and Human Services.

-- States will reach 20 percent participation in FY 1988, rising to 60 percent by FY 1992. Higher target rates for teenage recipients will be set within these overall standards.

-- Fifty percent Federal matching funds for work-related activities, excluding education and training, and for support services for participants in all activities will be provided out of AFDC administrative funds. Research and evaluation funds also are provided to develop outcome-oriented performance standards that do not lead to "creaming", which has been a problem in most efforts designed to improve the self-sufficiency of AFDC recipients. (These standards will be integrated into GROW as soon as they can be developed.)

While GROW will save money in the longer term, in the first year costs will slightly exceed the savings expected.

The second proposal relating to AFDC amends the Job Training Partnership Act by replacing the existing Summer Youth Employment program with one allowing States and local areas to establish a comprehensive program of services for youth in families receiving AFDC support. States and localities will be able to operate a year-round program of remedial education, basic skills training, and related support; a subsidized summer jobs program as they do now; or a mixture of both programs. The mix of services between training and jobs will be up to States and local areas.

This proposal is intended to allow those closest to such problems to put together the best combination of services to help youth who suffer from illiteracy and a lack of jobs skills. These youth are the ones most seriously at risk of failing to participate fully in our society and having to turn to AFDC for support.

The President has requested $800 million for this program in FY 1988 -- $50 million more than in the FY 1987 enacted appropriation for the Summer Youth Employment program. These funds will be targeted to areas where this youth problem is most severe.

The AFDC Youth Training proposal will be coordinated with GROW. Taken together, we believe these two programs will provide meaningful assistance to the AFDC population in general and particularly to those who can benefit from early interventions to prevent long-term welfare dependency.

Restoring America's Competitiveness

The ability of our Nation to meet global competition, to provide for our national security, and to improve the quality of life for all our citizens depends heavily, in the long run, upon national investments in science and technology. The Nation's future strengths in global markets will depend on the allocation of national resources to the generation of new knowledge and the effective and timely transfer of this new knowledge to specific applications.

To aid in meeting this goal, the Administration recommends further increases in Federally-supported basic research. This proposal includes:

-- An increase of about 18 percent in funding for basic research for the National Science Foundation in FY 1988 and a doubling of this budget by FY 1992.

-- An increase of about 22 percent in basic research activities of the National Aeronautics and Space Administration, including the initiation of two new science and technology programs.

-- An increase of about 15 percent for the general science programs of the Department of Energy, permitting better use of basic research facilities.

Support for basic research, particularly at universities, is key to generating sufficient new knowledge to ensure our leadership in technological innovation. Quite appropriately, the Federal Government has assumed a major role in the financing of basic research. This support will increase by 76 percent between FY 1982 and FY 1988 -- an average annual rate of growth of nearly 10 percent.

A second key element in assuring our leadership in science and industry is the future availability of high-quality scientists and engineers. Funding basic research in academic institutions is an effective way of expanding the pool of trained scientists and engineers. The Administration proposes to increase the emphasis on research programs that would contribute to the development of such "human capital". This emphasis will be reflected in the proposed new basic science and technology centers, in the new Super Conducting Super Collider just announced by the President, and in a variety of ongoing programs of the National Science Foundation, including the engineering research centers, the advanced scientific computing centers, the graduate fellowship program, and programs to improve student research and increase funds for scientific equipment at undergraduate institutions. Increased support will also be provided for other NSF programs aimed at improving the quality of pre-college science and mathematics education.

The Federal government should also encourage the transfer to the private sector of existing technology and new knowledge created in Federal laboratories. Both are of little practical use unless they are made available to the private sector to permit applications in the marketplace. To achieve this goal, there will be increased Federal efforts to transfer the results of Federally-supported research and development both through greater use of incentives for Federally-employed scientists and engineers and through the exchange of scientists and engineers between Government and industry.

Finally, the administration proposes to strengthen the Nation's "leading edge" technologies to meet other national needs. Examples include:

-- A new civil space technology initiative, together with previously planned funding increases to deploy the space station, develop the national aerospace plane, and foster the commercial development of space;

-- The strategic defense initiative and associated Department of Defense initiatives involving strategic computing and very high speed integrated circuits; and

-- Support for cooperative research and development ventures by the Department of Energy to encourage greater private sector participation in fossil, solar, and energy conservation research and development.

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Mr. Chairman and Members of the Committee: that completes my statement. Now I shall be happy to address your questions.