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FOREIGN ECONOMIC AID: MEANS AND OBJECTIVES

BY MILTON FRIEDMAN

FOREIGN economic aid is widely regarded as a weapon in the ideological war in which the United States is now involved. Its assigned role is to help win over to our side those uncommitted nations that are also underdeveloped and poor. According to this view, these nations are determined to develop economically. They will seek to do so, with or without our help. If we do not help them, they will turn to Russia. It is, therefore, in our own interest to help them to achieve their aims. And the way to help them is to make capital and technical assistance available largely free of charge, the cost to be borne by the United States and, we hope, those of its allies who are in a comparable stage of development.

This argument confuses two very different issues. One is the *objectives* toward which United States policy should be directed. The other is the *means* that are appropriate for the achievement of those objectives. I share fully the views of the proponents of foreign economic aid about objectives. It is clearly in our national interest that the underdeveloped nations choose the democratic rather than the totalitarian way of life. It is clearly in our national interest that they satisfy their aspirations for economic development as fully as possible in a democratic framework. And our national interest coincides with our humanitarian ideals: our fundamental objective is a world in which free men can peaceably use their capacities, abilities, and resources as effectively as possible to satisfy their aspirations. We cannot long hope to maintain a free island in a totalitarian world.

But this agreement about objectives does not settle the question of means. Is foreign economic aid as it has been administered, or as it is proposed that it should be administered, well adapted to secure these great objectives? This question is begged in most current discussion. Once the objectives are stated, it is generally simply taken for granted that foreign economic aid is an appropriate means, if not indeed the only appropriate means, to achieve these objectives. This conclusion seems to me fundamentally mistaken. Though foreign economic aid may win us some temporary allies, in the long run it will almost surely retard economic development and promote the triumph of Communism. It is playing into our enemies' hands, and should be abolished. Instead we should concentrate on promoting world-wide economic development through means that are consonant with the American tradition itself—strengthening of free market domestic economies in the less-developed nations, the removal of obstacles to private international trade, and the fostering of a climate favorable to private international investment.

To avoid confusion, it will be well to emphasize at the outset that this article is concerned solely with one particular category of United States expenditures on foreign aid—*economic aid*—and with one class of arguments for such expenditures—their value in promoting the economic development of other countries. To readers of THE YALE REVIEW, it may supplement Irving Kristol's penetrating analysis of "The Ideology of Economic Aid" in the Summer 1957 issue, which deals with some of the other issues connected with economic aid as well as some of the ambiguities and complexities in the general objectives I have simply taken for granted.

The sum listed in the Federal budget as spent for economic aid is only a small part of the total recorded expenditures for foreign aid. In the fiscal year ending June 30, 1957, total expenditures for foreign aid were nearly four billion dollars. Of this total, nearly two and a half billion dollars was for so-called "military aid"—primarily the transfer of military equipment to various United States allies. Another billion went for so-called "defense support"—expenditures in or payments to other countries (notably South Korea, Nationalist China, and South Vietnam) to finance activities that are regarded as contributing to their military effort. In addition, the President is empowered to make payments to certain countries, principally in the Middle East, the purpose of which is to induce the recipient countries to support particular policies that are thought to be in our interest—these are, in essence, straight military or political subsidies. Finally, about half a billion dollars went for so-called "economic aid" which includes both technical assistance (Point IV help) and funds for the economic development of recipient countries to which no direct military or political strings are attached.

At first glance, one may wonder why this relatively small budget category stirs up so much controversy. Part of the answer is that the figures cited are somewhat misleading. The generally more favorable attitude of Congress toward direct and indirect military aid understandably leads the Administration to classify as much as possible under these two headings. In addition, what in form is straight military aid may in effect be equivalent to economic aid, and it is often difficult to distinguish between the two. If country A would in any event have devoted a given sum to the purchase of military equipment and the United States pays for it instead, the country has available that sum for other purposes; the effect may be precisely the same as if the corresponding sum had been granted country A in straight economic aid. But more than this: it is on the enlargement of economic aid that advocates of greater public spending have concentrated their attention. In article and speech enlargement has been pressed by such men as Chester Bowles, Paul Hoffman, Walter Reuther, and Adlai Stevenson. In their recent book "A Proposal," Professors Millikan and Rostow of the Massachusetts Institute of Technology have urged that the United States should commit itself over a five-year period to put up some ten billion dollars for world economic development. And there is powerful support in the United Nations for setting up a special fund, SUNFED, for this purpose. In short, economic aid is neither so small nor so unimportant as current budgeted expenditures on it might suggest. On the contrary, it is the storm center of the whole

debate about how this country can help other countries develop.

The case for military aid and defense support clearly rests on a very different range of considerations than the case for economic aid. Military aid and defense support are to be attacked or defended in terms of their contribution, first, to our effective military strength and, second, to the achievement of our direct political objectives. I can see no objection to them in principle; any criticism of them, or defense of their expansion, must rest on the severely practical grounds that, dollar for dollar, they yield less, or more, strength than alternative modes of expenditure. The one serious danger of confusion between these categories and economic aid is that the argument for economic aid which this article considers is sometimes used as a rationalization to permit straight military or political subsidies to be made under a different label. We shall be concerned with neither these types of expenditure nor this use of the argument for economic aid.

Economic aid proper raises much broader and certainly very different issues. These issues deserve far more public debate than they are getting. We are on the verge of committing ourselves to a policy which in my view can only have disastrous consequences for our country and our way of life. And we are doing so not after thoughtful and thorough consideration of the issues involved, but almost by inadvertence, by proceeding along what seems the line of least resistance.

Two questions must be answered in judging government economic aid. First, is it likely in fact to promote the economic development of the countries to whom aid is granted? Second, do its political effects in those countries promote democracy and freedom?

The second question, though not much discussed, is easy to answer and admits of little dispute. As it has so far been administered, our aid program has consisted predominantly of grants or loans or provision of personnel or material directly to the governments of recipient countries for specified projects regarded as contributing to economic development. It has thereby tended to strengthen the role of the government sector in general economic activity relative to the private sector. Yet democracy and freedom have never been either attained or maintained except in communities in which the bulk of economic activity is organized through private enterprise.

This problem has of course been recognized and partly explains why some grants or loans have been made to private enterprises in the recipient countries rather than directly to governments. Last year, John B. Hollister, on the occasion of his retirement as head of the International Cooperation Administration, proposed that a much enlarged fraction of total funds be channeled to private enterprises. This modification, which aroused strong opposition and is not likely to be carried far, would reduce the tendency of the aid program to strengthen the government sector. It would, however, not eliminate it. We are hardly likely to make funds available to enterprises in poor standing with their governments or for projects opposed by governments. The final result will therefore be much the same.

Many proponents of foreign aid recognize that its long-run political effects are adverse to freedom and democracy. To some extent, they plead special extenuating circumstances. For example, the group in power in a particular country may for the time being be in a shaky political position, yet its overthrow may mean the assumption of power by anti-democratic forces. And economic aid may help such a government over its temporary political crisis. Their main reply, however, is that economic progress is a prerequisite to freedom and democracy in underdeveloped countries, and that economic aid will contribute to this outcome and thereby on balance promote political freedom. This makes the crucial question, even for political effects, the first, namely, the economic effects of economic aid.

The belief that foreign aid effectively promotes economic development rests in turn on three basic propositions: first, that the key to economic development is the availability of capital; second, that underdeveloped countries are too poor to provide the capital for themselves; third, that centralized and comprehensive economic planning and control by government is an essential requisite for economic development.

All three propositions are at best misleading half-truths. Additional capital is certainly essential for development. And of course the more capital the better, *other things being the same*. But the way in which capital is provided will affect other things. The Pharaohs raised enormous sums of capital to build the Pyramids; this was capital formation on a grand scale; it certainly did not promote economic development in the fundamental sense of contributing to a self-sustaining growth in the standard of life of the Egyptian masses. Modern Egypt has under government auspices built a steel mill; this involves capital formation; but it is a drain on the economic resources of Egypt, not a contribution to economic strength, since the cost of making steel in Egypt is very much greater than the cost of buying it elsewhere; it is simply a modern equivalent of the Pyramids except that maintenance expenses are higher. Such modern monuments are by no means the exception; they are almost certain to be the rule when funds are made available directly or indirectly to governments that are inevitably under pressure to produce the symbols of modern industrialism. There is hardly an underdeveloped country that does not now waste its substance on the symbol of a government-owned or government-subsidized international airline. And there is hardly one that does not want its own steel mill as yet another potent symbol.

Some monuments are inevitable in the course of economic development and may indeed be politically desirable as tangible and dramatic signs of change. If the appetite for monuments were at once so intense as to make them the first claim on a country's resources and yet so limited and satiable that their extent was independent of the resources available, monument-building might be a costly fact of life but would have little relevance to foreign economic aid. Unfortunately, this is hardly the case. The appetite grows by what it feeds on. The availability of resources at little or no cost to the country in question inevitably stimulates monument-building. Thus while foreign aid grants may in the first instance add to the capital available to a country, they also lead to a notable increase in the amount of capital devoted to economically wasteful projects.

Cannot, it will be asked, these problems be solved by our exercising control over the use of the capital we make available to governments? And would they not be avoided even more directly if we adopted the proposal to make funds available directly to private enterprises? Aside from the political problems raised by any attempt at close control of even the funds we give, the answer is no. In the first place, there is a purely technical difficulty. Our grants are only part of the total capital available to a country and of the funds available to the government. It will do no good to control the use of the one part while exercising no control over the other; the effect would simply be to alter the bookkeeping—whatever we regarded as appropriate projects would be treated as financed with our funds, and the monuments would be built with local funds. Effective control would thus require us to control the whole of the capital investment of the country, a result that is hardly feasible on political grounds. But even if it were, the problem would by no means be solved. We would simply be substituting one central planning group for another. This leads to the third proposition: that central planning by government is essential to economic development.

Before turning to this issue, it will be well to consider the assertion that the underdeveloped countries are too poor to save and provide capital for themselves. Here, too, the alleged fact is most dubious. Currently developed countries were once underdeveloped. Whence came their capital? The key problem is not one of possibility but of incentive and of proper use. For generations, India was a "sink" for the precious metals, as the writers on money always put it. There was much saving, but it took the unproductive form of accumulation of specie. In Africa, natives on the very margin of subsistence have, given a market demand for their produce, extended greatly the area under cultivation, an activity involving the formation of capital, though seldom entering into recorded figures on savings.

Domestic capital can be supplemented by foreign capital if the conditions are right—which means if property is secure against both private and public seizure. Many low-income countries cannot of course attract foreign capital; in most of these, in fact, locally owned capital is invested abroad, and for the same reason—because there is not an environment favorable to private property and free enterprise. And in this respect, too, government-to-government grants are likely to be adverse to economic development. They strengthen the government sector at the expense of the private sector, and reduce the pressure on the government to maintain an environment favorable to private enterprise. We may and do seek to counteract this effect by using our grants to get "concessions" from the government favorable to private enterprise. But this is seldom anything like a complete offset—the change in the objective power of the government sector is likely ultimately to outweigh by far the imposed restraint on how for the time being it uses that power. The final result of our grants is therefore likely to be a reduction in the amount of capital available from other sources both internally and from the outside.

In short, if any generalization is valid, it is that the availability of capital while an important problem is a subsidiary one—if other conditions for economic development are ripe, capital will be readily available; if they are not, capital made available is very likely to be wasted.

Let us turn now to the proposition that economic development requires centralized governmental control and planning, that it requires a coördinated "development program." This proposition, too, contains an element of truth. Government certainly has an important role to play in the process of development. It must provide a stable legal framework; it must provide law and order, security to person and property. Beyond this, it has an important role in promoting certain basic services, such as elementary education, roads, and a monetary system; it can make an important contribution by extension activities which help to spread knowledge of new and improved techniques. And numerous other activities of the same sort come to mind.

But none of these activities calls for a centralized program for economic development or detailed control of investment. And such a centralized program is likely to be a hindrance, not a help. Economic development is a process of changing old ways of doing things, of venturing into the unknown. It requires a maximum of flexibility, of possibility for experimentation. No one can predict in advance what will turn out to be the most effective use of a nation's productive resources. Yet the essence of a centralized program of economic development is that it introduces rigidity and inflexibility. It involves a central decision about what activities to undertake, and the use of central force and authority to enforce conformity with that decision.

It may well be that in many underdeveloped countries, existing or potential government officials are as competent both to judge what lines of activity will be profitable and to run particular plants as existing or potential private businessmen. There is yet a crucial advantage in letting private business do as much as possible. Private individuals risk their own funds and thus have a much stronger incentive to choose wisely and well. They can be more numerous and they have much detailed information about specific situations that cannot possibly be available to governmental officials. Even more important, however wisely the decisions are made, there are bound to be mistakes. Progress requires that these be recognized, that unsuccessful ventures be abandoned. There is at least some chance that unsuccessful private ventures will be allowed to fail. There is almost none that public ones will be—unless the failure is as flagrant as the British ground nuts venture. The mistake will simply be concealed by subsidy or tariff protection or prohibition of competition. If anything is clear from widespread experience with governmental economic activity, it is that a governmental venture, once established, is seldom abandoned. And surely it is almost as clear that governmental officials are less experimental, less flexible, less adaptive, than private individuals risking their own funds.

What is required in the underdeveloped countries is the release of the energies of millions of able, active, and vigorous

people who have been chained by ignorance, custom, and tradition. Such people exist in every underdeveloped country. If it seems otherwise, it is because we tend to seek them in our own image in "big business" on the Western model rather than in the villages and on the farms and in the shops and bazaars that line the streets of the crowded cities of many a poor country. These people require only a favorable environment to transform the face of their countries. Instead there is real danger that the inherited set of cultural and social restraints will simply be replaced by an equally far-reaching imposed set of political and economic controls, that one strait jacket will be substituted for another. What is required is rather an atmosphere of freedom, of maximum opportunity for individuals to experiment, and of incentive for them to do so in an environment in which there are objective tests of success and failure—in short, a vigorous, free capitalistic market.

Thus central control would be a poor way to promote economic development even if the central authorities chose individual projects as wisely as private individuals and with the same end in view. In fact, as we have already seen, the government is almost sure to promote other ends—the national and personal prestige that can be attained through monument-building—so that the case against centralized control is even stronger.

The issues we have been discussing are strikingly illustrated in a report submitted in December, 1956 by the M.I.T. Center for International Studies to the Special Senate Committee to study the Foreign Aid Program. The report studies the problem of how to judge whether a country should be given additional aid. The answer is that the criterion should be whether the country is making an "additional national effort" toward economic development. Two, and only two, "rules of thumb" are given for deciding whether this is the case: "one index that national effort is being mobilized for development is the launching of measures to capture a good fraction of increases in income for the purpose of further investment"; another "measure of national effort . . . is the degree to which a country's leaders have worked out an overall development program."

Here are two of the basic propositions we started with. And the striking thing is that by these tests, the United States would never have qualified as a country making an "additional national effort" toward economic development! We have never had explicit "measures to capture a good fraction of increases in income for the purpose of further investment." Nor have our "leaders" ever "worked out an overall development program." And what is true of the United States is true of every other free nation that has achieved economic development. The only possible exceptions are the economic programs worked out after the Second World War by Britain and some other European countries, and these were largely abandoned because they were failures.

The only countries that satisfy the tests suggested by the M.I.T. report are the Communist countries—these all have measures "to capture a good fraction of increases in income for the purpose of further investment" and all have an "overall development program." And none of these has in fact achieved economic development in the sense of a self-sustaining rise in the standard of living of the ordinary man. In the satellite countries, the standard of living of the ordinary man has quite clearly fallen. Even in Russia, the ordinary man is by no means clearly better off now than before the Communists took over, and, indeed, may be worse off even in terms solely of material comforts. While education and health services have clearly improved, food, shelter, and clothing have all apparently deteriorated for the masses. The achievements of which Russia justifiably boasts are to be found elsewhere: in its heavy industries, its military output, and its space satellites—achievements that from the point of view of the consumer classify strictly as monument building.

It thus seems clear that a free market without central planning has, at least to date, been not only the most effective route to economic development but the *only* effective route to a rising standard of life for the masses of the people. And it is eminently clear that it has been the only route consistent with political freedom and democracy. Yet the M.I.T. report and most other writings on the subject simply take the opposite for

granted, without even noting that in doing so they are going against the whole of the evidence to date, and without offering a shred of evidence of their own. This is modern mythology with a vengeance.

What is involved here is no less than another phase of the ideological war in which we are engaged. A central premise of the Communist ideology is that the state must exercise comprehensive control and direction over the economic activities of its citizens; a central premise of Western liberalism is that free men operating in a free market can promote their own objectives without the necessity for an all-powerful state.

Foreign economic aid implicitly accepts this premise of the Communist ideology; yet it is intended as a weapon against Communism. Many who favor it as applied abroad would be horrified at the idea of applying its principles at home. If they accept it, it is because they do not understand what it implies or because they take the word of the "experts" that it is the "only" way to win friends abroad. They, and the experts, are in the state of the man who discovered that he had been speaking prose all his life. Loyal Americans that they are, they have unthinkingly accepted a basic premise of the Communist ideology without recognizing it for what it is and in the face of the available evidence. This is a measure of the success of Marxist thought, which is most dangerous precisely when its products lose their labels.

Despite the intentions of foreign economic aid, its major effect, insofar as it has any effect at all, will be to speed the Communization of the underdeveloped world. It may, for a time, keep some of these countries nominally on our side. But neutral or even hostile democracies are less of a threat to the preservation of a free world than ostensibly friendly totalitarian countries.

An effective program to promote a free and prosperous world must be based on our own ideology, not on the ideology we are fighting. What policy would be consistent with our ideology?

The aim should be to promote free markets throughout the world and maximum reliance by all countries on free enterprise in an environment favorable to competition and to individual initiative. We cannot do this by telling other governments what to do or by bribing them to go against their own natures any more than we can force men to be free. What we can do is to set an example and to help establish an international climate favorable to economic and political freedom; we can make it easier for other countries to take the path of freedom if they wish to.

The most important area in which we can do this is foreign trade. Here, in particular, our policies belie our professions. We profess to believe in free competition and free markets, yet we have erected barriers to "protect" domestic producers from competition; we profess to believe in minimal government interference with economic activity, yet our government imposes quotas on imports and dumps exports abroad because of a policy of government support of farm prices. True, we have also reduced tariffs and barriers to trade in many areas, and these actions, ably supplemented by the unintended effects of inflation, have reduced our trade restrictions to their lowest level in many decades. Yet those that remain, as well as the fresh restrictions that have been imposed, particularly on agricultural products, have, I believe, done far more harm to our foreign relations than any good we have done even temporarily by our economic aid. The rest of the world regards us as hypocrites, and they are at least partly right.

Entirely aside from the problem of foreign relations, these policies do us direct economic harm. They prevent us from using our resources as effectively as we might both at home and abroad; they hurt us as well as the rest of the world. A free trader like myself would like to see them abolished for this reason alone—in order to enable us to have a higher standard of living. But this is only part of the case for free trade, and, in the present context, the lesser part.

A major factor pushing underdeveloped countries in the direction of central planning and of autarchy is their lack of confidence in a market for their products. Suppose, they argue, we do follow the route of free enterprise and free trade, concentrate on producing those things we can produce most cheaply, and count on getting the goods we want to consume through international trade. Is not success likely simply to produce increases in import barriers by the United States and other countries so that we find ourselves all dressed up with a fine export industry and nowhere to go? And, under present circumstances, can one say with any confidence that they are wrong? Ask the Swiss watchmakers and English bicycle producers.

It is not often recognized how widespread are the implications of the restrictions on trade and, in particular, the uncertainty about them. We do not, it will be said, offer a market for the potential products of most underdeveloped countries so that our trade barriers do not affect them. But this is clearly wrong. It is a major virtue of free international trade that it is multilateral not bilateral. Were we to import more from, say, Western Europe, Western Europe would be able to import more from still other countries, and so on in endless chain, so that our own greater exports might go to very different countries than those from whom we purchased products.

Or to take yet another facet of the problem—the effect on foreign investment. In part, such investment is stimulated by trade barriers: if India will not permit the import of complete cars, an automobile company may set up an assembly plant. But this investment is wasted from the point of view of world productivity: it is used simply to do in one country what could be done more efficiently elsewhere. Productive foreign investment is hindered by trade barriers, both directly and indirectly. It is hindered directly, because trade barriers distort the incentives to investment and also make it more difficult for the investor to receive the return on his investment in the currency he wants—a country can earn foreign currency to pay him only by exports. It is hindered indirectly because business and trade relations among nations are a major channel for the spread of information about investment opportunities and the establishment of contacts that make them possible. Commissions of V.I.P.'s assigned the task of finding "investment opportunities" are a poor substitute for the day-to-day contact of numerous individuals engaged in earning their daily living by selling goods and rendering services in a foreign country.

Or again, look for the sources of American influence on foreign attitudes and cultures and where will one find them? Not in the literature disseminated by USIS, useful though that may be, but in the activities of International Harvester, Caterpillar Tractor, Singer Sewing Machine, Coca-Cola, Hollywood, and so on. Channels of trade are by all odds the most effective means of disseminating understanding and knowledge of the United States.

British maintenance of free trade—whatever its motives—was surely a major factor knitting the nineteenth-century world together and promoting the rapid and effective development of many then underdeveloped countries. And trade barriers, currency controls, and other economic restrictions are surely a major factor dividing the twentieth-century world and impeding the effective development of the currently underdeveloped countries.

Suppose we were to announce to the world that we committed ourselves to abolish all tariffs, quotas, and other restrictions on trade by a specified date—say, in five or ten years—and that thereafter we would maintain complete free trade. Can there be any doubt that the effects on our international position—both immediately through the announcement effects and ultimately through the long-run economic effects—would be vastly more favorable than those achievable by any conceivable program of foreign economic aid even if one assigns to that aid all the virtues claimed by its proponents? We would be playing from our strength. We would be offering an opportunity to free men to make effective use of their freedom rather than contributing chains to enslave men.

It would, of course, be better if such action were taken by many nations. But it would be a serious mistake for us to link our actions to that of others; the result would be to slow the movement toward free trade to the pace desired by the most recalcitrant member. Far better to move unilaterally. We would benefit economically and politically from a unilateral

move, and we might have far more effect on other countries through example than over the conference table.

A movement toward free trade would affect adversely many particular individuals and concerns—those who have invested talent and capital in "protected" industries. But our mobility and adaptability are such that a gradual movement—over the course of, say, ten years—would give the affected individuals ample opportunity to adjust to the new circumstances with little if any loss. The new opportunities afforded by the expansion of world trade, and the more efficient use of our resources involved therein, would benefit many more than were harmed. After all, the transition to free trade over ten years would have far less of an impact than the technological changes that occur decade after decade and that we take in our stride.

As of the moment, we have a bear by the tail in our foreign economic policy—and unfortunately, it is not the Russian Bear. We get little if any political kudos for continuing economic aid—the recipient countries have come to take it for granted and even to regard it as their right. Yet for this very reason, the sudden cessation of aid would be regarded as an unfriendly and hostile act and would arouse great hostility toward the United States. Thus even if one accepts the arguments of the preceding sections, there remains the problem how to achieve the transition from our present policy to the alternative.

The simplest and least undesirable way seems to me to be to make a final terminal grant to each recipient country. The grant should be fairly generous, say something like two to three times the annual grants we have been making to the country. It should be completely unrestricted and preferably made in the form of a dollar—or even better a Swiss franc—balance on which the recipient country can draw as it wishes. In this way, our own involvement in central planning by other countries could be terminated at once, and the government of the recipient country would attach the greatest value to the grant.

The cost of such a termination program would be sizeable in the year of termination. But it would be a once-for-all cost rather than the steady and growing drain to which we appear to be on the verge of committing ourselves.

Foreign economic aid needs to be sharply distinguished from direct military aid and defense support even though it may be hard to classify any particular expenditure. Foreign economic aid consists of grants or loans from our government to other governments or to enterprises in other countries for specified projects regarded as contributing to economic development. It includes both technical assistance and grants or loans of money.

The objectives of foreign economic aid are commendable. The means are, however, inappropriate to the objectives. Foreign economic aid, far from contributing to rapid economic development along democratic lines, is likely to retard improvement in the well-being of the masses, to strengthen the government sector at the expense of the private sector, and to undermine democracy and freedom. The proponents of foreign aid have unwittingly accepted a basic premise of the Communist ideology that foreign aid is intended to combat. They have accepted the view that centralized and comprehensive economic planning and control by government is an essential requisite for economic development. This view is contradicted by our own experience and the experience of every other free country.

An effective program must be based on our own ideology, not on the ideology we are fighting. Such a program would call for eliminating the inconsistency between the free trade and free enterprise policies we preach and the protectionist and interventionist policies we at least partly practice. An effective and dramatic program would be to commit ourselves unilaterally to achieving complete free trade by a specified and not too distant date. This would do much to promote an environment and international climate favorable to the rapid development of the uncommitted world along free and democratic lines. It would be an act of truly enlightened self-interest.

Republican Study Committee

RSC

Chairman
REP. RICHARD T. SCHULZE

Executive Director
RICHARD B. DINGMAN

INTRODUCTION

President Reagan's February 18th economic recovery plan is a noble beginning. However, much more can and should be done to curtail federal expenditures.

Attached are recommendations for more than $50 billion of additional cuts or reviews.

It is possible some of our recommendations overlap with the President's proposals. Also, many of our recommendations arise from our earlier report on unnecessary federal expenditures documented by the General Accounting Office or other official watchdogs. Some of those unnecessary expenditures may have been remedied by now, but each one should be evaluated as a potential budget cut.

We should also remember that the President's proposed budget revisions do not add up to a CUT from last year's outlays. They simply hold back the amount of increase. Reagan's revised FY '81 budget is 13% above Carter's FY '80 outlays, and Reagan's proposed FY '82 budget is 6.2% above his FY '81 budget.

March 12, 1981

DEPARTMENT OF AGRICULTURE

A. Food Stamp Program

Revised entitlements stated that a family of four will be eligible with incomes of less than $11,000 per year. Under current law it is $14,000 per year. The income line should be revised to take into account the fact that many of these families also receive benefits from "in-kind" programs. The income index should include housing assistance, Medicaid payments and all other "in-kind" income. Assets tests should be tightened.

Reinstate the food stamp purchase requirement. The savings from this would be approximately $800 million.

Tighten food stamp eligibility requirements. Eligibility for the food stamp program is based on net rather than gross income. A family with a gross income well above the poverty level could conceivably qualify for food stamps by subtracting enough deductions and exemptions which do not currently qualify as income. This option also assumes legislative savings by requiring that family size, age, and sex of family members be taken into account in determining the food stamp allotment. This proposal has been recommended by the GAO. The cost savings would be approximately $700 million.

Tighten food stamps assets tests. In determining who can participate in the food stamp program, certain assets are exempt from calculating eligibility. Possessions that do not count as assets are: house, one car, personal effects, life insurance, etc. If the same assets test was used as with SSI the cost savings would be approximately $544 million.

Implement food stamp fraud control. Requirements for a standard photo ID card, countersigned warrants, a national application crosschecked for duplicate benefits, and a standardized earning clearance system would save approximately $138 million. (NOTE: This was offered as an amendment by Sen. Hayakawa last Congress.)

Strengthen work requirements. If work requirements were strengthened, an incentive would be added to foster self-reliance and eventual termination of food stamp participation. Also the dependent's age requirement for which a food stamp participant can choose not to work but to stay home with her child should be changed to age six rather than age twelve. This would then parallel the age requirement for the AFDC program. This could save approximately $34 million.

B. Head Start Program

Head Start Program (FY '82) -- $950 million. Suggested cut: $190 million.

This program provides a number of services for low-income preschool children (including health, education, nutrition and counseling). The FY '82 figure is a 16% increase over FY '81. The Head Start program represents another social engineering program with few lasting results. If states wish to encourage this type of preschool program, local resources should be directed this way. No evidence has shown conclusively that non-Head Start children learn more or have better educational records than Head Start children. A 20% cut could be a major start toward reducing this program.

DEPARTMENT OF DEFENSE

Although we believe that total defense spending will have to be increased in order to modernize our weapons system and achieve parity with or superiority over the Soviet Union, unnecessary expenditures resulting from waste, fraud, abuse or mismanagement must be stopped in every department, including the Department of Defense.

The following recommended budget cuts are all taken from the RSC Special Report on Waste, Fraud, Abuse and Mismanagement, which was a compilation of findings and recommendations by the General Accounting Office during 1979 and 1980. It is possible some of these recommendations have been implemented by now, but those which have not should be aggressively pursued through budgetary restraints.

Cut of $44,000,000 by centralizing the Air Force field component repair services. (GAO, #LCD-79-409, March 28, 1979)

Cut $400,000,000 by improving the DOD's system of accounting for the value of foreign military sales. (GAO, #FGMSD-79-21, March 16, 1979)

Cut $1,000,000 annually through better management of DOD cash holdings overseas. (GAO, #FGMSD-79-6, January 10, 1979)

Cut $18,000,000 by using available serviceable parts to avoid repairs. (GAO, #LCD039-205, January 31, 1979)

Cut $124,000,000 through reductions in flying hour programs in the Army, Navy and Air Force, (GAO, #LCD-79-401, March 27, 1979)

Cut $10,000,000 by instituting the GAO alternative to the present method of paying clothing allowances to military personnel. (GAO, #FPCD-79-12, April 20, 1979)

Cut $1,500,000 annually by consolidating the Army and Air Force Exchange Services. (GAO, #FPCD-99-60, May 22, 1979) Cut another $33,000,000 from the military exchange systems by limiting the exchange systems' goal to providing goods and services only rather than to make them responsible for providing morale, welfare, and recreational activities as well. (GAO, #FPCD-80-50, July 18, 1980)

Cut $57,000,000 through substituting civilians for military personnel assigned to morale, welfare, and recreational activities in the armed services. (GAO, #FPCD-79-54, July 11, 1979)

Cut $63,000,000 through consolidation of the undergraduate helicopter pilot training program by the Army and NAvy. (GAO, #FPCD-80-37, January 31, 1980)

Cut $1 billion by having the Air Force install one rather than two computer systems at about 105 bases to perform administrative and operating functions. (GAO, #FGMSD-80-15, October 26, 1979)

Cut $300,000,000 through the standardization of military aircraft ground service equipment. (GAO, #LCD-80-30, February 7, 1980)

Cut $775,000,000 through better management of shipbuilding contracts. (GAO, #PSAD-80-18, January 10, 1980)

Cut $50,000,000 through better inventory management at Air Force air logistics centers. (GAO, #LCD-80-6, October 25, 1979)

Cut $1 billion through increased implementation of the Air Force's Military Standard 1567 work measurement to enhance contractors' productivity and cost control in the acquisition of major Air Force weapons systems. (GAO, #PSAD-80-46, June 3, 1980)

Cut $13,000,000 through the standardization of DOD software computer systems. (GAO, #HRD-80-49, April 24, 1980)

Cut $2,000,000 through instituting stronger procurement controls in the Far East. (GAO, #HRD-80-23, November 19, 1979)

Cut $280,000,000 through improving the logistics factor in modernizing U.S. Air Reserve forces. (GAO, #LCD-80-11, November 6, 1979)

Cut $4,050,000,000 from the Navy's F/A-18 operational and support costs through the use of multiport avionics test equipment, consolidation of avionics repair facilities, buying of initial spares concurrently with aircraft installed units, making more effective use of pilot simulators, consolidation of F/A-18 squadrons into larger size units, use of the reliability centered maintenance concept to determine the need for depot maintenance and pipeline aircraft, and elimination of unneeded facilities improvements. (GAO, #LDC-80-65, June 6, 1980)

Cut $5,700,000 through reducing ship overhaul costs. (GAO, #LDC-80-70, June 17, 1980)

Cut $10,000,000 through improved inventory management of the Defense Logistics Agency's medical supply system. (GAO, #LCD-80-74, June 25, 1980)

Cut $7,500,000 by eliminating Marine Corps Logistics overlap. (GAO, #LCD-80-74, June 30, 1980)

Cut $30,000,000 through improving controls over property in the custody of military units.

Cut $530,000,000 by tightening control of the Army's Military District of Washington's Finance and Accounting Office. This amount is wasted due to fraud and inadequate accounting and procedural control. (GAO, #FGMSD-80-53, June 5, 1980)

Cut $6,860,000,000 through the limitation of the number of non-combat aircraft missions to those that can be adequately justified. (GAO, #LCD-80-83, July 22, 1980)

Cut $41,500,000 through faster processing of military discharges for adverse reasons. (GAO, #FPCD-80-57, July 3, 1980)

Cut $87,500,000 by reducing the Army's FY '81 ammunition budget request due to premature procurement (materials not fully tested and refined). (GAO, #LCD-80-62, June 12, 1980)

Cut $10,000,000 by removing certain limitations on the application of serviceable material returns to past demands. (GAO, #LCD-80-64, May 15, 1980)

Cut $960,000 through reductions in the Navy's contract for patrol combatant hydrofoil missile ships. (GAO, #PSAD-80-3, October 18, 1979)

Cut $500,000 by tighter controls over payments for medical services by the Veterans' Administration and Medicare programs in order to avoid duplication of payments and misapplied deductibles. (GAO, "Letter Report to Max Cleland and Secretary of HEW, Patricia Roberts Harris," October 22, 1979, #HRD-80-10)

Cut $335,000 annually by streamlining Grumman's computer operations supporting Navy contracts. (GAO, #PSAD-79-111, October 5, 1979)

Cut $323,000 through the consolidation of the Finance and Accounting Centers of the Military Traffic Management Command. (GAO, #LCD-79-331, August 2, 1979)

Cut $3,000,000 by tightening control over split award contracts and survivor awards. (GAO, #PSAD-79-96, August 2, 1979)

Cut $105,000,000 through reduction in strategic airlift crews. (GAO, #LCD-79-411, September 19, 1979)

Cut $5,300,000 through elimination of unneeded material handling equipment, establishment of reasonable equipment allowances and efficient use of needed equipment by the Navy. (GAO, #LCD-80-31, January 30, 1980)

Cut $800,000 by discontinuing a test-related basic allowance for subsistence payments to three military installations since the tests have been completed. (GAO, #FPCD-80-18, December 5, 1979)

Cut $3,210,000 by avoiding delays in definitizing letter contracts by the Army and Navy. (GAO, #PSAD-80-10, November 16, 1979)

Cut $1,700,000 by improving productivity in the Navy missile maintenance program. (GAO, #LCD-80-43, April 9, 1980)

Cut $54,000,000 from guaranteed minimum annuities for disabled Air Force civilian retirees. (GAO, #FPCD-80-26, November 30, 1979)

Cut $750,000 by cutting down erroneous payments to reservists and guardsmen for drills they did not attend. (GAO, #FGMSD-80-6, January 28, 1980)

Cut $10,000,000 by increasing efforts to recover the cost of using government-owned assets for foreign military sales. (GAO, #FGMSD-79-36, June 1, 1979)

Cut $200,000 from operation of the storage and distribution of bulk petroleum products by the Defense Logistics Agency through better transportation practices. (GAO, #LCD-79-218, June 14, 1979)

Cut $25,000,000 by eliminating funded personnel spaces in the Pacific after support functions employing them have been transferred to other services, which gained new personnel spaces for the increased workloads. (GAO, #FPCD-79-50, April 23, 1979)

Total suggested cuts: $16,014,778,000.

DEPARTMENT OF EDUCATION

A. Program Cuts

Abolition of the Cabinet-level Department of Education would save about $500 million.

Since the creation of this Cabinet-level department, an upward push has occurred in expenditures. The budget for FY '81 was about $1 billion over that of comparable programs for FY '80; the FY '82 budget is an additional billion dollars higher. Transfer of programs thru block grant programs to the states and a reduction of administrative personnel should save at least half a billion dollars. Reestablishment of the education function in Health and Human Services or as an independent agency reporting directly to the President (e.g., NASA) should make it easier to control future expenditures.

Office of Civil Rights FY '82 -- $50,971,000. Suggested cut -- $25,000,000.

This office in recent years has worked to harass schools for not meeting suggested ratios of minority (and female) students and faculty members rather than enforce legitimate complaints of discrimination. The office funding should be reduced by 50% and to consolidate efforts the office should be transferred to the Department of Justice.

Vocational Education Program FY '82 -- $962 million in outlays. Suggested cut -- $550 million.

Although the Reagan Administration proposes a 20% cut in vocational education funding ($236 million reduction in budget authority; $220 million reduction in budget outlays), the rationale for such a cut would justify a cut closer to 50%. States provide about $10 (matching grants) for each one dollar of federal money received and thus states and local resources support most of the funding. Vocational training programs have trained people for jobs which don't exist; many companies operate their own training programs. Even groups the federal government targets are not the focus of most vocational educational programs -- less than 15% of training go to disadvantaged, handicapped, or those with limited English speaking ability. A revitalized economy will do more than the vocational education program for providing jobs to the unemployed.

College Housing Loans FY '82 -- $12,879,000. Suggested cut -- $2 million.

As student population declines and more students prefer the independence of living off campus, there is less of a need for the federal government spending billions for college housing loans. There has been a problem in collecting loans in the past. A deeper cut would not harm students seeking an education. This might be reduced further in future years and be phased out.

B. Administrative Savings to Reduce Waste, Fraud and Abuse

Increased monitoring and auditing of Title I of the Elementary and Secondary Education Act (compensatory education) -- $36,700,000. Office of Inspector General, HEW, estimated savings January 1, 1979-December 31, 1979 (March 1, 1980) report.

Expanded collection efforts through Student Financial Assistance -- $321,000,000. Memorandum from the HEW Inspector General to the HEW Secretary (May 18, 1978).

Grant monies improperly spent for colleges and universities -- $3,500,000. Memorandum from the Inspector General of HEW to the HEW Secretary (May 18, 1978).

HEW grant money misspent to institutions of higher education (FY '77 item different from above money misspent) -- $13,500,000. Report of the Inspector General, HEW, January 1, 1979-December 31, 1979 (March 31, 1980).

Recommended adjustments under the Head Start program -- $11,400,000. Office of the Inspector General, Department of HEW, Annual Report January 1, 1979-December 31, 1979 (March 31, 1980).

Monies owed to the Department of Housing and Urban Development as a result of outstanding college housing loans -- $3,000,000,000. (This program is now administered by the Department of Education.) General Accounting Office report "The College Housing Loan Program: More Effective Management Needed" (March 26, 1980) #CED-80-75.

Estimated savings which could be realized through better management in the national direct student loan program -- $4,000,000. General Accounting Office, "Better Cash Management Can Reduce the Cost of the National Direct Student Loan Program" November 27, 1979, #FGMSD-80-5.

DEPARTMENT OF ENERGY

Synthetic Fuels Subsidies -- Savings $5.5 billion

The DOE currently has $5.5 billion provided under the interim Alternative Fuels Program. This money can be used for feasibility studies, cooperative agreements, price supports, purchase commitments and loan guarantees to subsidize construction of commercial synfuel facilities, in short, for everything the new Synthetic Fuels Corporation is empowered to do. The President, in his February 18 address to Congress acknowledged that he plans to appoint new directors as soon as possible and declare the corporation fully operational. Once this is done, the SFC can take over synthetic fuel development with its own $12.2 billion. And DOE will be prevented from obligating funds under the alternative fuels program thereby allowing the rescission of the DOE funds.

Strategic Petroleum Reserve -- Savings $20.4 billion

The Administration has not advocated any changes regarding the SPR but both the Dannemeyer and CBO analyses suggest that significant sums could be saved if the cost of filling the Strategic Petroleum Reserve was financed privately through the sale of bonds to the public. Dannemeyer puts the savings at $617.7 million in FY '81 outlays and the CBO projects a $20.4 billion savings in outlays over the next five fiscal years.

Repeal of Title X of the Public Health Service Act. Savings -- $162 million.

This has been one of the most controversial sections of "health" policies since it uses federal money to promote family planning, abortion, sex education, and values clarification. Pro-abortion groups (e.g., Planned Parenthood) have been able to get funding but groups opposed to abortion have been unsuccessful in getting federal funding for their projects. The federal government should be removed from the role of sex education and this would result in a budgetary savings.

Elminate "Trigger Level" Funds for Administration of Children, Youth and Families (ACYF). Savings -- $163.5 million.

These funds are the "trigger level" funds called for in the new Child Welfare Reform Act (P.L. 96-272) which will unleash a whole host of bureaucratic initiatives ... judicial and administrative reviews, state planning and case-tracking systems, others ... and not one dollar will go to the provision of care for children. As a matter of fact, the law specifically proscribes using any of the new funds for direct services to children.

As a matter of legislative history, these "trigger" funds were not in the May 15, 1980 budget resolution. They were slipped into the House Appropriations bill for HHS in August and hung up in the Senate prior to the reconciliation process. When the continuing resolution passed, it included the House's new higher figures, rather than the normal practice of returning to prior (FY '80) funding levels.

ACYF immediately lauched their midnight regs (December 31) and called for eight regional hearings on the new rules. The entire process has been a liberal charade.

Restrict Supplemental Security Income. Savings -- $72 million.

Currently there are tremendous abuses of the welfare system by newly arrived legal aliens. Many aliens gain admittance to this country under the auspices of a sponsor who files an affidavit of support, promising to make sure the alien stays off public assistance for five years. In many cases the sponsor reneges on the promise to support the alien and the alien then applies for and receives welfare (SSI).

In 1979 alone these legal aliens ripped off the American taxpayer by over $72 million annually. The GAO has found that 8% apply for SSI assistance within 30 days after their arrival. Some 63% apply within the first year, and 93% get on the welfare rolls within three years of entry.

One Social Security Claims Officer who is very familiar with the SSI/legal alien problem alleges that improper payments may run as high as $1.2 billion per year.

Conclusion: Cut all assistance for legal aliens with sponsors for the first five years of inhabiting the United States. Cost savings -- $72 million +.

DEPARTMENT OF LABOR

Eliminate the Labor-Management Services Administration. Savings -- $57.7 million.

"Redundant with the NLRB" according to the Dannemeyer budget. Performs services better left to private sector (aids in planning for work force adjustments, conducts studies on topics such as construction industry bargaining, public sector labor relations).

Repeal Davis-Bacon Requirements. Savings -- $125 million.

Strong recommendation for repeal by GAO. Badly mismanaged by the Department of Labor, highly inflationary and anti-competitive.

OSHA -- Reduce $73.6 million.

This agency is in need of redirection to change its thrust from an adversarial one to a cooperative one. Recommend cutting 10% each from budgets for safety and health standards program, federal enforcement grants program and from compliance assistance programs. In addition, eliminate completely state enforcement grants, and also allow a 10% increase for executive direction and administration.

Mine Safety and Health Administration. Reduce by $20.7 million.

Fewer inspections projected by MSHA for 1981 and 1982: reduce outlays by 10%.

Departmental Management

Eliminate both the Women's Bureau and the Civil Rights Office as their functions are also handled by other bureaus and agencies. Savings -- $7.5 million.

Streamline functions of Committee on Employment of the Handicapped; has potential for being clearinghouse for matters on handicapped once its publications system and other activities are streamlined: no increase for FY '81, reduce instead by 15%. Savings -- $0.5 million.

Eliminate activities from ILAB which pertain only tagentially to the general purposes of the Department of Labor. No increase for FY '81, and reduce instead by 10%. Savings -- $1.4 million.

Cut 10% from Inspector General's 1981 estimate -- $3.6 million.

DEPARTMENT OF TRANSPORTATION

The new Reagan budget proposes to cut or eliminate funding in more than a dozen transportation areas. Savings will be in the billions of dollars, and the federal government will begin stepping out of the subsidizing role it has been in for so long. Federal subsidization will be eliminated from seven areas: mass transit operating subsidies (no budget authority beyond 1984); Conrail funding (none provided beyond 1982); low-volume railroad branchlines (no appropriations beyond 1981); program for airline development; airport and airway users (substituting tax on users for federal subsidy); Cooperative Automotive Research Program (immediately); and inland waterway subsidies (user's tax to take over federal subsidy). There are areas, however, which can be cut further than recommended by the Administration.

AMTRAK -- Savings: $3 billion over five years

As with mass transit, Amtrak riders pay only a nominal portion of the cost to them each time they buy a ticket. Passengers currently pay only 40% of operating costs, and taxpayer subsidies make up the rest. The Reagan proposal is to increase Amtrak fares to cover 50%, 60%, 70%, and 80% of operating costs in 1982, 1983, 1984, and 1985. The burden could be removed from the taxpayers and shifted to the users if this proposal were modified further to mandate that users pay the full operating costs by 1985 with the following schedule -- 50% in 1982, 65% in 1983, 80% in 1984, and 100% in 1985. As with mass transit, funds from the taxpayers are benefitting only a segment of the population for their transportation needs -- and not with maximum efficiency at that. Savings between 1981 and 1985 -- $3 billion.

Highway Safety Grants -- Savings: $200 million

The Reagan budget proposal contains the suggestion that Highway safety grants ($200+ million annually) be diminished over six years for a savings of close to $600 million. An alternate suggestion would be to eliminate the program entirely by 1985. Funding could be reduced as follows: 1981 -- $200 million outlay; 1982 -- $150 million outlay; 1983 -- $100 million outlay; 1984 -- $50 million outlay; and 1985 -- $0.0. The Administration's reasoning for the reductions would apply also to the eventual elimination of the program -- a GAO study of the federal highway safety grants program concluded that there is no evidence that these grants reduce highway fatalities. Additionally, total highway safety funding is so small (2-3%) that the federal government has had little impact on what state and local governments actually do. The savings between 1981 and 1985 would be $759 million.

Washington Area Metro -- Savings: $149 million

A preliminary report from the General Accounting Office estimated that setting prevailing wages for Metro construction -- as is required by the Davis-Bacon Act, which states that workers on federally-assisted construction projects must be paid in accordance with the prevailing wages for the area -- may increase construction costs as much as 6.8%. Because union wages are usually judged to be the prevailing wages, and because they are usually higher than the real average, artificially increased Metro construction costs may account for $149 million. A waiver of the Davis-Bacon law for this major rapid transit system would save $149 million, according to GAO estimates.

DEPARTMENT OF THE TREASURY

Abolition of the Bureau of Alcohol, Tobacco, and Firearms (U.S. Treasury Department) -- Savings FY '82: $160,000,000.

The BATF represents one of the federal agencies which has gone beyond the intention of legislation in order to expand its power. The result has been a harassing of legitimate gun owners in enforcing such legislation as the Gun Act of 1968 leading to a serious breach of civil liberties. Attempts have been made to issue regulations which in effect enact gun control measures. If abolished, the remaining legitimate functions of the BATF could be dispersed throughout the remaining subsidiary offices of the U.S. Treasury Department.

Limiting Parental Personal Exemption for Students. Savings -- $1.1 billion (five-year savings: $5.5 billion).

Current law allows a parent to claim an exemption of $1000 for a dependent aged nineteen or over if the dependent is a student. (Exemption is provided for an over-eighteen dependent, non-student, if the dependent earns no more than $1000.) This exemption does not measure the cost of parents in educating their children and this targeted assistance serves little need presently. (The proposed tuition tax credit legislation and the present student loan program would help meet education expenses.) Repeal should be effective January 1, 1981.

ADDITIONAL BUDGET CUTS

National Science Foundation -- $27 million in 1981 and $53 million in 1982

The Administration budget cuts in this area did not go far enough. The National Science Foundation is one of Sen. Proxmire's favorite "Golden Fleece" award winners. NSF grants go to research projects of questionable value such as the study of the practices and attitudes of librarians and individuals placing, renewing, and cancelling periodical subscriptions or the study of the dynamics of family lives in a peasant Alpine village.

Additional budget cuts could be made in the following programs:

Science and Technology International Affairs, Ethics and Values in Science Technology. 1981 -- $2 million; 1982 -- $1.7 million.

Science Education, Curriculum Development (Federal aid to help develop text books for high schools. The private sector can do it better.) 1981 -- $5 million; 1982 -- $9 million.

Science Education Communication, Public Affairs. 1981 -- $6 million; 1982 -- $3 million.

Deep Sea Ocean Drilling, a cooperative program with the oil companies. 1981 -- $14 million; 1982 -- $14 million. This would still leave $3 million for close-out costs of the program.

Math and Physical Sciences. 1982 -- $10.8 million. This still leaves the NSF with $290.5 million in this area (a 13% increase over 1981 funding). Without the cut, the program would increase by 17%.

Engineering. 1982 -- $4.8 million. This still leaves the NSF with $99 million in this area (a 15% increase over 1981 funding). Wihtout this additional cut the funding level would be a 20.5% increase over 1981.

Biological, Behavorial, and Social Sciences could easily cut another $10 million.

Civil Aeronautics Board. Savings -- $28,800,000. Suggest abolishing CAB as soon as possible, say December 31, 1981, when CAB's most basic power, control over entry, is to be abolished under current law. The Department of Transportation can take over regulatory responsibility for domestic aviation subsidy program and for international aviation matters as it is scheduled to do by 1985. No reason DOT cannot take over these responsibilities more quickly. Suggested cut: total amount of its administrative expense of $28.8 million except minimal funds in FY '82 to allow it to windup its affairs.

Consumer Product Safety Commission. Savings -- $14,500,000. Suggest CPSC be converted into an education and informational agency for consumers. The categories of compliance, enforcement and regulatory development could be eliminated. Suggested cut: at least one third of total budget or $14.5 million.

Federal Communications Commission. Savings -- $7,500,000. Suggest action on deregulation of communications industry and restrict regulatory power. Suggested cut of 10% or $7,500,000 to start.

Federal Maritime Commission. Savings -- $12,000,000. Suggest eliminating FMC and transferring all FMC statutory authority to the Maritime Administration within the Department of Commerce. Suggested cut of all funds except for a small amount needed to wind up business.

Marine Mammal Commission. Savings -- $808,000. Suggest transfer of authority and responsibilities to Interior and Commerce Departments. Total cut of $808,000 except for minimal funds needed for windup of affairs.

National Commission on Libraries and Information Science. Savings -- $1,239,000. Suggest that this be incorporated into the Department of Education. Total budget cut except for minimal funds for windup.

National Mediation Board. Savings -- $4,000,000. Suggest that its function be put under Labor Department jurisdiction. Total budget cut except for funds for windup.

Neighborhood Reinvestment Board. Savings -- $13,426,000. Transfer authority for this program to HUD. Total budget cut.

Water Resources Council. Savings -- $34,259,000. This program should be put under the authority of the Interior Department. Cut total budget.

National Endowment for the Arts and Humanities. Savings -- $273 million. The Reagan Administration calls for no cuts in National Endowment for the Arts or National Endowment for the Humanities in FY '81 and cuts of $165 million in FY '82. Significant reductions should be made in the programs in 1981 and the programs should be eliminated in 1982. Many of the programs which are funded have little to do with enduring artistic accomplishments with some of them resembling high-flown welfare and employment schemes. Funds have gone to such questionable projects as supporting an exhibition of historic and modern prototype chair designs ($18,000) and support for a comprehensive recognition program which will give proper credit and stimulus to the non-design community for imaginative design solutions and creative planning partnerships. These endowments also duplicate programs which are provided by other departments of the federal government (e.g., Department of Education, Department of Health and Human Services). These endowments also support projects promoting humanism which would be at variance with the values of most Americans.

Cuts of $165 million should be made in FY '81 and the programs eliminated in FY '82 for a savings of $338 million ($173 million for the Arts and $165 million for the Humanities).

Summer Youth Employment Program (SYEP). Savings -- $403 million. As a means of alleviating structural unemployment, the Summer Youth Employment Program is limited in its usefulness. Participants do not receive on the job training, and less than 4% of enrollees receive any classroom training. Nor is the program cost effective in providing services to communities. A 1980 study commissioned by the Labor Department found that for every $2.90 per hour paid in wages to a summer participant, it would have cost only $2.42 per hour if a regular employee had performed the same amount of work. In addition, DOL stated last year that when supervisors were asked to judge the quality and quantity of work performance, half the participants were assessed at a level below regular employees.

The main value of SYEP is that it provides work experience to disadvantaged youth while "getting them off the streets." However, implementation of a youth differential minimum wage would likely achieve a similar result without additional cost to the government. Furthermore, the program should be redesigned to provide matching grants to local governments in order to give local administrators a greater incentive to eliminate inefficiency within the program.

The proposal to provide matching grants would reduce funding by approximately 50% in FY '82 as follows:

current estimated obligations	$ 806 million*
policy reduction	403 million
proposed outlays	403 million

* includes deferral of $39,548,000 from FY '81 to FY '82

<u>Legal Services Corporation (LSC). Savings -- $260.2 million</u>. Funding for the Legal Services Corporation has grown by enormous increments since it was established in 1974. From a level of $71.5 million in FY '74, the budget authority for FY '82 is expected to reach $347 million. LSC's budget total, however, is based on a grossly overstated estimation of the real need for free legal services.

For instance, LSC calculates the number of poor people it must serve based on the number of individuals at or below the Office of Management and Budget's defined poverty line. However, the LSC estimate does not take into account the income a person receives from most transfer payments and in-kind benefits. The Congressional Budget Office has estimated that if free legal assistance was made available only to the truly needy, the number of eligible clients would be approximately one-third less than at present.

Moreover, LSC estimates that a poor individual needs to see a lawyer an average of 1.1 times each year. By contrast, a national survey of eligible poor conducted by the General Accounting Office found that each poor <u>household</u> has .257 legal problems per year. LSC accounts for this discrepancy, in part, by assuming that poor people can recognize only one out of every four of their legal problems. Obviously, LSC's inflated estimates of the demand for legal services allow substantial room for budgeting cutbacks.

Turning the authority for delivering legal services back to the states would allow closer oversight of these activities. It is expected that this approach will lead to the establishment of new judicare and pro bono plans in lieu of existing staff attorney programs. In addition, frivolous class action suits would be eliminated as attorneys became accountable to individual clients and elected state officials. Funding for the proposed social services block grants should be reduced by an amount equal to 75% of the FY '82 Legal Services Corporation budget. (The Reagan proposal for social services block grants assumes a 25% reduction in total outlays for FY '82.)

Community Services Administration. Savings -- $375 million. Throughout its existence, the Community Services Administration (CSA) has been criticized for the following reasons: 1) the bureaucracy which administers grants to local agencies is unable to adequately monitor how funds are used -- this has led to recurrent cases of waste, fraud, and abuse of federal monies; 2) many local grantees are primarily advocacy-oriented and engage in frequent lobbying, political organizing, and activities which detract from the concept of providing services to the poor; 3) it is unclear whether the approximately $500 million spent annually on community action agencies has contributed to any significant gains in the living standard of the poverty population. In view of the high rate of inflation and the growing number of the unemployed, it makes sense that non-essential federal programs which add to inflationary budget deficits and crowding-out of private sector investment should be curtailed. CSA could be abolished without harming the individual community action agencies which are providing valuable services to the poor. These agencies could receive funding from state and local governments or from the private sector. Inefficient and fraudulent agencies, however, would likely close down. Termination of this bureaucracy would permit a funding reduction in the social services block grants by an additional 75% of CSA's FY '82 budget. (The Reagan proposed budget for social services block grants assumes a 25% reduction in total outlays for FY '82.)

Reductions in Foreign Development Aid Programs. Savings -- $0.57 billion. The Administration has proposed a reduction of $1.854 billion from the $7.246 billion projected 1982 Carter budget for foreign development aid, a cut of some 26%. This is still more than half a billion dollars over the Administration's proposed 1981 budget authority of $4,814 million.

We do not as yet have any specific details on the Administration's proposed cuts and thus are unable to suggest a detailed counter-proposal of our own; however, we feel that, at least for the next two or three years, until a careful assessment of whether U.S. funds are being used efficiently and a careful study of how well international institutions are serving the interests of the U.S. as well as the world community can be made, the budget authority for foreign development aid programs should not exceed the 1981 figure of $4.814 billion proposed by the Reagan Administration.

BIBLIOGRAPHY

There are a number of excellent reports, books, and studies available on reductions in the federal budget. The following is a list of some of the leading publications which focus on federal budget cutting and elimination of waste in federal programs.

1. America's New Beginning: A Program for Economic Recovery, Washington, D.C.: Office of the Press Secretary, The White House, February 18, 1981.

This is the Reagan Administration's discussion of the objectives of fiscal policy, suggested budgetary cuts projected to FY '86, and justification for changes.

2. Boaz, David, "Dave Stockman Is A Piker -- How To Really Cut Budgets: I'll See Your $26 Billion and Raise you $58 Billion," The Washington Post, February 15, 1981.

A program-by-program description where additional cuts totaling almost $60 billion more can be made in the federal budget.

3. Dannemeyer, William (U.S. Representative), "A Proposal for Cutting the FY 1981 Budget," Washington, D.C.: November 19, 1980.

Specific suggestions where and how the budget can be cut.

4. Fiscal Year 1982 Budget Revisions, Executive Office of the President, Office of Management and Budget, March, 1981.

5. The Government Subsidy Squeeze, Washington, D.C., Common Cause, 1980.

This book focuses on federal government subsidies (e.g., maritime, disaster loan programs, dairy regulations, Davis-Bacon) and recommends cuts in these programs with justifications.

6. Heatherly, Charles L. (editor), Mandate for Leadership: Policy Management in a Conservative Administration, Washington, D.C.: The Heritage Foundation, 1981.

This one-thousand-page-plus book examines a suggested agenda for a conservative administration focusing on policy changes, budget changes and cuts, and suggestions for government reform by Cabinet departments, independent regulatory agencies, and other agencies (e.g., EPA, OMB). Specific suggestions are given on FY '81 and FY '82 budgetary issues.

7. Lambro, Donald, Fat City: How Washington Wastes Your Taxes, South Bend, Indiana: Regnery/Gateway, Inc., 1980

This book by investigative reporter Lambro details recommendations for cutting $100 billion from the budget along with the author's recommendation for the elimination of what he views as 100 non-essential federal programs.

8. McAllister, Eugene J. (editor), Agenda for Progress: Examining Federal Spending, Washington, D.C.: The Heritage Foundation, 1981.

A discussion of the federal budget by function and including suggestions for budget cutting and reorienting federal programs.

9. Meeting America's Economic Crisis: A "Road Map" to Emergency Federal Spending Reductions, Washington, D.C.: The National Tax Limitation Committee, 1981.

This book focuses on housing, education, international programs, social services, etc. citing 100 opportunities to control spending with savings over $100 billion.

10. Proxmire, William (U.S. Senator), The Fleecing of America, New York: Houghton/Mifflin, 1980.

This book details waste in federal programs and how it can be reduced.

11. Reducing the Federal Budget: Strategies and Examples, Fiscal Years 1982-1986, Washington, D.C.: Congressional Budget Office, 1981.

A listing of suggestions for reducing the federal budget with justifications for such cuts. The book contains tables illustrating the savings as well as projected cuts organized by budget function.

12. "Waste, Fraud, Abuse and Mismanagement in the Federal Government," Special Report, Republican Study Committee, August 22, 1980.

This report itemizes 107 selected federal recommendations issued between January, 1979 and July, 1980 regarding waste and fraud in the federal government from official government reports (e.g., GAO). Total amount identified as unnecessary federal expenditures is over $34 billion.

NOTE: Regular suggestions on savings and on budget cuts can be obtained from the Monthly List of GAO Reports which are sent to Members' offices each month. You may also want to check the article, "A List of the Lists of Ways to Cut Spending," National Journal, December 20, 1980.

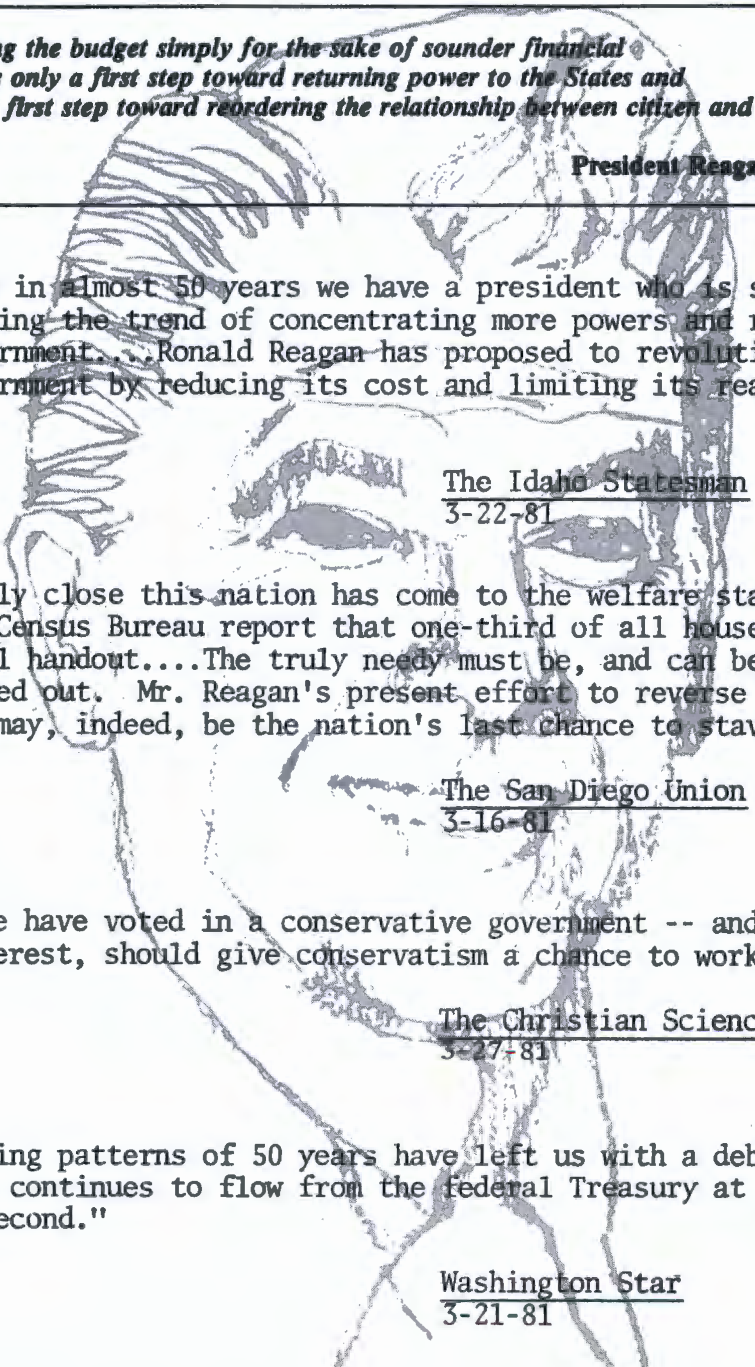
file Economic Package

Front Line

Volume 1, Number 2; April 16, 1981

The Reagan Revolution — American Renewal

> *"...we are not cutting the budget simply for the sake of sounder financial management. This is only a first step toward returning power to the States and communities, only a first step toward reordering the relationship between citizen and government."*
>
> **President Reagan, March 20, 1981**



"For the first time in almost 50 years we have a president who is seriously committed to reversing the trend of concentrating more powers and responsibilities in the federal government....Ronald Reagan has proposed to revolutionize the role of the federal government by reducing its cost and limiting its reach over our lives."

The Idaho Statesman
3-22-81

"Just how dangerously close this nation has come to the welfare state was illustrated the other day by a Census Bureau report that one-third of all households are receiving some sort of federal handout....The truly needy must be, and can be protected; the rest must be winnowed out. Mr. Reagan's present effort to reverse the extension of federal charity may, indeed, be the nation's last chance to stave off bankruptcy."

The San Diego Union
3-16-81

"The American people have voted in a conservative government -- and the Democrats, in the national interest, should give conservatism a chance to work."

The Christian Science Monitor
3-27-81

"The reckless spending patterns of 50 years have left us with a debt approaching $1 trillion. Money continues to flow from the federal Treasury at the mind-boggling rate of $22,000 a second."

Washington Star
3-21-81

Forty-four million Americans voted for Ronald Reagan November 4th. They want to see his program given a chance. Grass roots support for the President now will bring political opponents into the fold.

"Reagan Administration, take note: the Census Bureau reports that fully one household in three benefits from federal non-cash assistance, and most of the beneficiaries are above the poverty level."

The National Journal
3-21-81

"More howls can be expected as the President tries to hew through the bureaucratic deadwood....But it's not as if he were cutting down a whole forest; it's merely trail-blazing."

Tulsa World
3-25-81

"When Rep. James R. Jones scheduled a special hearing in Tulsa last Saturday on President Reagan's economic proposals....[n]early 500 persons turned up to express themselves, pro or con, on the Reagan program. And while no one took a poll, it was clear the citizens who came to speak as individuals were mostly in favor of the proposed Reagan budget cuts....The fact that 500 persons would take the trouble to attend a hearing for the opportunity of briefly expressing their views tells us there is not only support, but very enthusiastic support, for the Reagan approach."

Tulsa World
3-24-81

"Since between a third and a half of union members voted for Mr. Reagan last fall despite the alarms already being sounded by Mr. Kirkland about budget cuts and tight money, we must assume that most of these workers were being more realistic than Mr. Kirkland about the causes and cures of inflation. Many Americans voted for Mr. Reagan because of a generation of costly government programs and rising deficits....Mr. Kirkland has a unique opportunity to bring Big Labor into harmony with the times. He will not succeed if he persists in the discredited notion that governments can work miracles and that somebody else will pay for them."

Chicago Tribune
3-23-81

Newspapers around the country endorse not only the philosophy of government the new President brings to Washington, but the wisdom of specific cutbacks in federal spending, as the following extracts show:

"President Reagan won't get everything he asks for, but Congress reads its mail and its mail is running strongly pro-budget-cutting and pro-tax-cutting. Reagan will get a major part of what he is asking. The prospect of a lighter tax burden and a better trend in government spending will help turn the psychology around."

Forbes
3-30-81

"Government funding for three coal liquefaction plants would be canceled and for a fourth delayed, thereby saving $3.6 billion over the next three fiscal years.... There is no doubt that the cutbacks would mean a considerable slowing of the synthetic fuels program, but that would be to the good. Synfuels promise to make only a modest contribution to the nation's energy needs at an unjustifiably enormous cost to the taxpayers and the environment."

St. Louis Post-Dispatch
3-27-81

"President Reagan wants to derail federal subsidies for Amtrak and Conrail, and Congress should let him do it. Even if the economy were sound and far worthier candidates for federal largesse weren't being turned away, these enormously wasteful, mismanaged operations would have only the feeblest claim on the U.S. Treasury."

The Courier-Journal
3-29-81

"There's nothing wrong with cutting federal aid to college students--so long as the cuts are aimed at the excesses in the wide-open, heavily subsidized loans. That is the Reagan administration's intention, and it's on the right track.... [L]oans are available to the family of any student, regardless of its circumstances. If parents have the money on hand to pay college bills, they can take out a loan at 9 percent and redeposit the money in, say, a money market fund at 14 percent...It's true that the president proposes to throw a lot of people out of the loan program. Most of them should never have been let in."

The Washington Post
3-18-81

"The administration is not attempting to tumble the temple down; and the growth in federal student assistance has been staggering--from $585 million in 1970 to $5.6 billion this year. Mr. Reagan is seeking a relatively modest reduction, $1.2 billion less for Fiscal 1982, and to require that middle-income families and students in particular bear a greater portion of the costs of higher education... Student assistance is a wonderful example of federal generosity run amok."

The Washington Star
3-21-81

"Reagan got off to a brilliant start in his budget cutting on this dairy price issue....Killing this April 1 price support boost will save the federal government $147 million in fiscal 1981. It will save shoppers 7½ cents a gallon on milk, 10 cents a pound on butter and 9 cents a pound on cheese."

The Plain Dealer
3-27-81

"The Reagan Administration has gone back to the drawing board to find another $9 billion or more in budget savings. Among the reported targets is a plump and well-protected one: veterans programs...Veterans programs are not only enormous, but growing rapidly. The planned '82 budget marked an increase of $3.2 billion over last year, and that was only a prelude to the expansion expected in the near future as the bulk of World War II veterans enter retirement."

The Washington Post
3-1-81

"....[I]f increasing numbers of us wish to retain government's specialized functions and responsibilities, there probably is equity in requiring primary users to pay a greater share of the freight."

The Washington Star
3-22-81

"The sad truth is that CETA--a program with the best intentions in the world--simply did not, in actual practice, prove a cost-effective means of giving jobless people marketable skills to secure permanent private employment....The approach of putting private industry in the forefront with a supportive government role has worked well where it has been tried."

The Florida Times-Union
3-25-81

"Why should taxpayers be asked to contribute to the creation of commercial projects? After all, the initial public aid will not preserve them if they are not commercially viable to begin with....The Reagan administration has answered this question, and its need to reduce the size of the federal budget, by selectively taking a knife to such grants. The 1982 budget revisions call for eliminating the Commerce Department's Economic Development Administration..."

Wall Street Journal
3-25-81

The Program for Economic Recovery will not be complete without 10% tax-cuts over the next three years. These comments speak for themselves.

"The Reagan strategists knew what they were doing when they advised the President to push for passage of a clean bill incorporating Kemp-Roth tax cuts and liberalized depreciation. This was his campaign promise, and he can claim that the nation endorsed it. If the bill is opened up to revision, and if more tails are tied on the kite, there is no telling what will come out. Business should throw its full weight behind the Reagan proposals and let other concerns wait."

Business Week
3-30-81

"He [Rep. Rostenkowski] called a press conference this week to try to reassert the authority of Ways and Means by declaring the President's Kemp-Roth tax plan dead. The only problem is that where the President has a plan, and a good one, the chairman has none. He could only mumble something about trying to get Republicans and Democrats together to help him write one....To the extent that Mr. Rostenkowski proposed to slow the rise in the federal tax burden, he would mainly follow the old Carter approach of trying to shift burdens from lower to middle income taxpayers."

The Wall Street Journal
3-27-81

"I always believed that the moral case for Kemp-Roth was stronger than the economic argument; people have a right to their own income and ought to be allowed to keep all but that which is necessary for the payment of basic government services."

Washington Star
3-25-81

Bruce Bartlett
Deputy Director of Joint Economic Committee

***In the April 6 issue of* U.S. News & World Report, *even Democrats understand they must unite behind the President's program. Last November's message was clear: the time for a new beginning is* now.**

Sen. Russell B. Long
(D-La.)

"He received a mandate from the people to cut taxes and federal spending. That's what he is trying to do. I think the country wants Congress to go along, and I think we will."

Rep. Tip O'Neill, Jr.-House Speaker
(D-Mass.)

"While Democrats will carefully scrutinize his much publicized economic program, we will criticize it constructively and move it along expeditiously."

Rep. Thomas S. Foley-House Majority Whip
(D-Wash.)

"...[W]e Democrats in Congress will cooperate. Our hand is out to him."

Sen. Henry M. Jackson
(D-Wash.)

"The feeling generally is that, in fighting inflation, he has the only show in town and should be given the benefit of the doubt. I share that view."

Rep. James C. Wright, Jr.-House Majority Leader
(D-Tex.)

"Now, we are getting some of the details and specifics of his program. We will have to study them, but we Democrats want it understood we actively are cooperating."

Sen. Robert C. Byrd-Sen. Minority Leader
(D-W.Va.)

"He should be given high marks for his efforts to bolster our nation's defenses and for his determination to reduce the federal budget."

Rep. James R. Jones
(D-Okla.)

"There is in Congress a bipartisan spirit of cooperation to make the economic program successful."

Promises, Promises...

Sen. Alan Cranston
(D-Calif.)

"He will get cooperation--not obstruction--from most Democrats..."

The following statements made by policymakers within the political arena reflect support for the Administration's "Program for Economic Recovery."

Rep. Richard A. Gephardt
(D-Mo.)

AGREEING WITH REDUCTIONS

"Now we're agreeing to cut $40 billion in six months... we're going to do it, and it will be a revolutionary period."

National Journal
3-21-81

Rep. Thomas S. Foley - House Majority Whip
(D-Wash.)

EVEN THE DEMOCRATS SUPPORT US

"The vast majority of Democrats support many of the President's goals and want to see them succeed."

National Journal
3-21-81

Rep. Charles W. Stenholm
D-Tex.)

A UNITED CONGRESS

"[T]here is great flexibility and uncertainty among a lot of Democrats...a surprising number of conservatives [Democrats]and most Republicans" will unite to pass the fiscal 1982 budget.

National Journal
3-21-81

Sen. Gary Hart
(D-Colo.)

DEMOS GET THE MESSAGE

"I think most members of the Democratic Party have gotten the message that most people in this country want less government spending."

Wall Street Journal
3-26-81

Rep. E. de la Garza-Chairman of Agriculture Comm.
(D-Tex.)

DAIRY PRICE SUPPORTS -- THE PEOPLE CALL THE SHOTS

"We have to be responsive to the mandate of the American people."

Washington Post
3-27-81

Sen. Orrin G. Hatch
(R-Utah)

JOBS FOR YOUTH

"It is time for innovation and institutional changes which will allow an unrestrained free-enterprise system to increase employment opportunities for youth."

New York Times
3-25-81

Sen. Strom Thurmond
(R-S.C.)

SHOULDERING THEIR SHARE

"As much as I regret to see the veterans cut one dollar, I believe they are willing to take their share."

Congressional Quarterly
3-28-81

Rep. Robert H. Michel
(R-Ill.)

The Carter Economy Hurts the Poor

"Well, is it compassionate to cause inflation, ruin family budgets, to put the poor in a position where they can never hope to get out from under? I do not call that compassionate. But those who are now criticizing the President are exactly those who for years were voting for inflationary legislation that has crippled a generation of Americans. Where was their compassion then? Where was the compassion of groups now speaking against budget cuts when middle-income families were being taxed into ruin and despair because big spenders took their money in taxes?"

Congressional Record
March 26, 1981

David A. Stockman
Director of OMB

WORKFARE WILL WORK

"Well over 85 percent of the recipients of A.F.D.C. are children or mothers with small children, who wouldn't be expected to work...

[O]ur entire economic program is designed to put the working poor back to work to increase their income and to take the pressure of inflation and interest rates off them, because they're suffering the most as a result of the mess that we have in the economy."

"Issues & Answers"
3-22-81

AN ECONOMIC PROGRAM TO HELP ALL

"Here you have a national economic program that can bring the inflation rate down to eight percent from double digits next year, below five percent by the middle of the decade. Who's getting hit the worst, the hardest, by grocery costs, by energy costs today if it isn't the working poor?"

"Issues & Answers"
3-22-81

Rudolph G. Penner
AEI Public Policy Researcher

AND THE POOR WILL BE BETTER OFF

"The Administration's welfare program is designed to enhance economic growth and lower inflation. If it is successful -- and I believe that it will be -- it will benefit all income groups. Those benefits are harder to identify than the costs of the immediate budget cuts, but this does not make them any less real."

New York Times
3-29-81

David A. Stockman
Director of OMB

EVEN-HANDED BUDGET CUTTING

"We have cut direct budget programs that benefit middle and upper income people. We've cut the Export-Import Bank. We've cut the syn fuels program out. We have made higher income people no longer eligible for zero-interest loans under the Student Loan Program. We've suggested a cut-off point of $16,000 per year in terms of subsidies for school lunches. Those areas where there are direct expenditure programs in the budget that benefit the better-off, we have proposed for not just 10 percent or 20 percent reductions, but for wholesale elimination."

"Issues & Answers"
3-22-81

Robert Kilpatrick
Chairman of Business Roundtable

LIMITED GOVERNMENT

"The ball is now in the private sector's court. Limited government is going to mean that the problems are going to have to be solved by the private sector alone or working closely with government. If we don't do the job now, we won't have another chance the next time around."

New York Times
3-27-81

Robert B. Carleson
Special Assistant for Policy Development

REDUCING THE WELFARE ROLLS

"The 'workfare' program [in California] helped weed out a lot of people because many of them already held jobs while drawing welfare. Faced with the new requirement, they got off welfare because they couldn't report to two places of employment at the same time. It got rid of those already working. They were non-needy people."

The Sacramento Bee
3-16-81

Rep. Thomas J. Downey
(D-N.Y.)

GIVE REAGAN A CHANCE

"Good government and politics demand that we give the President's program a shot."

National Journal
3-21-81

America's Renewal — A New Beginning

It is a pleasure for me to be here today to speak to you about President Reagan's program for economic renewal in America. The President believes the answers to our economic woes lie in the vitality and courage of our people. His Administration is dedicated to unleashing the natural power of the individual to produce more and make a better life for all. His program will return our country to the economic strength we once knew.

We can recreate the incentives that take advantage of the genius of our economic system -- a system, as Walter Lippman observed more than 40 years ago, that for the first time in history gave men "a way of producing wealth in which the good fortune of others multiplied their own."

Now in the hands of the Congress, the program is not designed to change the foundation of our economy, but to return it to its greatness. President Reagan believes, and I wholeheartedly agree, that we have played fast and loose with the principles of free enterprise upon which this Nation was founded. We have gotten away from the idea that the Government's main function is to protect the people.

There are now nearly eight million people in this country who don't have jobs -- robbing millions of Americans of basic human dignity. Inflation today is at 11.7 percent. Unless we act, this statistic, which makes a mockery of hard work and savings, will get worse. Our Government deficit stands at more than $940 billion, driving up interest rates, fueling inflation and undermining the stability of our economy. Unless we act, this debt will continue to get bigger.

Excessive regulation by the government is costing the country an estimated $100 billion. One Government estimate indicated that fraud alone may account for anywhere from 1 to 10 percent -- as much as $25 billion of federal expenditures for social programs. The rate of increase in American productivity, once leading the world, has dropped to among the lowest of all major industrial nations. Taxes now consume 17.6 percent of the earnings of an average family of four, robbing dollars from our pocketbooks and incentive from the workplace. Unless we act, these sad statistics will continue to grow.

We are on the brink of an economic calamity because we have strayed from first principles. Together, we must alter our course. We can no longer procrastinate, hoping that things will somehow get better. They will not. Unless we act forcefully and now, the economy will get worse.

For too long we have attacked inflation with unemployment, and unemployment with inflation, trading misery for misery and ending up with both. The two go hand in hand.

Our economic problems are complex and must be attacked together. President Reagan has proposed a four-point, comprehensive package to deal with them. If only a part of the package is passed by the Congress, we will get only a part of the solution. We can no longer afford to tinker with our economy, because our economy cannot be finetuned.

President Reagan has called for a substantial reduction in the growth of federal spending. He has given to the Congress a detailed plan to cut $48.6 billion from the federal budget in fiscal year 1982. This is not a reduction in current spending levels, but a reduction in planned increases.

Second, he has proposed a 10- percent, across-the-board tax rate cut every year for the next three years for everyone who pays income tax. That is a total of a 30 percent tax rate cut during a three-year period. The reduction will also apply to the tax on unearned income, eventually eliminating the differential between the taxes on earned and unearned income.

Again, while these tax-rate cuts will leave an extra $500 billion in our pockets during the next five years, they only reduce the tax increases already built into the system.

Third, the President has asked for a prudent elimination of excessive regulation.

And fourth, the Reagan Administration has pledged to work with the Federal Reserve Board to develop a monetary policy consistent with the economic program, geared to stabilize the money supply and revitalize the economy.

This four-point plan is designed to get our economy moving again. We will continue to fulfill obligations to those, who, through no fault of their own, must depend on the rest of us. Those who are deserving can rest assured that the social safety programs they depend on will not be cut. The rest of us will feel the impact of the budget cuts, which have been distributed through the economy as evenly as possible. But through this plan and by these cuts, we will break the back of the inflationary psychology gripping us today.

The proposed cuts, about 49 billion dollars, were chosen by applying basic principles to every Federal expenditure.

The Reagan budget proposes reducing billions of dollars for some entitlement programs, such as food stamps, extended unemployment benefits and a number of others. In 1970, such programs cost Americans about five billion dollars a year. In 1981, they are costing us about $58 billion.

The reductions are aimed at restricting eligibility, reducing the overlap and eliminating the waste. By doing so, we can save nine billion dollars next year, nineteen billion dollars during the next two or three years, and still meet the needs of those who deserve our help.

Budget savings will also be found by consolidating narrow, categorical grants to State and local governments into block grants. The President has long believed that programs administered at those levels are often more efficient and responsive, and by funding them through block grants the local government gets an added flexibility that can result in real savings.

The budget inherited by the Reagan Administration also includes subsidies for everything from export companies to school lunches for upper class children to zero interest loans for those who could afford to send their own children to school. Federal taxpayers, for example, are paying $160 per year per cow to subsidize the dairy industry. Changes are proposed in these areas, and more.

As President Reagan told us in his Inaugural address, "All of us together, in and out of government, must bear the burden." The budget cuts are equitable, with no one group singled out to pay a higher price. But the clearest threat to our recovery comes now from those who oppose only a small part of the program, while supporting the overall effort. The cuts they oppose are the cuts that affect them.

"The accumulative effect of this shortsightedness can be damaging," the President warns us. "We're all in the same boat, and we have to get the engines started before the boat goes over the falls."

At the same time we are cutting spending, we also must go forward with a tax relief package. Both are essential if we are to have economic recovery. President Reagan's tax package will create new jobs, build and rebuild industry, and give the American people room to do what they do best.

What President Reagan is proposing is not the usual tax reform intended to shift income between different sets of taxpayers. His plan reduces everyone's taxes equally, providing needed incentive for both workers and industry.

Along with the personal income tax rate cuts, the President is proposing a program to allow business and industry to keep enough capital to modernize and engage in more research and development. This will involve an increase in depreciation allowances. In much shorter write-off periods, businesses would be allowed a five-year write-off for machinery, three years for vehicles and trucks, and 10 years for plant. In fiscal year 1982, business would have about $10 billion more for investment than it otherwise would have.

The third part of the program for economic renewal addresses the explosion in government regulation during the past decade. Between 1970 and 1979, spending for the major regulatory agencies quadrupled. The number of pages published annually in the Federal Register nearly tripled, and the number of pages in the Code of Federal Regulations has nearly doubled.

The result has been higher prices, higher unemployment, and lower productivity growth. Particularly hard hit by this overregulation are America's small business men and women, and small business is the bedrock of our economy. Vice President Bush now heads a Cabinet-level Task Force on Regulatory Relief.

A consistent monetary policy that does not allow money growth to increase faster than goods and services is the fourth part of the plan. In order to curb inflation, we need to slow the growth in our money supply. Interest rates, which shot over 20 percent last year, are a clear indication of past monetary inconsistency.

President Reagan has said that he does not want this plan to be just the plan of his Administration. He has asked the Members of Congress to make it their plan. And its success requires that all of us adopt it as ours. There can be no special interest other than the interest of all of our people. And we must act now, without delay and without being timid.

Let us act to restore the freedom of all men and women to excel and to create. Let us rely on our heritage of genius and courage. Let us reject the certain failure of present policies for the hope of economic renewal. There is no alternative. Together, we must answer our President's call to forge a new beginning for America.

The Heritage Foundation Backgrounder

No. 139

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file Economic Package

April 29, 1981

THE REAGAN ECONOMIC PROGRAM: SELECTED BUDGET CUTS

INTRODUCTION

Many of today's income security programs that provide financial assistance to groups such as the poor and elderly are being confronted with increasingly greater demands for their services and costs exceeding earlier expectations. These difficulties stem primarily from the programs' rapid growth, largely a result of increased coverage and liberalized benefit payments. Unfortunately, this expansion has often created excessive and unintended benefits. The proportion of the federal budget going to entitlement and income security payments has grown from 26 percent in 1960 to 50.3 percent in 1981.[1] The Reagan Administration has proposed reforms that would enhance the long-run stability of these programs by eliminating many of the misdirected benefits that have emerged during this period. The proposals are aimed at restoring these programs to their intended purpose of providing a "social safety net."

The proposed budget cuts to be discussed in this paper include many of the income security programs such as social security, unemployment compensation, and welfare as well as public service employment. The public jobs program is included because it offers benefits to workers who might otherwise be unemployed and may be thought of as a form of unemployment compensation.

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1 All numerical data, unless otherwise noted, are from one of two Administration reports: America's New Beginning: A Program for Economic Recovery (February 18, 1981) or Fiscal Year 1982 Budget Revisions (March 10, 1981). In addition, the years cited from these reports are fiscal years.

SOCIAL SECURITY

The original purpose of Social Security was to replace part of the earnings lost as a result of a worker's retirement. It was never intended to be the sole means of support for the elderly. Over the years, however, this objective has been expanded by the addition of programs paying large unearned benefits for purposes other than the provision of partial retirement income.[2] Many of these benefits are completely unrelated to a worker's contributions and are largely responsible for the emasculated condition of the Social Security trust fund. The Social Security system, however, is inappropriate for achieving these putative welfare objectives because it is financed by a regressive payroll tax. Such a tax may be suitable for the insurance goal of Social Security, but it is not justifiable to provide welfare benefits by a tax that places its heaviest burden on the very group it is designed to help. Thus, the increasing instability of the Social Security system can be attributed to two conflicting goals: "individual equity" and "social adequacy." The Administration's proposed changes are a move towards restoring the Social Security program to its original purpose of being a basic old-age and survivors insurance program. This would be accomplished by eliminating or modifying several of the current unearned and non-basic benefits.

Minimum Benefit

The minimum benefit, established by Congress in 1939 at $10 a month has grown more rapidly than any of the other Social Security benefits and currently is $122 a month. The minimum benefit is commonly regarded as a welfare component of the Social Security system because it is paid regardless of the beneficiary's past earnings history. The original purpose of the minimum benefit was to increase the income of those retirees with low earnings histories and to assist those who had worked in covered employment for only a short period of time as a result of incomplete coverage in the early years of the program. The amount of $10 was decided upon both for administrative purposes and to avoid paying benefits of minimal value. Several changes over the years no longer justify such welfare payments, e.g., a larger number of income security programs are available for the poor and elderly and expanded coverage under Social Security. The Administration's proposal to eliminate the minimum benefit would result in an estimated savings of $1.3 billion in 1982.

Today, the Supplemental Security Income (SSI) program provides a guaranteed level of income for the aged, blind and disabled that exceeds the minimum benefit provided under Social Security. In fact, the minimum benefit offsets SSI payments on a dollar for

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2 An unearned benefit here is defined as a benefit that is not directly related to and exceeds the tax contributions of its recipients.

dollar basis; therefore, these recipients would experience no reductions in their incomes. In addition, these people are also eligible to receive benefits such as food stamps, Medicaid, and housing subsidies.

Coverage under the Social Security system has grown from 58 percent of all workers in paid employment in 1940 to more than 89 percent in 1977. Moreover, the percentage of workers covered has been greater than 89 percent since 1965, and greater than 85 percent since 1955.[3] The only major group not covered by Social Security are federal government employees, who are covered by their own retirement systems. Therefore, arguments favoring minimum benefit payments as a result of the incomplete coverage of the Social Security system are no longer valid.

Furthermore, as a welfare component of Social Security, the minimum benefit has been a very inefficient way of redistributing income, often paying the non-poor benefits that were designed for the needy. Many minimum benefit recipients have had short work periods in covered employment or low earnings histories because they spent much of their time employed in the federal government, where they have also qualified for generous civil service pensions. These workers, often referred to as double dippers, can beat the system in several ways. They may work in secondary part-time jobs for the minimum number of years necessary to become eligible for Social Security benefits, while being primarily employed in the federal government. Or, they may become eligible by working in the private sector before or after working for the federal government just long enough to receive a civil service pension. This type of abuse of the Social Security system does not appear to be uncommon: as many as 40 percent of those receiving a civil service pension may also be getting benefits under Social Security.[4] In addition, a GAO study estimated that at least 12 percent of the minimum benefit recipients were homemakers with sporadic employment patterns.[5] Despite the fact that they depended primarily on their spouse for support, they received substantial unearned benefits. Still others taking advantage of these welfare provisions include individuals with large savings or retirement incomes, but relatively low earnings histories. These people, despite being relatively well-off, receive benefits far in excess of their contributions.

Because of the myriad of income security programs available to the elderly and the poor, elimination of the minimum monthly

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3 Peter J. Ferrara, Social Security: The Inherent Contradiction (San Francisco, California: Cato Institute, 1980), p. 421.

4 Alicia H. Munnell, The Future of Social Security (Washington, D.C.: Brookings Institution, 1977), p. 15.

5 U.S. General Accounting Office Report, "Minimum Social Security Benefit: A Windfall That Should Be Eliminated" (HRD-80-29, December 10, 1979), p. 17.

benefit will not hurt the needy. Rather, it will reduce unearned payments to those who cannot demonstrate a need for them.

Student Benefits

As of 1965, Social Security benefits have been payable to unmarried students between the ages of 18 and 21 (in 1972 the upper limit was extended to 22) whose parents are Social Security recipients. The benefits were designed to assist students in finishing high school and/or obtaining postsecondary education. These benefits were added at a time when the Social Security trust fund had adequate reserves. Student benefits have increased rapidly since the inception of the program: from $165 million in 1965 to over $2 billion in 1980. The Administration proposes to eliminate the student benefit by refusing any new participants and by reducing current student payments by 25 percent a year. Savings of $1 billion could be realized by 1982 and as much as $7 billion by 1986.

Social Security payments to adult students are neither fair nor necessary. Benefits from this program are not based on a student's ability to pay his educational costs, but on the earnings histories of his parents. The higher their past earnings, the greater the benefit he is entitled to. This perversion of the system results in inversely relating benefits to need. Moreover, benefits from this program may have the adverse effect of inducing a number of older workers to retire earlier, allowing their children to become eligible for these benefits.

In addition, when the program was first introduced in 1965, federal assistance to students was negligible. This is no longer the case today. There are currently several federal programs that provide assistance for students. In particular, the Basic Educational Opportunity (Pell) Grant is designed to target benefits based on educational costs and need, while the Guaranteed Student Loan program provides aid to all students, regardless of their financial status.[6] Elimination of the student benefit would reduce some of the problems associated with benefit overpayment that results from ignoring educational cost and duplicating payments from other federal programs.

Lump Sum Death Benefit

The lump sum death benefit provides a payment of $255 to the deceased's survivors upon the death of an insured worker. Originally, there was no provision in Social Security for survivors' benefits, and the lump sum death benefit was designed to provide a return on the worker's investment in Social Security. In 1939,

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6 The Administration is proposing changes in both these programs. These reforms, however, would be geared primarily toward higher income groups that cannot demonstrate a need for student assistance.

Social Security was expanded to include benefits for the survivors and dependents of deceased wage earners. The lump sum death benefit, however, was payable only if there was no one eligible to receive suvivors' benefits. In 1950 Congress decided that the death benefit would be payable regardless of whether or not there was anyone eligible to collect survivors' benefits. The intent of the benefit was changed from providing a return on the wage earner's investment in Social security to providing assistance in meeting expenses incurred as a result of the worker's final illness or death. About half of the current lump sum death benefit payments are made even when there is no surviving family, with payments often going to funeral home operators. The Administration proposes to eliminate this benefit when there are no survivors, which will result in savings of about $0.2 billion in 1982.

The Administration's proposal is a step in the right direction, but it does not go far enough. The lump sum death benefit should be eliminated entirely. A study by the GAO found that most of the beneficiaries of lump sum death benefits had already received benefits that were much greater than their contributions. The GAO report revealed that in a 1978 sample of lump sum death benefit claimants, 86 percent of the recipients had received average benefits that exceeded average employee contributions, and in over 75 percent of the cases, benefits received were about 15 times greater than contributions.[7]

Furthermore, the purpose of Social Security itself is to provide income for a covered worker and his dependents when his earnings are reduced from retirement, disability, or death. Its objective is not to defray the costs of final illness or burial. Because the death benefit is not means related, it would be more appropriate to set up a provision under the Supplemental Security Income program to provide a death benefit based on need, as was suggested by HHS in 1979.

Disability Insurance

Disability insurance (DI) was added to the Social Security system in 1965. The purpose of DI benefits is to provide an adequate standard of living for disabled workers and their families by replacing part of the earnings lost as a result of a disability. To qualify for benefits, a worker has to prove his inability to engage in gainful employment due to a medically determinable physical or mental impairment that is expected to last for at least 12 continuous months or to result in death. Payments of DI benefits have grown dramatically since 1970, with costs rising by 500 percent and the number of cases by 80 percent.

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7 U.S. General Accounting Office Report, "The Lump Sum Death Benefit -- Should It Be Changed?" (HRD-80-87, August 8, 1980), p. i.

A major drawback of DI is that it may create work disincentives by replacing a large portion of a disabled worker's prior net earnings. Moreover, indexation adjusts these benefits fully for inflation. The problems associated with overly generous benefits are especially acute among low wage earners because of the redistributive aspect of the benefit formula favoring them. The incentive to return to work may further be reduced when the value of Medicare and benefits from other sources, such as workmen's compensation, are considered. A study by L. Scott Muller reported that in 1972, 44 percent of DI beneficiaries also received benefits from other sources as a result of their disability.[8] Furthermore, the GAO reports that over 500,000 current beneficiaries may be receiving benefits despite no longer being disabled.

The Administration's proposals are aimed at minimizing these problems and reducing the drain on the DI trust fund by "tightening administration and ending misdirected benefits." Specifically, under the Administration's direction, the Social Security Administration would examine DI beneficiaries more closely to determine whether or not the worker's disability warrants assistance. In addition, eligibility requirements would be strengthened by requiring a claimant to have worked at least six of the last thirteen quarters. Finally, a "megacap" would be created that would limit the sum of benefits from public sources to a level not exceeding the worker's prior after-tax earnings, adjusted for inflation. The reduction in outlays is estimated at $0.1 billion in 1981 and $0.4 billion in 1982.

Medical evidence is often insufficient; therefore, the role of consultative examinations should be expanded to ensure the authenticity of disability. According to GAO: "It makes little sense to save $107 in consultative examination funds if the savings result in incorrectly paying $29,000 in benefits."[9] Once such "authenticity" is determined, however, the minimum qualifying period should be waived to allow workers with legitimate disabilities to receive benefits. The thirteen-month restriction should be retained to ensure that only workers with fairly recent work experience receive benefits. This would allow an individual a reasonable period before his insurance "policy" expires.

The disabled worker should not be limited by the amount of benefits he receives from other sources. If a worker is receiving extra benefits, it is presumably because he has given up part of his income in the past to insure himself against possible disability. A "megacap" may be denying the worker benefits rightfully

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8 L. Scott Muller, "Receipt of Multiple Benefits by Disabled-Worker Beneficiaries," Social Security Bulletin, 43 (November 1980), p. 4.

9 U.S. General Accounting Office Report, "Controls Over Medical Examinations Necessary For the Social Security Administration to Better Determine Disability" (HRD-79-119, October 9, 1979), p. 13.

due him. The DI benefit formula, however, does contain a redistributive element, which should be replaced by a proportional benefit structure, thereby ensuring an equitable return on all contributions. If this were applied to all public programs providing compensation for disability, a "megacap" would not be necessary.

Indexing

The Administration should also re-evaluate other policies used in determining Social Security payments. One commonly discussed proposal that would also improve efficiency and equity within the Social Security system is the modification of benefit indexation.

Benefits are currently adjusted for inflation by indexing them to the Consumer Price Index (CPI). Use of the CPI, however, may improperly lead to excessive Social Security benefits because it is commonly regarded by economists to overstate the true rate of inflation. One of the major flaws in the CPI is its treatment of homeownership. The CPI overstates housing costs by ignoring the investment value of the home. Other criticisms of the CPI include outdated buying patterns (determined in 1972-73), failure to account for consumer substitution when faced with higher prices, and limited applicability to certain subgroups, such as the elderly. In this connection, it should be noted that only a very small proportion of the elderly are in the housing market, a category heavily weighted in calculating the CPI. Choosing an index that more accurately reflects the buying patterns of social security recipients could result in sizeable savings.

BLACK LUNG BENEFITS

The black lung disability trust fund (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 underground 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.

The Administration proposes to "restrict benefits to those who are truly medically disabled by black lung and to ensure that the program is financed entirely by a reasonable levy on the coal industry." The ultimate goal is to eliminate claimants with questionable disabilities and to reduce trust fund outlays to a level that would allow payments to be financed solely by a coal tax. These changes are anticipated to result in savings of nearly $400 million in 1982.

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.

UNEMPLOYMENT COMPENSATION

Unemployment compensation has been designed to replace approximately 50 percent of a worker's former average weekly wage. The Federal-State Extended Unemployment Act of 1970, enacted to give additional assistance to unemployed workers during periods of high state or national unemployment, authorizes the extension of benefits at the regular weekly amount for an additional thirteen weeks whenever the unemployment rate among insured workers (IUR) rises above some state or national "triggering" level. The state trigger takes effect when the state's IUR equals or exceeds, for a thirteen-week period, 120 percent of the average rate for the corresponding period in each of the previous two years and when such a rate is also at least 4 percent. A state also has the option to extend benefits if the state's overall unemployment rate is at least 5 percent for thirteen weeks. When the national IUR reaches 4.5 percent, the national trigger is "on," and all states, even those with relatively low unemployment rates, become eligible for the extended benefits.

Unemployment compensation often has the adverse effect of making layoffs desirable for both employees and employers. Generous benefits and added leisure time often create significant work disincentives. An employer may be induced into laying off more workers during an economic downturn than he otherwise would because the tax used to finance unemployment compensation is not always directly related to the unemployment experience of the firm. The extended benefits program adds to these distortions and generates even greater inefficiency.

The Reagan Administration has proposed restructuring the extended benefits program so that it would provide relief only to those areas plagued by high unemployment. The changes suggested are meant to achieve results analogous to tax cuts -- to restore work incentives by making employment relatively more attractive than unemployment. Specifically, the Administration's proposal would: 1) eliminate the national trigger; 2) change the way the state triggers are calculated; 3) raise the state trigger level from 4 to 5 percent of the IUR and, at state option, to 6 percent without regard to prior years; 4) require that extended benefits recipients have worked twenty weeks in the one-year base period; and 5) strictly enforce the new rule requiring claimants to accept any reasonable job offer. Employment will be considered acceptable if it pays at least the minimum wage and can replace the individual's current unemployment insurance benefits.[10] The first two changes will become effective July 1, 1981, while the third change would take effect only on October 1, 1982, thereby allowing necessary changes in state law. The 1980 Reconciliation Act already requires that the work test be applied to all extended benefits recipients after April 1, 1981. These modifications would save $523 million in 1981 and $1.2 billion in 1982.

Abolishing the national trigger would reduce costly unemployment insurance benefits in states that would otherwise not qualify for extended benefits. In addition, efficiency in the labor market would be enhanced by eliminating one of the sources creating work disincentives. When the national trigger is "on," benefits are extended in all states, even those with relatively low unemployment rates. Despite the considerably better job opportunities in such states, unemployment may rise as a result of increased work disincentives associated with the availability of more benefits.

The proposal would also exclude extended benefits recipients from the calculation of the IUR. The problem with using the IUR as a measure of unemployment for triggering purposes is that it creates an extended benefits program which becomes self-perpetuating. When the trigger is "on," all persons filing claims for benefits are included in the IUR. This results in exhaustees that normally would no longer be considered part of the labor force to be included in the IUR for an additional 13 weeks. On the other hand, when the trigger is "off," those same workers are excluded. Making this fundamental change would save substantial benefit payments in states that have already reached their triggering level. An even better approach, however, would be to use the overall unemployment rate in calculating the trigger because it would more accurately reflect job availability in the economy.

Raising the state trigger level is desirable because it would ensure that only those in genuine need receive assistance. This, in part, is necessary to compensate for the changing composition of the labor force, which over the years has raised the natural rate of unemployment. Restricting eligibility to extended

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10 The Administration is also proposing to apply this work test to individuals who have been unemployed for at least three months. The purpose is to hasten worker readjustment to a changing labor market by shifting employment from relatively unstable sectors in the economy. The proposed reform would become effective October 1, 1982.

benefits claimants who have worked at least twenty weeks in the one-year base period would limit participation to workers with a genuine attachment to the labor force. Finally, strengthening the work test can eliminate much of the waste and fraud in the program.

Although the changes proposed are all desirable from an efficiency and equity standpoint, they do not go far enough. The extended benefits program should be eliminated entirely. The original purpose of unemployment compensation was to provide temporary relief. The program is not suited to correct long-term structural problems.

TRADE ADJUSTMENT ASSISTANCE

Trade Adjustment Assistance (TAA) was introduced in 1962 to assist workers suffering from increased imports, which were a direct result of government policies aimed at the liberalization of international trade. Today, however, the Secretary of Labor can declare workers eligible if imports have contributed significantly to unemployment and to a decline in the sales and/or production of the firm(s) in question. In other words, workers no longer have to prove that they are hurt by freer trade or that imports are the major cause of their injury. The primary purpose of the TAA program is to help workers adjust to changed economic conditions by easing the transition period between jobs. Assistance available to workers consists of: 1) trade readjustment allowances; 2) employment services; and/or 3) job search and relocation allowances. TAA benefits supplement unemployment insurance benefits by providing 70 percent of a worker's former average weekly wage, up to a maximum of the national average weekly manufacturing wage. Because unemployment insurance replaces only about 50 percent of gross earnings, TAA can be significant to the unemployed worker. In addition, these benefits are available for up to a year. In 1980, outlays on the program had grown to 1.7 billion dollars, which was more than six times as much as in the preceding year.

The major problem with TAA is that it compounds all the problems associated with unemployment compensation. The more generous benefits and the lengthier entitlement period exacerbate work disincentives. Greater benefits also discourage workers from seeking employment in more stable industries. Since employers pay no supplemental tax for laying off workers who would receive TAA benefits, an employer may find it profitable to lay off workers during a period of slack demand, assuming that relatively generous TAA benefits will induce a worker to wait to be rehired rather than actively search for a new job. Finally, TAA creates inequities by discriminating in favor of a select group of unemployed workers, those affected by imports.

The Administration proposes to extend TAA benefits only to those workers who have exhausted their regular unemployment compensation and to limit the size of these benefits to levels no higher than those under unemployment insurance. An unemployed worker will be allowed to receive benefits from TAA and unemployment insurance for up to a year. These changes will become effective October 1, 1981, and could reduce spending by $1.2 billion in 1982 alone.

The limitations proposed on the availability of TAA benefits would improve efficiency within the program markedly. The results of several studies seem to indicate that reducing the availability of benefits would dramatically mitigate pernicious practices of employees and employers alike. One such study found that TAA recipients were much more likely to have experienced temporary unemployment than their counterparts receiving only unemployment insurance. Moreover, they were much less likely to have changed their industry or occupation. It can be said that "one of the surest ways to bring about adjustment is to provide no assistance, and assistance that compensated for every burden would leave no incentive to adjust."[11] The generous assistance payments seem to act as a deterrent to workers from seeking employment in new areas, thereby artificially generating too strong an attachment to a vulnerable industry. The proposed changes are needed to restore work incentives and to discourage misuse of the program.

Although the proposed changes in TAA would result in great savings and lead to a more efficient allocation of resources, the program would still have some shortcomings. Even greater savings could be realized if the eligibility requirements were made more stringent by requiring workers not only to show that they were displaced as a direct result of U.S. international trade liberalization but that it had been the single most important cause of their injury. To further this goal, the role of determining eligibility should be returned to the International Trade Commission. The Department of Labor has all too often demonstrated a bias in favor of organized labor, many of whose members are TAA recipients. This is important because 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. Moreover, since workers produce goods and

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[11] J. D. Richardson, "Trade Adjustment Assistance Under the U.S. Trade Act of 1974: An Analytical Examination and Worker Survey," National Bureau of Economic Research, Working Paper 556, September 1980.

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.

Finally, the availability of TAA after 26 weeks of unemployment compensation renders it more like an extended benefits program. These payments should be reduced drastically, while expanding the availability of the adjustment services.

AFDC

The Aid to Families with Dependent Children (AFDC) program provides cash assistance to needy families on behalf of dependent children when one parent is deceased, incapacitated, or -- in some states -- unemployed. The program is financed by federal funds to states on a matching basis depending on the per capita income of the state. The Administration is proposing some basic reforms in the AFDC program that would improve the targeting of welfare benefits, reduce fraud, simplify administration, and lower costs. The proposed changes, some of which are discussed in more detail below, are expected to yield savings of $0.7 billion in 1982.

The Administration proposes to reform the AFDC program so that it would more accurately reflect a family's financial need by including other sources of income available to the household in determining eligibility and benefit levels. First, eligibility and benefits would be based on actual prior income, rather than the projected future income that states currently are allowed to employ. Prospective budgeting frequently results in considerable overpayments due to the uncertainty involved in estimating future income. Second, the earnings of stepparents and others living in the household with AFDC recipients would be included in determining the need. Third, states would also be allowed to consider food stamp benefits and housing subsidies in the definition of income. These changes would limit benefits to the truly needy.

The Administration also intends to examine the characteristics of AFDC recipients more closely to decide whether or not they belong in the program. Certain classes of participants would be precluded or restricted from receiving benefits. First, benefits would no longer be paid to strikers. Second, parents attending college would be required to meet all work requirements under the AFDC program. Welfare payments to strikers and students are unwarranted because they subsidize non-work activities of potentially self-supporting individuals. Third, the definition of a dependent child would be amended to deny benefits to children over 18. Currently, a state may choose to pay benefits to students from 18 to 21 years of age. Such assistance is more appropriate under educational programs designed for the needy. Fourth, benefits and eligibility would be limited to unemployed parents of two-parent families in which the principal earner is unemployed. Fifth, states would be required to establish community work experience programs that would require individuals deemed employable to work in exchange for their benefits. Exceptions would be granted to the disabled, persons under 18 or over 65, those working full-time, or mothers with young children. The hours of work would be determined by taking the AFDC benefit and dividing by the minimum wage. These proposals would target AFDC benefits to those most in need.

Several administrative changes would also be made to lower costs or enhance efficiency. These include eliminating benefits of less than $10 a month and creating a National Recipient Information System that would be used to collect information on individuals receiving assistance.

The most controversial reforms, however, are in the formula used to compute benefits. The earned income tax credit (EITC) provides a low-income parent a 10 percent credit on earnings of up to $5,000 and is reduced at a rate of 12.5 percent on earnings beyond $6,000 until it is completely phased out at $10,000. Workers currently receiving the EITC may get it either as an advance monthly payment or as a lump sum at the end of the year. The AFDC monthly benefit is determined by disregarding a recipient's first $30 earned in a month plus one-third of his remaining income. In addition, child care and work-related expenses are also deductible. Excessive costs often allow extraordinarily large deductions, permitting families with relatively high earnings to remain on AFDC.

The Administration proposes to count the EITC on a current basis, regardless of whether or not it is received as an advance payment. The objective is to reflect current need and reduce erroneous overpayments from counting them as a lump sum at the end of the year. In addition, the AFDC work expense disregard and the child care disregard would be capped, and the order in which the disregards are deducted from earned income would be changed. More specifically, the disregards from earned income would be applied in the following manner: 1) flat $30; 2) standard allowance for work expenses would be limited to $75; 3) $50 allowance per child for child care expenses; and 4) one-third of the remaining earned income. The $30 and one-third disregards referred to above would apply only to those workers who begin work while already receiving AFDC benefits and then only for a four-month period. Finally, a gross income ceiling of 150 percent of the state's standard of need would be established for eligibility in the AFDC program.

These changes would create greater incentives to reduce expenses, improve administration, and reduce fraud and waste. Several studies report, however, that these reforms may substantially reduce the already weak financial incentives to work for AFDC recipients, especially after four months when the $30 and one-third disregards expire. These studies, however, ignore the fact that those recipients considered employable would often not have a choice. If they could not get work in the private sector, they would have to work for their benefits under the workfare program or lose their eligibility for AFDC. This reform would reduce dependency on welfare, while encouraging attachment to the labor force for these people.

FOOD STAMPS

The food stamp program was originally created to provide for the nutritional needs of America's needy families. Spending on the program has risen sharply from $34 million in 1965 to nearly $11 billion in fiscal year 1981. Moreover, the food stamp program has been suffering financial problems which have required Congress to take emergency action for the past several years to provide funds beyond the original appropriation. The Administration has advanced several proposals to reduce payments by tightening eligibility standards so as to focus on the truly needy. The proposed reforms, to be discussed below, are expected to reduce the federal food stamp outlays by $2.3 billion in 1982.

The Administration's proposals would restrict eligibility to a gross income limit at 130 percent of the poverty level, which is about $11,000 a year for a family of four. Setting eligibility standards on the basis of gross, rather than net income, would remove families that have earnings well above the poverty level. The earned income deduction of 20 percent would be retained. This enhances work incentives by partially offsetting both increased taxes as well as the higher implicit marginal tax rates imposed by the loss of welfare benefits associated with increased income. The net result may be a reduced dependence on public assistance.

The Administration proposes to eliminate the overlap between the food stamp and free lunch programs. Currently, food stamp allotments are provided to pay for three meals a day. The Congressional Budget Office estimates that about 6.8 million students whose families already receive food stamps on their behalf are also benefitting from free school lunches.[12] As a result, these

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[12] See <u>Congressional Record</u>, February 5, 1981, p. E405.

children are being subsidized for four, rather than three, meals each school day. Food stamp allotments would be adjusted for households with students in primary and secondary schools to avoid overcompensation in this manner.

Furthermore, the Administration proposes to determine eligibility by household income in the prior period, rather than leaving states with the option to base eligibility on either the household's anticipated future income or the prior month's income. The proposal would reduce excessive costs resulting from fraud and miscalculations associated with the former choice.

When a recipient is awarded food stamps for the first time, the allotment would also reflect the portion of the month for which assistance is actually needed by pro-rating his benefits rather than providing them for the full month. This would further reduce problems with overcompensation.

The Administration also proposes to repeal provisions that would allow the Secretary of Agriculture to estimate future price changes in calculating food stamp allotments and income deductions. Basing benefit payments on actual costs should be retained because the uncertainty involved in projecting food prices may lead to an overpayment of benefits. Moreover, the time lag is not uncommon in other indexed programs, including those for the poor. In addition, specialized deductions for 1982, added in recent amendments, would be repealed to ease administration and constrain misdirected benefits.

The Administration, however, would continue to exclude the value of in-kind payments from the definition of income. The exemption of such benefits is unnecessary and very costly because it overstates the true financial needs of many households. In effect, it allows more households to become eligible for greater benefits than otherwise necessary.

The Administration's proposals improve the cost-effectiveness of the food stamp program by targeting benefits more carefully. There are, however, still other reforms that could be enacted.

First, the purchase requirement, which was eliminated by Congress in 1977, should be restored. Under the purchase requirement, food stamp recipients would have to contribute some of their own money for food stamps representing a larger value. Currently, the food stamp program has become a generalized income transfer program, which allows recipient households to substitute their limited incomes for other nonfood purchases, some of which may be unnecessary in meeting basic needs. Requiring all but the very poorest food stamp beneficiaries to pay a portion of the costs would instill incentives to allocate their limited funds in a more efficient manner. In short, it would discourage the marginally needy from participating in the program.

Second, stricter eligibility restrictions should be placed on strikers and workers who have voluntarily quit their jobs without good cause. These people should not be subsidized at the expense of the taxpayer because they have voluntarily decided to pursue interests other than work.

Third, able-bodied recipients should be required to work for their benefits. Such a system as "workfare" would also discourage the marginally needy from applying for aid.

MEDICAID

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 how have 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.

Health care costs have risen alarmingly over the past fifteen years, thereby increasing the burden of maintaining programs such as Medicaid, the services of which themselves have been growing at a rate of more than 15 percent annually for the last five years. 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.[13] 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,

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13 M. Stanton Evans, "The Medical Nightmare," National Review, March 20, 1981, p. 294.

excessive costs will be imposed upon taxpayers and consumers of insurance. Furthermore, high federal matching rates for Medicaid give states incentives to raise benefit levels and ease eligibility requirements beyond levels necessary for adequate care. Eligibility errors alone account for an estimated $1.2 billion in overpayments annually.

To slow the rate of growth of Medicaid costs, the Administration proposes to cap open-ended federal expenditures as an interim measure until a long-range plan of comprehensive health reform can be developed to reduce accelerating cost inflation and improve Medicaid. These changes would be effected some time between 1983 and 1986. The level of federal expenditures would be reduced $100 million below the current base estimate for 1981, then allowed to increase by 5 percent in 1982, and would subsequently be increased by the rate of inflation as measured by the GNP deflator. Each state would retain its present relative share of total federal Medicaid spending. In addition, states would be given greater latitude in operating their own programs. This would allow them to modify their eligibility and benefit requirements to provide medical care in an improved and more cost-effective manner. These changes would save approximately $1 billion in 1982.

The proposed limiting of federal expenditures on Medicaid would encourage state adminstrators to reduce fraud, waste, and mismanagement. This goal would be enhanced by greater flexibility awarded the state to restructure their programs to meet the needs of their population in a more cost-effective manner.

The cap may not reduce inefficiency, but instead result in arbitrary cuts in coverage and services provided. In addition, inequities among states could be exacerbated because funding decisions would be based on past, rather than present, economic conditions. It is therefore important to note that the Administration views the proposed cap as only an interim measure until comprehensive reforms are developed.

PUBLIC SERVICE EMPLOYMENT

The public service employment (PSE) program is run by state and local governments under the Comprehensive Employment and Training Act (CETA). The program is financed by federal funds to help participants adjust to labor market conditions by providing them with temporary jobs (not to exceed 18 months). PSE was originally intended to provide low-income, structurally unemployed workers with training to prepare them for unsubsidized jobs in the private sector. During the 1974-75 recession, Congress expanded the role of the public jobs program by making it a counter-cyclical as well as counter-structural tool.

Because the program has been viewed as ineffective in achieving either goal, the Administration proposes to eliminate PSE by phasing out the two CETA programs that provide it with funds: Title II-D, which deals with structural unemployment, and Title VI, which addresses cyclical employment problems. This would be done by the end of 1981. Under the Adminstration's proposals, the Secretary of Labor would be directed to phase out both PSE programs by placing a freeze on hiring, and permitting those currently enrolled (about 300,000) to "continue in their jobs and be absorbed into the regular State and local government payroll, be placed in an unsubsidized job in the private sector, or have to seek employment elsewhere." Unemployment compensation, however, would be available to those who would lose their jobs. These actions would reduce outlays by $0.6 billion in 1981 and $3.6 billion in 1982.

Recent evidence suggests that PSE has been a poor counter-cyclical device. Title VI of CETA was originally enacted to use PSE employment as a measure to combat the high unemployment rates experienced during the 1974-75 recession. High levels of PSE employment, however, were only attained in 1977-78, when the unemployment rate had already fallen appreciably. In fact, shifts in the business cycle may be exacerbated if government policy cannot accurately coordinate PSE employment levels to meet the constantly changing economic conditions. In other words, it may not be possible to continuously create or destroy such jobs at will. Moreover, if PSE employment generates an artificial demand for the services they provide, it may make it increasingly difficult to reduce the number of these jobs in the future. If such a trend were to continue, it could result in an inefficient allocation of labor between the public and private sectors. This would be especially true if the PSE jobs were not aimed at providing for worker entry into subsequent unsubsidized employment.

Further, the job creation abilities of the PSE program are highly suspect. State and local governments may be using PSE funds to replace their own revenues to hire employees that would have been hired anyway. This phenomenon is called "fiscal substitution," and it further discredits PSE as an effective counter-cyclical instrument.

As a counter-structural tool, PSE jobs have an equally dismal record. Current training programs have been far more effective than PSE jobs in improving the employability of their participants. Only about one-third of the participants in PSE employment find jobs after leaving the program. Furthermore, the average cost of finding employment for a person from the PSE program is two to three times as great as under the training programs. This apparent failure can primarily be attributed to the "make-work" jobs the program creates. PSE jobs prepare participants for positions that often have no counterpart in unsubsidized employment. If such positions did exist, the market would have already created them. Furthermore, the easy availability of PSE employment may actually delay worker assimilation into long-term unsubsidized employment.

Proponents of PSE argue that the make-work and fiscal substitution concepts are "mutually contradictory." If PSE jobs are make-work and serve no useful purpose, then state and local governments would not have hired these individuals in the absence of federal funding. On the other hand, so the argument goes, if PSE workers are substituted for regular public employees, then they must be worthwhile. These beliefs, however, are not mutually contradictory at all: a proportion of all PSE employees may satisfy the make-work criteria, while another set may qualify for the fiscal substitution group. The sum of these two separate factions may make up most of the PSE enrollment.

Another argument advanced in support of public jobs is that elimination of the program would result in a curtailment of valuable community services. However, if these services are really important, then the public's demand for them would be revealed through the political process. Otherwise, the tax dollars spent on these projects would be considered to outweigh the benefits.

George Gilder asserts that each CETA job may actually destroy more than one private sector job for the poor.[14] To support this claim, he cites a GAO report that estimates the cost of creating a CETA job at over $20,000, including overhead expenses. This amount, it is noted, may be nearly double the cost of employment in small businesses, which tend to be labor intensive and would be the most likely source of hiring in the absence of a public jobs program. Moreover, eliminating PSE would reduce the tax burden on all businesses and restore greater competition in the labor market by paying wages commensurate with the value of work performed. Both effects would stimulate the economy in the direction of more real jobs creation in the private sector.

CONCLUSION

The Administration's proposed budget cuts are necessary and an important step in reducing uncontrolled growth of government spending. A recent nationwide poll conducted by Sindlinger and Company, Inc. for The Heritage Foundation revealed strong support for the Reagan economic program, particularly in the area of spending cuts. In fact, a substantial number of those polled believed that the Administration's proposed reduction in government spending was too low. Several programs now considered "untouchable" by the Administration often award large unearned benefits to recipients regardless of need. Social Security retirement benefits and Medicare, for example, were largely exempted from budget cuts because they provide assistance for the elderly. As a result, many of the beneficiaries of these programs

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[14] George Gilder, <u>Wealth and Poverty</u> (New York: Basic Books, Inc., 1981), p. 161.

may be be better off than the taxpayers financing them. For this reason, the Administration should extend its budget reform to these areas as well, while maintaining its present position of protecting the truly needy.

Implementing the spending reforms discussed in this paper — would eliminate many unintended and duplicative benefits without harming the truly needy. Moreover, these proposals would produce a more equitable and efficient allocation of resources. This would result in a stronger and more productive economy that would benefit all Americans.

Peter G. Germanis
Policy Analyst