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Report to the Chairman, Committee on Government Reform and Oversight, House of Representatives

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DEFICIT REDUCTION

Better Targeting Can Reduce Spending and Improve Programs and Services

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The Honorable William F. Clinger, Jr.
Chairman, Committee on
Government Reform and Oversight
House of Representatives

Dear Mr. Chairman:

You asked us to summarize previously issued GAO work suggesting better targeting of federal programs and services as a strategy for downsizing government. In previous reports,[1] we have identified instances in which individuals, organizations, and jurisdictions outside the population originally targeted for assistance have received program funds, service benefits, or tax subsidies. As agreed with your office, this letter presents examples illustrating better targeting in a wide range of federal programs and services and discusses targeting in general.

Results in Brief

Targeting is a promising approach to deficit reduction that can bring about both reduced spending as well as improved federal programs and services. When resources are poorly targeted, the federal government spends more money than needed to reach its intended audience and achieve program or service goals. Moreover, in a climate of large budget deficits, the inefficiencies resulting from poorly targeted programs and services have sometimes called into question the legitimacy of continuing these activities or maintaining them at their current levels.

The question of whether funding for particular programs should be reduced and the allocation of resources altered are issues for the Congress to decide. Regardless of the form increased targeting takes, some beneficiaries of federal programs will receive less funding and resources, while others could receive somewhat more. In some cases, increased targeting would be wholly consistent with stated legislative and program objectives. In other cases, however, the Congress would need to refocus these objectives to be consistent with how it wishes to shift resources.

As the Congress examines federal programs and considers how to meet its deficit reduction goals, our past work suggests many different kinds of

[1]See Addressing the Deficit: Budgetary Implications of Selected GAO Work for Fiscal Year 1996 (GAO/OCG-95-2, March 15, 1995) and Deficit Reduction: Opportunities to Address Long-Standing Government Performance Issues (GAO/T-OCG-95-6, September 13, 1995).

programs and services for which resources could be better targeted. Examples include the following:

- Formulas for grants to state and local governments, such as the Maternal and Child Health block grant formula, could be revised to better reflect differences in the fiscal capacity of recipient jurisdictions to fund the program from their own resources as well as differences in jurisdictions' needs for the program. If grant funding were reduced, this strategy could permit lower overall funding while simultaneously reallocating remaining grant funds more equitably.[2]
- Eligibility rules for federal benefit programs, such as the Market Promotion Program, could be altered to restrict or reduce benefits going to some groups or individuals without altering program or service objectives.
- Fees could be instituted for individuals, groups, and/or industries that directly consume certain kinds of government-provided, business-type services (for example, inspections, claims processing, or recreation). In addition, existing charges, such as those applied to private ski operators using federal land, could be increased in these business-type activities so that a greater portion of the activity costs are borne by the direct beneficiaries.
- Tax preferences, such as those given to state and local governments that issue industrial development bonds (IDBS), could be narrowed or eliminated by revising eligibility criteria and/or limiting the amount of the preference allowable.

Scope and Methodology

As agreed with your office, we limited our examination of targeting opportunities to our published work. To answer your questions about whether targeting can help the federal government downsize and to provide illustrative examples of a targeting strategy for deficit reduction, we updated information from our March 1995 report on the budgetary implications of our work.[3] At this date, the Congress is considering several of the options described in this report. Notwithstanding pending congressional actions, we included the options because they illustrate how

[2]An equitable allocation of federal assistance to state and local governments is promoted when grant formulas reflect three dimensions of need: (1) the number of people potentially eligible for services under a given grant program, (2) the cost of providing such services, and (3) the ability of state and local taxpayers to support the nonfederal share of financing such services. Funding formulas that reflect these three dimensions would promote an equitable allocation of federal resources in the sense that if all states imposed taxes at comparable rates, comparable services would be available to those with similar needs.

[3]GAO/OCG-95-2, March 15, 1995.

targeting can fit in an effective deficit reduction strategy. That report presents a deficit reduction framework consisting of three broad themes. The first focuses on reassessing the objectives of federal programs and services. Our premise is that periodically reconsidering a program's original purpose, the conditions under which it continues to operate, and its cost-effectiveness is appropriate. The second focuses on improved targeting of federal programs and services to beneficiaries. This theme concerns how efficiently federal programs and services reach their intended recipients. The third focuses on improving the efficiency of program and service delivery. This theme suggests that focusing on the approach or delivery method can significantly reduce spending or increase collections.

This letter expands on the second theme—improved targeting—as a strategy that allows for reducing the deficit while improving the design of federal government activities. We did this work in Washington, D.C., from August 1995 through October 1995.

Applying the Targeting Framework: Illustrative Examples

The following examples from our work illustrate potential opportunities to better target federal programs and services. Examples are detailed under one of four strategies for better targeting the intended beneficiaries: revise grant formulas, change eligibility rules, target fees and charges, and narrow tax preferences.

Revise Grant Formulas

At a time when federal domestic discretionary resources are constrained, better targeting of grant formulas offers a strategy to concentrate lower federal spending levels on states or localities with greater needs and lower capacity to absorb grant reductions. Through this process, federal funding reductions would fall more heavily on those communities with lesser relative needs and with greatest fiscal capacity to finance services from their own revenue base. We have issued many reports over the past decade showing that the allocation of federal grants to state and local governments is not well targeted. This work has been confirmed by many economic analyses from other sources.[4] As a result, program recipients in areas with relatively lower needs and greater wealth received a higher level of services than those available in harder pressed areas, or wealthier areas were able to provide the same level of services at lower tax rates.

[4]See, for example, Federal-State-Local Fiscal Relations, U.S. Treasury Department, Office of State and Local Finance, (Washington, D.C.: 1985).

Reductions in federal grants to states could be targeted by adjusting the allocation formulas to concentrate funding on those states with relatively lesser fiscal capacities and greater needs. Similarly, reductions in federal grants to local governments could be targeted by either concentrating cuts on areas with the strongest tax bases or by changing program eligibility to restrict grant funding in places with high fiscal capacity and/or few programmatic needs.

Maternal and Child Health Services Block Grants

For example, in 1992 we reported that Maternal and Child Health (MCH) Services block grants could be allocated more equitably.[5] This program was designed to secure basic health care for low-income and moderate-income expectant mothers, their infants, and children with special health care needs. However, our report concluded that the allocation method for distributing MCH grants to states ran counter to the equity standards we developed. We found that while the number of children at risk, the costs of providing maternal and child health services, and the states' ability to pay for these services varied from state to state, the current MCH allocation method did not consider these factors. As a result, Louisiana—with the second highest proportion of children at risk and average service costs—ranked 14th in per capita grant funding. Similarly, at the time of our analysis, Kansas and Illinois received nearly equal per capita grants, even though Illinois had about 28 percent higher health care costs. In practical terms, this meant that Illinois consumers had to spend more money than Kansans to buy the same MCH services.

We concluded that a new MCH allocation method that strikes a balance between each state's (1) need adjusted for costs and (2) ability to pay could substantially improve the overall equity of the MCH program. Federal spending for the MCH program reached a reported $687 million in fiscal year 1994. If overall funding for this program were reduced, such a new allocation method could help target the remaining MCH program funds more equitably.

Medicaid Program Formula

In another example, we found that the Medicaid program formula does not target most federal funds to states with weak tax bases and high concentrations of poor people.[6] In 1990, we reported that while the program covered 75 percent of those below the poverty line nationwide, the coverage varied from 37 percent in Idaho to 111 percent in Michigan.

[5] Maternal and Child Health: Block Grant Funds Should Be Distributed More Equitably (GAO/HRD-92-5, April 2, 1992).

[6] Medicaid Formula: Fairness Could Be Improved (GAO/T-HRD-91-5, December 7, 1990) and Medicaid: Alternatives for Improving the Distribution of Funds to States (GAO/HRD-93-112FS, August 20, 1993).

We suggested that a formula using better indicators of states' financing capacities and poverty rates coupled with a reduced minimum federal share would more equitably distribute the burden state taxpayers face in financing Medicaid benefits for low-income residents in their respective states.

Federal spending for Medicaid in fiscal year 1994 reached a reported $82 billion, and the Office of Management and Budget (OMB) projects spending to reach $136.5 billion by fiscal year 2000. Should the Congress act to reduce federal Medicaid spending, a revised grant allocation system could help target the reduced funding more equitably. Along these lines, a block grant that the Congressional Budget Office (CBO) estimated would reduce federal Medicaid spending by $163 billion over the next 7 years was included in the recently passed Balanced Budget Act of 1995. Under this proposal future Medicaid costs would be reduced and equity in the distribution of the remaining funding would be improved because the allocation formula uses new factors that more precisely measure differences in states' fiscal capacity and poverty levels.

Title I Grants to Local Educational Agencies

In another example, Title I grants to local educational agencies (LEAS), which fund supplementary education services for low achievers in poverty areas, could be modified to improve targeting among counties. Under these grants, formerly known as Chapter 1 grants, school districts have broad discretionary powers to determine how resources are distributed to schools, specifying the grades served and the type and extent of services, and defining which students are low achievers. In 1992, we reported that these factors resulted in considerable variation among students who receive Title I LEA services.[7] For example, in some school districts Title I LEA funds served only children scoring below the 20th percentile on standardized tests. In other districts, program funds served some children scoring above the national average (the 50th percentile).

We found that the legislatively mandated formula for Title I LEA grants did not (1) accurately reflect the distribution of poverty-related low achievers, (2) provide extra assistance to areas with relatively less ability to fund remedial education services, or (3) adequately reflect differences in local costs of providing education services. We concluded that modifications to the Title I LEA allocation method could target more funds to counties with the largest numbers of poverty-related low achievers and those least able to finance remedial instruction.

[7] Remedial Education: Modifying Chapter 1 Formula Would Target More Funds to Those Most in Need (GAO/HRD-92-16, July 28, 1992).

Federal funding for Title I grants to local educational agencies reached a reported $6.3 billion in fiscal year 1994. If the Congress decides to reduce funding for these grants, a revised formula could better target Title I LEA grants to those counties with the greatest overall need. The formula could be revised to rely on a more precise method of estimating the number of poverty-related low achievers, use an income adjustment factor to grant additional assistance to areas least capable of financing remedial instruction, and employ a uniform measure of educational services costs that recognizes differences within and between states.

Change Eligibility Rules

Changing eligibility rules to better target the intended beneficiaries of federal programs offers another strategy that can allow for deficit reduction by concentrating reductions on beneficiaries with little demonstrable need for government assistance. We have issued many reports in recent years showing that programs could be better targeted to more cost-effectively address those beneficiaries most in need.

Vaccines for Children Program

For example, we found that the Vaccines for Children (VFC) Program is not well targeted.[8] This program was created to improve immunization rates for measles, mumps, rubella, and other childhood diseases by lowering the cost of immunization for all children. However, we found that most children had already been immunized because cost was not a significant barrier and that a disproportionate number of children in underserved areas were not immunized. We suggested that the Congress consider targeting the program. Services could be improved by directing VFC funds to children in those particular geographic areas where underimmunization has been a persistent problem. Fiscal year 1995 costs for the childhood vaccine program were estimated at about $450 million.

Market Promotion Program

Based on our examinations of the Market Promotion Program (MPP), we believe that the program's eligibility rules could be tightened to provide support to small, generic, new-to-export companies, but not to large companies with substantial corporate advertising budgets.[9] The MPP uses federal funds to subsidize efforts to expand export markets for U.S. agricultural products by financing such activities as advertising and consumer promotions. From 1986 through 1994, about one-third of MPP funds and those of its predecessor program (the Targeted Export

[8]Vaccines for Children: Reexamination of Program Goals and Implementation Needed to Ensure Vaccination (GAO/PEMD-95-22, June 15, 1995).

[9]International Trade: Changes Needed to Improve Effectiveness of the Market Promotion Program (GAO/GGD-93-125, July 7, 1993).

Assistance (TEA) program) supported private for-profit companies' brand-name promotions. These companies included many large for-profit businesses with substantial corporate advertising budgets, such as Sunkist Growers and E.J. Gallo Winery. In fiscal year 1995, MPP funding was reduced to $84.5 million from the budgeted level of $110 million.

Eligibility rules could be revised to ensure that MPP funds are supporting additional promotional activities rather than simply replacing company or industry funds. While large firms receive MPP funds to increase exports of U.S. agricultural products, the resources otherwise available to such firms may indicate that they have no demonstrable need for government assistance.

Crop Price Supports

Our reviews of U.S. Department of Agriculture crop price supports show that the program's eligibility rules allow producers to avoid payment limits and reduced program payments.[10] These income support payments, known as deficiency payments, are the principal payments made to producers who participate in farm programs for wheat, feed grains, cotton, and rice. The payments are designed to protect producers' incomes when crop prices fall below a legally established target price. The Food Security Act of 1985 limited the payments for those commodities to $50,000 per person annually. For the act's purposes, a person is broadly defined as an individual, an entity (such as a corporation, limited partnership, association, trust, or estate), or a member of a joint operation (such as a general partnership or joint venture). Despite reforms made by the Congress in 1987, producers have avoided the payment limit by reorganizing their farming operations to include additional persons.

According to OMB, deficiency payments amounted to $6.4 billion in fiscal year 1994. One option to further tighten payment limits as a means to reduce program costs would be to change eligibility rules to limit payments to $50,000 per individual and only provide benefits to individuals actively engaged in farming.

Veterans Disability Compensation

In another example, narrowing eligibility rules for veterans disability compensation could generate savings without affecting veterans who suffered disabilities as a result of military service. In 1994, CBO reported that about 250,000 veterans were receiving about $1.5 billion annually in Department of Veterans Affairs (VA) compensation for diseases neither caused nor aggravated by military service. Our study of five other

[10] Agriculture Payments: Number of Individuals Receiving 1990 Deficiency Payments and the Amounts (GAO/RCED-92-163FS, April 27, 1992) and Agriculture Payments: Effectiveness of Efforts to Reduce Farm Payments Has Been Limited (GAO/RCED-92-2, December 5, 1991).

countries' veterans programs shows that they do not compensate veterans under these circumstances.[11] Dollar savings could be achieved by targeting disability benefits more narrowly, as is done by other countries.

Target Fees and Charges to Beneficiaries for Business-type Government Activities

Adjusting fees and charges to the beneficiaries of some business-type federal programs and services offers a third targeting strategy to reduce the deficit. Fees exist for many services provided by the federal government, including customs and other inspections, use of recreation and other facilities, and mail delivery. However, in many cases, the direct beneficiaries of these kinds of governmental activities contribute little to support the program or administrative costs of the activity. As a result, the programs and services are often overused and/or under-provided, and money must be found elsewhere in the budget to make up the difference between administrative costs and beneficiary charges.

Child Support Enforcement Program

For example, although many beneficiaries of the Child Support Enforcement Program have higher incomes than the population originally envisioned to be served by this program they pay relatively little to support the program's administrative costs. The Congress created the Child Support Enforcement Program in 1975 to strengthen state and local efforts to obtain child support for both families eligible for Aid to Families with Dependent Children (AFDC) and non-AFDC families. Child support enforcement services were made available to non-AFDC individuals because it was believed that many families might not have to apply for welfare if they had adequate assistance in obtaining the support due from the noncustodial parent.

In 1994, the program collected a reported $7.3 billion for 8.2 million non-AFDC clients. Bureau of the Census data for 1991 showed that about 65 percent of the individuals requesting non-AFDC child support enforcement services in that year had family incomes, excluding any child support received, exceeding 150 percent of the federal poverty level. Because states have exercised their discretion to charge only minimal application and service fees, they are doing little to recover the federal government's 66-percent share of program costs. In fiscal year 1994, state fee practices returned $33 million of the reported $1.1 billion spent to provide non-AFDC services. Rising non-AFDC caseloads and new program requirements could lead to administrative costs exceeding $1.6 billion by fiscal year 2000, with very little offset from those benefiting from the services.

[11] Disabled Veterans Programs: U.S. Eligibility and Benefit Types Compared With Five Other Countries (GAO/HRD-94-6, November 24, 1993).

We have reported and testified on opportunities to defray some of the costs of child support programs.[12] Based on this work, we believe that mandatory application fees should be dropped and that states should charge a minimum percentage service fee on successful collections for non-AFDC families. Under this proposal, non-AFDC beneficiaries would pay an increased share of the costs of administering this program.

Veterans' Long-term Care

As a second example, veterans' long-term care costs could be reduced and comparability among retirees increased if veterans' copayments for these services were increased. All veterans with a medical need for nursing home care are eligible to receive such care in VA and community facilities to the extent that space and resources are available. VA is required to collect a fee, commonly known as a copayment, from certain veterans with nonservice-connected problems and incomes above a designated level. Nursing home care is free for other veterans who receive care in VA or contract community nursing homes. By contrast, we found that state veterans' homes recovered as much as 50 percent of the costs of operating their facilities through charges to veterans receiving services.[13] Similarly, through estate recoveries during the 12 months ending June 30, 1992, Oregon recovered about 13 percent of the costs of nursing home care provided under its Medicaid program. However, in fiscal year 1990, the VA offset less than one-tenth of 1 percent of its costs through beneficiary copayments.

OMB reported that in fiscal year 1994, VA's operating expenses were about $1.7 billion to provide nursing home and domiciliary care to veterans. The Congress may wish to consider increasing cost sharing for VA nursing home care by adopting cost-sharing requirements similar to those imposed by most state veterans' homes and by implementing an estate recovery program similar to those operated by many states under their Medicaid programs. The potential for recoveries appears to be greater within the VA system than under Medicaid. Home ownership is significantly higher among VA hospital users than among Medicaid nursing home recipients, and veterans living in VA nursing homes generally contribute less toward the cost of their care than do Medicaid recipients, allowing veterans to build larger estates.

[12] Child Support Enforcement: Opportunity to Defray Burgeoning Federal and State Non-AFDC Costs (GAO/HRD-92-91, June 5, 1992) and Child Support Enforcement: Opportunity to Reduce Federal and State Costs (GAO/T-HEHS-95-181, June 13, 1995).

[13] VA Health Care: Offsetting Long-Term Care Costs by Adopting State Copayment Practices (GAO/HRD-92-96, August 12, 1992).

Ski Fee System

In another example, we found that the current ski fee system does not ensure that the Forest Service receives fair market value for the use of its land.[14] In 1991, privately owned ski areas operating on Forest Service land—such as those in Vail, Colorado; Jackson Hole, Wyoming; and Taos, New Mexico—generated $737 million in gross sales. After making adjustments reflecting the revenues generated from federal land, these areas paid about $13.5 million, or about 2.2 percent of the total revenues generated, in fees to the government. When the Forest Service ski fee system was developed in 1965, the rates were to be adjusted periodically to reflect changes in economic conditions for these business-type operations. However, the rates by which fees are calculated have not been updated since the fee system was developed.

Narrow Tax Preferences

Changing eligibility rules for tax preferences offers a fourth targeting strategy to reduce the federal budget deficit. While tax expenditures can be a valid means for achieving certain federal objectives, studies by GAO and others have raised concerns about the effectiveness, efficiency, and equity of some tax expenditures. As with poorly targeted fees, poorly targeted tax preferences often lead to overutilization by beneficiaries and reduced revenues that either add to the deficit or must be made up elsewhere in the budget.

Industrial Development Bonds

For example, tax-exempt industrial development bonds (IDBS) are poorly targeted. IDBS are issued by state and local governments to finance the creation or expansion of manufacturing facilities to create new jobs or to promote start-up companies or companies in economically distressed areas. However, in a review of IDB-funded projects, we found that only about one-fourth of the projects were located in economically distressed areas.[15] We also found that the job creation benefits attributed to IDBS would likely have occurred anyway. In addition, most developers contacted said that they would have proceeded with their projects without IDBS. Moreover, few companies obtaining tax subsidized financing were start-up companies. OMB estimated that revenue loss due to the tax exempt status of small issue IDBS reached $690 million in fiscal year 1994.

Qualified Mortgage Bonds

Similarly, we found that achievement of public benefits from qualified mortgage bonds (QMBS) is questionable. We found that QMBS did little to

[14] Forest Service: Little Assurance That Fair Market Value Fees Are Collected From Ski Areas (GAO/RCED-93-107, April 16, 1993).

[15] Industrial Development Bonds: Achievement of Public Benefits Is Unclear (GAO/RCED-93-106, April 22, 1993).

increase home ownership, were usually provided to home buyers who did not need them to obtain a conventional (unassisted) mortgage loan, and were not cost-effective.[16] OMB estimated that revenue loss due to the tax-exempt status of QMBs amounted to $1.76 billion in fiscal year 1994.

Both IDBs and QMBs could be better targeted. For example, IDBs could be focused on economically distressed areas or start-up companies, and QMBs could be directed toward home buyers who could not reasonably qualify for unassisted conventional loans.

Tax Treatment of Health Insurance

In another example, the current tax treatment of health insurance gives few incentives to workers to economize on purchasing health insurance.[17] Some analysts believe that the tax-preferred status of these benefits has contributed to the overuse of health care services and large increases in our nation's health care costs. Improved targeting for this subsidy could play a role in reducing the associated revenue losses and improving the efficiency of the nation's health care system.

Targeting is a viable approach because higher income employees are more likely to have health care coverage and, because they pay higher marginal tax rates than low-income earners, the tax benefits from employer-provided health benefits are greater for high-wage earners. The Department of the Treasury estimated that revenue loss due to the tax-exempt status of employer-provided health insurance amounted to $33.5 billion in fiscal year 1992. An option to better target this tax preference would be to place a cap on the dollar amount of health insurance premiums that could be excluded from income. Including in a worker's income the dollar amount over the cap could improve the efficiency of the health care system and, to a lesser extent, tax equity. Alternatively, including health insurance premiums in income but allowing a tax credit for some percentage of the premium would improve equity since tax savings per dollar of premium would be the same for all taxpayers, irrespective of the tax brackets.

[16] Home Ownership: Limiting Mortgage Assistance Provided to Owners With High-Income Growth (GAO/RCED-90-117, September 26, 1990).

[17] Tax Policy: Effects of Changing the Tax Treatment of Fringe Benefits (GAO/GGD-92-43, April 7, 1992).

Targeting Can Allow for Deficit Reduction While Improving Programs and Services

As the examples from our published work show, more effective targeting is one of several available approaches that can allow for reducing spending while improving federal programs and services. Programs and services, such as grants to states to provide health care for low- and moderate-income individuals or export promotion support for emerging firms, are created due to some perception of eligibility and/or need. In these instances, individuals, organizations, or jurisdictions outside the original targeted population—that is, populations with a greater capacity to provide the program or service from their own resources or having fewer needs—have received program funds, services, or tax subsidies. This poor targeting may have occurred because grant formulas or eligibility rules were constructed too broadly or fees did not fully reflect beneficiaries' capacity to offset program costs. In other instances, the circumstances creating a need for the program or service may have changed.

The end result of poor targeting is that the federal government spends more money than needed to reach the intended beneficiaries and achieve its program or service goals. Moreover, in a climate of continuing large budget deficits, the inefficiencies resulting from poorly targeted programs and services have sometimes called into question the legitimacy of continuing these activities or maintaining them at their current levels.

In many instances, broad support remains for the objectives of poorly targeted programs and services. In these areas, better targeting can increase the efficiency and effectiveness of the program or service while allowing for program reductions. In other cases, poor targeting raises fundamental questions about the program's or service's merit and/or feasibility. In these circumstances, decisionmakers may want to consider whether the program or service should be eliminated.

We are sending copies of this report to the Ranking Minority Member of the House Committee on Government Reform and Oversight. Copies will be available to others upon request. Major contributors to this report were

Margaret T. Wrightson, Assistant Director, and Timothy L. Minelli, Senior Evaluator. Please contact me at (202) 512-9573 if you or your staff have any questions concerning the report.

Sincerely yours,

Paul L. Posner

Paul L. Posner
Director, Budget Issues

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