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BUDGET CUTS: THE KEY TO ECONOMIC RECOVERY

INTRODUCTION

After only seven months in office, the major planks of President Reagan's economic recovery plan are now in place: a three-year tax cut amounting to $37 billion in 1982 for individuals and businesses and a monumental budget-cutting package that slashes federal outlays by $35.2 billion in 1982. The reconciliation budget package (H.R. 3982) which President Reagan signed into law August 13 involved hundreds of federal programs, marathon meetings of fifty-eight subcommittees, and legislative sessions where more than 250 Members worked out the final agreements. The bill that finally cleared the Congress on July 31 legislated reductions of nearly $35.2 billion from the fiscal 1982 budget, $44 billion in 1983, and $51 billion in 1984. Reductions were legislated in airport and highway spending, in Medicare and Medicaid formulas, in eligibility for social security disability payments, and for extended unemployment insurance benefits, in various veterans' entitlements, and in many other federal programs.

But because of continuing high interest rates, overruns in social programs, and a depressed economy, budget deficits loom much larger than the Administration originally predicted. The Administration had hoped to keep the budget deficits down to $42.5 billion in 1982, while promising a balanced federal budget by 1984. For months, the President has been committed to making additional budget cuts of about $10-$15 billion for 1982, but now he must consider massive new cuts if recently released deficit numbers are to be reduced. Alice Rivlin, director of the Congressional Budget Office, recently predicted that federal deficits would reach $80 billion next year -- nearly double the last official estimate. In testimony to the House Budget Committee, Rivlin stated that the Reagan Administration would have to find an additional $100 billion in budget cuts to balance the federal budget in fiscal 1984.

Many private economists and investment research groups have come to a similar conclusion. Alan Greenspan, a former Chairman of the Council of Economic Advisors, for instance, said he expects the budget deficit to be $67 billion, even after Reagan cuts $15 to $20 billion from spending. The Office of Management and Budget is also refiguring its estimates of budget deficits and its latest "guess," according to an internal memorandum of the Senate Budget Committee, forecasts a budget deficit of $72.4 billion for 1983 and $78 billion for 1984.

The gushing red ink seems to have further frightened an already skittish Wall Street. Many Wall Street investment firms feel that the government's huge borrowing to offset the federal deficit is propelling interest rates to distressing levels. Richard Hooey, Vice President and economist of the Bache investment firms, recently wrote that "Excessive treasury financing today and the expectation of its persistence in the future is the primary reason why real interest rates are very high today. We're hopeful that the Reagan administration will develop a strategy to lower current and expected budget deficits more effectively than they have to date. If they do, then we can expect that interest rates will finally fall."[1]

Many Members of Congress have expressed alarm that the high interest rates might be choking the economy and ruining the success of the Reagan economic program. House Minority Leader Robert H. Michel (R-Ill.) reflected the distress many Republicans were feeling due to the failure of interest rates to fall more in line with the inflation rate: "Within 90 days something's got to give. I'm a political creature, and our political futures [require] there's got to be some movement before spring." Representative G. V. Montgomery (D-Miss.), one of the "boll weevil" Democrats who gave Reagan crucial support during the budget and tax votes commented: "Nobody can live with 20-22 percent interest."

From their recent pronouncements, President Reagan and the Republican leadership in Congress appear adamantly committed to a budget cutting strategy as a remedy to counter high interest rates and an uncertain inflation picture. President Reagan recently called a meeting of his Cabinet to announce his intentions to cut $10 to $15 billion more from the federal budget in 1982; at the same time, he asked his Cabinet officers to prepare for cuts in domestic spending of up to $74 billion in 1983 and 1984, depending on the reductions he decides in the the size of defense spending. White House officials said Reagan was pledged to a "hard line" effort to meet his target for a deficit of $42.5 billion in fiscal 1982, even if it requires additional deep cuts in social spending and defense outlays. "The President is determined to stay on target," reported the White House official.

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[1] Richard B. Hooey, "Now's the Time," Forbes, September 15, 1981, p. 247.

Since the military has so far escaped cuts in its budget, many congressmen support trimming the proposed military buildup as a way to reduce the burgeoning federal deficit. President Reagan recently suggested paring the military budget by 2 percent, although some congressmen have attacked the plan as inadequate. By suggesting cuts of just $13 billion from planned military outlays of $652 billion, Reagan will have to find $75 billion or more to cut from social programs through 1984. Under Reagan's plan, defense outlays would be reduced by $2 billion in fiscal 1982, $5 billion in 1983, and $6 billion in 1984. Reagan's projected outlays for the military would still be $21.7 billion more than President Carter had planned to spend.

The modest size of President Reagan's military cuts provoked attack by two Senate leaders. The Chairman of the Budget Committee, Pete Domenici (R-NM), declared "the majority of my committee and the majority of Congress are looking for larger cuts than that." Senator William Armstrong (R-Colo.) said he personally favors cuts of $30 billion or so for 1983 and 1984, rather than the $13 billion in the Reagan plan. On ABC-TV's "Issues and Answers," California Senator Alan Cranston said he does not think the "rather modest reductions now proposed are going to be very significant."

President Reagan, however, feels that any more military cuts would jeopardize his plans to rebuild America's defense capabilities. In a memo to the Secretary of Defense Weinberger and the budget chief Stockman, Mr. Reagan concluded: "I firmly believe that we have struck the balance necessary to assure both an increasingly strong defense and the economic health on which defense and well-being depend."

Many defense analysts think President Reagan has a point. They assert that the proximate cause of the recent explosion in government spending cannot be attributed to military expenditures. Since 1968, the burden of military spending as a percentage of the GNP has been declining. In 1968, military spending represented 9.4 percent of the GNP. By 1975, the percentage of the GNP devoted to defense dropped to 5.6 percent. Through the decade of the 1970s, military spending declined in real terms by almost 14 percent. By 1979, military expenditures had dropped to their lowest percentage since 1950, a level of only 5 percent of GNP. Even figuring the full military buildup suggested by Reagan, the total outlays for defense amount to less than 6 percent of the GNP in 1984.

Given the modest cuts in military spending suggested by Reagan, some congressmen feel he will encounter stiff opposition in trying to pass through Congress any further cuts in social spending. Representative Jim Jones (D-Okla.) feels Reagan will not be able to repeat his earlier budget victories: "I think what the administration did in imposing legislation that was written downtown resulted in some short-term political victories. But it also created some ill will among legislators. I think OMB will now have a much harder time achieving such victories." Likewise, many political commentators and journalists contend that all the "easy" cuts have been made in the federal budget and that any further cuts will be politically tough to make.

The fact is, however, that the President's first round of budget cuts are not really reductions in the previous year's outlays at all; they simply represent a reduction in the increase planned by the Carter Administration. The budget cuts amount to a cut in government spending of roughly 10 percent. Reagan's 1981 budget is still 13 percent above Carter's 1980 outlays and his 1982 budget is 6.2 percent above Carter's 1981 outlays.

Budget cuts are never easy -- there are always groups which benefit from any program, no matter how useless, wasteful, or worthless the program may be to the general welfare. These interest groups will fight tenaciously, even bitterly, for the continuation of a program they often see as a "right." But any cursory examination of the budget will show multitudinous opportunities to reduce the budget by billions more, without even touching the level of benefits to the truly needy.

Donald Lambro, in an outstanding study of government mismanagement, Fat City, has written that waste and extravagance in government spending is omnipresent: "I am talking about a degree of waste and wantonness that permeates the very fabric of government; squandering, abuse, fraud, mismanagement, and extravagance so widespread as to raise the question of whether we can any longer allow our government to continue operating as it has without doing irrevocable damage to the economic foundation of our nation and the livlihood of every American."[2]

A review of the recent explosion in government expenditures is shocking. The annual federal budget remained below $100 billion for nearly 75 years, until 1961. But, as Lambro has reported, it took only nine years, from 1962 to 1971, for the budget to pass the $200 billion mark. After that, it took only four years to reach the $300 billion, and just two years to surpass $400 billion. By fiscal 1979, government spending had hit $500 billion a year. And for the upcoming fiscal year 1982 the spiral of spending will reach over $700 billion. Total government expenditures as a percentage of GNP in 1951 were about 21 percent of the GNP. By 1960, that figure rose to 26 percent of GNP, and for the year 1980, total government expenditures rose to 32 percent of our country's total output -- a rise of over 50 percent in only 30 years.

Not surprisingly, the enormous growth of government spending has meant a spectacular increase in government debt to finance

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[2] Donald Lambro, Fat City: How Washington Wastes Your Taxes (South Bend, Indiana: Regnery/Gateway, 1980), p. xvii.

shortfalls in revenues. In 1960, the total federal debt was $290.9 billion. By 1970 that debt had risen to around $380 billion. But because of the huge deficits of the 1970s, total federal debt in 1980 was a staggering one trillion eighty-four billion dollars, and growing.

Attempts to reign in this spending have usually been thwarted by cries -- often from upper-income classes -- that any cuts would endanger the very survival of our nation's poor. The cause of helping the poverty-stricken has often been used as a smoke-screen by special interests to guard their own sources of government largesse: the business firm which demands export subsidies, the social worker fearful of losing a lucrative job, a transportation company dependent on federal operating subsidies, an upper-income American receiving health or retirement benefits far in excess of what he paid in. The real benefactors of government spending many times may not be the welfare mother living high off government subsidies -- although undoubtedly abuses exist in social welfare programs -- but the government social worker, business firm, consultant, or middle-income bureaucrat that runs the social welfare program, often in an honest, forthright, and diligent manner. Behind every government program or service, there may be thousands of middle- or high-income individuals who benefit, perhaps unwittingly.

AGENDA OF BUDGET CUTS

This paper identifies over $70 billion of government waste, fraud, abuse, and programs that our country can do without. At the start, no areas of the budget were deemed sacrosanct or necessarily free from wasteful spending. This study found programs to cut, agencies to eliminate, subsidies to be reduced, and eligibility requirements to be tightened in nearly every department of government from social programs -- health, education, housing, social security -- to the military budget. Billions of dollars can be safely cut from the military budget, and not impinge on the ability of the miltary services to meet the Soviet challenge. There is fraud, abuse, mismanagement, and potential for greater efficiency in almost every department in the government -- the Pentagon is no exception. If the President is to achieve full support for a military buildup, he must be sure that the billions in funds are being used in the most effective means possible. In many cases, we suggested that social programs could be best administered at the state and local level. The idea was not to increase state bureaucracies while reducing federal ones, but that the nature of state government is inherently different from federal government: states have no power to print money to finance deficit spending, citizens often have more influence over policies at the state and local level, and each state has it own unique needs and historical character which federal bureaucracies cannot know.

The criterion used to identify possible cuts was not whether benefits flowed from a program or agency -- there are always benefits flowing from even the most monstrous and corrupt program. The criterion should rather be whether the cost of the program justifies increasing the tax burden even further on the average income family striving to make ends meet. The over $70 billion worth of government programs identified below did not meet that criterion. Scores of other programs costing billions of dollars are scattered through the hundreds of pages of the federal budget which escaped our cutting block simply because of time considerations. The list presented below represents only a modest start at reducing the total economic resources commanded by the government while increasing the role of citizens to forge their own economic future.

Program	Estimated Savings in 1982 (in millions)
Amtrak	$ 535
Bilateral Aid	500
Black Lung	478
Block Grants	22,900
Corporation for Public Broadcasting	40
Davis-Bacon	1,000
Education	*
Energy Conservation	1,000
Export-Import Bank	900
Extra Personal Exemption for the Elderly	2,500
Federal Trade Commission	68
Indexation	11,000
International Agencies	725
Interstate Commerce Commission	80
Legal Services	347
Medicaid and Medicare	Not Available
Military Spending	6,133
PL 480 -- Food for Peace	430
Taxing Half of Social Security Benefits	6,700
Taxing All Unemployment Benefits	4,500
Trade Adjustment Assistance	200
User Fees	3,190
Veterans Administration	8,200
Grand Total	$71,426

*Included in block grant.

NOTE: These figures were collected from a number of sources and undoubtedly will change as economic assumptions and committee action evolve. It may not be appropriate to realize savings in 1982 from these changes: taxation of half of social security benefits, taxation of all unemployment benefits, and rescinding the extra personal exemption for the elderly. Revenues from these sources could be achieved only by taxing 1981 income. Figures are estimates of the magnitude of the budget cuts suggested.

BLOCK GRANTS

Proposed Change

Most social welfare programs can be subsumed into eight major block grants that have few federal restrictions attached. States and localities would decide for themselves the specific welfare programs offered, the eligibility requirements, and most restrictions on the dispersal of funds. The eight block grants suggested are: 1) food programs; 2) housing programs; 3) health programs; 4) cash assistance programs; 5) employment and training program; 6) education programs; 7) service programs; and 8) Indian benefits block grants. State and local governments should have the option of transferring up to 50 percent of the funds in each category to other categories as they see the need. The programs which would be placed into each block grant and the 1982 estimated funding are listed below.

PROGRAM	ESTIMATED 1982 AUTHORIZED EXPENDITURES (in thousands)
Food Program Block Grant	
Child Nutrition Program	$ 2,622,000
Elderly Feeding Program	80,000
Food Donations Program	65,000
Food Stamp Program	11,598,684
Special Supplemental Food Program for Women, Infants, and Children	1,017,000
Special Milk Program for Children	31,185
Total	$15,313,869
Housing Programs Block Grants	
Community Development Block Grant	$ 3,660,000
Urban Development Block Grant	500,000
Rural Housing Program (Section 8)	1,282,000
Lower Income Housing Assistance Program	4,063,145
Homeownership Assistance Program (Section 235)	317,000
Rent Supplement Program	224,000
Rental Housing Assistance Program (Section 236)	680,000
Low-Rent Public Housing	2,703,000
College Housing Grants and Loans	21,000
Housing for Elderly	780,000
Total	$14,230,145
Health Programs Block Grants	
Primary Health Care Block Grant	$ 280,000
Medicaid	17,100,000
Alcohol and Drug Abuse, Mental Health Block Grant	491,000

PROGRAM	ESTIMATED 1982 AUTHORIZED EXPENDITURES
Maternal and Child Health Block Grant	373,000
Preventive Health Service Block Grant	95,000
Family Planning Service	130,000
Adolescent Teen Pregnancy	30,000
Venereal Disease	40,000
Migrant Health	43,000
Developmental Disabilities	61,100
Health Services Research	20,000
Health Statistics	39,000
Health Care Technology	3,000
National Research Service Awards	182,000
Health Planning	102,000
Health Maintenance Organization	21,000
Alcohol, Drug Abuse Prevention, Treatment, Rehabilitation Grants	30,000
Alcohol, Drug Abuse Research	70,000
Secretary of Health and Human Services	4,100
Health Manpower Programs	218,800
Immunization	29,500
Total	$19,362,500
Cash Assistance Block Grant	
Supplemental Security Income	$ 7,938,476
Assistance Payments Program (AFDC)	7,533,758
Refugee Assistance	675,112
Earned Income Tax Credit Program	1,252,000
Low Income Energy Assistance Program	1,875,000
Total	$19,329,346
Employment and Work Training Block Grant	
Employment and Training Assistance	$ 4,531,000
Employment Services Program	810,000
Community Service Employment for Older Americans	277,000
Work Incentive Program (WIN)	365,000
Unemployment Compensation Program	18,583,655
Railroad Unemployment Compensation	266,000
Total	$24,832,655
Education Programs Block Grant	
Financial Assistance for Elementary and Secondary Education	3,480,000
Financial Assistance for Higher Education	7,400,000
Vocational & Adult Education Program	835,000
Education Block Grant	589,400
Education for the Handicapped (Education for Handicapped Act)	1,150,000

PROGRAM	ESTIMATED 1982 AUTHORIZED EXPENDITURES
Women's Educational Equity (Civil Rights Act, Title IV)	6,000
Head Start	950,000
Follow-Through	44,300
Training and Advisory Services	37,000
Bilingual Education	144,000
Research & Improvement	166,000
Special Institutions	228,000
Salaries & Expenses	308,000
Total	$15,337,700
Service Programs Block Grants	
Rehabilitation Services	$1,009,000
Social Services Block Grant	2,400,000
ACTION Domestic Programs	145,325
Community Services Programs	389,400
Head Start	950,000
Child Welfare Service	220,000
Child Welfare Training	5,200*
Foster Care	394,000
Adoption Assistance	10,000
Child Abuse	7,000
Runaway Youth	25,000
Development Disabilities	61,180
OHDS Salaries and Expenses	64,630*
Administration on Aging	715,000
Total	$6,295,735
Indian Programs Block Grants	
Indian Benefits Programs	$ 2,187,000
Grand Total**	$114,801,950

*estimates from 1981
**These figures were collected from a number of sources and undoubtedly will change as economic assumption and committee action evolve. They are provided only as estimates of the magnitude of the block grants suggested.

Background

President Reagan originally suggested grouping eighty-seven categorical grant programs into five block grants which would give states and localities almost total discretion over use of the funds. Reagan achieved only limited success in this block grant proposal. The reconciliation act consolidated only fifty-six categorical programs -- omitting many of the largest programs -- into nine block grants generally beginning in 1982. Congress allowed most of the major programs that were to be included in the social service, education, and emergency assistance block grants to remain more or less intact -- ignoring Reagan's proposal to return the money to the states and localities with few strings attached.

Rationale

Reform of the welfare system has been suggested for decades. The current welfare system is a confused, uncoordinated, and duplicative morass of bureaucratic regulations and restrictions which deluge the states with a suffocating burden of paperwork. Welfare recipients are often eligible for a multitude of overlapping programs and subsidies which multiply benefits for the same need.

According to Charles Hobbs, former Chief Deputy Director of Social Welfare for California, a single-parent family with two children below the poverty line is theoretically eligible for twenty-three of the estimated forty-four welfare programs which currently exist, and may be able to participate partially in a dozen or so more. No one seems to know how many people succeed in drawing income from multiple programs, but one thing is certain -- the number of overlapping programs theoretically allows some welfare recipients to achieve income four to five times the value of the AFDC (Aid to Families with Dependent Children) cash payments. One can be sure that social workers are eager to help recipients receive the fullest amount of benefits possible.

Federal administration of the welfare system is the proximate cause of the welfare debacle. Under the wing of the federal government, the welfare system has grown tremendously in cost. The combined average of welfare programs, broadly defined, was 25.11 percent a year between 1971 and 1976 -- two-and-one-half times the growth rate of the GNP.

Attempting to lessen the growth of social welfare by cutting one or several programs will prove futile. Powerful interest groups stand behind each program and often can succeed in blocking cuts in funding. Even if the program is cut, the victory can be hollow: recipients will simply sign up for other existing programs, with no net reduction in overall spending. A comprehensive reform of all welfare programs may, in fact, be politically more palatable since the attention of the public can be focused on the entire system rather than dissipated by countless battles over individual programs.

The agenda offered here -- closely following an approach outlined by Charles Hobbs in a monograph to be published by The Heritage Foundation -- amounts to an enormous reduction in federal control over welfare, educational, and health expenditures, not because these functions are unimportant, but because these types of public assistance programs are much more efficiently administered at the state and local level. The recrudescence of American federalism is supported on a number of grounds:

1) Federal restrictions and regulations are enormously expensive, often foolish and meddlesome in intent, and impose cumbersome burdens on state and local government. The administrative cost of federal programs is substantial and growing; needed funds are diverted from assistance to the poor to support well-paid bureaucrats.

2) States and localities know better the needs of the people because the level of government is closer to the people.

3) Citizens have a more powerful voice over the affairs of state and local government.

4) States and localities have no power to print money to finance deficits; revenues must approximately match expenditures. This restriction is an important check on fiscal irresponsibility and profligate social welfare spending.

5) Each state has its own unique needs and historical character which federal bureaucrats cannot know as well as local officials. The diversity in citizens' tastes for public services and levels of government spending is a basic strength of a free country. Centralization imposes a conformity of tastes and reduces flexibility, adaptation to local conditions, and political innovation.

6) Recent experience indicates that state and local governments are no less enlightened, prone to discrimination, or hostile to providing needed social services than the federal government.

7) Each state can act as an experimental zone for innovative ideas to aid the poor or needy; the federal government has no competitors and therefore rarely is an innovator in political ideas.

8) Competition among states for businesses and citizens promotes the efficient provision of the most needed public services at the most economical price.

9) A reduction in the size of the federal government, accompanied by a renewed state and local effort, lessens the chance for arbitrary abuse of central authority and the magnitude of corruption.

Fiscal Impact

It is estimated that at least 20 percent could be cut from the federal appropriation for these programs if the federal government cut most restrictions and regulations from the block grants. In addition, the federal programs are now highly duplicative in purpose, as well as an administrative monstrosity. By returning the programs to the local governments in the form of an unrestricted cash grant, states could eliminate the duplications and the federal administrative costs. States might even establish a basic cash grant to the poor and eliminate all in-kind benefits --

along with the substantial administrative costs associated with the proc ams. The cost saving is conservatively estimated to be over $20 billion for 1982.

LEGAL SERVICES CORPORATION

Proposed Change

Federally-funded free legal advice is a generally unneeded service to our nation's poor. The agency can be eliminated with little harm accruing to the poor.

Background

Appropriations for the Corporation have grown from $72 million in 1975 to $321 million in 1981. The Reagan Administration initially suggested that the program be abolished, but under pressure from the legal associations suggested the Corporation be maintained at a severely reduced level. Congress separated funding for the Legal Services from the reconciliation bill, and the appropriation measure currently being considered in Congress reduces funding to $241 million.

Rationale

The rapid growth of the agency has been accompanied by the expenditure of significant sums on political advocacy and legislative lobbying. Legal Services lawyers have often lobbied on behalf of welfare rights, supported rent strikes and boycotts, and engaged in partisan political behavior.

Using a conservative poverty figure, the Legal Services Corporation has benefited only 4 percent of the nation's poor -- an extremely small number for the huge expenditures. Legitimate legal services for the poor can be accomplished through the pro bono work of the 500,000 private attorneys nationwide. Donald Lambro questioned the worth of the agency in helping the poor: "This agency does nothing to either improve the glum day-to-day lives of the truly poor, or perhaps more to the point, help them to rise out of their circumstances. Indeed, it assumes the poor will always remain in their disadvantaged state in order to provide employment for a corps of government-paid attorneys who are ready to litigate at the drop of a tort."[3]

The only real service the agency has provided so far seems to be secure jobs for our nation's glut of lawyers. Not only does the agency employ legions of attorneys out of law school, but each suit the agency brings draws on the services of private law firms, often well paid, to represent the other side.

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3 Ibid., p. 332.

Fiscal Impact

The elimination of the Legal Services Corporation would save $347 million dollars in the 1982 budget.

INTERNATIONAL AGENCIES

Proposed Change

*Development aid should be discontinued.

*Phase-out contributions to multilateral development banks.

Background

The World Bank currently runs six multilateral development banks which are supported by U.S. taxpayers: IBRD (International Bank for Reconstruction and Development); IDA (International Development Association); IFC (International Finance Corporation); IADB (Inter-American Development Bank); ADB (Asian Development Bank); and AFDB (African Development Bank).

The mission of the multilateral and bilateral aid program is to "provide humanitarian assistance to the needy abroad, encourage economic development, and promote U.S. foreign policy." Since the 1960s, the United States has been spending an increasing portion of its total foreign aid budget on multilateral aid programs -- those in which the U.S. is only one participant among many countries.

Reagan's first round of budget cuts did not significantly reduce the Carter Administration's request for the multilateral banks; rather, the scheduled payments to the agencies were stretched out over additional years. Stretching out payments does save the U.S. taxpayer money. But the U.S. should consider withdrawing its financial support from the multilateral organizations entirely.

Rationale

One of the major disadvantages of providing aid through multilateral banks is that the U.S. loses substantial control of the use of its funds. The U.S. government receives no assurances that it can direct the loan or grants of the multilateral banks to those countries which it feels worthy of U.S. support. Between October 1977 and February 1978, for instance, the U.S. voted to deny loans in ten occasions; in all the cases, the U.S. was overruled by the other participating countries.

The record of multilateral banks on providing aid to countries which are anti-U.S. and flagrant human rights violators has been abysmal. The IDA, for instance, recently granted six additional loans totaling hundreds of million of dollars to such blatant human rights violators as Vietnam and the Central African Republic. The World Bank and the regional banks have also provided substantial support to Ethiopia and Afghanistan.

Critics have made further objections to U.S participation in multilateral aid programs:

1) The banks promote an economic policy of high taxes, government regulation, economic austerity, and centralization -- all policies which impede economic growth, personal freedom, and free markets.

2) The banks waste most of their money on high cost, low value projects.

3) Corruption is rampant in the agencies, and in the countries which receive the money.

4) The aid mostly benefits government officials in countries which are recipients of aid and rarely helps the poorest of the poor.

Fiscal Impact

E. Dwight Phaup, Associate Professor of Economics at Union College, estimated a savings of $500 million could be realized in FY 1982 if the development banks were shifted to the private sector. The International Development Bank (IDA) could be phased out over five years with an annual average saving of over $225 million (not including the reductions in contingent liabilities).

BILATERAL AID

Proposed Change

Bilateral aid organizations can be cut by one-third since many of their functions can be better carried on in the private sector.

Background

The main bilateral aid organization is IDCA (International Development Cooperation Agency), and its subsidiaries include: AID (Agency for International Development) and OPIC (Overseas Private Investment Corporation). AID provides bilateral aid to support economic development and render humanitarian assistance to foreign nations in need. OPIC provides loans, loan guarantees, advisory services, and "insurance against the political risks of expropriation, war, revolution and insurrection, and the inconvertibility of local currencies to U.S. firms considering investing directly in developing nations."

Rationale

Bilateral aid programs rarely wins friends for the U.S., and private funding would naturally flow to underdeveloped countries if they would create stable political conditions attractive to business. Unfortunately, many countries are hostile to foreign investment or impose stringent restrictions on business, making foreign investment unattractive.

OPIC should be eliminated, since the agency benefits only U.S. multinational corporations which trade abroad. These companies should bear the risk of investing in foreign countries, not the U.S. taxpayer, since the companies stand to profit from successful foreign ventures.

Fiscal Impact

A one-third cutback in AID funds would save approximately $500 million. OPIC currently does not require budgetary appropriations.

EXPORT-IMPORT BANK

Proposed Change

Phase-out the Export-Import Bank over three years.

Background

The Ex-Im Bank provides credit aid to support U.S. export sales, especially to help foreign governments purchase U.S. goods such as jet aircraft and nuclear power plants. The interest rates offered on Ex-Im Bank loans are only two-thirds the rate the U.S. corporations pay for borrowing in the private sector -- about 8.5 percent in 1980.

The Reagan Administration had suggested a $600 million cut in the Ex-Im Bank's direct loan authority to a level of $4.4 billion in 1982, and a cut of $810 million in loan authority in 1983 to a level of $4.69 billion. The Congress, however, authorized an outlay of $5.065 billion in fiscal 1982 and $5.413 in 1983 -- large increases over the Reagan budget proposal. In addition, Congress approved a provision which requires the U.S. Treasury Secretary to prepare a report on whether further export aid is necessary to counter the export subsidies offered by other governments.

Rationale

The Ex-Im Bank provides federal subsidies to business involved in export enterprises. There is no reason why these firms should not compete freely in the marketplace, unaided by special government loan credits. As the OMB has stated, taxpayers should not be forced "to share the interest cost of private profit-making -- and often larger -- corporations engaged in export enterprises." These subsidized interest rates distort the capital markets, reduce efficiency, increase taxes, and hurt productivity.

The program has literally become an income transfer program to a few multinational companies which hardly deserve subsidies from the U.S. taxpayer. Between 1977 and 1981, the Carter Administration planned to increase direct lending activity of the Ex-Im Bank 600 percent. Some supporters of the Bank argue that export subsidies can be used as a bargaining chip by negotiating with other countries to pressure them to lower their own export subsidies. But the tremendous growth of the program in recent years indicates that the main purpose of the loan credits is not to use them as bargaining chips, but as a transfer payment to a few U.S. corporations.

When exporting of domestic goods is a profitable venture, the private sector provides loans to finance exports. Indeed, the private capital markets have been the main source of financing the $150 billion increase in U.S. export since 1978. The subsidization of exports is not necessary to assure a balance of payments equilibrium or a healthy expansion of our export industry.

Some businessmen argue that export subsidies help them to compete with foreign companies receiving subsidies from their governments. While foreign governments sometimes do subsidize their export industries, three factors argue against reciprocating by providing aid to our export enterprises: 1) Export subsidies drain badly-needed capital from companies which are not subsidized; 2) increasing taxes to subsidize American corporations is an unfair burden on non-exporting U.S. companies and all taxpayers; and 3) the export subsidies provided by foreign governments actually benefit the U.S. consumer by reducing the cost of imported goods.

Fiscal Impact

If the Ex-Im Bank were phased-out over three years, the fiscal year 1982 savings would be around $900 million.

PL 480 -- FOOD FOR PEACE

Proposed Change

A reduction of PL 480 by one-third would leave sufficient funds for emergency humanitarian assistance to needy countries.

Background

PL 480 is a food program which provides low-interest loans to foreign governments for food imports (Title I), and food donations to needy people in foreign countries (Title II). The stated goal of PL 480 is to meet humanitarian needs and promote economic development abroad.

The Reagan Administration suggested the elimination of the $76 million supplemental request for Title I and the reduction of budget authority of both Titles by $100 million in 1982. This action would have set budget authority at $1.163 billion in each year 1972-1984.

Congress, in the reconciliation budget, provided substantially more funds than suggested by setting funding for PL 480 at $1.304 billion in 1982, $1.320 billion in 1983, and $1.402 billion in 1984.

Rationale

There are a number of reasons why the scope of the program can be significantly reduced:

1) The program is no longer needed to dispose of surplus U.S. farm crops (if it ever was).

2) The food donations program may undermine local food production by providing U.S. food free of charge or at lower cost than local farmers can afford to grow it.

3) The food sales can create a permanent state of dependency on U.S. giveaways.

4) The food program has been used to support U.S. military concerns.

Many critics of the program contend that humanitarian assistance can be handled adequately through charitable or special relief organizations in the U.S. A one-third cut in the program still permits sufficient funds for emergency relief efforts in needy countries.

Fiscal Impact

A one-third cut in 1982 would save approximately $430 million.

EDUCATION DEPARTMENT

Proposed Change

Eliminate the Cabinet-level department. All programs should be returned to the states in the form of an unrestricted block grant (see section on block grants). A cut of 20 percent can be easily accommodated without harming important educational programs since the block grants eliminate the costly burden of federal regulations and administrative expenses.

Background

Congress voted to establish a Department of Education in September 1979 at the urging of then-President Jimmy Carter. Many people regarded the creation of the agency as a political payoff for the National Education Association's (NEA) endorsement of Carter in the 1976 presidential election. Carter sold the agency to Congress on the grounds that combining all education activities would save administrative costs -- according to OMB between $15 and $19 million.

Washington veterans, however, realized that frugality is not often a characteristic of new federal agencies. The Education Department was no exception: federal expenditures for education have ballooned to an estimated $15.6 billion in fiscal year 1981 from a total of $12.5 billion in 1979. The increased federal spending on education has been accompanied by the greater centralization of educational policymaking and regulation.

Currently, over 50 percent of federal funds to education is channeled to support elementary, secondary, and vocational education. These funds aid special programs for educationally-deprived children and subsidize school library resources, textbooks, and other instructional material, educational centers and services, educational research and development, and finally, state departments of education. The Education Department has also emerged as an important source of funds for colleges and universities and the lower-income students who attend higher educational institutions.

Rationale

The rise of the federal presence in education has been contemporaneous with the decline in educational standards, especially as measured by SAT and other standardized tests. Simply spending more federal dollars on education has not improved its quality. For example, per pupil spending increased by 58 percent from 1971-1976, at a time when school enrollment declined by 4 percent. Professional staffs during this time grew by 8 percent. As enrollment declined and the number of administrators and teachers skyrocketed, all measures of educational achievement plumetted. Mean college board scores (SAT), for example, declined from 478 (verbal) and 502 (mathematical) in 1962-1963, to 444 and 480, respectively, in 1973-1974.

Eugenia Froedge Toma, Professor of Economics at Loyola-Marymount University, links the declining quality of America's public schools directly to the increased federal presence in education. The Department of Education, Toma argues, has been to the economic benefit of teachers and administrators, not students. As the federal government expands its role in funding and regulating our nation's schools, Toma says, competition between schools to provide the best education for the money is lost: "Less competition is desired because it enables the educators, and not the students, to reap the benefits from the school system. It is precisely this phenomenon -- reduced competition -- which is the source of the decline in American Education."[4]

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[4] See Eugene J. McAllister, ed., Agenda for Progress: Examining Federal Spending, (Washington, D.C.: The Heritage Foundation, 1981), p. 197.

If educational quality is to be heightened, the federal presence must be eliminated. The federal government, as well as state governments, impose a dull pattern of uniformity on local school systems so that all school districts tend to resemble one another. For its part, the federal educational bureaucracy spends most of its time promulgating thousands of regulations which tie the hands of local school boards and divert attention and funds away from improving the quality of education. The loss of local control has been the chief cause of parental discontent with school curriculum and discipline policies. As financial and managerial control fall from the hands of locally-elected school boards into the domain of state and federal bureaucracies, parents rightly deplore a loss of control over their children's education. The heavy hand of government bureaucracy has stifled the traditional strengths of the American educational system: creativity, diversity, parental support, and excellence.

The elimination of the department, as well as all the accumulated regulations, will go a long way to restoring control of schools to where it rightly belongs -- the parents. The money can be returned to states, and, in large part, to localities, to use in their discretion.

Fiscal Impact

A cut of 20 percent in educational funding is a conservative estimate since the elimination of all educational regulations may save that much alone, not to count the savings accrued from eliminating federal administration costs. Estimating an education block grant at a funding level 20 percent below 1981 outlays would save about $2.8 billion. Local school districts would save millions more, however, because of the elimination of the enormously expensive regulations sent forth by the Washington educational bureaucracy.

FEDERAL TRADE COMMISSION (FTC)

Proposed Change

The entire department can be eliminated with the exception of the Bureau of Competition, which can be merged with the Justice Department.

Background

The FTC is an independent regulatory agency with three main divisions. The Bureau of Competition is charged under the Clayton Act with enforcing antitrust laws. The Bureau of Consumer Protection is responsible for protecting consumer interests. The third division, the Bureau of Economics, prepares economic reports and analyses which require thousands of manufacturers, trade organizations, and mining industries to send detailed information to the agency. The FTC has over 1,700 employees, including 600 lawyers.

The Reagan Administration suggested cuts of $8.4 million from the FTC's 1982 budget of $76 million. The proposal, which represents a cut in the 1982 budget of 10.9 percent, requires a general staff reduction and the phasing out of regional offices. The appropriations measure has not yet been considered by Congress.

Rationale

Senator Harrison Schmitt of New Mexico has called the FTC "the second most powerful legislature in the country." The agency, Schmitt said, now "claims the power to declare any commercial act to be 'unfair,' regardless of state law, and thereby to amend all state statutes and reverse all state cases that may be inconsistent with its declaration."[5]

The agency has used its power to inflict regulations and lawsuits, primarily on small businesses, concerning matters not even remotely harmful to consumer interests. The agency's budget is a relatively small $79 million in 1982, but the burden the agency imposes on the consumer by raising the prices of consumer products and wasting the time of businessmen is staggering.

A case in point is the FTC's probe of the automobile industry. Although the FTC admitted it had no reason to expect any wrongdoing on the part of the automobile industry, it asked the industry for private data and records going back as far as thirty years. The fishing expedition, according to the industry, would cost it as much as $200 million -- an expense which adds nothing to consumer welfare and increases the price tag of automobiles.

The case is not an isolated incident. Indeed, a review of FTC actions is a chronicle of wasted money, costly litigation, silly regulations, and worthless government paternalism. The GAO has estimated that regulations from federal agencies like the FTC cost American consumers around $60 billion a year. This cost reduces American business competitiveness, raises the inflation rate, and provides few added benefits to consumers. If the federal government wants to help consumers, one of the most constructive acts would be to eliminate the FTC. Not only would the prices of consumer goods fall and taxes reduced, but the competitiveness of the marketplace would be enhanced. FTC regulations, while burdensome even to the largest companies, are devastating to smaller businesses. By driving up the costs of small businesses, agencies like the FTC reduce the competitiveness of the marketplace -- the best protector of the consumers' interest.

Fiscal Impact

The entire agency can be eliminated with a saving in 1982 of $68 million.

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[5] Reported in Lambro, op. cit., p. 383.

CORPORATION FOR PUBLIC BROADCASTING

Proposed Change

The agency should be phased out over three years.

Background

The Corporation for Public Broadcasting disperses federal aid to 217 public radio stations and 170 public television stations. The Reagan Administration had proposed a 25 percent cut in 1982 outlays for the Corporation to a level of $129 million. The final budget reconciliation bill authorized $130 million annually for fiscal 1984-1986. The Reagan Administration had suggested a level of $100 million by 1986. Congress authorized more than $90 million more than Reagan had requested between 1982-1986.

Rationale

The OMB has clearly stated the case against federal funding of public radio and television stations:

> The contribution of public broadcasting to society is debatable, but one fact is clear: the prime beneficiaries of a public broadcasting station are its listeners and viewers. Any benefit which non-listeners and non-viewers receive from the Corporation for Public Broadcasting (CPB) is purely conjectural and more than likely nonexistent. Thus, there is no overriding national justification for the funding of the CPB.[6]

Donations from private subscribers, corporations, and private foundations have shown significant increases since 1973. Good public stations may survive on those donations without government support. If viewers are unwilling to support the public station, it may be an indication that the broadcasting service is not of sufficient importance to them. In addition, public stations could offer to run advertisements to cover the cost of programming. In any case, the average taxpayer should not be asked to support public radio and television entertainment for an audience which tends to be wealthier and more educated than the general populace. If this select audience wants the benefit of public programming without commercials, they should be willing to pay for the service. In most areas, cable television stations may now fill the need of those preferring public television programming.

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6 Executive Office of the President, Office of Management and Budget, "Additional Details on Budget Savings, Fiscal Year 1982 Budget Revision," April 1981, p. 344.

Fiscal Impact

A phase-out of the Corporation over three years would save over $40 million a year between 1982-1986.

INTERSTATE COMMERCE COMMISSION (ICC)

Proposed Change

Immediate elimination of the Commission.

Background

The government began the ICC over ninety years ago to regulate the powerful railroad system -- which at that time was the major means of interstate travel. In 1979, President Carter, with the support of Senator Kennedy and others, proposed legislation which would deregulate the railroads, the trucking industry, and other interstate vehicles. The pace of cutting back the authority of the ICC has been slowed under the Reagan Administration, which seems to prefer that the ICC continue regulating our nation's transportation system.

Rationale

Donald Lambro has suggested that the need for the ICC -- if it ever existed -- certainly is not apparent today. Lambro concludes:

> For more than 90 years the Interstate Commerce Commission has been inflicting costly, complex, and often ludicrous regulations upon the nation's rail, truck, barge, and bus industries. This in turn has added billions of dollars to the cost of everything we buy. By suffocating competition within the transportation industry, the ICC has reduced American productivity, wasted precious operating capital, crippled the railroads, and frozen small businessmen -- particularly minorities -- out of the interstate trucking markets solely to protect what has become a government-sanctioned trucking cartel. It is, in short, an agency that should have been abolished many years ago.[7]

Fierce competition among transportation companies -- airlines, truckers, railroads, and barges -- assures reasonable rates, quality service, and safety. The ICC does not promote competition, it hinders it. The major benefit of the ICC accrues to existing companies that are protected from encroaching competition by ICC regulations blocking new entrants into the trucking, railroad,

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[7] Lambro, op. cit., p. 262.

and water transportation industries. The antiquated regulations, for example, prevent railroads from abandoning underutilized railways or require truckers to make empty backhauls. The regulations, according to Stanford University economist Thomas Gale Moore, cost Americans more than $10 billion per year. The ICC is a classic case of a regulatory agency captured by the regulated industry itself. The nation's transportation network can only become more efficient, less costly, and more productive if the ICC were abolished.

Fiscal Impact

The elimination of the agency would save around $80 million, but the overall increases in productivity in transportation services would produce billions more in economic benefits.

MILITARY SPENDING

Proposed Changes and Rationale

The General Accounting Office has suggested numerous reforms which do not affect needed weapons procurement, manpower levels, or military preparedness. Among the most important changes suggested by the Comptroller General include the following:

1) Consolidate military base support activities

U.S. military bases are scattered across the country and throughout the world. These bases require support services -- in areas such as repair, maintenance, security, vehicle operation, utilities, accounting, purchasing -- over 100 in all. Almost 550,000 service personnel are assigned to these duties, at a cost for fiscal 1979 of $12 billion.

Military bases themselves need not be consolidated to effect economies. Substantial savings are estimated by consolidating military support facilities and personnel for the military bases located in the same geographical area. The GAO offers as an example the seven military bases centered in the Sacramento, California area, which employ almost 10,000 in support functions. By combining base support systems for all seven military bases, scale economies saving millions of dollars are realized at no loss of military effectiveness. The Comptroller General of the U.S. has called the idea "One of the most obvious -- and one of the easiest -- sources of true economy which the Secretary of Defense can achieve."[8] Werner Grosshans, Deputy Director Procurement, Logistics, and Readiness Division, suggested that a cut of

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8 Comptroller General of the United States in a Letter to Caspar Weinberger, Secretary of Defense, "Proposed Agenda of Significant Management Improvements and Cost Reduction Opportunities -- Department of Defense," p. 2.

5 percent in base support personnel nationwide -- a conservative estimate -- would produce an annual saving of $370 million.

2) Consolidate, to a greater extent, the purchase, issue, and use of common supplies among various military branches.

While a great deal of progress has been achieved in consolidating common food and supply purchases for the military branches, much more can be accomplished, according to the GAO. Over $100 million in operating costs could be saved, if a central agency, called the Defense Logistics Agency (DLA), were put in charge of purchasing, storing, and issuing over 1,300,000 consumable items for the military branches. These savings from centralized management arise from reduction in inventory, overhead, and personnel cost.

The GAO has documented a number of cases in the Air Force, Army, and Navy which indicate that parts inventories are unnecessarily duplicated, overstocked, or inefficiently used. The amount saved by correcting the mismanagement of parts inventories would amount to millions of dollars.

3) Better control of the logistics -- the procurement, distribution, maintenance, and replacement of weapons -- would save $3.25 billion in FY 1982.

The Department of Defense will procure over $100 billion in goods and services in FY 1982. There is a large degree of saving possible in this area which would not necessitate eliminating major programs. Among the possible recommendations are the following:[9]

a. Consider using more than one contractor to manufacture weapons systems. According to the Congressional Budget Office (CBO), large savings sometimes can be made if weapons bought in large quantities are contracted out to more than one company.

b. Establish more efficient procurement rates for large scale equipment purchases. Dramatic increases in production costs, especially overhead, arise if weapons are bought at more economical, often larger, production runs. The GAO has laid much of the blame for inefficient production runs on Congress. The agency concluded that improper analysis and inconsistent funding of weapons procurement result in "...ill-planned and poorly executed program management, fostering inadequate or insufficient research and development, and inefficient production rates which contribute to increase program costs and cost overruns."[10] If weapons systems were funded in a more consistent and adequate

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[9] Congressional Budget Office, "Reducing the Federal Budget: Strategies and Examples, Fiscal Years 1982-1986," February 1981, p. 33.

[10] Comptroller General, op. cit., p. 9.

manner by Congress, the GAO reported, savings in the magnitude of 10 to 30 percent of weapons budgets could result.

c. Consider multiyear contracting to purchase equipment or supplies rather than year-to-year funding. Multiyear contracting saves money because a contractor is provided with the opportunity to realize scale economies and increased efficiency. The GAO suggests that the quality of service from contractors should increase as well because the number of contractors willing to bid on any individual contract should increase as the length of the contract increases.

In 1979, the Department of Defense's multiyear contracts amounted to only 2.6 percent of the procurement budget that year. This small percentage is due in part to the current statutes which prevent agencies from entering into contracts or services over one year's duration.

If these statutes were changed, large economies are possible. The Commander of the Air Force Systems Command, for instance, recently argued for multiyear funding:

> Looking at six new potential multiyear candidates, which would cost a total of about $13 billion on a single year basis, I feel confident that we could achieve savings of well over one billion dollars if authorized to procure them on a multiyear basis.[11]

d. Reduce procurement red tape for savings in the order of $2.25 billion. The Department of Defense currently has an overwhelming number of bureaucratic regulations guiding every stage of the procurement process. Over 30,000 pages of regulations govern minute details of material standards, manufacturing processes, quality assurance, contract supervision procedures, and documentation. According to the CBO, complying with all these regulations adds between 20 percent and 100 percent to the costs of goods, for little or no gain in effectiveness.

4) Military compensation should be changed to a salary system whenever possible.

The present pay system is inequitable, paternalistic, complicated, and inefficient because of the existence of many tax-free, in-kind benefits. In fact, the Comptroller General has argued that because the pay system is so complicated "few members who are paid under it know accurately how much of what they earn is equivalent to a civilian salary. They usually underestimate their equivalent salaries, which clearly does not help to recruit and retain personnel."[12]

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[11] Ibid., p. 11.
[12] Ibid., p. 16.

Under the present military pay system, the serviceman who is single earns much less than a married couple because of the much wider range of in-kind benefits that are available to a married couple. A straight salary system would help eliminate these pay inequities and also make clear the total personnel cost of an all-volunteer service. The prevalence of a wide range of valuable (and tax-free) in-kind benefits conceals a large part of military compensation.

Military commissaries, for example, sell groceries and other goods at substantial discounts to active duty and retired military personnel. Fraud, waste, and mismanagement are particularly prevalent in the military commissary systems. According to the GAO, 58 percent of all potential fraud and mismanagement cases in the first half of 1980 concerned operations in the commissary systems. The GAO reported: "Exchange procurement appears to be highly susceptible to fraud involving kickbacks and gratuities...."[13] The GAO suggested the Department of Defense develop an efficient management information system and a system of internal controls to deter fraud and reduce the likelihood of waste.

A study should be made to determine whether the existence of commissaries are really a necessary service to attract and retain servicemen at all bases. Commissaries were originally set up in 1866 to provide service to remote frontier posts, but today the service is offered on military bases regardless of their proximity to metropolitan areas.

The large federal subsidy to commissaries consists not only in an annual appropriation from the Treasury, but in foregone tax revenues resulting from the tax-free status of commissary products. Servicemen must be compensated for the elimination of commissary services by increasing their basic pay. That alternative appears both more efficient and less paternalistic, while reducing the opportunity for fraud. On balance, estimated efficiency gains are at least $33 million.

In some cases, in-kind benefits are critical to providing adequate support service to American servicemen. This is especially true of military bases in underdeveloped foreign nations and sparsely populated areas in the U.S. where food, entertainment, clothing etc. may not be readily available. The in-kind benefits for military people close by metropolitan areas should mostly be eliminated, while at the same time the basic pay of servicemen should be raised to replace the in-kind benefits.

5) <u>The twenty-year retirement feature of the military retirement system should be re-examined</u>.

According to Kenneth Coffrey, Associate Director of the Federal Personnel and Compensation Division, the cost of the

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[13] U.S. General Accounting Office Report, "More Effective Internal Control Needed to Prevent Fraud and Waste in Military Exchanges," (FPCD-81-19) December 31, 1980, p. i.

military retirement system has increased fivefold during the decade of the 1970s. The retirement system now has an unfunded liability of close to $500 billion.[14]

The system has increased in cost so enormously because the provisions are far more generous than any private retirement plan. The features include:

* Retirement with full benefits after twenty years of service at any age.

* Retirement annuities based on the most recent salary rather than the average over the career of servicemen.

* Military servicemen make no direct contribution to the retirement plan.

Dr. Coffrey has concluded that "unless changes are made, there is doubt we will be able to afford a continuation of the present system without making sacrifice in other areas."[15] The cost is not the only cause for concern with the military retirement system. Another problem is the retirement of most servicemen after the twenty-year service requirement is met. According to Coffrey, "The ability to receive retirement benefits at a relatively early age and begin a second career is, understandably, too powerful an incentive to resist, and there can be little doubt that few will do so unless there are fundamental changes in the system."[16]

One possible change to encourage greater enlistment after twenty years of service would be a sliding scale of retirement benefits depending on length of military service. The single twenty year retirement criterion would be abandoned; relatively more generous pensions would be provided to those who have longer careers or for those who have especially strenuous or dangerous positions. The cost of such a system would be about $120 million less for FY 1982 than the present retirement system and the incentives for servicemen to continue in the service would be increased.

6) <u>The Department of Defense has been consistently underestimating the inflation rate, at great cost to military preparedness and efficiency</u>.

The Office of the Secretary of Defense, with OMB's guidance, develops a projection of future inflation rates that is used to

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14 Dr. Kenneth Coffrey before the Defense Task Force, House Committee on the Budget, "Proposals for More Effective Military Manpower Policies," March 10, 1981, U.S. General Accounting Office, p. 12.

15 <u>Ibid.</u>, p. 13.

16 <u>Ibid.</u>, p. 14.

determine requests for funds for procurement, shipbuilding, research and development, operations and maintenance, military construction, and family housing. These projections have consistently been significantly different from actual inflation experienced. Inflation projections for greater than three years in the future, have been less than half the actual inflation rate.

Underestimating the inflation rate has led to funding shortfalls, less efficient production schedules, higher unit costs, and program stretchouts, adding millions, possibly billions, to defense costs. If program costs are underestimated, reductions may be made in other areas to make up the shortfall: spare parts inventory, support, testing, or training. Just as importantly, the general public begins to distrust military planners when appropriations consistently fall short of needs. Examples of program cutbacks due to underestimating inflation have been quite frequent, including:

* F-16 (reduced from 180 to 120 to 96)
* F-15 (reduced from 60 to 30)
* A-10 (reduced from 144 to 60)

Such production cutbacks are not only costly, but the shortfalls and delays in weapon production severely reduce our military preparedness.

7) <u>Pay raises for military servicemen should not be provided across-the-board but should be focused on areas of specific personnel shortages</u>.

In order to reduce the outflow of experienced personnel from the armed services, President Reagan proposed a 5.3 percent pay raise for military personnel on top of the proposed 9.1 percent included in the Carter Administration's 1982 budget. In total, Reagan has suggested spending an extra $3.9 billion for military pay increases for fiscal years 1981-1982.

An across-the-board pay increase of this magnitude far outpaces the pay raises of other federal workers and may be an inefficient method to assure the retention of experienced personnel. According to the GAO, the armed services are not experiencing across-the-board personnel shortfalls, rather it is only in specific occupations within the military that are experiencing shortages. For example, the Air Force has experienced chronic shortages in filling forty-eight job classifications. The Army faces shortages in combat arms skills and space imbalance skills, while the Navy has a severe problem in finding nearly 20,000 petty officers.

However, other jobs in the military are currently overstocked with qualified personnel. The remedy is not to provide extra increases, beyond what other federal workers earn, to all military personnel, but just for those jobs where critical shortages are apparent. At least one billion dollars can be saved by targeting pay increases to specific job classifications.

8) <u>The Department of Defense may be overusing and abusing the management consulting services of outside agencies</u>.

The Defense Department currently spends roughly $2.6 billion a year on private consultants. According to a GAO study, much of that money may be spent on pointless jobs while up to 71 percent of the projects can be done by the Defense Department itself. The Department of Defense was criticized for not establishing competitive bidding for over 80 percent of the consulting contracts awarded. In addition, over 57 percent of the contracts the GAO studied were allowed to be continually renewed without proper yearly justification for the contract.

The GAO also raised questions about the propriety of awarding private consulting contracts to former Department of Defense employees -- a practice which occurred in 50 percent of the contracts it studied. The Department of Defense appears particularly susceptible to accepting unsolicited consulting contracts. Of the 256 contracts reviewed, approximately 40 percent were unsolicited by the Department. The large number of unsolicited contracts casts doubt on the importance of the consulting work and the proper use of the Defense Department's own in-house expertise. By eliminating only 10 percent of outside consulting contracts, the Department of Defense could save $260 million.

9) <u>Potentially, large amounts can be saved if the military would undertake a more critical analysis of the costs and benefits of new military technologies</u>.

Not all new military technologies should be automatically adopted. Careful analysis should be given to whether the cost of new technologies is clearly worth the additional benefits promised over current systems or lower cost alternatives. Those military systems which incorporate the most advanced technologies may at times be so complex and sophisticated that the strength and readiness of our military forces is undermined. Not only may it be difficult to attract the large numbers of highly trained personnel to man the systems, but the performance of the equipment is sometimes reduced as sophisticated technological features are added.

Technological advances, of course, are often the means by which the U.S. attains important military advantages in weapon systems. A reliable system that is relative easy to use and maintain may, in fact, add more to our national security than the enhanced performance promised by some new technology. The GAO has recommended that the "Secretary of Defense and the Congress carefully examine lower cost alternative programs before approving new weapon systems. In particular, they should explore with senior military officers the pros and cons of larger quantities of alternative weapons versus smaller numbers of highly sophisticated and expensive systems."

10) American allies can share more of the cost of U.S. military expenditures on bases and equipment deployed abroad to defend those allies.

Americans currently provide unmatched military support for allies that are able to bear a larger portion of their own defense needs. Japan, for example, spends only .9 percent of its GNP on defense, Italy 2.4 percent, France 3.3 percent, and West Germany 3.4 percent -- while the U.S. is spending more than 5 percent of its GNP on the military. The GAO recommended that "the United States and Japan should seek more equitable cost sharing agreements." The GAO also stated, "Japan has prospered under the security provided by the U.S. defense umbrella and has developed an economic superpower capable of assuming a greater share of common defense costs."

The protection of Western Europe and Japan by the U.S. was justified after World War II when their economies were in shambles and the U.S. was the preeminent economic leader. But today, our allies have the economic power to bear their fair share of the military expenditures necessary to defend their countries. Since the U.S. has already moved to increase the military budget to eight or nine percent of the GNP, we are justified in encouraging our allies to reciprocate in bearing a greater defense burden. The National Tax Limitation Committee has suggested a possible saving of $5 billion a year if our allies became independent. A reasonable aim for FY 1982 is to achieve a position whereby the U.S. can reduce foreign military expenditures by $1 billion.

Fiscal Impact

It is difficult to quantify the savings resulting from many of the reforms suggested, especially since some reforms will have effects only over the longer term. A conservative estimate of possible savings from these changes is $6.133 billion in 1982.

A summary of the savings for each recommendation is listed below:

Recommendation	Saving (in millions)
1. Consolidate base support	$ 370
2. Consolidate common supplies	100
3. Better control of logistics	3,250
4. Military compensation reform	33
5. Retirement re-examined	120
6. Better predictions of inflation rate	not available
7. Targeted pay raises	1,000
8. Reduction in consulting services	260
9. Critical analysis of new technologies	not available
10. Cost sharing with allies	1,000
Total	$6,133

EXTRA PERSONAL EXEMPTION FOR THE ELDERLY

Proposed Change

The extra $1,000 personal exemption for the elderly should be rescinded.

Background

The current federal income tax system entitles taxpayers 65 years or older to an additional $1,000 personal exemption. This provision was originally adopted as part of the Revenue Act of 1948 to help offset the presumed reduction in income often experienced by the elderly.

Rationale

The extra personal exemption for the elderly is simply an inefficient form of welfare. Because eligibility is based on age, it is often a poor surrogate for true financial need. In fact, the majority of the elderly derive no advantage from the subsidy, since their incomes are so low that they pay no taxes anyway. As incomes rise, those in higher marginal tax brackets receive greater tax savings, e.g., the 7.4 percent of the elderly taxpayers with incomes over $50,000 get over 17 percent of the tax relief from the extra exemption. The added exemption actually provides benefits that are inversely related to need.

Fiscal Impact

The CBO estimates that federal revenues would increase by $2.5 billion in 1982 if the extra exemption were repealed.

TAXING HALF OF SOCIAL SECURITY BENEFITS

Proposed Change

Half of all social security benefits should be included in taxable income.

Rationale

Employees now pay income taxes on their earnings that are also subject to the social security payroll tax; employers' contributions, however, are tax deductible to the employer and escape income taxation. Including half of all social security benefits in taxable income would approximate the current tax treatment of private pensions and benefits from other government programs. This measure would have few, if any, ramifications on low-income groups since the tax code already has several provisions that take into account an individual's ability to pay, e.g., graduated tax rates, a zero-bracket amount, and a personal exemption, which is doubled for those over 65. Excluding social security recipients from taxation simply helps those recipients with relatively high incomes. Although this proposal would reduce the after-tax benefits for some recipients, it should not be viewed solely as a tax increase, but also as a tax cut, because it would reduce the need to raise payroll taxes in the future.

Fiscal Impact

According to CBO, this change could increase revenues by about $6.7 billion in 1982, with this figure approaching $13.6 billion by 1986.

TRADE ADJUSTMENT ASSISTANCE

Proposed Change

The Trade Adjustment Assistance (TAA) program should be abolished.

Background

TAA was originally introduced in 1962 to assist workers suffering from increased imports, which were the direct result of government policies aimed at the liberalization of international trade. Over the years, however, the eligibility rules were eased considerably, to the point where the Secretary of Labor could declare workers eligible if imports contributed significantly to unemployment and to a decline in the sales and/or production of firms in question. The budget reconciliation package does tighten this requirement somewhat by stipulating that assistance be provided only when import competition can be shown to be a "substantial cause" of injury. Even with this modification, however, workers still do not have to prove that they were hurt by freer trade.

The basic purpose of TAA is to help workers adjust to changed economic conditions by easing the transition between jobs. Workers can only become eligible after exhausting all unemployment compensation benefits. Assistance available to workers consists of: 1) trade readjustment allowances; 2) employment services; and/or 3) job search and relocation allowances. Combined unemployment compensation and TAA payments are limited to 52 weeks, with an individual's TAA benefit not to exceed the size of his weekly benefit level under unemployment insurance.

Rationale

The major fault of TAA is that it compounds all the problems associated with unemployment compensation. The lengthier entitlement period exacerbates work disincentives by discouraging workers from seeking employment in more stable industries. Moreover, there often is only a very tenuous link between layoffs and increased unemployment from imports. Is greater compensation then justifiable for workers who are laid off because their firms failed to modernize or because workers have demanded excessive compensation and, consequently, have effectively priced themselves out of the market? Automobile workers, for example, currently receive a large amount of supplemental benefits despite the ruling by the ITC that imports were not a substantial cause or threat of serious injury to the U.S. auto industry. Instead, the Commission found that the recession, rising costs of credit, high gasoline prices, and the resulting shift in demand for small cars harmed the industry more than imports. In addition, since workers produce goods and services for local, regional, national, and international markets, and all of these workers may be affected by unfavorable conditions, why should import-affected workers receive preferential treatment solely because they happen to produce for an international market? This would be especially true if increased imports were a result of greater competition rather than trade concessions granted by the government. Import-affected workers, however, are sometimes considered more deserving because their layoff is the result of promoting a socially desirable policy, i.e., one meant to achieve the greater benefits associated with free trade. Although this may be true, workers in other industries often are displaced for equally deserving causes. For example, stricter environmental controls, more stringent safety standards, and deregulation are just a few. Yet workers who become unemployed as a result of these policies receive no supplements beyond unemployment compensation.

Fiscal Impact

Eliminating TAA could save $200 million in fiscal 1982.

BLACK LUNG

Proposed Change

The Black Lung Disability Trust Fund (BLDTF) could be made financially sound by adopting two reforms: 1) restricting benefits to those genuinely disabled by pneumoconiosis; and 2) increasing the tax on coal to finance benefits entirely from the trust fund. The ultimate goal is to eliminate persons with questionable disabilities from the rolls and to finance benefit payments solely by a coal tax.

Background

The BLDTF was established April 1, 1978, by the Black Lung Benefits Revenue Act. Coal miners who are disabled from pneumoconiosis, or black lung disease, are eligible to receive benefits from the trust fund for themselves and/or eligible survivors if their disease cannot be linked to a single employer or where the company no longer exists. If an existing company is found liable, then it must pay the benefits directly. The trust fund is financed by a tax on coal production, which is 50 cents per ton for under-ground coal production and 25 cents per ton for surface-mined coal. The claims against BLDTF, however, have produced a three-year deficit of $956 million at the end of fiscal year 1980. These claims are currently financed by loans from the Treasury. The Office of Management and Budget estimates that under existing law this deficit could grow to $9.2 billion by 1995.

Rationale

The trust fund's insolvency is largely due to liberalized eligibility standards that allow coal miners to receive benefits even if X-rays show no signs of black lung disease. A study by GAO reported that in one sample 88 percent of the claimants were either not disabled or could not prove that they had the disease. Equity and efficiency considerations mandate restricting the financing of the trust fund to a tax on coal production to ensure that all taxpayers are not forced to subsidize black lung benefits. Consumers and producers of coal should be forced to internalize the tax in order to ensure that the optimum quantity of coal is produced.

Fiscal Impact

Eliminating the projected deficit for 1982 through these reforms can result in savings of $478 million.

INDEXATION

Proposed Change

The Consumer Price Index has tended to overstate the true rate of inflation throughout most of the 1970s; therefore, a one-time adjustment in benefit increases should be instituted to make them a more accurate reflection of what benefits would have been had a more precise index been used all along. Once this is accomplished, a more precise index should permanently replace the CPI. Possible alternatives include the CPI X-1, the Personal Consumption Expenditure "chain index," or even the CPI, if the treatment of the housing component is improved and if consumption patterns are updated more frequently.

Background

The CPI measures price changes by comparing current prices to base period prices, and using the base period consumption patterns for weighting purposes. The GAO estimates that over 50 percent of federal expenditures are indexed for inflation with the CPI being the most widely used index for adjustment purposes. Federal spending now increases by about $2 billion for each one percent rise in the CPI. Moreover, the CPI may improperly lead to excessive federal expenditures because it is commonly regarded by economists to overstate the true rate of inflation. According to the CBO, federal expenditures in 1981 would be $11 billion lower had the PCE chain index replaced the CPI in 1974.

Rationale

One of the major flaws in the CPI is its treatment of home-ownership. The CPI tends to overstate housing costs by ignoring the distinction between the consumption and investment aspects of housing. Other criticisms of the CPI include outdated buying patterns (determined in 1972-1973), failure to account for substitution of goods in the market basket when consumers are faced with higher prices, and limited applicability of the index to certain subgroups such as the elderly.

A "rental equivalence" (CPI X-1) index, now being developed by the Bureau of Labor Statistics, attempts to circumvent some of the more serious problems connected with the housing component. This approach tries to separate the consumption and investment motives of purchasing a home by using market rents as a proxy for the shelter services of a similar owner-occupied home.

Other economists have suggested using the Personal Consumption Expenditure (PCE) chain index of the National Income and Product Accounts. This index would be preferable to the CPI for several reasons. First, its coverage is somewhat broader, as it includes all goods and services produced for consumption. Second, it also employs the rental equivalency approach used in computing the CPI X-1. Finally, it uses current consumption patterns rather than those determined in the 1972-73 survey period.

Some have argued that implementing a new index at this time would not be cost-effective because of the currently high interest rates. Just as the index exaggerates the inflation rate when interest rates are rising, it has the opposite effect when they are declining. As a consequence, it may be better to delay any change to an alternative index to allow the government to recoup past losses from overindexation. The proposed change discussed above, however, renders this objection moot, because it would enable the government to make up for its past munificence immediately. CBO's calculations suggest that such a change, if implemented in 1981, would reduce increases for that year from about 11.2 percent to 3 percent, after which one of the more accurate indexes could replace the CPI.

Fiscal Impact

Among other things, continuing high interest rates will cause the CPI to overstate the inflation rate again in 1981. Thus, a one-time benefit increase adjustment in 1982 will probably yield savings of well over $11 billion.

ENERGY CONSERVATION

Proposed Change

Eliminate funding for low-income weatherization grants and the energy conservation tax credit.

Background

The reconciliation bill authorized state and local governments $175 million to help poor families weatherize their homes. In addition, the energy conservation tax credit is expected to provide at least $799 million in support of private sector conservation.

Rationale

Government involvement in the area of energy conservation is difficult to rationalize. High energy prices already offer the public the proper incentives to conserve. If the private sector is unwilling to invest in energy-saving devices in the absence of energy conservation tax credits, it is presumably because the costs of conservation outweigh the savings. The pernicious effects of a tax credt are twofold: it either subsidizes those who would have taken conservation measures anyway or it encourages spending on conservation beyond a level commensurate with benefits.

In the case of low-income energy assistance, if the burden of energy costs is perceived as being too great on the poor, it would be more efficient to grant them direct cash subsidies, allowing them to determine for themselves how best to allocate their limited funds.

Fiscal Impact

Savings of about $1 billion could be achieved through these reforms.

TAXATION OF ALL UNEMPLOYMENT BENEFITS

Proposed Change

All unemployment benefits should be included in taxable income.

Background

The exclusion of unemployment benefits from taxable income stems from a 1938 IRS ruling. At that time, only a relatively few people paid federal income taxes and the exclusion was granted primarily for administrative convenience. With the passage of the Revenue Act of 1978, unemployment compensation paid under government programs became taxable for married couples with incomes over $25,000 and for single taxpayers with incomes above $20,000.

Rationale

The tax-exempt status of unemployment benefits for individuals and families with incomes below a certain level can create work disincentives and inequities. Various provisions of the tax code already take into account an unemployed person's weakened ability to pay taxes, e.g., progressive tax rates, the personal exemption, and the zero-bracket rate. The determination of whether or not one is to pay taxes should be based on income, regardless of the source, rather than employment status. Moreover, the tax-free nature of unemployment compensation benefits high income recipients and those with working spouses most despite the fact that their level of need is probably not as great.

Fiscal Impact

CBO estimates indicate that $4.5 billion in additional revenues could be raised in fiscal 1982 by taxing all unemployment benefits.

DAVIS-BACON ACT

Proposed Change

The Davis-Bacon Act should be repealed.

Background

The Davis-Bacon Act was passed in 1931 to protect local labor from the cut-rate competition of itinerant contractors and their lower-paid employees. The Act requires contractors on federally-funded construction projects to pay the "prevailing" wage, which is generally set at the wage that is paid to at least 30 percent of similarly employed workers in a locality.

Rationale

Since the enactment of Davis-Bacon, Congress has passed the minimum wage and other employee protection laws that have removed the need for the Act. The 30 percent rule frequently leads to the adoption of higher union wage scales, since union members are more likely to be paid an identical rate. The law has several harmful effects. First, it unnecessarily raises construction costs on federal and federally-assisted projects by restricting the government's ability to contract with the lowest bidders. Second, setting a wage floor on some projects tends to raise all wages in construction and, consequently, construction costs throughout the economy. Third, artificially high wage rates impose a discriminatory bias against the employment of nonunion workers, who may not be productive enough to retain their jobs at the new wage. This may have serious repercussions on the poor and unskilled by denying them an opportunity to gain experience and on-the-job training by initially accepting a lower wage.

Fiscal Impact

Various studies indicate that the total cost to the government of the Davis-Bacon Act approaches $1 billion annually. CBO estimated that rescinding the Act in just the three largest federal construction programs (military construction, EPA construction grants, and ground transportation construction) could yield savings of $776 million by 1986.

USER FEES

Proposed Changes

1) General aviation user fees should be increased to cover their associated costs. This would require raising the taxes on private plane owners by 600 percent, although total operating costs per plane would rise by less than 15 percent.

2). The Coast Guard should collect fees for the provision of its services. The charge for direct services such as the issuance of licenses or the inspection of facilities could be priced according to the cost of the service. Other services could be paid for through several mechanisms: an annual boating fee, a tonnage duty, or a fuel tax.

3) User fees should also be imposed to recover the costs of constructing and operating inland waterways and deep-draft ports. One option is to assess a harbor and channel user fee where a ship is charged each time it uses a particular waterway facility.

Background

1) The federal government spent about $3 billion in 1980 operating and maintaining the nation's air traffic control system. General aviation uses (those flying private aircraft) accounted for $740 million in costs, but were charged only $80 million. Commercial carriers, on the other hand, paid about 90 percent of the costs attributable to them.

2) The Coast Guard's operating expenses will be approximately $1.4 billion in 1982. The Coast Guard provides virtually all of its services free of charge: navigational aids, search-and-rescue operations, etc.

3) The Army Corps of Engineers and the Coast Guard spent over $3.3 billion between 1982 and 1986 operating and maintaining ports and channels for all deep-draft vessels. The same cost for inland waterways will be about $7 billion over the next five years.

Rationale

User fees are appealing from both the standpoint of equity and efficiency. They are equitable because they shift the burden from the taxpayer to those actually using the publicly-provided goods and services. In the cases outlined above, the beneficiaries of the various programs are clearly identifiable groups that should be charged the full cost of the services provided, particularly since the beneficiaries (private aircraft owners, recreational boaters, and the maritime industry) are likely to be more affluent than the average taxpayer. User charges also ensure greater efficiency in resource allocation. By eliminating or reducing the effective government subsidy, users will be faced with the true price of each activity and will therefore be forced to weigh costs and benefits more carefully. As it stands now, these subsidies encourage the overutilization of the aviation and waterway systems. Finally, user fees are also a source of revenue the government can use in place of general taxation or, as is often the case today, deficit financing.

Fiscal Impact

CBO estimates the added revenues in 1982 to be: $800 million from general aviation user fees; $680 million from user charges on certain Coast Guard activities; $540 million from user fees on deep-draft navigation; and $1,170 million from inland waterway user fees, for a total of about $3.19 billion.

AMTRAK

Proposed Change

Authorization for Amtrak should be limited to $200 million in fiscal 1982 and eliminated altogether thereafter.

Background

The National Railroad Passenger Corporation (Amtrak) is a private corporation heavily subsidized by the federal government. Revenues from passengers account for only 40 percent of Amtrak operating costs. The final reconciliation legislation reduces future authorizations for Amtrak subsidies somewhat, requiring that it recover at least 50 percent of its operating costs from ticket sales or other non-federal sources in fiscal 1982. Among its options are raising fares, eliminating unprofitable routes, and modifying service.

Rationale

There is no longer any reasonable justification for the continued support of rail passengers. In 1978, the federal subsidy per Amtrak passenger was $37. This compares to only 11 cents for bus passengers and 75 cents for aviation passengers. In some cases, this subsidy reaches ridiculous proportions. For example, it would be less costly for the government to give someone a round trip airline ticket from Washington, D.C. to Cincinnati than to subsidize a one-way ticket on the Shenandoah. Even the widely used New York-Washington route sustained a $7 loss per ticket in 1979.

The evidence for maintaining the present system on the grounds that it offers special services in terms of environmental benefits and energy savings is weak. The average Amtrak train is no more fuel efficient than an automobile and far less so than a bus. In fact, a 1979 CBO report indicated that the country would actually save energy if all service outside the Northeast Corridor were ended. In short, it makes little sense to continue promoting an inefficient means of transportation through taxpayer dollars.

Fiscal Impact

By largely phasing out Amtrak subsidies, savings of $535 million can be realized in fiscal 1982.

MEDICAID AND MEDICARE[17]

Proposed Changes

"Both the Medicaid and Medicare programs would be improved by introducing rational and equitable systems of cost-sharing. A combination of greater deductibles and co-payments for routine services, coupled with catastrophic illness or stop-loss provisions assuring that greater cost-sharing imposes no burden on those with the most serious medical problems should be implemented."

More specifically:

1) "Medicaid should be replaced by a system of sliding scale premium subsidies in which the very poor would be fully subsidized (the subsidy would equal 100 percent of their actual cost)."

2) "...converting the Medicare program to a program of fixed dollar premium subsidies equal in real value to the average cost to Medicare for serving people in each major category."

Background

Medicaid is an open-ended entitlement program that was enacted in 1965 under Title XIX of the Social Security Act to provide medical care for the needy. It is financed as a federal-state matching program, with states administering the program subject to federal guidelines. Benefits are available to low-income persons who are aged, blind, and disabled, and members of families with dependent children when one parent is absent, incapacitated, or unemployed, i.e., those eligible for assistance under SSI and AFDC. Some states also extend Medicaid benefits to the "medically indigent." This class includes people who have

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[17] These proposals are taken directly from Jack A. Meyer, "Health," in McAllister, op. cit., pp. 241-263.

incomes large enough to cover basic living expenses apart from medical care. The federal government's contribution rate to medical expenses is determined by a formula that is inversely related to the per capita income of a state. Federal contribution rates range from 50 to 78 percent. There is, however, considerable variation among states with respect to eligibility requirements and benefit levels.

Medicare was established in 1965 under Title XVIII of the Social Security Act. It helps pay the medical care costs of the elderly (65 and over) and disabled, as well as persons with end-stage renal diseases. The program has two parts. The first is hospital insurance, which is financed from payroll taxes and covers inpatient hospital services, skilled nursing facility services and home health services. The second part is Supplementary Medical Insurance, which is financed from general revenues and the premium payments by beneficiaries. This part includes outpatient hospital services, physician's services, diagnostic tests, home health servies, and certain other health services.

Health care costs have risen alarmingly over the past fifteen years, thereby increasing the burden of maintaining programs such as Medicare and Medicaid, the services of which themselves have been growing at a rate of more than 15 percent annually. The cost to taxpayers now averages more than $1,300 per Medicaid recipient. One of the principal causes of escalating health care costs has been the increasing tendency for third parties to pay medical expenses. Currently, about 90 percent of hospital bills, and 60 percent of medical expenses in general, are paid by someone other than the patient. Third-party payments artificially inflate the demand for health care because covered patients perceive such services as being free. This not only drives up the price of medical care, but also results in vast inefficiencies by encouraging people to use health care services beyond a level commensurate with costs. Moreover, providers of health care have every incentive to provide excessive care, because they know that it often is costless to the consumer and they will be rewarded with greater revenues. As a result, excessive costs will be imposed upon taxpayers and consumers of insurance.

Rationale

The proposal outlined above would substantially improve the cost-control of health care costs by reintroducing price as a variable in the decision-making process. For example, giving Medicare recipients a voucher would give them a choice of a variety of plans in the private sector. Moreover, by encouraging private insurers to compete for the provision of health care services to the elderly, improved medical coverage at a reduced cost is likely to emerge.

The salutary effects for the Medicaid program would be similar. By charging patients for part of their care, no matter how little, both the consumers and the providers of health care would have added incentives to economize.

Fiscal Impact

The amount of savings would depend on a variety of factors: the degree of competition, changes in consumer preference, etc.

VETERANS ADMINISTRATION[18]

Proposed Changes

1) Service-connected compensation for veterans and survivors of veterans should be restricted to those whose disabilities are either combat-related or that arise while on the job and that would qualify them for benefits under existing workmen's compensation laws.

2) Pensions for veterans and survivors of veterans should be limited to disability cases that are service-connected.

3) The VA health care system should be dismantled with its hospitals and other facilities turned over to local governments or the private sector.

Background

1) Eligibility for service-connected compensation was originally restricted to combat-related injuries. These restictions have since been liberalized to the extent that members of the armed services can now receive compensation regardless of how the injury was sustained.

2) All veterans reaching the age of 65 are now considered by law to be disabled. They and their dependents are allowed to receive pensions if they meet certain income eligibility criteria. The cost of these pensions will rise rapidly in the coming decade. The majority of veterans have not yet reached the age of retirement, but in 1978, 43 percent of all veterans were between the ages of 50 and 65. As these veterans reach retirement age, the cost of non-service related pensions is expected to increase from $3.8 billion in 1981 to $11 billion in 1993.

3) The VA has the most extensive health care system in the country, with 172 hospitals, 9,000 doctors, and 26,000 nurses. It extends medical care to those unable to obtain it themselves. Unfortunately, its costs are excessively high when compared to similar care in private hospitals.

Rationale

1) VA compensation that provides benefits to individuals who have not been disabled either in combat or while performing

[18] These proposals are adopted from Cotton M. Lindsay in McAllister, op. cit., pp. 285-301.

job-related duties is costly and unfair. Why should the general taxpayer be forced to subsidize insurance coverage for veterans that is even more munificent than regular workmen's compensation, particularly if the injury is not even remotely related to any type of military activity? Limiting benefits to those who have job-related injuries would put this program on the same footing as other disability insurance programs.

2) There is no reasonable justification for providing pensions to veterans and their survivors if this need bears no relationship to military service. There is now an array of other income security programs that provide assistant to the indigent, i.e., SSI, AFDC, food stamps, etc.

3) As was the case with pensions, extending medical care to the needy is an expensive procedure, and one that duplicates benefits provided by existing health care programs such as Medicaid and Medicare. Furthermore, in 1978, only one in six patients was treated for a service-connected condition.

Fiscal Impact

In a study for The Heritage Foundation, Cotton Lindsay estimated that these three reforms together would reduce federal expenditures by $8.2 billion in fiscal 1982.

CONCLUSION

A closer examination of new areas for budget reform is now called for to alleviate fears arising from larger than predicted budget deficits. Opponents of the Reagan Adminstration's economic recovery plan are pointing to these predictions as a sign of misguided economic policy. These criticisms seem somewhat premature, based on spurious rationalizations coming even before the actual implementation of the tax cut or budget reform measures. Moreover, larger than projected budget deficits will not arise from the recently enacted tax cut, which primarily serves to offset inflation-induced bracket creep, but rather from the incessant burgeoning of federal spending.

Increasing government expenditures can be financed in one of three ways: by raising taxes, borrowing from the private sector, or the monetization of all or part of any deficit that results. Regardless of the means used, the outcome is the same: an emasculated private sector, incapable of the capital accumulation needed to sustain economic growth. Higher taxes reduce incentives to work, save, and invest by making actitivities such as leisure, consumption, and tax shelters relatively more attractive. Increased government borrowing crowds out private investment and reallocates resources from individuals and businesses to the federal government. Finally, monetary policy to accommodate excessive federal spending leads to inflation, often referred to as the cruelest tax of all. Thus, past policy initiatives aimed at curing our economic ills through an increased role for the public sector are primarily responsible for the present inflation, unemployment, and economic stagnation. Restraint in the growth of federal spending and the restoration of economic incentives for production through a reduced tax burden are the keys to a successful program for economic recovery.

Government policy has for too long favored social adequacy over economic efficiency. The results have not produced a more equalized distribution of income, but rather a reduced level of economic growth. The budget cuts outlined in this paper can reverse this trend and restore control to the budgetary process. Moreover, they can be achieved without sacrificing public services for those with genuine needs.

The rationale for these budget reform measures is based on sound economic principles, with efficiency and equity as the foremost considerations. First, the consolidation of the myriad of categorical grants to state and local governments as block grants recognizes the special needs of states and localities while removing the federal government from its overextended role as chief decision-maker. Second, the immediate revision of many entitlement programs is necessary to eliminate duplicative and overly generous benefits that tend to undermine efforts to reduce dependency on public assistance and to encourage individual initiative and self-reliance. Third, common sense and simple equity dictate the reduction in benefits for people in the middle- and upper-income strata. Fourth, user charges for services that benefit a clearly identifiable group are desirable where there is no need for the beneficiaries to be subsidized by all taxpayers. Fifth, more stringent standards should be applied to economic subsidy programs to ensure efficient use that does not interfere with or replace private sector activities.

Proper application of these criteria are essential if we are to have a healthy and growing economy. Even in the absence of a budget deficit, however, these cuts would be advisable because they would allow an even greater reduction in the tax burden and improve the overall workings of the economy. Today, this becomes even more important as the specter of growing deficits fuels inflationary expectations, thereby eroding confidence and delaying rejuvenation of the economy.

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