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BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

# What Can Be Done To Check The Growth Of Federal Entitlement And Indexed Spending?


Federal spending for entitlement and indexed programs has grown significantly over the past decade. In this report, GAO examines the nature of such spending, the reasons behind its growth, and what can be done to limit such spending in the future.

GAO identifies seven approaches for checking the growth of entitlement and indexed spending. These include:

- --Eliminate the program altogether.
- --Limit the indexing of program benefits.
- --Tighten eligibility criteria to target available funds to the most needy.
- --Reduce the level of benefits.
- --Cap the program's total spending.
- --Limit spending to amounts annually appropriated.
- --Improve the efficiency with which a program is administered.


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To the President of the Senate and the
Speaker of the House of Representatives

There is a growing consensus on the need to cut the rate of growth in Federal spending. Consequently, the Congress today is searching for ways to reduce the budget. To assist the Congress in this effort, we offer in this report seven basic approaches to controlling that portion of the budget consisting of entitlements and indexed spending. The seven methods that the Congress should consider include:

--eliminate a program altogether,

--limit the indexing of program benefits,

--tighten eligibility criteria to target available funds to the most needy,

--reduce the level of benefits,

--place a cap on the program's total spending,

--limit spending to amounts annually appropriated, and

--improve the efficiency with which a program is administered.

Except for program elimination, these seven approaches are not mutually exclusive. We expect that the Congress will use all of these approaches in one form or another in its effort to restrain Federal spending. Any particular decision to limit the size or growth of entitlement and indexed spending, whether made on program by program or on a more aggregate basis, will involve difficult choices about precisely where and how to limit such spending.

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by falling real incomes. Two arguments have been advanced in opposition to this approach. First, during periods of high inflation, benefits would not be fully protected against inflation. Second, if we are able to return to greater price level stability and higher productivity growth, we would normally see wages increasing at a faster rate than the CPI. Under this proposal, increases for those receiving entitlements would be limited to the amount of the cost of living increases.

3. Substitute for the present CPI an index judged more efficient in measuring changes in the cost of living of those receiving entitlements or make adjustments in the index to compensate for its alleged statistical deficiencies. Proponents argue that if such measures could be found, adopting them would preserve the benefits inherent in automatic adjustment processes, without incurring the social costs associated with over-compensating program recipients. If there were, at present, agreement on how best to adjust the present CPI so that it more accurately measured changes in the cost of living, such changes should be adopted whether or not the CPI is used to index entitlement programs. Unfortunately, there is, at present, no consensus on how best to make such changes, nor is there agreement on what cost of living index, other than the CPI, should be used to adjust entitlements during inflationary periods.

Despite specific drawbacks, any of these three indexing options would enable the Congress to gain increasing control over the growth of this segment of the budget. We believe the first option is preferable because it permits the President to recommend and the Congress to consider the cost of living increases as part of the budget process. In this way, the action has the full visibility of the budget process.

While many entitlement programs are indexed, some entitlement programs are not. The three approaches to limiting the costs of indexing discussed above would thus not apply to such non-indexed entitlements. However, there are a number of other ways to restrain the growth of entitlement programs, whether indexed or not. These approaches are discussed generally in this report and in the context of specific programs in other General Accounting Office reports. In numerous reports on individual entitlement programs, we have suggested how such programs could be administered more efficiently, how entitlement spending could be focused better to serve

In Appendix III, we discuss the seven basic approaches to short term control of entitlement and indexed spending listed at the outset of this letter. As the Congress and its committees engage in efforts to apply these approaches to limiting spending, our staff is available to assist further based on our previous and on-going work in reviewing specific issues and programs.

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Comptroller General
of the United States

## Contents

## BUDGET CONTROLLABILITY, ENTITLEMENTS, AND INDEXING OF FEDERAL SPENDING

Federal spending is now more than 22 percent of the gross national product, the highest percentage since World War II. Federal revenue has not grown enough to maintain current levels of domestic Government services and an expanded level of defense without increasing deficits in the budget. There is widespread congressional concern about the size of the Federal budget, and many feel it is time to cut back Federal domestic spending. The task of cutting the Federal budget brings one face to face with the issue of its "controllability."

In this appendix, we address that issue, with particular attention to the controllability of entitlements, indexed spending, and other Federal programs with similar characteristics. The discussion in this appendix is preliminary to our description of the growth of entitlements and indexed spending in appendix II and to our presentation of specific measures and devices for controlling budgets in appendix III.

### THE LONG TERM ASPECTS OF BUDGET CONTROL

Control of the Federal budget is both a short term and a long term problem. Much of the recent public attention, concern, and debate have been focused on the short term aspects of budget control and on the entitlement and indexed programs that constitute the majority of Federal outlays. Before presenting the more detailed concepts of controllability, entitlements, and indexing, however, we want to emphasize the few points about the longer term aspects of budget control that are important to understanding the broad context in which specific program budget decisions should be analyzed and debated.

It is important to keep in mind that, in the long run, most Federal spending is within the control of the Congress. The executive branch is bound by statutes that mandate spending, but the Congress can alter those laws and thereby alter future spending. The enactment of the Omnibus Reconciliation Act of 1980, which changed some laws to reduce spending, demonstrates that it can be done.

Controllability for the Congress means making a trade-off between two basic objectives: (1) providing a long term, stable commitment to people who voluntarily or involuntarily participate in Federal programs and (2) controlling the budget in both the short and the long terms. There is no magic formula for making this trade-off. Any particular decision to limit the size or growth of the budget has to consider specific groups of people, specific sectors of the economy, and specific problems, whether

From the perspective of the Office of Management and Budget (OMB), the spending in any 1 year for a program that is determined by existing statute, contract, or other obligations is considered relatively uncontrollable and is so classified. OMB also treats the legislative and judicial budgets as uncontrollable; the Congress, on the other hand, regards these budgets as alterable. Under OMB's general rules, the President's budget, submitted on January 15, 1981, reported that about 76 percent of the budget is now relatively uncontrollable.

Uncontrollable spending as defined in the President's budget includes outlays for "open-ended programs and fixed costs" and "outlays from prior year contracts and obligations." Outlays for open-ended programs and fixed costs are made in four major categories: (1) entitlements providing payments to individuals, (2) open-ended entitlements such as revenue sharing and farm price supports, (3) housing assistance, Postal Service Subsidy, and the cost of the legislative and judicial branches, and (4) net interest on the Federal debt. Table 1 shows the amounts spent in these categories for fiscal year 1980 and their proportions of the total outlay.

Entitlements constitute about 48 percent of the Federal budget, almost two thirds of uncontrollable spending. The benefits of many entitlement programs are indexed--adjusted for price changes--at least annually. Table 2 lists the indexing status of the seventeen most expensive programs. With the exception of Federal civilian and military pay, which is indexed indirectly, and a few minor programs, indexing of Federal spending is limited to nine of these seventeen entitlement programs.

## Entitlements as uncontrollable

The nature of entitlement programs makes their cost largely beyond the control of the appropriations process and difficult to predict accurately. From the congressional perspective, the source of uncontrollability of entitlement spending lies in an entitlement's creation of statutory claims to prescribed payments. Entitlement programs require payments (in cash or in services) to any person, business, local government, or State that participates in the program and meets the eligibility requirements established by law.

Once enacted, entitlement legislation may automatically authorize an administrative agency to spend the funds for making the prescribed payments without advance appropriations from the Congress, thereby effectively relinquishing congressional control through the normal appropriations process. Through entitlements, the Congress has relinquished a measure of its discretion in determining the size of the Federal budget.

Entitlement costs are difficult to predict because most entitlements are open-ended--that is, benefits must be provided

Table 2

Indexing Status of Selected Major Entitlement Programs 1980

| | Outlays in billions | Indexed | Index used | Indexing frequency |
|---|---|---|---|---|
| Social Security--Old Age Survivors | $101.8 | yes | CPI a/ | Annually |
| Medicare | 35.0 | no b/ | | |
| Federal Employees' Retirement and Insurance | 27.3 | yes | CPI | Semi-annually |
| Unemployment assistance | 18.0 | no | | |
| Social Security--Disability | 15.3 | yes | CPI | Annually |
| Medicaid | 14.0 | no | | |
| Veterans Compensation and Pensions | 11.0 | yes | CPI | Annually |
| Food Stamps c/ | 9.1 | yes | CPI | Annually |
| Aid to Families with Dependent Children | 7.3 | no d/ | | |
| Revenue Sharing | 6.8 | no | | |
| Supplemental Security Income | 6.4 | yes | CPI | Annually |
| Railroad Retirement | 4.7 | yes | CPI | Annually |
| Commodity Credit Corporation (price supports) | 2.9 | yes | Parity prices etc. | Varies, part annually |
| Social Service Grants | 2.8 | no | | |
| Veterans Readjustment Benefits | 2.4 | no | | |
| Benefits for Disabled Miners | 1.8 | yes | CPI indirectly | Annually |

a/Consumer price index (CPI).

b/Some parts of the Medicare and Medicaid programs--physicians' payments for example--are explicitly indexed but not to a general price index.

c/The entitlement status of the Food Stamp program is questionable. The Food and Agriculture Act of 1977 capped the overall funding level of the program and required that the program be funded through advance appropriations, thus removing the entitlement status. However, the Congress has continued to fund the program at the full level needed to provide stamps to all eligible people who apply; therefore the Congress still treats the program as a mandatory expenditure.

d/Since Aid to Families with Dependent Children is an open-ended Federal commitment to pay a fixed percentage of State costs, increases in payment levels by States affect the Federal budget in a manner similar to automatic indexing.

The Congress sets the standards of eligibility for the programs but does not directly control the rate of participation in them. After the programs have been established, total spending can vary dramatically without congressional action, even in the absence of inflation and indexing.

## The similarity of tax expenditures and some credit programs to entitlements

Tax expenditure and credit assistance programs have some of the characteristics of entitlements, even though they are not so classified. Tax expenditure programs are selective tax reductions for particular groups of people or for people engaged in particular activities. Examples include the tax deduction for medical expenses and the tax credit for business investment in certain depreciable property. By allowing taxpayers to deduct their mortgage interest costs from their taxable income or to credit a part of investment costs against their tax, the Government effectively shares those expenses, no less than if each beneficiary were paid out of funds that the Congress had appropriated for the purpose.

The beneficiaries have long understood that the Federal Government is sharing part of their costs. Their advocates regularly appear at congressional hearings to support these tax subsidies. They often record their own costs net of the tax savings. But the Federal Government itself has only recently begun viewing the tax preferences as the equivalent of direct outlays.

The tax expenditure concept is based on the idea that the rules of an income tax system can be divided into two parts. One part consists of just the rules that are necessary to carry out the revenue-raising function of a tax on income. Such rules prescribe how net income is to be measured, what the tax unit is, what tax rates are to apply, and so forth. The other part contains the exceptions to these rules that reduce the taxes for some taxpayers but not others. These exceptions have the same effect as direct Government payments to the favored taxpayer without the attendant cost of administering direct payments.

It is because this effect is the same that tax expenditures are in some ways similar in purpose and operation to direct expenditure programs like entitlements. Tax relief for the elderly or for people with large medical bills, for example, is recognized as being directed to special groups regarded as deserving special tax treatment. In turn, the tax relief becomes a statutory "entitlement." Moreover, tax expenditure programs bypass the systematic oversight of the appropriations committees of the Congress, as do many entitlements.

Some credit assistance programs are also like entitlements. Under these, the Government's guaranteeing and issuing of loans to individuals and businesses and to local, State, and foreign

## THE REASONS FOR THE GROWTH OF ENTITLEMENTS AND INDEXED SPENDING

Federal expenditures have grown in the last 10 years at a higher rate than can be attributed to inflation alone. In the first half of that decade, entitlement and indexed spending grew even more rapidly than the budget as a whole. In this appendix, we examine the increases in these types of spending and the reasons for them.

While spending for entitlements increased from about $66 billion to $275 billion from 1970 to 1980, the largest share of the budgetary growth after 1975 appears to be attributable to inflation. Several additional factors that underlie entitlement spending growth from 1970 to 1975 will be discussed later in this appendix. Tables 3 and 4 show the growth in entitlement spending between 1970 and 1980 in totals and for selected programs. Table 3 shows the growth in entitlements as a percentage of uncontrollable spending (up from 52.7 to 62.5 percent), as a percentage of total Federal outlays (up from 33.7 to 47.4 percent), and as a percentage of gross national product (GNP) (up from 6.7 to 10.4 percent). Together, the two tables reveal that much of the budgetary growth in entitlement spending after 1975 can be accounted for by inflation. Entitlements as a portion of uncontrollable spending, total outlays, and GNP remained relatively constant from 1975 to 1980.

Between 1970 and 1975, a number of entitlement programs were indexed by the Congress. As a result of the growth in the number of programs indexed and of all other factors leading to the expansion of these programs, outlays for fully indexed entitlement programs have grown from 3 percent of total budget outlays in 1970 to approximately 30 percent of all Federal budget outlays today. This 30 percent figure excludes implicitly indexed spending for items such as Medicare and Federal wages and salaries. If these programs are included, the total increases to approximately half of the budget.

In the remainder of this appendix, we discuss the many factors that have been responsible for increasing the costs of entitlement programs, including:

--inflation and indexing,

--demographic changes that increase the size of the recipient population,

--increasing participation rates,

--court decisions, and

Table 4

Growth in Selected Entitlement Programs
Budget Outlays
($ in billions)

| Program name | FY 1970 | FY 1980 | FY 1982 a/ |
|---|---|---|---|
| Social Security- Old Age Survivors | $26.7 | $101.8 | $140.3 |
| Medicare | 7.0 | 35.0 | 46.6 |
| Federal Employees' Retirement and Insurance | 5.8 | 27.3 | 36.6 |
| Unemployment Assistance | 3.4 | 18.0 | 24.1 |
| Social Security-Disability | 2.9 | 15.3 | 19.4 |
| Medicaid | 2.7 | 14.0 | 18.1 |
| Veterans Compensation and Pensions | 5.3 | 11.0 | 13.7 |
| Food Stamps | 0.6 | 9.1 | 12.2 |
| Aid to Families with Dependenct Children | 4.1 | 7.3 | 7.7 |
| Revenue Sharing | did not exist | 6.8 | 4.6 |
| Supplemental Security Income | did not exist | 6.4 | 8.0 |
| Railroad Retirement | 1.6 | 4.7 | 5.8 |
| Child Nutrition | 0.3 | 3.4 | 5.4 |
| Commodity Credit Corporation (price supports) | 3.8 | 2.9 | 2.2 |
| Social Service Grants | 0.6 | 2.8 | 3.1 |
| Veterans Readjustment Benefits | 1.0 | 2.4 | 1.7 |
| Benefits for Disabled Miners | did not exist | 1.8 | 2.0 |

a/From President's Budget for Fiscal Year 1982, January 1981.

Table 5

Inflation and Indexed Costs: Retirement, Quasi-Retirement, and Disability Programs

| | FY 1970 outlays ($ billions) | FY 1977 outlays ($ billions) | Total change ($ billions) | Change caused by inflation ($ billions) | Percent caused by inflation |
|---|---|---|---|---|---|
| Social Security | $29.1 | $82.4 | $53.3 | $26.4 | 50% |
| Railroad Retirement | 1.7 | 3.8 | 2.2 | 1.3 | 59% |
| Civil Service Retirement | 2.6 | 9.4 | 6.8 | 2.8 | 41% |
| Military Retired Pay | 2.9 | 8.2 | 5.4 | 2.6 | 48% |



APPENDIX II

this is expected to rise to 12 to 14 percent (32 million to 38 million people) by the year 2000.

These demographic changes will increase the demand for health care services, housing assistance, and income maintenance. For example, within the population older than 65, the number of people older than 75 is increasing most rapidly. These people have the highest incidence of chronic and disabling conditions and, therefore, use health services more than others. Health programs for the elderly cost $112 billion in fiscal year 1978.

More and more older people are living alone. Since 1960, the number living alone has increased three times faster than the simple growth in the size of the elderly population. Therefore, their participation in housing assistance programs can be expected to remain high.

Social Security is another example on how entitlements are sensitive to demographic changes. It is now a mature program, covering more than 90 percent of all U.S. workers. Costs have increased in recent years in part because fewer retired people than in the past received minimum benefits. Some who retired in the past received minimum benefits. Some who retired in the past still do, but many people retiring now have average earnings that entitle them to much higher payments, and a greater percentage of people retiring in the future will qualify for maximum benefits.

## INCREASING PARTICIPATION RATES

Another cause of increasing entitlement program costs has been an increase in the percentage of eligible recipients who apply for benefits. Participation rates change for a variety of reasons. Some of these are increased awareness of the availability of benefits, changing social attitudes, statutory changes affecting participation, and altered economic conditions.

Heightened awareness of the availability of benefits may come about when the agency responsible for administering an entitlement program attempts to inform potential recipients of their eligibility and encourages them to apply. Agencies may do this either voluntarily or in response to congressional mandate or court order. The 1971 Food Stamp Act amendments, for example, contained a requirement that the Department of Agriculture attempt to find and inform potential recipients of the availability of food stamps. When the Department proved reluctant to carry out such an outreach program, it was compelled to do so by the courts.

Participation may also increase because potential recipients become more willing to apply for benefits. Some observers of AFDC argue that the War Against Poverty of the 1960s plus the activities of the National Welfare Rights Organization helped reduce the stigma of receiving AFDC benefits and increased program on to decide several eligibility issues. Generally, they took an expansive view of the statutes, determining that the congressional intent had been to favor the applicants. Consequently, the Congress amended the Social Security Disability law in 1967, to reaffirm the more restrictive eligibility criteria that had been used by the Social Security Administration.

Gauging exactly how much court decisions change entitlement costs is almost impossible, but they have almost certainly raised them in some instances. It is certainly more difficult, for example, to drop AFDC recipients from the rolls as a consequence of the 1970 Supreme Court decision in Goldberg v. Kelly. According to this decision, hearings and the right of notice are required before benefits can be terminated.

In another example, court suits followed the Department of Agriculture's original failure to implement the Special Supplement Food Program for Women, Infants, and Children. In 1976, the Department complied with a court decision in a class action suit that instructed it to expend all funds that had been authorized for the program since 1972. The Department of Agriculture was also forced by several law suits to comply with the outreach provision of the 1971 Food Stamp amendments by informing low-income families of the benefits of participation. The Department and the States had been slow to implement this provision, and several class action suits were filed to compel implementation.

In perhaps the best known of these cases, Bennett v. Butz (386 F. Supp. 10 (D. Minn. 1974)), the district court ruled that the law required the Department of Agriculture not only to inform low-income households of the benefits of the Food Stamp program but also to insure that eligible households would participate. Department officials have maintained that these decisions have had little effect on program participation and costs. Whether they have or not, the Congress amended the Food Stamp Act in 1977 to eliminate the "insure participation" requirement and to place emphasis, instead, on informing people of available benefits. The Congress believed that insuring participation had imposed an excessive burden on the Department of Agriculture.

The intent of the Congress is not always clear from the legislative history of a law, but if the Congress believes that the courts have misinterpreted its intent, it can always change the statute to make its intent known. The Congress did just that in the case of Social Security Disability, as we have seen. Such cases are an important means of resolving questions of congressional intent with respect to the administration of entitlement programs.

The Congress can minimize the ability of the courts to affect program expenditures by broadly interpreting statutory authority if it will more precisely define benefit eligibility, Administrative actions

The give and take of the legislative process often produces laws that state only general congressional intent and purpose and that provide unclear guidance to administrative agencies on precisely how to implement them. We discussed this previously as a factor in the effect of court decisions. It should also be recognized that the Congress often makes legislative language general out of political necessity and in order to provide leeway to administering agencies and States. An agency's interpretation, especially with respect to eligibility criteria, can mean more or fewer recipients and, therefore, greater or lower program expenditures.

Administrative changes have been used repeatedly to try to control the costs of the Medicaid and Medicare programs. Occasionally they have been used to expand their costs as well. In March 1980, President Carter announced that Medicare would henceforth pay for the services of a chiropractor without the approval of an M.D. The chiropractors had lobbied for this change for some time. The additional costs to the program were estimated to be about $75 million annually.

Pilot programs are also a useful means of getting a program started administratively. The experience of a successful pilot program can justify an expanded and more permanent program. Pilot programs are particularly attractive when funds need not be periodically justified and appropriated. This approach has been used by the Food and Nutrition Service of the Department of Agriculture, for example. Section 32 of Public Law 74-320 provides that 30 percent of all customs receipts will be made available to the Secretary of Agriculture for encouraging the export and domestic consumption of the U.S. agricultural products. This permanent appropriation has been used to establish pilot programs for the Special Milk, Food Stamp, School Breakfast, and Special Supplemental Food programs.

In this appendix, we have identified some of the factors that have driven Federal spending for entitlements and indexed programs steadily upward. In the long run, they set the context for congressional efforts to control the Federal budget. Although the issue of controllability requires long term consideration, the real need for the Congress to control today's budget requires action now. Thus, we turn now to some approaches the Congress should consider in its current work on entitlement and indexed programs.

--Is the entitlement well designed to achieve the stated purpose?

Eliminating an entire program immediately has some disadvantages. It could be considered by many individual and State beneficiaries to be a violation of a commitment. It could have significant indirect socioeconomic effects. It could lead to considerable legal action against the Federal Government. The full extent of such reactions cannot, of course, be known before a program is eliminated, but awareness of their possibility should accompany any decision to eliminate programs. Eliminating programs in phases, however, would allow time to prepare for such effects.

Recently we recommended the elimination of one entitlement program--Social Security benefits for postsecondary students (see HRD-79-108, August 30, 1979, and HRD-81-37, December 31, 1980). We reported that the basic purpose of the Old Age and Survivors and Disability Insurance programs is to provide some minimum family income in the event of a taxpayer's retirement, disability, or death, but payments to students divert tax money from that basic purpose. During the 1979-80 school year, an average of about 796,000 students received Social Security benefits totaling an estimated $1.95 billion. Moreover, since this program was created in 1965, Federal education aid programs have expanded to include four programs--Basic Educational Opportunity Grants, Guaranteed Student Loans, Supplemental Educational Opportunity Grants, and State Student Incentive Grants--that provide benefits similar to those given to students under Social Security.

We recommended in the reports cited above that the Congress amend the Social Security Act to discontinue student benefits for postsecondary students and take the steps necessary to insure that there would be sufficient financial resources to meet any increased demand for education programs that might arise from discontinuing these benefits.

## LIMIT THE INDEXING OF BENEFITS

The methods of limiting indexing range from discontinuing indexing entirely to making various types of changes in the way program benefits are adjusted for inflation. Specifically, we discuss here four methods:

--discontinue automatic indexing,

--use a less generous index,

--adjust benefits less frequently, and

--set a ceiling on benefit amount indexed.

index as it is currently constructed. For example, the housing component of the CPI measures new purchases of housing at currently prevailing mortgage interest rates. It does not reflect the relatively stable costs of pre-existing mortgage payments or the effect of economic conditions on average rental costs. Thus, the CPI in its present form overstates the increase in the living costs of the average family during periods of accelerating inflation and increasing mortgage interest rates, if no new purchase of housing is made. By one measure, this overstatement was as much as 2.5 percent in 1979. It is equally important, however, to note that the CPI in its present form will exaggerate the decline in housing costs during a period of declining inflation and falling interest rates for the same reasons. Revising the housing component of the CPI will lower the measured rate of inflation under present economic conditions. If the revised index tracks actual housing costs accurately, then indexing should reflect changes in the cost of living in a more realistic fashion.

Whether or not the CPI is revised, the wage index and the personal consumption expenditure index could be used with it or in place of it. For example, whichever was the lower--the wage index or the CPI--could be used for periodic automatic cost of living increases. CBO's preliminary estimate of the outlay savings for the Social Security program alone using this option are:

| Fiscal Year | Savings |
|---|---|
| 1982 | $ 3.8 billion |
| 1983 | 4.4 |
| 1984 | 5.1 |
| 1985 | 5.6 |
| 1986 | 6.3 |
| Cumulative | $25.2 |

Another option is to use the personal consumption expenditure (PCE) index of the national income and product accounts. Published regularly by the Department of Commerce, the PCE uses rental equivalence and more frequent changes than the CPI uses to measure the goods and services affected by changes in individual consumption patterns. For the Social Security program alone, CBO's preliminary estimate in outlay savings (in rounded figures) is:

| Fiscal Year | Savings |
|---|---|
| 1982 | $ 1.9 billion |
| 1983 | 1.2 |
| 1984 | 2.0 |
| 1985 | 2.4 |
| 1986 | 2.8 |
| Cumulative | $10.2 |

are adjusted twice a year, could be adjusted only once a year. This would reduce Federal spending during a fiscal year by keeping nominal spending at a given level for a longer time. Cumulative expenditures over a period of years would thus be lower. In periods of moderate or high inflation, participants in these programs would have to wait a little longer to "catch up" with inflation.

Civil Service Retirement and Military Retired Pay have been indexed for a number of years. Until 1977, the programs were adjusted when the CPI reached and maintained for 3 months a level at least 3 percent higher than the level at the time of the previous adjustment. The adjustment was equal to the percentage increase in the CPI for the 3-month period plus 1 percent. As a result, the indexing formula contributed to a steady rise in real benefits and overcompensated for inflation. Currently, benefits are adjusted twice each year on March 1 and September 1 by a percentage equal to the percentage increase in the CPI during the 6-month period ending December 31 and June 30, respectively.

In recent years, we have issued a number of reports expressing our concern about the inequitable and inconsistent benefits and the affordability of Federal employee retirement systems. In some of these reports we have addressed the issue of cost-of-living adjustments. In July 1976, we reported that the Federal annuity adjustment processes were far more generous than the processes used by most non-Federal employers to adjust pensions ("Cost-of-Living Adjustment Processes for Federal Annuities Need to Be Changed," FPCD-76-80). We recommended and still believe that the law should be changed to provide for annual adjustments based on the cost of living rise during the preceding year. CBO has estimated that if the postretirement increases were limited to one annual increase occurring in October, and the method used to make the adjustments were the same as for Social Security, the Federal Government would save $10.2 billion in outlays through fiscal year 1986. The CBO estimate is shown below.

| Fiscal Year | Savings |
|---|---|
| 1982 | $ 1.7 billion |
| 1983 | 2.0 |
| 1984 | 2.1 |
| 1985 | 2.2 |
| 1986 | 2.2 |
| Cumulative | $10.2 |

We also recommended that the Congress repeal the provisions that permit retiring employees to receive higher starting annuities because of changes in the CPI before their retirement. Initial cost-of-living adjustments of new retirees could be prorated to reflect only CPI increases after their effective

| Calendar Year | Savings |
|---|---|
| 1981 | $ -- billion |
| 1982 | 0.1 |
| 1983 | 0.3 |
| 1984 | 0.5 |
| 1985 | 0.8 |
| Cumulative | $1.7 |

By applying the same CPI rates with $7,500 as the break point, estimated savings over a 5-year period would be about $6 billion.

| Calendar Year | Savings |
|---|---|
| 1981 | $0.1 billion |
| 1982 | 0.5 |
| 1983 | 1.0 |
| 1984 | 1.7 |
| 1985 | 2.7 |
| Cumulative | $6.0 |

In projecting these savings, the Social Security actuaries based the annual benefit amount break points on benefits for an entire family rather than benefits for its working member alone. Savings would have been negligible if only the worker's benefits had been considered. This is because the maximum annual benefit amount a worker could receive in 1980 was only $7,356. When including other benefits, such as spouse or student benefits, the total benefits received by a family could be higher. These estimated reductions were based on OMB's 1980 mid-session review assumptions.

## TIGHTEN ELIGIBILITY CRITERIA

Eligibility criteria can be tightened in either of two ways. Statutes can be changed by the Congress, or administrative agencies can interpret eligibility criteria more strictly. The Congress can, at its discretion, revise the scope of a program by changing the enabling legislation. In the case of the original Medicaid statute, for example, the Congress determined that the States defined "medically needy" more generously than it thought necessary, and consequently it passed legislation that redefined the term more precisely. This checked the additional cost created by generous interpretations of previously defined terms.

More recently, changing the retirement age has been discussed as a way to reduce Social Security spending. We examined this subject in our study "Inconsistencies in Retirement Age: Issues and Implications" (PAD-78-24, April 17, 1978). In that report, we discussed the inconsistencies in what people than singling some out. For example, the Social Security Disability Amendments of 1980 (Public Law 96-265, June 9, 1980) statutorily lowered the benefits to future participants in the Social Security Disability program. This change is estimated to save $2.6 billion in fiscal years 1981-85.

CBO suggests yet another example of lowering the benefit level. In its study "Reducing the Federal Budget: Strategies and Examples, Fiscal Years 1982-1986," (p. 118) it says that

> Federal outlays could be reduced if the current formulas for calculating Federal support for Medicaid and AFDC were modified or new formulas were adopted. One possible modification would be to remove the statutory 50 percent minimum Federal share from Medicaid and AFDC. This would lower outlays by $3.3 billion. Under this option, the decline of the Federal share of State Medicaid and AFDC expenditures in 13 affected States would range from about 2 percentage points to about 33 percentage points. An alternative proposal, one that would affect all States rather than just those with the highest per capita incomes, would be to reduce the Federal share under the Medicaid formula by 3 percentage points. This would save roughly the same total amount as removing the 50 percent Federal minimum.

These examples suggest that this method can provide opportunities for savings of considerable magnitude. However, like many of the other approaches we have discussed, it has negative points too. In its budget deliberations, the Congress will have to weigh the potentially adverse impact of lowering benefits to program recipients against escalating Federal expenditures.

## CAP ENTITLEMENT SPENDING

The Congress has occasionally tried to control entitlement spending by imposing an authorization ceiling or cap on appropriations. In the past, the Congress has capped programs either to counteract exploding costs or to correct fraud and other abuses. To establish a cap, the Congress inserts language in an entitlement statute to limit spending to a specific amount for a specified or an unspecified period of time. While an authorization ceiling does not insure that subsequent appropriation amounts will be limited to the cap, it may in effect subject proposed appropriations above the ceiling to additional scrutiny.

Grants to the States for Social Services, Grants to the States for Vocational Rehabilitation, and the Food Stamp program have all been capped. The Special Supplemental Food Program for Women, Infants, and Children, begun as a pilot program in 1972, was made a capped entitlement for fiscal years 1979-82. Of the programs the Congress has capped, we discuss entitlement and completely discretionary benefits. The compromise has the added advantage of allowing the Congress to establish or alter spending controls case by case.

Capping does raise the additional issue of whether State and local governments should be granted compensatory discretion in using program funds because funds in a previously open-ended program have been limited. In 1972, for example, the States argued that the cap on Social Service Grants did not provide enough funds to let them comply with day-care staffing regulations. The Congress has repeatedly postponed the effective date for State compliance with Federal regulations, in response to the arguments of the States, yet the regulations have to be implemented. Experience in the Grants to the States program indicates that placing a cap on entitlements makes States less willing to accept strict participation conditions and narrow requirements on how they are to spend their money.

Cap entitlements to individuals

Capping entitlements to individuals changes the entitlement status of the program. A capped entitlement retains some of its characteristics--all eligible people are entitled to benefits under the program within the resource limits of the cap. Participants are thus guaranteed at least partial benefits until funds run out. It can be said that the program is an entitlement up to the cap.

However, participation cannot be predicted with certainty. Changes in the demographic character of the population alter the number of people who are eligible for benefits, and changes in the economy can alter the number of eligible recipients for such items as unemployment benefits.

If participation increases and the increased benefit payments that result push projected costs above the cap, then the Congress must decide whether to raise the cap in the normal discretionary legislative process or allow the program administrator to reduce benefits to all participants. In the case of Food Stamps, this capping decision has proved highly controversial and has highlighted both the advantages and the disadvantages of capping.

One advantage is that capping focuses congressional attention not only on the increased cost of the program but also on the issue of whether the program should continue in its current form. Because increasing expenditures beyond the current cap requires both new authorizing legislation and an appropriation, the Congress has the opportunity to reevaluate the entitlement in the light of new and more precise cost information. Raising the cap may be coupled with more stringent provisions for reducing fraud and improving program management. This was done with Food Stamps in 1980.

a limited assurance that funds will be available for benefit payments for the period specified in the authorizing legislation. Limiting funds to the amount annually appropriated, however, effectively eliminates the entitlement nature of the program.

Limiting funds to annual appropriations is a conscious decision by the Congress that a program will no longer be granted the preferential treatment that most entitlement programs receive in the appropriations process. Rather, the Congress decides to treat it as a discretionary program, scrutinizing its funding level in the appropriations process. Changing entitlements to discretionary programs does not necessarily mean that costs will automatically decrease or increase more slowly, however.

Moreover, controlling entitlements by subjecting them to annual appropriations is inconsistent with the purpose for which the programs are normally created--to guarantee recipients a certain level of benefits or services by giving the program preferred access to Federal funds. Personal budgeting becomes more difficult for people who depend on retirement or other basic income maintenance, if the money available for annuities is subject to the vagaries of annual appropriations.

Such action would sever the implicit contract that the Federal Government has made with the recipients under entitlement programs. This is not a desirable means of controlling entitlement spending, except for individual programs such as the Special Supplemental Food Program for Women, Infants, and Children, whose nature the Congress chose to change from an entitlement to another type of program.

IMPROVE PROGRAM EFFICIENCY

We have concluded that not enough emphasis has been placed on insuring that these relatively uncontrollable programs are efficiently and effectively executed. Pursuant to our basic statutory authority, we review the operations and activities of almost every agency of the Government. This affords us the opportunity to develop numerous recommendations for savings and for improving the way the Government operates. Many of our recommendations have been accepted by the executive branch and by the Congress. Many others have not been acted on, even though the potential savings are quite substantial. Some examples are:

--changing the Department of Agriculture's procedures to alleviate Food Stamp program abuses. This could save more than half a billion dollars each year.

--requiring States to deposit Social Security taxes semimonthly or biweekly. This would generate additional interest of about $49 million in fiscal year 1982 and about $290 million during fiscal years 1983-85.

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--calculating Social Security benefits to the nearest penny--or to the nearest dime, as the Department of Health and Human Services has proposed. This would save at least $8 million in fiscal year 1982 and at least $181 million during fiscal years 1983-85.

Such action is needed in many other areas.

Eliminating waste alone is not enough, but even this saves substantial amounts of funds. Perhaps its most positive aspect is that it can often be done very quickly by means of administrative changes. Better still, it most often has no really adverse effect.

## DECIDING WHICH METHOD TO USE

Except for program termination, the seven methods of cutting expenditures in entitlement and indexed spending that we discussed in this appendix are not mutually exclusive. We expect that the Congress will use all of them in one form or another, in its effort to restrain Federal spending. Any particular decision to limit the size or growth of entitlement and indexed spending, whether made program by program or in the aggregate, will require difficult choices about precisely where and how to limit spending.

We hope that the approaches we offer above will assist the Congress in this effort. We have cited only a few examples from our earlier work of where and how entitlement spending could be reduced. As the Congress and its committees engage in efforts to apply these approaches to limiting spending, our staff is available to give further assistance based on our previous work in reviewing specific issues and programs.

On the other hand, a cap may be incompatible with provisions in the entitlement that were intentionally designed to allow for increased spending in response to disruptive economic conditions. Participation in some entitlement programs is highly sensitive to the economy, especially when benefits are tied to the cost of living. Food Stamps is an example. Program characteristics that drive costs up may come into direct conflict with spending caps in which levels of unemployment and inflation have not been precisely anticipated.

Adding a cap can thus create an inconsistency in a program. It can combine a mechanism that restricts spending with other mechanisms that automatically increase benefits and expenditures. It also creates uncertainty as to what amount of benefits recipients can depend on.

Assuming that benefits will be ratably reduced, capping entails the further complication of deciding when to begin reducing the benefits. Changing benefit levels in the middle of a fiscal year increases administrative costs, especially for programs that the States administer. Should the Congress decide to raise a cap and maintain benefit levels after the process of reducing benefits has begun, then administrative costs rise even higher. This has the additional effect of increasing total program costs.

Caps can be effective controls, but they are rigid and inconsistent with the open-ended nature of many entitlement programs. Some of the caps have certainly held the costs of the program down, as happened with Grants to the States and the Special Supplemental Food Program for Women, Infants, and Children. Other caps, such as the one on Food Stamps, seem to have little effect, because when it has become apparent that spending would exceed the cap, the Congress has consistently provided additional funds to prevent the reduction in benefits that enforcing the cap would cause.

We are aware of only three entitlements that have been capped for purposes of controlling program costs. The capping of Grants to the States for Vocational Rehabilitation is too recent to provide much insight. The result of capping the Social Service Grants and Food Stamps are mixed, although we know for certain that capping affects entitlements to States and to individuals differently. More experience is necessary before we can judge the overall effectiveness of caps as a means of controlling entitlement spending growth.

## LIMIT SPENDING TO ANNUAL APPROPRIATIONS

Another proposal for controlling entitlement spending is to limit funds available in any given fiscal year to what may be appropriated for that year. This method differs from capping with respect to time. Capping can limit funds to 1 year, to several years, to the life of the program. It thus provides two--Grants to the States for Social Services, under Title XX of the Social Security Act, and Food Stamps.

Early in the 1970s, the States discovered that the loosely written provisions of the Social Security Act allowed a 75 percent Federal reimbursement for many services that had previously been financed solely by State and local funds. When the Congress learned that costs would escalate from $1.7 billion in 1972 to $4.7 billion in 1973, it limited spending to $2.5 billion. Linked to the decision to cap Social Service Grants, however, was the creation of Revenue Sharing.

The Congress capped Food Stamps twice. The program operated until 1971 as a capped entitlement since the time of its transformation from a pilot program into a statutory program in 1964. In 1972, concern over malnutrition and low participation rates led the Congress to change it to an open-ended entitlement Widespread reports of fraud and other abuse of the program combined with sharply escalating costs--driven by the 1974-75 recession, semi-annual indexing, lower purchase requirements, and generally loose eligibility standards--led the Congress to put the cap back on in 1977. Under the cap, benefits to recipients may be ratably reduced if the cap is about to be reached.

There are two general types of cap--caps on entitlement spending to State and local governments and caps on entitlement spending to individuals.

Cap entitlements to governments

Placing a cap on an entitlement that reimburses a government essentially converts it into a specific amount of money to be divided among a known number of participants. Since the number of participants is known in advance, it is possible to distribute funds equitably by using a formula. For example, the $3.1 billion authorized for the Title XX Social Service Grants in fiscal year 1981 will be allocated to the States on the basis of their populations.

The authorization ceiling on the Title XX Social Service Grants has been effective in limiting program spending to amounts established in advance of the fiscal year. This cap has also become a floor, because spending has equaled the ceiling amount in every case. From time to time, the Congress has raised the ceiling but only as a part of the normal process of allocating discretionary funds. In other words, the entitlements must compete with other discretionary programs for marginal increases in funding.

Capping has the advantage of giving the Congress control over marginal increases in program spending above the cap while guaranteeing the basic entitlement up to the cap. Capping can be viewed as the compromise position between an open-ended refer to as "early" and "normal" retirement ages. In addressing such issues as demographic, funding, and sociological implications, we raised the point (on page 34 of that report) that:

> The American pension system still reflects the days in which the Social Security system was conceived; a time in which a labor surplus was being reduced by retiring people at a certain age. But the country now faces a future labor shortage. In order to add and maintain a sufficiently large labor force, [some suggest] . . . that people retire later, not earlier.

To implement such a change, the Congress could consider altering the Social Security legislation to gradually raise the "normal" retirement qualification age from 65 to 68. Doing this in phases would give potential recipients time to adjust to and prepare for the change, perhaps lessening the adversity of its impact.

Aside from congressional changes in the enabling statute's eligibility criteria, administrative actions offer important short term possibilities for controlling entitlement spending. Within the discretion granted to it by statute, an executive agency may be able to reduce program costs by acting administratively to interpret eligibility criteria more strictly. A variety of these administrative cost-saving measures have been tried in Medicaid and Medicare, for example, with mixed success.

Changes that make it more difficult to qualify for benefits or that eliminate reimbursement for particular services are often challenged in the courts, and the challenges frequently succeed. A Federal court recently struck down Department of Labor regulations designed to reduce expenditures in the Extended Unemployment Compensation program by redefining the insured unemployment rate that triggered benefit programs (see AFL-CIO v. Marshall, Civil Action No. 80-1360 (August 7, 1980), Daily Labor Report 157 (August 12, 1980)).

Although savings resulting from relatively strict administrative interpretations of eligibility criteria could be substantial, they cannot reach the magnitude that could be achieved by simply eliminating whole categories of potential recipients, as the Congress might do, or by lowering benefits to future recipients, as the Congress has done recently in the Social Security Disability program (as we discuss below).

## LOWER BENEFIT LEVELS

A fourth method of reducing entitlement spending is to lower benefit levels. In times of high inflation such as we have now, the Congress may decide that to cut back Federal spending, less generous benefits should be made available. Reductions could be shared across all recipient groups rather dates of retirement. We issued another report in November 1977 in which we provided further information in support of our recommendations on initial adjustments for new retirees ("Cost-of-Living Adjustments for New Federal Retirees: More Rational and Less Costly Processes Are Needed," FPCD-78-2). We pointed out that the processes overcompensate retiring employees since, by law, they can receive a higher starting annuity that reflects the preceding cost-of-living adjustment granted while they were still employed. Depending on the timing of their retirement, they may also be eligible for an additional adjustment immediately upon retirement. Such increases escalate the costs of Federal retirement by inflating the basic annuity upon which succeeding adjustments are applied and can encourage valuable, experienced employees to retire. A recent change in law provides that adjustments for new retirees be prorated to include only the cost-of-living increases that occur after retirement.

Even though some of the changes we have recommended have been adopted, the Federal cost-of-living adjustment processes are still more generous than those of non-Federal pension plans and more consistent with those provided by the Social Security program. Federal retirees are the only group we are aware of who receive unlimited cost-of-living adjustments automatically twice a year.

### Set a ceiling on the benefit amount indexed

Another alternative available for controlling the cost of indexing is to set a ceiling on the benefit level to which a periodic cost-of-living adjustment is made. A variety of levels are available, including the poverty level, average individual income, average wages, average family income, and median family income. We used the Social Security program to illustrate the potential cost savings achievable by limiting the cost-of-living increases to selected benefit amounts.

Currently, Social Security benefits are increased in June of each year, and the increase is based on CPI increases for the first quarter of the current year over the first quarter of the preceding year provided the increase is 3 percent or more. With the assistance of Social Security Administration actuaries, we determined the savings that may be realized if the full CPI rate were applied to annual benefit amounts up to the two selected break points of $7,500 and $10,000 and one half the CPI rate applied to benefits exceeding each of these amounts. As we illustrate below, by applying the full CPI rate to $10,000 and half of the CPI rate to family benefits exceeding this amount, about $1.7 billion may be saved in benefits over a 5-year period.

Another way to control the cost of indexing for some entitlement programs would be to create or revise special price indexes specifically related to the program in question. An example of a special index is presented in our ongoing study to construct an index for retirees. We undertook this study for two reasons--(1) the considerable interest in the feasibility of a separate consumer price index for retirees and (2) the controversy generated by the fact that retirement benefits are adjusted to price index movements that reflect the buying habits of workers rather than retirees.

Whatever index is chosen for use--whether it be the CPI, wage index, PCE, or a special index in current or revised form--a formula for relating changes in the index to changes in benefits has to be developed. Variation in the formula provides a means for reducing benefit levels consistently relative to inflation as measured by a given index. The choice of a formula can have significant budgetary implications. For example, when Social Security was indexed, the original formula used to relate changes in the index to changes in benefits overcompensated for inflation. This oversight has been corrected, but it makes a point that must be addressed whenever a program is indexed. A formula must be chosen carefully or it may end up generating changes in real--not just dollar--benefits when the price level changes.

Finally, a full adjustment to compensate for rising prices may occasionally conflict with other public policy goals. For example, indexing permits the continued purchase of a constant quantity of gasoline as its price rises without any sacrifice of other goods and services. This reduces the incentive to conserve that rising fuel prices would provide.

Whether or not the Congress chooses to develop or use less generous indexes to control spending growth, it is important to remember that no price index currently in existence perfectly mirrors changes in the cost of living. Consequently, we believe that improvements should be made to the indexes themselves when study reveals that it is cost-effective to improve the accuracy with which an index reflects price changes. In the following two subsections, we discuss other means of holding down the cost of indexing, including less-frequent benefit adjustments and less-than-full compensation for inflation.

Adjust benefits less frequently

Indexed retirement and disability programs have grown rapidly in recent years. Indeed, indexing is an important source of growth in spending for these programs. Their rate of growth has exceeded that of the total Federal budget.

Adjusting indexed programs less frequently is one method of limiting the effect of indexing on Federal expenditures. The Federal employee retirement programs, for instance, which

Discontinue automatic indexing

Since the Congress had been consistently raising benefit levels faster than the inflation rate, indexing was adopted in the 1960s and 1970s as a control device. Indexing was seen as a way of avoiding the periodic votes on benefit levels and the pressure to increase real benefit levels. When indexing began to be widely adopted, the Congress did not have its present budget process, which now makes periodic increases more difficult. Today, automatic increases that adjust real benefit levels to the very high rate of inflation are greater than many people believe we can afford.

Therefore, the Congress should consider discontinuing automatic indexing. If automatic indexing were dropped altogether, the Congress could address the extent of the increases program by program. Alternatively--preferably in our view--it could address the question across the board when adopting the concurrent resolution on the budget.

Perhaps the best method for deciding periodic adjustments in entitlement benefits would involve both the President and the Congress. A procedure could be used similar to the one used to adjust Federal white-collar pay periodically. The President could recommend a specific percentage adjustment to benefit levels that would take effect unless the Congress acted to change it.

In a recent report, CBO has estimated the savings for Social Security spending using this type of procedure ("Reducing the Federal Budget: Strategies and Examples, Fiscal Years 1982-1986"). CBO estimated that if the President and the Congress held the increases in benefits to 85 percent of the expected rise in the consumer price index starting in July 1981, the savings would total $44 billion in 1982-86. By 1986, these savings would represent a spending level 8.2 percent lower than the level under the current indexing system. CBO's preliminary estimate of outlay savings over the 5 years is shown below.

| Fiscal Year | Savings |
|---|---|
| 1982 | $ 2.8 billion |
| 1983 | 5.2 |
| 1984 | 8.2 |
| 1985 | 11.7 |
| 1986 | 16.0 |
| Cumulative | $43.9 |

Use a less generous index

If automatic indexing were retained, the Congress could consider using a less generous index than the consumer price

## ALTERNATIVE APPROACHES FOR LIMITING FUTURE GROWTH

When the Federal budget is viewed over a long enough period of time, it contains no uncontrollable programs. Laws establishing uncontrollable entitlement programs can be changed. The only question is how long it takes to make the changes. This in turn depends on the willingness of the Congress and the executive branch to engage in long range planning and to enact and implement the necessary legislative changes.

Nevertheless, while the issue of controllability involves long term considerations, the real need for the Congress to control the budget today requires action now. The question of how to control in the short run that portion of the budget that is committed to relatively uncontrollable programs has stimulated a variety of suggestions for action. In this appendix, we outline seven basic approaches to short term spending control. The seven basic methods that the Congress should consider in its current effort to control entitlement and indexed spending are:

--eliminate a program altogether,

--limit the indexing of program benefits,

--tighten eligibility criteria to target available funds to the most needy,

--reduce the level of benefits,

--place a cap on a program's total spending,

--limit spending to amounts annually appropriated, and

--improve the efficiency with which a program is administered.

## ELIMINATE ENTIRE PROGRAMS

The most direct way to cut entitlement spending significantly is to eliminate entire programs. A recent study of the Congressional Budget Office (CBO), "Reducing the Federal Budget: Strategies and Examples, Fiscal Years 1982-1986," offers four criteria for deciding whether to phase out entitlement programs. The questions the criteria raise are:

--Is the program obsolete?

--Is the program duplicative?

--Is the entitlement justified by need but not awarded according to need?

reimbursable services, and other aspects of entitlement statutes. By taking such measures, the Congress can reduce the number of issues that provide grounds for judicially testing both administrative interpretations of entitlement laws and the constitutionality of the provisions in them.

## PROGRAM EXPANSION AND OTHER CHANGES

### Legislative actions

Some of the growth in entitlement programs has been deliberate. The Congress has created new programs and amended existing ones to increase benefits, broaden eligibility, and protect benefits against inflation. The Congress has created and expanded four programs since 1964 that account significantly for the rise in entitlement spending since then. Two of these--Medicare and Supplemental Security Income--serve primarily the elderly. Two--Food Stamps and Medicaid--serve primarily the poor, including some elderly. Spending for all four programs increased from $5.7 billion in 1967 to $44.4 billion in 1979. As a percentage of total Federal outlays, expenditures for these four programs have risen from 4.2 percent to 9 percent since 1967. Spending increases automatically in Social Security Income (SSI) with rises in the consumer price index and in Medicaid, Medicare, and Food Stamps with rises in the cost of providing a specific level of goods or services.

Service providers, recipient organizations, and other lobbies actively propose legislative action to maintain and expand existing entitlement programs. All have some stake in the status quo, as recipients or as providers of services. In programs like School Lunch and Special Milk, various business and agriculture interests see the programs as another market to be tapped and expanded where possible. When the beneficiaries are well organized, as the veterans are, or are perceived as having the support of the general public, the Congress has responded favorably to demands for program expansion. It has provided higher benefits payments, extended eligibility periods, and broadened eligibility criteria.

In addition to creating new or expanding existing entitlements, the Congress sometimes enacts new legislation to clarify ambiguous statutory language. This kind of corrective action was taken in the case of the original Medicaid statute. Under this statute, some States paid more generous assistance benefits than the Congress thought necessary. Consequently, legislation was passed establishing a 3-year transition to a system in which the medically needy would be specifically limited to people whose financial resources were not more than one third greater than the levels set for public assistance eligibility. Thus, the Congress reacted quickly to check the additional cost created by imprecisely defined terms.

participation. The Supreme Court decision in Goldberg v. Kelly (397 U.S. 254 (1970)) establishing welfare benefits as an important right protected by the due process clause of the 14th amendment may have limited the ability of States to restrict payments on the basis of residency requirements and thus indirectly contributed to higher participation and costs.

Over time, recipients have come to feel that receiving welfare benefits is a right, not a source of embarrassment and shame. Although people seem to be more willing to apply for what is available, it is impossible to know exactly how much of the increased participation is the result of changes in attitudes. Nevertheless, such changes have contributed to a higher rate of participation by eligible beneficiaries.

Probably the most important enhancement of participation is caused by statutory changes in entitlement programs. The Food Stamp program is a good example. In 1971, the Congress lowered the purchase requirement and liberalized eligibility criteria for benefits. The purpose of this was to increase both benefits and participation, and, accordingly, the cost of the Food Stamp program rose, mainly because of the 1971 amendments.

## JUDICIAL DECISIONS

Beneficiaries or providers of services sometimes turn to the courts when they are unable to obtain favorable regulations or are convinced that congressional changes in statutes are unconstitutional. Since receipt of entitlement benefits is conditioned upon individual ability to qualify for program participation, the eligibility criteria are very important in determining the extent of the eligible population. When the Congress has given an agency only general guidelines concerning eligibility for benefits, some people rejected for benefits will inevitably challenge the rejection in court. When an administration or agency limits implementation of a program by narrowly interpreting its statutory authority, a court suit can be one way of forcing it to broaden its interpretation.

In such situations, the courts may directly influence the administration of an entitlement program. Thus, many observers contend that the courts become a fundamental part of policy-making. In deciding cases that question eligibility standards established by an administering agency, the courts not only interpret congressional intent but also implicitly define the number of eligible recipients. The more generously the courts interpret congressional intent regarding eligibility standards, the greater will be the accompanying costs of providing benefits.

Similarly, courts can interpret the constitution or statutory authority in a way that implicitly defines service standards in programs that directly affect the level of benefits provided eligible recipients. In the years following the passage of both Medicaid and Social Security Disability, the courts were called or 9 percent was caused by the greater relative price of medical care. This 9 percent change represents the real rise in medical costs relative to the costs of other goods and services.

The growth in expenditures for other transfer programs can thus be attributed to inflation, to a rise in the relative prices of the goods subsidized, and to two factors discussed later in this report--an increase in the number of program participants and an increase in the quantities of goods and services provided to them.

Federal wages and salaries

Federal civilian and military pay increased from $39.9 billion in 1970 to $71.7 billion in 1980, an increase of 79.7 percent. Federal pay adjustments differ from the automatic adjustments in the explicitly indexed Federal programs, however. First, private salaries go up as a result of both inflation and increased productivity. Therefore, comparability increases reflect more than just an increase in the cost of living. Second, the President can propose an alternative plan that recommends Federal pay increases based on partial rather than full comparability to the private sector. The President does not have similar discretion under any of the explicitly indexed Federal programs. Third, a comparability increase of, say, 5 percent does not automatically increase Federal outlays for personnel by 5 percent. This is because OMB and the Congress can force Federal agencies to absorb part of a pay increase by reducing employment levels, unlike indexed entitlement programs, in which the number of beneficiaries cannot be reduced without legislative changes.

SHIFTING DEMOGRAPHIC ELIGIBILITIES

Demographic changes affect the number of individuals eligible to benefit from certain programs. Entitlement program expenditures are particularly sensitive to the demographic changes that affect the size of the recipient population. This is especially true of programs that aid the elderly.

Some of the largest entitlement program--Supplemental Security Income, Medicare, Social Security, Railroad Retirement, Federal civilian and military retirement--serve people aged 65 and older. Estimated Federal spending for the elderly amounted to approximately $212 billion in fiscal year 1980, or 37 percent of the Federal budget. This percentage is likely to continue to grow, because the number of elderly and their proportion of the total population are expected to increase. As the people born after World War II grow toward retirement, they will affect significantly the growth of expenditures for programs serving the elderly, especially Social Security and Medicare. The number of people older than 65 grew from 8 percent of the total population in 1950 to 11 percent in 1979;

--program expansions or changes through legislation and administrative actions.

## INFLATION AND INDEXED COSTS

In our 1979 study "An Analysis of the Effects of Indexing for Inflation on Federal Expenditures" (PAD-79-22, August 15, 1979), we estimated that about half of the growth in indexed entitlement spending since 1970 is the result of inflation. As the rate of inflation has risen in recent years, the additional costs of fully compensating for it have been substantial.

The actual effect of inflation and indexing on increases in total spending over any interval longer than a year or two depends not only on the change in the price index and the change in real expenditures but also on the sequence and timing of these changes. In our 1979 report cited above, we analyzed the effects of inflation on three types of Federal expenditures: (1) retirement, quasi-retirement, and disability programs, (2) other transfer programs, and (3) Federal wages and salaries. We bring up to date our findings for these three categories below.

### Retirement, quasi-retirement, and disability programs

Federal expenditures for indexed retirement, quasi-retirement, and disability programs exceeded $156 billion in fiscal year 1980. This is an increase of $119.7 billion, or 326 percent, over fiscal year 1969. In 1979, we estimated for the period 1970 to 1977 how much of the increase was caused by inflation. The results of these estimates are shown in table 5.

Social Security benefits function as quasi-retirement benefits because they are intended only partially to replace earning lost because of retirement, death, or disability. Between 1969 and 1980, Social Security expenditures increased $87.4 billion, Railroad Retirement expenditures increased $3.1 billion, and Civil Service and military retirement pay increased $20.9 billion.

### Other transfer programs

From fiscal year 1970 to 1980, Federal expenditures for health and nutrition programs increased from $10.6 billion to $82.3 billion. The benefits of these programs are explicitly and implicitly adjusted for inflation. Also, because these programs subsidize a fixed level of goods and services or are indexed to price changes for specific goods and services, expenditures for them increase as their prices increase relative to the prices of all other goods and services in the economy.

For example, in our 1979 report we calculated that $6.1 billion or 42 percent of the increase in Medicare expenditures from 1970 to 1977 was caused by inflation and that $1.3 billion

APPENDIX II

Table 3

Trends in the Cost of Entitlements 1970-80 a/

| | 1970 | 1975 | 1980 |
|---|---|---|---|
| Expenditures for uncontrollables (in billions) | | | |
| Entitlements | $ 66.3 | $155.9 | $274.7 |
| Net interest | 14.4 | 23.2 | 52.5 |
| Other open-ended and fixed costs | 3.6 | 7.8 | 15.7 |
| Prior-year contracts | 41.5 | 50.6 | 96.5 |
| ALL UNCONTROLLABLES | $125.8 | $237.6 | $439.4 |
| TOTAL OUTLAYS | $196.6 | $326.2 | $579.6 |
| Entitlements as percent of all uncontrollables | 52.7% | 65.6% | 62.5% |
| Entitlements as percent of total outlays | 33.7 | 47.8 | 47.4 |
| Outlays as percent of GNP | 19.8 | 21.1 | 22.0 |
| Entitlements as percent of GNP | 6.7 | 10.1 | 10.4 |

a/Totals are approximate because of rounding.

governments have increased significantly in recent years. The main objective of these programs is to reallocate economic resources to help maintain, develop, or expand activities such as those entailed in education, home building, small business, specific firms, U.S. exports, and energy resource development. Reallocation is accomplished by making credit available on terms more favorable than can be obtained in private credit markets. Lower interest rates are typically the main benefit to borrowers. Other concessions include lower collateral requirements and longer maturities. In addition, some Federal credit programs have helped create deeper secondary markets for certain securities, which helps to lower interest rates for the favored items. Loan guarantees have not been included in the budget and have not been subject to the same degree of review and control as other programs. They are explicitly excluded by the definition of budget authority in the Congressional Budget Act of 1974.

Two types of credit assistance program have characteristics resembling entitlements. The Veterans Administration (VA) guaranteed mortgage loan program created in the 1940s is an example of the first type. Actuarially sound, such programs provide relatively small loans to a large number of individuals and households. The VA program guarantees loans made to all eligible veterans and active duty service personnel. In this way, it resembles an entitlement.

The second, more recent type of credit program provides assistance to more risky borrowers and is not self-financing. To carry out a desired public purpose, the Federal Government subsidizes these programs. Examples include the Farmers Home Administration emergency loans to eligible farmers, ranchers, and agriculture operators. The loans cover losses, operating expenses, and other needs arising from natural disasters, so that the borrowers may continue their operations and return to local sources of credit as soon as possible. These benefits are also payable on the basis of the recipient's ability to meet certain eligibility criteria, as is the case in entitlement programs.

to all eligible persons who apply. Participation rates in some entitlement programs--especially Unemployment Insurance, Aid to Families with Dependent Children (AFDC), and Food Stamps--are particularly sensitive to changes in the general health of the economy. Predicting costs for these programs depends upon the accuracy of economic and participation rate forecasting. Indexing adds further uncertainty to predicting the cost of entitlement programs.

Indexed programs as uncontrollable

By indexing some Federal programs, the Congress has established procedures to protect benefits from erosion by inflation. Indexing preserves the real benefits of those who participate in Federal programs even as the dollar benefits become less valuable during inflationary periods. Most currently indexed Federal spending is for entitlement programs.

In a number of Federal entitlement programs, such as Social Security and Railroad Retirement, benefit levels measured in dollar figures are indexed by linking them to a price index. When the price index changes by more than a specified amount, the dollar figures are adjusted by a proportional amount. Moreover, although the wages and salaries of Federal workers are not explicitly linked to an index of the cost of living, they are adjusted to private sector pay, and this may be thought of as an implicit form of indexing.

Other entitlement programs that subsidize a constant level of goods and services are implicitly indexed. Expenditures for them increase automatically when the costs of the goods and services rise. Among them are Medicare, Medicaid, Child Nutrition, and Food Stamps, all of which contain explicit and implicit adjustments for inflation. For example, Medicare and Medicaid are not formally linked to a general price index. They do not include a formula that adjusts benefit levels when there is an increase in the cost of living. However, since they subsidize a fixed level of goods and services for those who participate, spending for them is linked to health care prices.

Since the benefits of most entitlement programs are indexed in some manner to increases in the cost of living, rates of inflation higher than anticipated automatically raise costs more than predicted. Moreover, some programs that are not indexed are triggered by economic conditions anyway. This is true of the 13-week Federal supplement to unemployment compensation and of the Trade Adjustment Assistance program, for example. This characteristic, which might be called "indexed eligibility," adds another dimension of uncertainty in predicting the budget costs of indexing during times of high inflation and high unemployment.

Thus, the major difficulty in controlling expenditures at the present time in most of the programs we describe in this report lies in their open-ended nature and in their indexing.

Table 1

Relatively Uncontrollable and Relatively Controllable

Budget Outlays and Percent of Total Outlays in 1980

| | Outlays in billions | Percent of total outlays |
|---|---|---|
| **Relatively uncontrollable** | | |
| Open-ended programs and fixed costs | | |
| Entitlements to individuals | | |
| Social Security and Railroad Retirement | $121.8 | 21.0% |
| Federal employees' retirement and insurance | 27.2 | 4.7 |
| Unemployment assistance | 18.0 | 3.1 |
| Medical care | 49.0 | 8.5 |
| Assistance to students | 3.9 | 0.7 |
| Veterans Compensation and Pensions | 11.0 | 1.9 |
| Food and nutrition assistance | 13.2 | 2.3 |
| Public assistance and related programs | 15.0 | 2.6 |
| All other | 3.1 | 0.5 |
| TOTAL | 262.2 | 45.3 |
| Other entitlements | | |
| General revenue sharing | 6.8 | 1.2 |
| Farm price supports (CCC) | 2.9 | 0.5 |
| Social Service Grants | 2.8 | 0.5 |
| TOTAL | 12.5 | 2.2 |
| TOTAL ENTITLEMENTS | $274.7 | 47.5% |
| Other open-ended programs and fixed costs a/ | 15.7 | 2.7 |
| Net interest | 52.5 | 9.1 |
| TOTAL OPEN-ENDED PROGRAMS AND FIXED COSTS | $342.9 | 59.3% |
| Outlays from prior-year contracts and obligations | 96.5 | 16.6 |
| TOTAL RELATIVELY UNCONTROLLABLE | $439.4 | 75.8% |
| **Relatively controllable** | 146.0 | 25.2 |
| Undistributed employer share, employee retirement | -5.8 | -1.0 |
| TOTAL BUDGET OUTLAYS | $579.6 | 100.0% |

a/Includes housing assistance, Postal Service subsidy, and the legislative and judicial branches.

Source: Budget of the United States Government Fiscal Year 1982, table 17, with GAO addition of the entitlement classification.

it affects one program or several. We list in the paragraphs below some of the longer term considerations.

The majority of domestic spending is for entitlement programs. For the most part, entitlements support individuals who are elderly, retired, sick, poor, or veterans. In operation, these programs have the effect of redistributing income and are intended to relieve serious problems such as illness and poverty.

The people who benefit from entitlements have adjusted their personal lives to expect certain payments as they become eligible for them when they retire or become ill. Furthermore, the States, which distribute a portion of these Federal benefits, have in most cases entered into commitments--employing staff, constructing buildings, contracting for services--in order to administer the programs properly. For these reasons, it is very difficult to change the rules in ways that do not violate the legitimate expectations of beneficiaries and program administrators alike.

Currently, 37 percent of Federal spending goes to the Nation's elderly through some of the largest entitlement programs. Demographic trends show the elderly proportion of the total population rising significantly over the next few decades. Whereas people 65 years of age and older comprised only 4.1 percent of the population in 1900, this figure increased to 9.8 percent in 1970 and is further projected to increase to between 11.1 and 12.9 percent by the year 2000.

Full indexing maintains a constant real benefit level for the people or governments that participate in indexed programs, thereby adding stability to their incomes and the services that are provided to them. Thus, the Congress has to decide between its desire for longer term stability in real benefit levels and its desire to control the budget in the short term by changing benefit levels by less than the inflation rate.

As we address the issue of indexing during this period of high inflation, it is helpful to remember that indexing was adopted in the recent past as a device for limiting spending. This was because the Congress had been regularly raising benefit levels for certain programs by amounts that exceeded the lower inflation rates of the past. In so doing, it was increasing real benefit levels.

## "CONTROLLABILITY" DEFINED AND MEASURED

Both the executive branch and the Congress categorize each budget spending account as either controllable or uncontrollable under current law for the budget year. Thus, the focus is on a very short term--a single year. What uncontrollable does and does not mean, however, depends on the perspective from which the authority to spend is viewed.

## TABLES



## ABBREVIATIONS

| | |
|---|---|
| AFDC | Aid to Families with Dependent Children |
| CBO | Congressional Budget Office |
| CPI | Consumer price index |
| GAO | General Accounting Office |
| GNP | Gross national product |
| OMB | Office of Management and Budget |
| PCE | Personal consumption expenditure |
| SSI | Supplemental Security Income |
| VA | Veterans Administration |

the most needy, and how needless duplication and overlap among entitlements could be eliminated. For example, we have recommended eliminating benefits to students under Social Security, since the same types of benefits are available to needy students under Federal education aid programs; and we have suggested modifying the laws providing for Federal retirement in order to eliminate certain inequities and inconsistencies in the provision of benefits to retirees. We expect to make further recommendations based on work still in process. In this report, we have cited a few examples from our work of where and how entitlement spending could be reduced in order to illustrate the entire range of methods available to the Congress for cutting the growth in entitlement budgets.

This report contains three Appendixes. In Appendix I we address the issue of budget controllability, with particular attention to the controllability of entitlements and indexed spending. The majority of domestic spending is for entitlement programs. For the most part, entitlements support individuals who are elderly, retired, sick, poor, or veterans. In operation, these programs have the effect of redistributing income and are intended to relieve serious problems such as illness and poverty. The people who benefit from entitlements have adjusted their personal lives to expect certain payments as they become eligible for them when they retire or become ill. Furthermore, the States, which distribute a portion of these Federal benefits, have in most cases entered into commitments--employing staff, constructing buildings, contracting for services--in order to administer the programs properly. For these reasons, it is very difficult to cut entitlement spending.

In Appendix II we examine the increases in entitlement and indexed spending during the 1970s, and the reasons for them. In that decade, entitlement and indexed spending grew even more rapidly than the budget as a whole. Primarily as a result of the growth in the number of programs indexed by the Congress between 1970 and 1975, outlays for fully indexed entitlement programs have grown from 3 percent of total budget outlays in 1970 to approximately 30 percent of all Federal budget outlays today. Spending for all entitlements increased from about $66 billion in 1970 to $156 billion in 1975 and $275 billion in 1980. The largest share of the entitlement growth after 1975 appears to be attributable to inflation. Several additional factors underly entitlement spending growth from 1970 to 1975.

On February 18, 1981, the President proposed a multiyear plan for economic recovery which includes proposals for reducing Federal domestic spending. The President's proposal suggests that entitlement spending can be limited by tightening eligibility criteria for some programs, lowering benefit levels of others, capping, and other means. However, the President's plan dealt in only a minor way with the indexing of Federal spending (the automatic adjustment for cost of living changes).

In contrast, this report describes several approaches for limiting the growth of indexed programs. In particular, there are three approaches for altering the present practice of automatic, full indexing utilizing the Consumer Price Index (CPI) that we believe merit early consideration as part of the congressional action on spending reductions.

1. Give the President and the Congress the discretion to modify the amount of the index through the budget process. The President could be authorized to recommend a specific percentage adjustment to benefit levels that would take effect unless the Congress acted to change it. This is the same procedure now used to adjust Federal white collar pay. This alternative has the advantage of returning some flexibility to the cost of living increases. Clearly, any reduction in indexation could adversely affect the lives of truly needy recipients. One way of overcoming this problem is to authorize the President to use differential rates of indexation at different benefit levels. This approach would require decisions by the President and the Congress each year based on budgetary considerations.

2. Limit the adjustment to the level of the average increase in worker pay or the CPI, whichever is less. This alternative moves away from the exclusive use of a price index. The argument for making such a change is based on equity considerations. While, at present, income from indexed entitlement programs is protected against inflation, not all entitlement programs are indexed and wage earners income is certainly not protected. The result is that in periods of rapid inflation and slow productivity growth, present formulas redistribute income in favor of the indexed groups--and increase the burden on wage earners. Switching to this alternative would have wage earners and entitlement recipients share equally in the burdens imposed