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Reducing Entitlement Spending

REDUCING ENTITLEMENT SPENDING

The Congress of the United States
Congressional Budget Office

NOTE

Numbers in the tables and text of this report may not sum to totals because of rounding.

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Preface

This study analyzes three ways to realize budgetary savings by taxing or reducing benefits from entitlement programs considered as a group, rather than reducing benefits program by program. The Congressional Budget Office (CBO) prepared the study in response to requests from Members of Congress and others for an elaboration of the analysis presented on this subject in CBO's March 1994 volume *Reducing the Deficit: Spending and Revenue Options*. The study also examines the current distribution among family income groups of benefits from 11 major entitlement programs, in response to a request from Senator Alan K. Simpson and eight other Senators for information on current payments to individuals and families under these entitlements.

The specific options considered are taxing all entitlement benefits under the federal individual income tax, reducing benefits provided to middle- and high-income families, and denying benefits to families with the highest incomes. For each option, the study estimates budgetary savings and the distributional impact on families; it also discusses issues that would affect the options' administration and effectiveness. In accordance with CBO's mandate to provide objective and impartial analysis, this study contains no recommendations.

Roberton Williams of CBO's Tax Analysis Division wrote the study under the direction of Rosemary Marcuss and Frank Sammartino. Paul Cullinan of the Budget Analysis Division helped write the first draft of the study. Richard Kasten assisted in developing the microsimulation model used to analyze the policy options. Roger Hitchner of the Natural Resources and Commerce Division drafted the discussion of agricultural subsidies. Many other CBO staff members provided comments including Robert Dennis, Nancy Gordon, Mark Musell, Neil Singer, Ralph Smith, David Torregrosa, and David Weiner. Eugene Steuerle and Patricia Ruggles offered useful comments on a late draft.

Leah Mazade edited the manuscript, and Christian Spoor provided editorial help during the production process. Simone Thomas produced drafts of the study. Martina Wojak-Piotrow prepared the study for publication.

Robert D. Reischauer
Director

September 1994

Contents

	SUMMARY	ix
ONE	INTRODUCTION	1
	The Major Entitlement Programs *2* Approaches to Reducing Entitlement Spending *4*	
TWO	THE MAJOR ENTITLEMENTS: WHO GETS THEM AND SHOULD THEY BE MEANS-TESTED?	7
	Cash Social Insurance Programs *7* Federal Civilian and Military Retirement Programs *16* Means-Tested Income Support Programs *20* Government-Sponsored Health Insurance *25* The Distribution of All Entitlement Benefits *29*	
THREE	OPTIONS FOR CURTAILING ENTITLEMENTS AND THEIR EFFECTS ON THE BUDGET	31
	Make Entitlements Subject to the Individual Income Tax *31* Reduce Entitlements for Middle- and High-Income Recipients *34* Deny Entitlements to High-Income Recipients *36*	
FOUR	DISTRIBUTIONAL EFFECTS	39
	Effects on Different Types of Families *40* Effects Among Programs *41*	
FIVE	IMPLEMENTING A GLOBAL MEANS TEST	47
	Administering Agency *47* Should a Means Test Be Prospective or Retrospective? *49* Type of Unit *50* Measuring Resources *51* Taxing or Reducing In-Kind Benefits *52* Rate of Benefit Reduction *53*	
SIX	COMPARING THE POLICY OPTIONS	55

APPENDIXES

A Calculating Budgetary Savings and Distributional Effects *61*

B Budgetary Savings and Distributional Effects of Options with Equivalent Budgetary Savings *63*

TABLES

S-1. Recipient Families by Income and Type, 1990 x

S-2. Estimated Gains in Revenues and Reductions in Spending Under Three Policy Options to Cut Net Entitlement Costs, Fiscal Years 1995-1999 xiii

S-3. Distribution of Losses of Benefits Among Recipient Families Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type xiv

1. CBO Baseline Projections of Mandatory Federal Spending by Program, Fiscal Years 1993 and 1999 3

2. Average Social Security and Railroad Retirement Benefits per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990 9

3. Percentage of Families Receiving Cash Benefits, Average Benefits per Family, and Benefits as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990 10

4. Average Unemployment Compensation per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990 14

5. Percentage of Families Receiving Federal Civilian and Military Pensions, Average Pension per Recipient Family, and Pensions as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990 17

6. Average Federal Civilian and Military Pensions per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990 19

7. Percentage of Families Receiving Means-Tested Benefits, Average Benefits per Recipient Family, and Benefits as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990 22

8.	Percentage of Families Receiving the Earned Income Tax Credit, Average Credit per Recipient Family, and Credit as a Percentage of Family Income, by Family Income and Type, 1990	24
9.	Percentage of Families Receiving Health Benefits, Average Value per Recipient Family, and Benefits as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990	26
10.	Characteristics of Families Receiving Entitlement Benefits, by Family Income and Type, 1990	28
11.	Additional Federal Revenues from Broadening Taxable Income to Include Entitlements, Fiscal Years 1995-1999	33
12.	Budgetary Savings from Reducing Entitlement Benefits for Middle- and High-Income Recipients, Fiscal Years 1995-1999	36
13.	Budgetary Savings from Denying Entitlement Benefits to High-Income Recipients, Fiscal Years 1995-1999	37
14.	Percentage of Recipient Families Losing Benefits Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type	40
15.	Distribution of Budgetary Savings Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type	41
16.	Percentage of Average Benefits Lost by Families Losing Benefits Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type	42
17.	How Three Policy Options to Cut Net Entitlement Costs Affect the Benefits Lost by Recipient Families, by Program	44
18.	Comparing the Effects of Three Policy Options to Cut Net Entitlement Costs	56
B-1.	Estimated Gains in Revenues and Reductions in Spending Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, Fiscal Years 1995-1999	66
B-2.	Percentage of Recipient Families Losing Benefits Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, by Family Income and Type	67
B-3.	Distribution of Budgetary Savings Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, by Family Income and Type	68

B-4. Average Percentage of Benefits Lost by Families Losing Benefits Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, by Family Income and Type 69

B-5. How Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs Affect the Benefits Lost by Recipient Families, by Program 70

FIGURE

1. Components of Federal Spending as a Percentage of Gross Domestic Product, 1962-2004 1

BOX

1. Measuring the Distribution of Entitlements 8

Summary

Current projections for the federal budget deficit in the near future show it falling to its lowest level in several years. But the prospects over the longer term are less rosy: if present programs continue as they are, the deficit will begin to rise again toward the end of the decade and reach record levels soon after the turn of the century. As a large and growing share of the budget, spending for entitlement programs is a major contributor to that surge.

To help limit the projected rise in the deficit, some Members of Congress and concerned commentators have proposed scaling back entitlement benefits--specifically, by denying payments (or a share of them) to recipients based strictly on the amount of their incomes. This approach, known as means-testing, has several pluses: straightforward interpretation, simplicity of design, apparent ease of administration, and some political appeal. A related approach, that of considering more benefits as income for tax purposes, has the added advantages of broadening--and therefore improving--the definition of income for purposes of the income tax, and being even easier to administer.

This study examines several ways to means-test entitlements. It describes who gets entitlement benefits, why those people have been designated as beneficiaries, and how alternative approaches to means-testing are likely to affect them. The analysis suggests that several popularly promoted approaches are neither as simple as they appear nor obviously preferable to alternatives in terms of equity.

How Much Is Spent on Entitlements?

Mandatory federal spending for entitlement programs totaled more than $750 billion in 1993--more than half of the federal budget and up from 30 percent three decades earlier. Outlays for entitlements are projected to grow more than 3 percent faster than the rate of inflation each year for the foreseeable future. By 2004, assuming that present budgetary policy remains in place, entitlements will account for nearly two-thirds of federal spending. The aging of the baby-boom generation will continue to drive that share higher over succeeding decades.

This rapid growth has caused mandatory spending to consume a growing share of the country's output. Since 1962, spending for entitlements as a percentage of gross domestic product has doubled from 6 percent to 12 percent and will exceed 14 percent by early in the next century.

Given the size and growth of entitlement spending, substantial reduction of the nation's budget deficit will almost certainly require bringing that spending under control. Limiting eligibility or reducing benefits program by program is, of course, always an option. But that approach would be both time-consuming and politically difficult. In addition, it could have an uneven impact on recipients, particularly those who receive

benefits from more than one program. A "global" approach, such as making more entitlements subject to federal income taxes or reducing or denying benefits from combinations of programs to recipients with high incomes, is also possible. This study examines several global approaches.

What Are the Major Entitlement Programs?

Entitlements can be grouped into four major categories. About half of all entitlement spending goes to *cash social insurance programs*, which include Social Security, Railroad Retirement, unemployment compensation, veterans' compensation and pensions, and agricultural price supports. (Veterans' pensions are, in fact, means-tested benefits. They are combined here with veterans' compensation because available data do not distinguish between the two programs.) Social Security is by far the largest of these programs, accounting for four-fifths of total outlays in this category.

Just under one-third of the nation's spending for entitlements pays for two *government health insurance programs*--Medicare for elderly and disabled people and Medicaid for the poor. About one-tenth of outlays finance *government pensions* for retired civilian and military employees. Another tenth funds four *means-tested assistance programs* that are designed to aid

Summary Table 1.
Recipient Families by Income and Type, 1990

Family Category	Percentage of All Families	Percentage of Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Percentage of All Benefits
All Families	100	49	10,320	100
Income (1990 dollars)[a]				
1 to 29,999	57	58	9,590	63
30,000 to 99,999	39	37	11,710	33
100,000 or more	4	31	15,220	4
Type[b]				
With children	34	39	8,200	22
Elderly	21	98	13,970	58
Other	45	32	6,930	20

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, the outlay portion of the earned income tax credit, Medicare, Medicaid, and federal civilian and military pensions. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

poor people: Supplemental Security Income (SSI) for the elderly and disabled, Aid to Families with Dependent Children (AFDC), the Food Stamp program, and the refundable portion of the earned income tax credit (EITC).

Of these programs, the Congressional Budget Office (CBO) projects that expenditures for health programs and the EITC will grow most rapidly in the near future. Over the next five years, Medicare and Medicaid costs will rise about 8 percent annually in real terms (after adjusting for inflation) because of rapid inflation in health care costs and growing numbers of participants. Changes made in the Omnibus Budget Reconciliation Act of 1993 will cause spending for the EITC to increase nearly 13 percent annually after adjusting for inflation, but outlays for that program will flatten out by the turn of the century.

Who Gets Entitlements?

In 1990, nearly half of all families in this country received benefits from one or more of 11 major entitlement programs. For recipient families, the value of these benefits averaged about $10,300 (see Summary Table 1). Because nearly all people over age 65 qualify for Medicare and Social Security, participation in those programs was highest among the elderly; 98 percent received benefits averaging almost $14,000. As a result, almost three-fifths of all entitlement spending went to families who included at least one member age 65 or older.

About 40 percent of families with children received average benefits of roughly $8,200, and about one-third of nonelderly childless families got entitlements averaging just under $7,000. One-fifth of total spending for entitlements went to each of these two groups of families.

Families at the bottom end of the income distribution (low-income families) are more likely to receive entitlements than their wealthier counterparts, but average benefits rise with recipients' incomes. Three-fifths of families with incomes below $30,000 received benefits from at least one entitlement in 1990 averaging about $9,600. In contrast, one-third of families with incomes above $100,000 got benefits that averaged around $15,000. In other words, a larger share of low-income than high-income families received benefits but got smaller benefits than higher-income recipients. The net result of these two factors was a distribution of total benefits among categories of income that roughly mirrored the distribution of families among those categories. For example, families with incomes below $30,000 constituted just under 60 percent of all families and received just over 60 percent of all entitlements (see Summary Table 1).

Approaches to Reducing Entitlement Spending

To reduce spending for entitlements requires cutting the amount of benefits they pay or limiting the number of people who receive them. Such reductions could apply to individual programs--changes made in recent years have taken that approach. Or the cuts could be more global, using some sort of means test to limit spending for most or all programs. Alternatively, the Congress could cut net spending for entitlements indirectly by taxing benefits and thus increasing revenues.

Over the past 15 years, the Congress has limited spending for particular entitlements by reducing cost-of-living adjustments, holding down payments to providers of medical care, and restricting eligibility for benefits. Current legislative proposals would continue this trend by reducing the levels of benefits for future recipients of Social Security and lowering Medicare and Medicaid reimbursement rates for hospitals and medical care providers. Changing individual programs, however, requires considerable time and substantial effort to achieve consensus.

Another approach to curbing the net cost of entitlements would be to broaden the definition of taxable income in the federal individual income tax to include more entitlement benefits. Unemployment compensation and that part of government pensions that exceeds workers' contributions are already fully subject to income taxes, as are part of Social Security benefits for middle- and high-income recipients.

On the one hand, expanding the definition of taxable income to include all entitlements could improve the equity of the income tax by treating income from entitlements like private-sector income. On the other hand, if the Congress set levels of benefits under the assumption that entitlements would not be taxed, subjecting them to taxes could reduce the net benefits that a person receives below what the Congress has deemed appropriate.

A second global approach to reducing entitlements would employ some sort of means test to limit or deny benefits to people with high incomes. Such cuts would impose the costs of this approach to reducing the deficit on those most able to bear them. They would also curtail total payments to people who are receiving benefits from more than one program. This approach might solve the problem of burgeoning entitlements more directly than cuts in individual programs. Nevertheless, it could also keep the programs from achieving the specific goals that they were created to meet.

Which recipients lost benefits would depend on the level of income at which cuts began and the rate at which benefits were taken away as income rose. Setting "thresholds" for those actions at higher levels of income would exempt more current recipients from cuts; reducing benefits at rates that rose more gradually with income or that were limited to less than 100 percent would protect a larger share of benefits. The more benefits are shielded from cuts, however, the smaller will be the budgetary savings.

Budgetary and Distributional Effects of Alternative Policy Options

CBO analysts simulated three specific policy options to show the budgetary savings that taxing or means-testing entitlements might generate. The options that were examined approximate proposals put forth to address the problem of surging entitlement spending. Modifications to each option could raise or lower its budgetary savings.

Make Entitlements Subject to Federal Individual Income Taxes

The first option would tax benefits that were not attributable to the past contributions of recipients. Entitlement payments subject to federal income taxes under the option would comprise 85 percent of all Social Security and Railroad Retirement benefits, 85 percent of the insurance value of Medicare hospital benefits, the full insurance value of Medicare Supplementary Medical Insurance less any premiums paid, the face value of food stamps, the insurance value of Medicaid, and the full benefits paid for veterans' compensation and pensions, AFDC, and SSI. (The insurance value of Medicare or Medicaid equals the total cost of the program divided by the number of people participating. Counting only 85 percent of Social Security, Railroad Retirement, and Medicare hospital benefits recognizes that recipients paid taxes during their working years to finance part of their benefits. As noted above, unemployment compensation and federal civilian and military pensions exceeding workers' contributions are already fully taxable.)

If this option was implemented for the 1995 tax year, it would generate $18 billion of additional revenues in fiscal year 1995 and $258 billion over five years (see Summary Table 2). More than five-sixths of the additional revenues would come from Social Security and Medicare recipients.

The additional taxes from making more entitlements taxable would average 10 percent of benefits for nearly two-thirds of the families who receive entitlements (see Summary Table 3). Five out of six elderly recipients would pay higher taxes, compared with just one-third of recipient families with children. (The difference in those latter proportions reflects two facts: almost all elderly people receive substantial amounts of entitlements, and families with children who get benefits are most likely to be poor and to be getting means-tested assistance--and therefore unlikely to owe taxes.) Of the additional tax revenues, almost half would come from families with incomes under $30,000. Nearly three-fourths would come from elderly recipients.

Four modifications to the tax option could change both the revenues that the government gained from it and the way the added taxes were distributed among families of various incomes.

- o Excluding a base amount of entitlements for all taxpayers would protect the poorest families from owing taxes (that they might not be able to pay) on those benefits. It would also, however, fully shield high-income families whose benefits fell below that base amount.

- o Establishing a threshold for family income before any entitlements became taxable would exempt low-income families from new taxes without reducing the tax liability of wealthy families.

- o Taxing only a fraction of all entitlements would lessen the impact of this option on all beneficiaries and would exempt only the poorest recipients whose taxable incomes (including countable benefits) were too low to require them to pay taxes.

- o Exempting some entitlements from taxation would reduce the number of families who were affected, protecting families in those programs that were declared exempt.

Reduce Entitlement Benefits for Middle- and High-Income Recipients

A second option to lower net outlays for entitlements is modeled on a recent proposal of the Concord Coalition. (The coalition is a bipartisan organization headed by former Members of Congress that focuses on fiscal policy.) The option would cut up to 85 percent of benefits on a graduated scale for families with annual incomes above $40,000. It would index the income brackets for inflation, but the brackets would be the same for families of all sizes.

The option would affect the following entitlements: Social Security and Railroad Retirement, unemploy-

Summary Table 2.
Estimated Gains in Revenues and Reductions in Spending Under Three Policy Options to Cut Net Entitlement Costs, Fiscal Years 1995-1999 (In billions of dollars)

Policy Option	1995	1996	1997	1998	1999	1995-1999
Broaden Definition of Taxable Income to Include Entitlements	18.0	52.6	57.0	62.3	68.1	258.0
Reduce Entitlement Benefits for Middle- and High-Income Recipients[a]	9.4	45.4	42.2	44.9	47.9	189.8
Deny Entitlement Benefits to High-Income Recipients	4.1	10.1	9.3	10.0	10.7	44.2

SOURCE: Congressional Budget Office.

NOTE: The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Medicare, Medicaid, Supplemental Security Income, Aid to Families with Dependent Children, and the Food Stamp program.

a. This option closely resembles the proposal of the Concord Coalition to reduce spending for entitlements.

ment compensation, veterans' compensation and pensions, SSI, AFDC, the face value of food stamps, and the insurance value of Medicare and Medicaid, minus any premiums paid. Following the Concord Coalition's proposal, federal civilian and military pensions would be exempt from cuts. (The coalition excluded pensions from their plan because pensions are part of the labor contract between the government and its employees and not entitlements in the same sense as the other programs.)

If the option was fully implemented at the beginning of 1995, it would reduce outlays for entitlements by about $9 billion in fiscal year 1995 and $190 billion over five years (see Summary Table 2). About 60 percent of the savings would come from reducing Social Security benefits, and 30 percent would come from cutting Medicare.

This option would take away an average of a quarter of the benefits of about one-fifth of all recipients (see Summary Table 3). Families with incomes below $30,000 would be essentially exempt from cuts; more than half of families with incomes between $30,000 and $100,000 and five-sixths of those with incomes above $100,000 would see their benefits fall. Almost

Summary Table 3.
Distribution of Losses of Benefits Among Recipient Families Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type (In percent)

Family Category	Recipient Families Losing Benefits	Aggregate Benefits Lost	Benefits Lost by Families Losing Benefits
	Broaden Definition of Taxable Income to Include Entitlements		
All Families	64	100	10
Income (1995 dollars)[a]			
1 to 29,999	63	46	8
30,000 to 99,999	64	46	12
100,000 or more	71	8	17
Type[b]			
With children	34	9	5
Elderly	85	73	11
Other	60	18	10
	Reduce Entitlement Benefits for Middle- and High-Income Recipients		
All Families	22	100	23
Income (1995 dollars)[a]			
1 to 29,999	c	c	d
30,000 to 99,999	56	54	15
100,000 or more	82	45	71
Type[b]			
With children	20	12	20
Elderly	25	72	23
Other	21	15	22

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

half of all savings would come from the latter group, whose entitlements would drop by about 70 percent.

Neither the likelihood of suffering cuts in benefits nor the average benefit loss would vary much among different types of families. However, because elderly families receive significantly more entitlement benefits than other groups, they would bear nearly three-quarters of the costs.

Three modifications would change the budgetary savings and the way the option's effects were distributed among categories of recipients.

- Raising the level of income at which reductions begin would exempt more families from cuts, reduce the size of the cuts for all but the highest-income families, and lower the savings in outlays.

- Lowering the percentage of benefits cut for families in each category of income would have similar effects.

- Limiting the maximum cut to less than 85 percent would lessen the option's impact--but only for families at the top of the income distribution.

Summary Table 3. Continued

Family Category	Recipient Families Losing Benefits	Aggregate Benefits Lost	Benefits Lost by Families Losing Benefits
	Deny Entitlement Benefits to High-Income Recipients		
All Families	1	100	77
Income (1995 dollars)[a]			
1 to 29,999	0	0	0
30,000 to 99,999	c	c	d
100,000 or more	29	100	77
Type[b]			
With children	c	c	d
Elderly	2	94	80
Other	1	5	57

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

c. Less than 0.5 percent.

d. Too few families would be affected to allow estimation of a statistically meaningful value.

Deny Entitlements to High-Income Recipients

A final option that approximates recent legislative proposals would deny all entitlements to families with very high incomes. The specific proposal analyzed for this study would phase out entitlements at a rate of 50 percent for single people with 1995 nonentitlement income of more than $100,000 and couples with incomes above $120,000. It would take away all entitlements when income exceeded those limits by $10,000 or more. All dollar values would be indexed for inflation.

If the proposal was applied to the same programs as the benefit reduction option discussed above, it would reduce outlays for entitlements by $4 billion in fiscal year 1995 and nearly $45 billion over five years (see Summary Table 2). Roughly three-fifths of the savings would come from Social Security, and another one-third would come from Medicare.

This option would affect only the richest 1 percent of entitlement recipients, taking away an average of three-fourths of their benefits (see Summary Table 3). Even so, less than one-third of all recipients with incomes above $100,000 would suffer cuts. The reductions would fall most heavily on the elderly, who would account for 94 percent of the total savings. Families with children would essentially be exempt from any loss of benefits because most of those receiving benefits have incomes below the option's threshold for cutting entitlements.

Two modifications could change the savings and distributional impact of this proposal.

- Lowering the threshold for family income above which benefits could be cut would generate greater savings. Although this change would reduce the benefits of more recipients, a small reduction in the thresholds would still protect low- and middle-income families.

- Broadening the range of income over which benefits are phased out would lower savings and cushion the effects of the option on families near the upper income limit.

Issues in Implementing the Options

Taxing entitlements or establishing a global means test would require decisions about how to structure and administer each option. Of the three options, counting entitlements as taxable income would be the simplest to carry out because it would use the existing administrative structures of the Internal Revenue Service (IRS). Each program would send recipients a statement of the benefits provided to them during the calendar year that would be subject to income taxes. In turn, recipients would report those amounts as income on their federal tax returns. Accounting periods, tax units, measurement of means, and tax rates would all be defined by the tax code. These issues become more complicated under the benefit reduction and denial options.

A global means test--either to reduce or deny benefits--could be administered in one of several ways: by the individual agencies that currently administer the entitlement programs, by a single newly created agency that would oversee all entitlements, or by a single existing agency like the IRS. A single agency would have the advantage of having to gather data in only one place to apply a single standard to all of the programs. Using an existing organization would avoid creating a new bureaucracy. Adding to the workload of an existing agency could, however, make it difficult for that organization to carry out its principal functions.

Whether a means test is prospective or retrospective would determine how well programs meet the needs of their participants and how easy or difficult it would be to administer the test. On the one hand, a prospective test, which looks at the income people expect to receive in the near future, would provide a better gauge of need in the period when benefits are paid. But a prospective test would be prone to error and by its nature would require reconciliation to recoup overpayments or make additional payments. A retrospective test, on the other hand, although less likely to misestimate a recipient's resources, could base cuts in benefits on a measure of well-being that poorly assesses current needs.

In applying a means test, a major issue is the choice of the appropriate "unit" (individual, couple, family, or some other). That decision determines which recipients would be affected and how much of their benefits they would lose. It also influences whether people would face incentives to change their living arrangements to avoid losing their entitlements.

Applying a means test to individuals would preclude families' breaking up or forming to keep their benefits, but it might understate or overstate a recipient's well-being by ignoring the resources that are shared within a family. Conversely, basing a means test on family income might offer a better measure of a beneficiary's financial situation. It could, however, induce families to split up to avoid losing their benefits. Constructing family-based measures of resources that take account of differences in the size and composition of families could mitigate any economic incentives to alter a family's makeup.

How resources are measured can also have an effect--on the way benefit losses are distributed among recipients and on the way recipients behave. Broad measures that include both cash and in-kind income and assets might offer the best assessment of well-being, but they could also be more expensive and complicated to obtain and more subject to error than simpler measures. The problems of valuing noncash resources alone could make any all-inclusive measure unworkable. And excluding some forms of income or assets could prove difficult as well--by inducing potential beneficiaries to shift their income and assets into those excluded sources and thus avoid losing their benefits.

The rate at which entitlements are cut as incomes rise affects both the budgetary savings that means-testing would generate and disincentives for beneficiaries to work and save. The higher the rate at which benefits are cut, the greater will be the budgetary savings--but also the more likely people will be to work or save less to avoid losing benefits. How much recipients would respond to the disincentives that means-testing creates is unknown. Their response would depend not only on the rate of benefit reduction but also on the range of resources over which means-testing would apply and the way in which the means test would be administered.

A final implementation issue involves taxing or reducing benefits received in kind from Medicare, Medicaid, and the Food Stamp program. To put any of the three options in place would require assigning monetary values to such benefits, but there is little agreement about how to do that.

CBO's analysis valued food stamps at their face value and Medicare and Medicaid at their insurance value. Yet those amounts, particularly for the health programs, probably overstate the value to many participants of the benefits they receive. And even if policymakers could agree on how to value in-kind benefits, many beneficiaries, particularly those at the bottom of the income distribution, would lack the financial resources to pay taxes on those benefits.

Furthermore, because reducing health benefits by any given percentage is probably impractical, the benefit reduction option would be likely to assess premiums on the families it affects equal to an appropriate percentage of the value assigned to benefits. Again, some families receiving benefits might be unable to afford those premiums. Each of the options would require features to address these difficulties.

Comparing the Policy Options

The three policy options discussed in this study would differ markedly in several aspects: their budgetary savings, how they would distribute costs among recipients of entitlements, and the problems of administration they would pose. The three options are essentially similar in that they all would impose taxes on entitlements based on a family's entitlement and nonentitlement income. They differ in the tax rates they would impose and the income brackets over which those rates would apply.

Among the three options examined in this study, the tax option would generate the greatest budgetary savings--about $260 billion in new revenues over five years. It would also affect the most recipients, but it would impose the smallest costs--about 10 percent of benefits--on those families who would pay higher taxes. Because rates in the federal individual income tax are

relatively flat, this option would be the least progressive of those examined. It would, however, be the easiest and probably the least costly to administer: recipients would simply report and pay taxes on their benefits when they filed their federal tax returns.

At the other extreme, the option denying benefits to high-income families would save much less than the other two options--about $44 billion over five years--because it would affect the fewest recipients. The affected families, however, would lose a greater share of their benefits--about three-fourths--making the denial option the most progressive of the three approaches. Finally, although each affected case would be costly to administer, only 1 percent of recipient families would be involved. Thus, the total administrative costs of this option would be limited.

Reducing benefits that go to middle- and high-income families would produce savings and effects on beneficiaries that fall between those of the other two options. Over five years, the benefit reduction option would save three-quarters as much as the tax option but more than four times as much as the denial option. On the one hand, it would be more progressive than the tax option, taking more than twice as great a share of benefits away from about a third as many recipients. On the other hand, it would be less progressive than the denial option: on average, it would take away one-third of the share of benefits but would affect more than 20 times the number of families.

The benefit reduction option would be the most costly of the three to administer. Agencies would have to obtain information on the incomes of most recipients, and many cases would require reconciliation of levels of benefits at the end of each year.

Modifying the three options so that they would generate more comparable budgetary savings would reduce the differences among their effects on beneficiaries. Nevertheless, the options would maintain their relative positions in terms of number of families affected, share of benefits lost, progressivity, and cost of administration.

Chapter One

Introduction

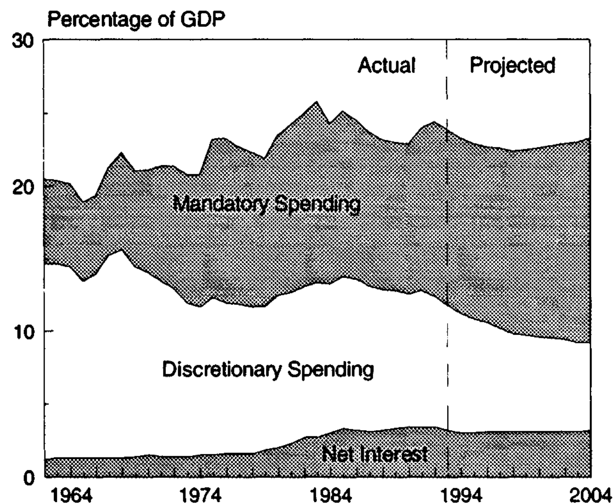
During the 1980s and 1990s, the federal budget deficit has exceeded 2.5 percent of gross domestic product (GDP) every year, an unprecedented stretch of peacetime deficit spending. Although the spending constraints of the Budget Enforcement Act of 1990 are expected to hold the deficit at roughly this share of GDP for the next few years, the Congressional Budget Office (CBO) projects that the deficit will grow faster than GDP each year thereafter if current policies are maintained. In dollar terms, CBO projects that the deficit will rise from about $200 billion in 1994 to almost $400 billion in 2004. Ever-mounting federal deficits directly reduce national savings and threaten the growth of U.S. living standards.

Many factors have combined over recent decades to produce the nation's deficit problem. Federal spending has grown as a percentage of GDP while revenues have claimed a relatively constant share. The growth in spending has come from different movements of the three major components of federal expenditures (see Figure 1).[1]

- *Discretionary spending* encompasses programs controlled by annual appropriation bills. It includes funding for defense, international activities, and domestic programs such as transportation, law enforcement, and government operations. Expenditures for this category have shrunk by more than one-third over the past three decades, falling from 13.5 percent of GDP in 1962 to slightly more than 8 percent in 1994.

- *Mandatory spending* consists overwhelmingly of entitlements such as Social Security, Medicare, and Medicaid, government programs that make payments to recipients who meet criteria specified in law and who apply for funds. Mandatory spending has doubled over the 1962-1994 period--from 6 percent to 12 percent of GDP.

Figure 1.
Components of Federal Spending as a Percentage of Gross Domestic Product, 1962-2004



SOURCE: Congressional Budget Office.

1. Government spending also includes two smaller categories. *Offsetting receipts* are fees and similar charges that the budget records as negative outlays. *Deposit insurance spending* reflects the government's commitments to protect deposits in insolvent institutions minus the fees charged for this insurance.

- *Net interest spending* includes federal interest payments to the public less interest income received by the government. Driven by the quadrupling of the national debt since 1980 and by market interest rates, net interest has also more than doubled since 1962, rising from 1.2 percent to 3.0 percent of GDP.

The figures above point to a clear conclusion: any attempt to reduce the budget deficit that does not involve increasing the share of income claimed by taxes must curb the rapid growth of mandatory spending--particularly spending for entitlements. The Congress has already sharply constrained discretionary spending to the point where many Members argue that further cuts would be destructive. Beyond making decisions that affect the size of the debt, the Congress has little control over net interest spending. CBO projects that if entitlements are not constrained, they will grow to 14 percent of GDP over the next 10 years.

The rapid growth of entitlements, combined with reductions in spending for defense and other discretionary programs, has raised the entitlement share of outlays from 30 percent in 1962 to 54 percent in 1993. If present policies continue, entitlements could constitute nearly two-thirds of all federal spending by early in the next century. The aging of the baby-boom generation will drive that fraction still higher over succeeding decades. What are the major entitlements that are generating this growing category of federal spending? And what approaches might the Congress pursue to bring that growth under control?

The Major Entitlement Programs

Entitlement programs span a wide range of activities that give cash or in-kind assistance to recipients. The diverse programs provide benefits to individuals, families, businesses, or units of government that meet specific criteria established in law. Qualified parties who apply receive benefits based on formulas that are codified in law and not subject to annual appropriation action by the Congress.

The federal government's major entitlement programs can be grouped in four categories.[2] *Cash social insurance programs* provide cash payments to qualifying individuals without respect to their economic well-being. This category includes Social Security's Old-Age and Disability programs, unemployment compensation, veterans' compensation and pensions, and agricultural price supports.[3] Those programs accounted for almost half of all federal entitlement spending in 1993, with 80 percent of that share going for Social Security benefits (see Table 1).

Two *health insurance programs*, Medicare and Medicaid, pay for health care services for elderly, disabled, and poor people. Medicare benefits are not subject to a means test; that is, beneficiaries do not lose benefits as their incomes rise. In contrast, Medicaid assistance goes only to families with limited financial resources. Together the two programs consumed almost a third of all entitlement spending in 1993.

About 10 percent of federal outlays for entitlements finance *means-tested assistance programs*. Such programs offer aid in cash and in kind to families with low incomes and assets. Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI) provide cash assistance. The Food Stamp program offers vouchers that recipients can use to purchase food. The earned income tax credit (EITC) makes cash payments to taxpayers with limited earnings who qualify for tax credits that exceed what they owe in federal income taxes.

2. The categorization used in this study is neither precise nor comprehensive. For example, because of limitations in the available data, veterans' pensions are included under cash social insurance programs, even though, unlike other such entitlements, they are paid only on the basis of need. Medicaid is listed here as a health program but could have been included under means-tested assistance. The study does not discuss the government's smaller entitlement programs, which include family support programs other than Aid to Families with Dependent Children, child nutrition programs, student loan programs, social services, and credit reform accounts.

3. Federal pensions and most means-tested benefits also involve cash payments but are considered under separate categories in this study. Pensions fall under a different rubric because they are part of the labor contract between government workers and their employers. Means-tested benefits are classified separately because they provide an economic safety net for low-income families.

Finally, *government retirement programs* provide pensions for federal civilian and military retirees. These programs account for nearly one-tenth of entitlement spending.

The principal beneficiaries of these entitlements are the elderly. Social Security and Medicare benefits make up nearly 60 percent of all entitlement spending, and roughly five-sixths of that amount benefits people age 65 or older. The elderly also receive about 10 percent of other such spending, bringing their total share of all entitlements to nearly 60 percent.

People with low incomes also benefit substantially from entitlement programs. Means-tested benefits, which go only to these families, account for about one-fifth of all entitlement spending. However, because some benefits that are not means-tested also go to the poor, the fraction of entitlement benefits that assist poor families and individuals significantly exceeds one-fifth.

CBO projects that spending for entitlements over the next five years will grow by about 3 percent annually in real terms--that is, after adjusting for inflation.

Table 1.
CBO Baseline Projections of Mandatory Federal Spending by Program, Fiscal Years 1993 and 1999

	1993 (Actual)		1999 (Projected)		Average Annual Percentage of Real Growth, 1993-1999
	Billions of 1993 Dollars	Percentage of Mandatory Spending	Billions of 1993 Dollars	Percentage of Mandatory Spending	
Cash Social Insurance Programs					
Social Security and Railroad Retirement	302	40	342	37	2.1
Unemployment compensation	35	5	23	3	-6.5
Veterans' compensation and pensions	21	3	18	2	-2.2
Agricultural price supports	16	2	8	1	-11.8
Subtotal	374	49	391	42	0.8
Health Programs					
Medicare	143	19	220	24	7.5
Medicaid	76	10	126	14	8.9
Subtotal	219	29	347	38	8.0
Means-Tested Assistance					
Aid to Families with Dependent Children and other family support	16	2	17	2	0.8
Supplemental Security Income	21	3	29	3	5.7
Food stamps	25	3	26	3	0.6
Earned income tax credit	9	1	21	2	15.1
Subtotal	71	9	93	10	4.3
Government Retirement Programs					
Federal civilian pensions	39	5	43	5	1.5
Military pensions	26	3	29	3	2.0
Subtotal	65	8	72	8	1.7
Other Mandatory Outlays	34	4	23	3	-6.0
Total	762	100	927	100	3.3

SOURCE: Congressional Budget Office.

Under current law, only three programs will exhibit particularly rapid growth (see Table 1). Spending for Medicare and Medicaid will increase about 8 percent annually in real terms. (That projection assumes that the Congress does not enact significant health care reform legislation and the health care industry remains relatively unchanged.) The EITC will also expand rapidly because of substantial changes made in the Omnibus Budget Reconciliation Act of 1993. Outlays for the program will grow 15 percent a year in real terms through 1999 but will then level off.

Approaches to Reducing Entitlement Spending

The approach usually taken to constrain entitlement spending involves cutting spending program by program. The Congress has followed that path in its previous efforts at control. An alternative approach, which has not yet been tried, derives from the premise that a government with fiscal problems should not provide benefits to those who have little need for government support. This strategy would be global rather than program based, using some form of means-testing to limit eligibility (and thus expenditures) for all entitlement programs. Several recent proposals follow that approach. The broad range of global options also includes making more entitlement income subject to the federal individual income tax.

Changes to Individual Programs

Most of the legislative changes in entitlements over the past 15 years have focused on three methods for curbing spending: reducing cost-of-living adjustments (COLAs), limiting payments to providers of medical care, or restricting eligibility for benefits. Current proposals would use similar methods. The Congress delayed or denied COLAs in some years (1981, 1982, 1985, and 1993) to lower spending for federal civilian and military retirement and disability programs. In addition, COLAs were the tool used to obtain the largest short-term cut in spending generated by the Social Security Amendments of 1983. H.R. 4245, the Social Security Long-Range Solvency Act of 1994, proposes a one-time reduction in the COLA for Social Security to reduce benefits for current recipients.

Virtually every budget reconciliation bill enacted over the past decade has restricted Medicare reimbursements (or the annual increases in reimbursement rates) for services provided by hospitals and doctors. The sequestration required in fiscal year 1986 under the Balanced Budget and Emergency Deficit Control Act of 1985 took the same tack. The different health care reform bills considered by the 103rd Congress would have reduced federal spending for Medicare and Medicaid in a variety of ways including lowering reimbursement rates for hospital care, limiting payments to other health care providers, and moving some beneficiaries from Medicaid to coverage under private health insurance. Some plans would also have increased the premiums that enrollees pay for benefits from Medicare's Supplementary Medical Insurance (Part B).

Tightening eligibility requirements to lower outlays was primarily limited to the Omnibus Budget Reconciliation Act of 1981. That action focused on AFDC and the Food Stamp program, both of which are means-tested. The Social Security Long-Range Solvency Act proposes to raise the age at which annuitants could receive full benefits and to cut benefits for future retirees who had high average earnings during their working years.

Another approach that the Congress has considered to lower the net cost of entitlement programs is counting benefits as taxable income under the federal individual income tax. Most entitlement benefits are not taxed. But some--notably unemployment compensation and federal civilian and military pensions in excess of pensioners' contributions--are fully taxable, as are up to 85 percent of Social Security payments to middle- and high-income recipients.

Constraining entitlements program by program recognizes that each one has its own constituencies and purposes. Indeed, the Congress designed the eligibility requirements and levels of benefits of the programs with an eye to achieving those specific goals. Lumping all of the entitlements together and applying a single limit to the resources of all potential beneficiaries would fail to take account of important differences between programs as varied as assistance for the poor-

est Americans, pensions the government has promised its employees as part of their labor contract, and benefits for the elderly for which recipients have paid payroll taxes during their working years. Furthermore, applying the same means test in determining benefits for recipients in different age cohorts would ignore changes that have occurred over time in the tax contributions recipients have made to program trust funds.

The major drawback to reducing entitlements one by one is the difficulty of achieving the consensus required to change individual programs. Decisions about how to cut benefits fairly across different programs would pose dilemmas not easily resolved. These problems argue for considering a broader approach to limiting entitlement spending.

Changes to Entitlement Programs as a Group

A number of the recent proposals for global reduction of entitlements have a common theme: reducing or eliminating all entitlement benefits for higher-income recipients. Proposed amendments to bills before the Senate would have denied emergency unemployment benefits to individuals with high incomes. The Concord Coalition--a bipartisan organization headed by former Members of Congress that focuses on fiscal policy--in *The Zero Deficit Plan* and Presidential candidate H. Ross Perot have proposed reducing the benefits that middle- and high-income families receive from entitlement programs as a group while leaving individual programs unaltered. Peter Peterson in his book *Facing Up* argues for cutting benefits in specific programs and reducing benefits more broadly with methods similar to those of the Concord Coalition. Peterson further suggests broadening the definition of taxable income to include entitlements as a way to offset entitlement spending with additional revenues.

Such a global approach--either through means-testing or by taxing benefits--may seem to be a more direct way to curb spending than cutting individual programs. But it may have unpredictable--and undesirable--effects. The specific goals of some programs could be compromised in unintended ways. At the same time, applying a single yardstick to all entitlements might be considered more equitable than ad hoc adjustments made to each program individually.

One approach would impose a global means test to limit or deny entitlements to high-income individuals. A means test would help to restrain federal spending by requiring greater sacrifices from those most able to bear the cost. In addition, it would impose those sacrifices not on wealthier people in general but rather on those wealthier people who benefit from the programs that are involved.

The income threshold above which benefits would be cut and the rate at which cuts would be made determine which recipients would be affected by such means-testing. Higher thresholds would exempt more current recipients from cuts; rates of benefit reduction that rose more gradually or were limited to less than 100 percent would protect a larger share of benefits. Both actions, however, would limit the budgetary savings from the means test.

An alternative approach--requiring those who receive benefits to pay income taxes on them--would achieve the same ends as limiting benefits and would be in keeping with the objective of a broad-based tax system that treats all forms of income similarly. Although Social Security benefits are much like private pensions --both are earned during one's working years and are paid for through reduced take-home pay--the federal tax system treats them differently: it levies no taxes on the benefits of three-fourths of all Social Security recipients, but it fully taxes all private pension payments in excess of a person's contributions. Although some entitlements are taxable--including unemployment compensation, federal and military pensions, and veterans' compensation--others are not; yet income from those untaxed sources is no different from income from private sources that is subject to taxes.

Making all entitlements subject to federal income taxes could improve the equity of the tax system and provide revenues to offset some of the costs of entitlements. Furthermore, this approach would take advantage of the existing structure of the income tax and the system that administers it. At the same time, to the extent that the Congress sets benefits assuming that they will not be taxed, imposing taxes on those entitlements

would reduce the net benefits that people receive below the amounts that the Congress has deemed appropriate.

For this study, CBO examined specific policy options to constrain net spending for entitlements as a group. To preface that examination, however, it investigated the distribution of entitlement benefits among families by income category and family type, considering arguments for and against means-testing particular benefits (see Chapter 2). Three policy options were formulated: taxing all entitlement benefits, reducing benefits for middle- and high-income recipients, and denying benefits to high-income recipients. Chapter 3 discusses those options in detail along with CBO's estimates of the budgetary savings they would generate over the next five years. Important factors in any decision about global restrictions of benefits are the distribution of benefit losses among families by income and type and the administrative issues that each option would raise (see Chapters 4 and 5, respectively, for their consideration). The study's final chapter summarizes the effects of the three options.

Chapter Two

The Major Entitlements: Who Gets Them and Should They Be Means-Tested?

Whether an entitlement program should be subject to a global means test depends on its goals and method of operation. The question calls for considering entitlement programs on several levels: their basic characteristics, how their benefits are distributed among families of different types and with different incomes, and the arguments for and against reducing benefits through some form of global means-testing.

For a number of reasons, the tables showing how benefits are distributed among recipient families may give a misleading picture of who receives assistance (see Box 1). Consequently, readers should be cautious in drawing conclusions based on those data.

Cash Social Insurance Programs

Cash payments make up more than two-thirds of all federal entitlements. The largest cash social insurance programs that the government funds are Social Security and Railroad Retirement, unemployment compensation, and veterans' compensation and pensions.[1]

1. Because of data limitations, Railroad Retirement is included with Social Security. For similar reasons, veterans' pensions are included in this category, even though they are means-tested. Workers' compensation is omitted from this analysis because it has little effect on the federal budget. Although the program paid out nearly $40 billion for medical services and wage replacement in 1990, the federal government paid only 8 percent of those benefits, primarily to federal employees. Nearly 60 percent of benefits came through private insurers, almost 20 percent came from employers who chose to self-insure, and 15 percent came from state funds.

Social Security

The Congress designed the federal Old-Age, Survivors, and Disability Insurance programs, more commonly known as Social Security, to replace a portion of the earnings a worker loses because of retirement, death, or disability. The programs provide cash payments to retired and disabled workers and to eligible dependents and survivors based on a worker's history of earnings and on his or her family characteristics. The formula used to determine benefits replaces a larger share of lost earnings for people with low earnings than for people with high ones. As a result, Social Security both redistributes income and replaces earnings.

Proponents of including Social Security benefits under a global means test argue that the program pays welfarelike benefits to people who are not poor. For example, the program pays benefits to the spouse of a retired worker equal to one-half of the worker's benefit. The justification for the payments is presumed need--that couples need more income than single people to maintain a given standard of living.[2] But many couples who receive such benefits would not be considered needy under almost any standard.

Surviving children of a deceased worker receive benefits regardless of the surviving parent's income;

2. The spousal benefit is limited to 50 percent of the worker's primary insurance amount. The amount may be reduced further if the spouse receives benefits before age 65 or has earnings above specified limits. Social Security pays spousal benefits only to the extent that the spouse's benefits from his or her own employment are less than the amount due him or her as a spouse.

Box 1.
Measuring the Distribution of Entitlements

Statistics in this chapter showing how entitlement benefits are distributed among categories of families come from tabulations of data from the Current Population Survey (CPS), a microdata file created by the Bureau of the Census. The Congressional Budget Office (CBO) has adjusted and supplemented those data to make them more consistent with information from tax returns and administrative records of the entitlement programs examined in this study.

The adjusted file represents the noninstitutionalized domestic population of the United States. The family, defined as related people living together, is the unit of measure CBO uses to analyze who receives benefits. People not living with relatives are counted as one-person families. Family income is all cash income before taxes plus the face value of food stamps that a family receives. Families with zero or negative income are included in calculations of totals but are omitted from individual income categories.

In the tables of distributional data in this study, families are grouped by income and by type--that is, according to the presence of children under age 18 and the age of the family head. *Families with children* are all families with a child under age 18, regardless of who else is present. *Elderly families* are all families with no children and at least one member age 65 or older. *Other families* are thus nonelderly childless families.

Some of the data in the tables may seem anomalous. For example, some families with high incomes appear to receive means-tested benefits that should go only to the poor. These apparently erroneous results occur for one or more of four reasons:

1. Individuals who are themselves poor but who live with relatives with high incomes may qualify for means-tested assistance, even though the larger family of which they are a part would not. For example, a poor elderly parent living with her wealthy adult child could receive Supplemental Security Income (SSI). Such cases are not erroneous.

2. Families may qualify for benefits during part of a year because of low monthly income, even though their total income for the year would make them ineligible. These cases also are not erroneous.

3. Respondents to the CPS may misreport either their incomes or their receipt of entitlement benefits. For example, an elderly recipient of Social Security benefits might mistakenly say that he or she received SSI rather than Social Security. Such errors cannot be detected with certainty and hence may show up in distributional tabulations.

4. Families who are ineligible for benefits may be receiving them anyway, either because of errors in determining eligibility or because the families misrepresented their resources in applying for benefits. Cases in the latter category should be rare, however, because families would be unlikely to respond truthfully to interviewers for the CPS and yet lie to program administrators.

Readers should keep these factors in mind as they consider the distributional data and draw conclusions about whether significant amounts of means-tested benefits go to people with high incomes.

they retain their benefits even if that parent remarries. Consequently, some surviving children in very affluent families receive Social Security benefits, even though their family could support them more than adequately without Social Security.

Another argument for means-testing Social Security benefits asserts that low-income workers should not have to pay 6.2 percent of their cash wages (12.4 percent including the employer share) to provide benefits for high-income retirees. In 1990, families with incomes above $100,000 received more than $8 billion in Social Security benefits. Adherents of this position maintain that Social Security was designed to provide a floor of income protection. It was not intended to subsidize the incomes of people who would have substantially more than adequate means even without Social Security.[3]

3. High-income retirees will generally not receive subsidies in the future because they will have paid more taxes and will get relatively smaller benefits.

An opposing view contends that recipients have paid for their benefits through payroll taxes and that the benefits are thus comparable with those from private insurance and private pensions. In this analogy, survivors' benefits are like the proceeds of a life insurance policy paid out as an annuity, and benefits for retired workers are like payments under a defined benefit pension plan. Yet the differences must be noted as well. Private pensions do not base benefits on family characteristics such as whether the worker has dependents. And benefits from private disability insurance generally depend on workers' earnings at the time of disability--not their earnings in earlier years.

Some opponents of applying a means test to Social Security worry that such a policy would undermine the political consensus supporting the program. Their argument holds that people generally view Social Security benefits as an entitlement that workers have paid for, not a form of welfare. As such, the program has widespread political support that allows for some redistributing of wealth.

Imposing a means test to reduce Social Security benefits for more affluent beneficiaries might be seen as turning Social Security into a program for the poor. Given the historically weak support for welfare pro-

Table 2.
Average Social Security and Railroad Retirement Benefits per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990

Family Category	Average Benefits per Recipient Family (1990 dollars) Before Taxes	Average Benefits per Recipient Family (1990 dollars) After Taxes	Effective Tax Rate (Percent)
All Families	7,880	7,730	1.9
Income (1990 dollars)[a]			
1 to 9,999	5,180	5,180	0
10,000 to 19,999	7,870	7,870	0
20,000 to 29,999	8,870	8,860	b
30,000 to 39,999	9,180	9,090	0.9
40,000 to 49,999	9,180	8,870	3.4
50,000 to 74,999	9,300	8,630	7.2
75,000 to 99,999	8,930	8,060	9.8
100,000 to 149,999	9,750	8,560	12.2
150,000 or more	10,170	8,770	13.8
Type[c]			
With children	6,890	6,870	0.3
Elderly	8,500	8,320	2.1
Other	6,290	6,170	1.8

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTE: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Less than 0.05 percent.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

Table 3.
Percentage of Families Receiving Cash Benefits, Average Benefits per Family, and Benefits as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990

Family Category	Percentage of Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Benefits as a Percentage of Recipient Family's Income
	Social Security[a]		
All Families	29	7,880	26
Income (1990 dollars)[b]			
1 to 9,999	37	5,180	78
10,000 to 19,999	36	7,870	53
20,000 to 29,999	31	8,870	36
30,000 to 39,999	26	9,180	27
40,000 to 49,999	22	9,180	21
50,000 to 74,999	20	9,300	16
75,000 to 99,999	20	8,930	10
100,000 to 149,999	20	9,750	8
150,000 or more	21	10,170	3
Type[c]			
With children	10	6,890	20
Elderly	94	8,500	28
Other	13	6,290	23
	Unemployment Compensation		
All Families	8	2,230	6
Income (1990 dollars)[b]			
1 to 9,999	4	1,690	25
10,000 to 19,999	8	1,890	13
20,000 to 29,999	9	2,330	9
30,000 to 39,999	11	2,160	6
40,000 to 49,999	10	2,450	5
50,000 to 74,999	9	2,570	4
75,000 to 99,999	8	2,830	3
100,000 to 149,999	6	3,610	3
150,000 or more	4	3,280	1
Type[c]			
With children	11	2,160	7
Elderly	2	2,540	6
Other	9	2,270	7

grams in this country, this perception could weaken the program over time and eventually lead to lower benefits. Or it might give additional momentum to initiatives that allow workers to opt out of Social Security. Moreover, means-testing could encourage many affluent families to rearrange their finances to avoid losing benefits.

Finally, a form of means-testing already applies to Social Security benefits. Recipients with incomes

Table 3.
Continued

Family Category	Percentage of Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Benefits as a Percentage of Recipient Family's Income
	Veterans' Benefits[d]		
All Families	3	4,470	13
Income (1990 dollars)[b]			
1 to 9,999	3	2,750	43
10,000 to 19,999	3	3,960	27
20,000 to 29,999	3	4,650	19
30,000 to 39,999	4	5,550	16
40,000 to 49,999	4	4,730	11
50,000 to 74,999	4	5,480	9
75,000 to 99,999	5	4,980	6
100,000 to 149,999	4	4,140	3
150,000 or more	2	4,790	2
Type[c]			
With children	2	4,850	14
Elderly	6	3,750	12
Other	3	4,860	13

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Includes Railroad Retirement benefits.

b. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

d. Veterans' benefits comprise veterans' compensation and veterans' pensions.

above specific thresholds must pay federal income tax on as much as 85 percent of their benefits.[4] Because the thresholds exempt most recipients from any tax liability, however, after-tax benefits were only 2 percent less than total benefits in 1990, when no more than 50 percent of benefits were subject to taxes. At the same time, taxes on benefits are highly progressive: families with incomes under $20,000 paid no taxes on their Social Security in 1990, but families with incomes of more than $100,000 paid federal taxes equal to 12 per-

4. Individuals with countable incomes--adjusted gross income plus tax-exempt interest and one-half of Social Security benefits--above $25,000 and couples with countable incomes above $32,000 pay taxes on up to half of their Social Security benefits. For individuals with incomes above $32,000 and couples with incomes above $44,000, that fraction can be as high as 85 percent.

cent or more of their benefits (see Table 2 on page 9). Tax rates are higher today because the Omnibus Budget Reconciliation Act of 1993 increased the maximum share of benefits subject to taxes from 50 percent to 85 percent.

Social Security is the most broad-based of all entitlement programs, providing significant income support for elderly and low-income families. In 1990, almost 30 percent of all families received Social Security benefits averaging nearly $8,000 (see Table 3 on pages 10 and 11). Almost all elderly families--94 percent--received payments, compared with less than 15 percent of families with no elderly members.

Low-income families were more likely to get benefits than their high-income counterparts--more than one-third versus about one-fifth--largely because retirees generally have lower incomes than workers. Average benefits, however, were smaller for recipients with low family incomes than for those with higher ones--slightly more than $6,600 for families with incomes below $20,000 compared with more than $9,300 for those with incomes above $50,000.[5] But even with lower benefits, low-income families depend more on Social Security for their incomes than do wealthier families: recipient families with incomes under $20,000 get more than half of their income from the program; families with incomes above $50,000 get less than one-sixth.

Unemployment Compensation

Enacted as part of the Social Security Act of 1935, unemployment compensation is a federal/state program paying weekly benefits for a limited period to unemployed workers with a recent history of earnings in jobs that the program covers. The underlying principle of the program is to offset in part the loss of earnings during unemployment and help families maintain their standard of living. The program is, of course, countercyclical: spending rises and falls with the unemployment rate. In periods of relatively high unemployment, the Congress has sometimes enacted additional benefit programs that assist the long-term unemployed.

Both federal and state laws affect the financing and payment of unemployment benefits. Employers pay federal and state payroll taxes into trust funds that finance the regular program. Under general guidelines and some restrictions imposed by the federal government, states establish eligibility requirements, the duration and amount of benefits, and state payroll taxes. The federal government pays all of the program's administrative costs and funds benefits for some groups of workers, primarily federal civilian and military employees.

Because the program applies no means test to unemployed workers, some payments go to individuals in families with significant annual incomes, either from other family members who are working, from the unemployed worker during that part of the year in which he or she was employed, or from nonwage sources. In 1990, families with incomes above $50,000 received nearly one-fourth of all unemployment compensation.

Some observers feel that providing benefits to families with relatively high incomes is an inappropriate use of limited federal resources that could be better spent to help families who are less well off. These critics point to the regressivity of the program's financing and question why low-income workers should have to pay taxes to provide support for much more affluent, though temporarily unemployed, workers. Employers pay taxes on base amounts--ranging from $7,000 to $25,000, depending on the state, but typically $10,000 to $15,000--of each worker's wages to fund unemployment compensation. Economists generally agree, however, that workers actually bear the burden of the tax in the form of lower wages.

Critics also note that the structure of the program encourages unemployed people to spend more time looking for work before they take a job (up to the time limit on benefits) than they would if they were not receiving payments. Workers in more affluent families may be better able than their poorer counterparts to delay going back to work while they look for better opportunities. As a result, they may collect more benefits during each spell of unemployment than their less affluent confreres.

Opponents of applying a means test to unemployment compensation assert that means-testing would have little impact on the federal deficit. Although the

5. Low-income recipients get small benefits because they had low earnings during their working years and therefore also generally have small or no private pensions and little savings.

federal government imposes some guidelines and constraints, states determine tax rates and levels of benefits and administer and fund payments to most beneficiaries. If benefits were cut, states would accumulate larger balances in their trust funds.

States could respond to the higher balances by reducing their payroll taxes or raising the level of benefits. Either way, the federal deficit would be affected only by the reduced benefits paid to federal and military employees, a relatively small part of total payments by the program. However, this argument addresses only the question of whether means-testing would reduce the federal deficit; it ignores the question of whether benefits should be paid to middle- and high-income workers.

Additional arguments against means-testing unemployment compensation rest on the insurance aspect of the program. Workers bear the costs (in the form of lower wages) of insurance premiums paid as taxes on their employers in exchange for a measure of income protection if they should lose their jobs. Consequently, say these arguments, any worker who meets the criteria for eligibility that involve the loss of a job should receive these insurance payments, regardless of other income.

A final contention of opponents to a global means test for this entitlement is that unemployment benefits are already means-tested to some degree in two ways. First, benefits generally replace a fixed share of earnings up to a maximum amount. Lower-income workers thus receive benefits that replace a larger share of earnings than is replaced for higher-income workers.

Second, since the Tax Reform Act of 1986 made all unemployment payments taxable under the progressive rates of the federal income tax, recipients with significant incomes from other sources find their after-tax benefits reduced. Overall, 9 percent of benefits went for federal income taxes in 1990, but the distribution among categories of family income was progressive: recipient families with incomes under $30,000 lost about 7 percent of their unemployment compensation to taxes, compared with roughly 20 percent for those with incomes above $100,000 (see Table 4).

About one family in 12 collected unemployment benefits averaging slightly more than $2,200 in 1990 (see Table 3). Families with incomes between $30,000 and $50,000 were somewhat more likely to draw benefits than families with either higher or lower incomes. At the same time, average benefits generally rose with income from $1,700 for families with incomes under $10,000 to about $3,500 for those with incomes above $100,000. For the poorest families receiving payments, unemployment compensation made up one-fourth of their annual income, compared with less than 5 percent of income for recipient families with incomes above $50,000.

Veterans' Compensation and Pensions

Federal support for military veterans dates back to the 1800s. Today, compensation and pensions constitute the bulk of entitlement spending for veterans.[6] Veterans' pensions provide income for needy veterans and are means-tested, going only to the poorest people who have served in the military. In contrast, veterans' compensation benefits are a form of indemnity payment for those suffering a loss of physical or mental capacity resulting from their military service. The government pays the benefits to veterans and their families regardless of their income.

Although veterans' disability ratings (from 10 percent to 100 percent disabled) may indirectly relate to the loss of earnings associated with a service-connected health condition, for many veterans their specific injuries do not seem to affect their subsequent earnings. As a result, some veterans and their families have substantial incomes in addition to the disability payments. In 1990, nearly 30 percent of payments went to families with incomes above $50,000.

The availability of veterans' benefits to people in high-income families disturbs some observers who place a relatively high value on need as the basis for government benefits. In their eyes, providing payments to disabled veterans with high incomes raises issues of equity: many nonveterans with similar health limitations and much less income are not entitled to any federal benefits. Furthermore, to the extent that service-

6. Although veterans' compensation and pensions differ greatly in terms of who is eligible to receive benefits, the two programs are combined in this analysis because data limitations do not allow accurate distinction between the two.

Table 4.
Average Unemployment Compensation per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990

Family Category	Average Benefits per Recipient Family (1990 dollars) Before Taxes	After Taxes	Effective Tax Rate (Percent)
All Families	2,230	2,020	9.4
Income (1990 dollars)[a]			
1 to 9,999	1,690	1,630	4.0
10,000 to 19,999	1,890	1,750	7.3
20,000 to 29,999	2,330	2,150	7.8
30,000 to 39,999	2,160	1,970	9.0
40,000 to 49,999	2,450	2,200	10.4
50,000 to 74,999	2,570	2,270	11.8
75,000 to 99,999	2,830	2,410	14.9
100,000 to 149,999	3,610	2,810	22.0
150,000 or more	3,280	2,640	19.4
Type[b]			
With children	2,160	2,130	1.3
Elderly	2,540	2,170	14.6
Other	2,270	1,910	16.0

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTE: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

connected disabilities do not affect whether a veteran can earn a living, some people would argue that disability payments are not warranted in such cases. Also to be considered, however, is that a policy that would restrict indemnity payments for those veterans who have overcome major health limitations and been successfully integrated into the work force could undermine work incentives.

Only 3 percent of families received veterans' compensation or pensions in 1990, when payments averaged nearly $4,500 (see Table 3). Families with incomes above $30,000 were somewhat more likely than poorer families to collect benefits, but average benefits varied irregularly with income. Low-income recipients relied heavily on these benefits: families with incomes below $10,000 received more than 40 percent of their total income from veterans' programs.

Agricultural Price and Income Supports

Support for farmers takes many forms. The federal government makes direct cash payments to them, limits production and purchases commodities to bolster prices, and offers low-interest loans.[7] The government also pays farmers when they lose crops as a result of natural events such as flood or drought. The heavily subsidized federal crop insurance program and direct disaster payments are the mechanisms used for those

7. Although this section discusses payments to farmers, the distributional analyses and policy options in the rest of the study exclude them for two reasons. First, available data on the distribution of payments from farm programs are not consistent with data on the distribution of benefits from other programs. That discrepancy makes it difficult to combine the data meaningfully. Second, because payments by farm programs are tied to the production of certain crops on specific pieces of land--and not to individual farmers--limiting benefits for individuals may require a completely different approach from that used for other entitlements.

transfers. All of these farm programs enhance farmers' incomes. They also smooth them--payments rise when prices are low or when natural disaster strikes, and fall when prices rise.

The payments often considered most similar to other federal entitlements are deficiency payments. Farmers receive them for participating in programs for wheat, feed grains (corn, sorghum, barley, and oats), rice, or cotton. The payment rate per unit of a particular crop depends on market prices: rates rise--to make up for "deficiencies"--when market prices fall and fall when market prices rise.

Between one-third and one-half of the nation's 2.1 million farms receive deficiency payments. Producers of agricultural commodities other than grains or cotton--for example, soybeans, sugar, peanuts, tobacco, and dairy products--receive support from the federal government in other ways. Producers of livestock, fruits, and vegetables receive little direct support.

Eligibility for deficiency payments is tied to the land--a key difference between agricultural programs and other federal entitlements discussed in this study. Farmers can receive payments only if the land they are farming has an "acreage base." (An acreage base is an officially recognized amount of land on a particular farm that is eligible for benefits.) Past production on the farm determines acreage bases, which are specific to individual crops. Thus, farms may have a wheat base, a corn base, a sorghum base, and so on.

To receive payments, farmers must also comply with other aspects of the programs. Programs may require farmers to adopt measures to reduce soil erosion or meet requirements to set aside some acreage from production. The latter typically vary from year to year depending on market conditions.

The law limits annual deficiency payments to individual farmers to $50,000. But farmers can also receive payments as shareholders in corporations. Some could receive as much as $100,000 in payments annually--$50,000 as an individual plus $25,000 as a shareholder in a maximum of two corporate farms (each of which could receive a maximum payment of $50,000). Annual deficiency payments averaged $6.3 billion during the 1990-1993 period.

Some quite well-to-do individuals and corporations receive deficiency payments. Data from 1990 from the Internal Revenue Service show that among farms organized as sole proprietorships, about $270 million in program payments went to 29,000 farmers with adjusted gross incomes from nonfarm sources exceeding $100,000.[8] Another $150 million went to 19,000 farmers with adjusted gross incomes from nonfarm sources of between $75,000 and $100,000.

Sole proprietorships received about 75 percent of all farm program payments, with the remainder going to partnerships, family corporations, and other corporations. Corporations and partnerships received higher average payments than sole proprietors, but information about their financial condition is not available.[9] Although no means test now applies to recipients of deficiency payments, the Administration recently proposed one: any individual with annual income from off-farm sources of more than $100,000 would be ineligible for payments.

Proponents of means tests for deficiency payments argue that the limited resources available to farm programs should be better targeted. They cite as appropriate goals those of eliminating poverty among farm families, keeping financially vulnerable farmers afloat, and encouraging more small or middle-size "family" farms rather than very large farms.[10] Although the three goals are somewhat different, they would all be consistent with reducing payments to those farmers, farm corporations, and landowners who would be considered wealthy by most standards.

Opponents of means-testing eligibility for deficiency payments maintain a different viewpoint. They argue that such payments are meant not only to help the poor but to support an industry that provides an abun-

8. Michael Compson, "Limiting Farm Program Payments: The Impact on Farm Sole Proprietors," *Agricultural Income and Finance--Situation and Outlook Report* (Department of Agriculture, February 1994), p. 53. Program payments reported in this study include some Conservation Reserve Program payments and some disaster benefits in addition to deficiency payments.

9. Robert D. Reinsel, *The Distribution of Farm Program Payments, 1987*, Agricultural Information Bulletin 607 (Department of Agriculture, June 1990).

10. For a more complete discussion, see Daniel A. Sumner, *Targeting Farm Programs* (Washington, D.C.: Resources for the Future, National Center for Food and Agricultural Policy, October 1989).

dant, safe, and relatively cheap food supply to the U.S. public. Opponents also claim that reducing support for the agricultural industry could hurt farms of a relatively efficient size as well as the competitive position of U.S. farm commodities in world markets. Some environmental groups that have opposed means tests for deficiency payments add another justification: the receipt of program benefits is a powerful lever to get farmers to adopt measures for soil conservation and water quality protection.

An additional complication of limiting deficiency payments is that it is hard to do--or at least hard to do in a way that reduces federal outlays. The government makes deficiency payments to the individual who raises a qualifying crop on a particular piece of land. The land defines the eligibility for payments. If one person becomes ineligible, another can take over production of the crop by buying or renting the land. The second person then becomes eligible for payments.

Because those payments are potentially large, the incentives are strong to organize farm businesses and land-tenure arrangements to maximize them. Many such reorganizations have occurred in response to past changes in limitations on payments or in eligibility rules. The reorganizations cause savings in outlays to be far less than might be indicated by the initial distribution of the payments.

Yet such reorganizations may serve other objectives of farm policy. For example, they might encourage smaller farming operations. Or a larger share of payments might go to farmers that almost everyone would consider "needy." In addition, eliminating payments to wealthy farmers might quiet critics of the rest of the farm program. These reorganizations, however, use resources that might be better used elsewhere and may create less efficient farming units.

Although it is possible to make certain people ineligible to receive deficiency payments, it is much more difficult to stop them from indirectly benefiting from the programs. The unavoidable fact of current farm programs is that although individuals receive the payments from the government, the right to benefits is associated with the land. Sales prices and rental rates for farmland reflect the value of that entitlement. Eliminating payments to a wealthy owner-operator might cause him or her to rent the land to several smaller operators, who would be eligible for payments. The rent charged for the land would be higher than if no government payments were associated with it. The wealthy landowner would continue to reap most or all of the benefits of the government program, even though he or she was ineligible for payments.

Some people have advanced proposals that would make the individual, rather than the land, the source of eligibility for deficiency payments. That change would enable more accurate targeting of benefits, but it would dramatically alter the nature of the farm programs. Instead of supporting the industry, benefits would support certain individuals who were farming at some specific time. Critics fear that under a change of that kind, farm programs might become more like welfare programs. Supporters believe that tying benefits to individuals, rather than to the land and how it is used, would lead to a more efficient and more market-oriented farm sector.

Federal Civilian and Military Retirement Programs

The federal government will pay pensions totaling about $66 billion to nearly 2.5 million retired civilian workers and more than 1.5 million military retirees in fiscal year 1994. Over the next decade, spending for federal pensions is projected to grow at an annual rate of 1 percent after adjusting for inflation. Because government civilian and military personnel may retire long before age 65--many military service members retire in their 40s--they may pursue second careers while they collect retirement benefits. As a result, many recipient families have above-average incomes.

In 1990, families with incomes above $50,000 received about one-third of federal civilian pensions and more than half of all military pensions--a total of nearly $23 billion. Overall, slightly more than 2 percent of families received civilian pensions and another nearly 2 percent received military pensions from the government; annual payments averaged about $14,300 and $13,500, respectively (see Table 5). For those families, federal pensions made up about one-third of the incomes of civilian retirees and about one-fourth of those of military retirees.

Table 5.
Percentage of Families Receiving Federal Civilian and Military Pensions, Average Pension per Recipient Family, and Pensions as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990

Family Category	Percentage of Families Receiving Pensions	Average Pension per Recipient Family (1990 dollars)	Pensions as a Percentage of Recipient Family's Income
	Civilian Pensions		
All Families	2	14,340	34
Income (1990 dollars)[a]			
1 to 9,999	1	b	b
10,000 to 19,999	2	9,160	61
20,000 to 29,999	3	12,230	49
30,000 to 39,999	3	14,230	41
40,000 to 49,999	3	17,760	39
50,000 to 74,999	3	19,480	32
75,000 to 99,999	3	19,670	23
100,000 to 149,999	3	25,190	21
150,000 or more	3	25,490	9
Type[c]			
With children	1	b	b
Elderly	6	14,550	34
Other	1	b	b
	Military Pensions		
All Families	2	13,460	27
Income (1990 dollars)[a]			
1 to 9,999	d	b	b
10,000 to 19,999	1	b	b
20,000 to 29,999	1	b	b
30,000 to 39,999	2	11,370	32
40,000 to 49,999	3	12,850	29
50,000 to 74,999	3	14,280	23
75,000 to 99,999	3	23,550	27
100,000 to 149,999	4	19,680	17
150,000 or more	2	33,770	8
Type[c]			
With children	1	b	b
Elderly	3	13,200	22
Other	2	14,320	29

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Too few families received benefits to allow estimation of a statistically meaningful value.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

d. Less than 0.5 percent.

Many critics of federal retirement spending have focused on the generosity of pension plans for retired federal employees relative to those for private-sector workers. They note that the federal plans have more lenient provisions for early retirement than many private-sector plans. In addition, federal pensions generally include full cost-of-living adjustments, something virtually nonexistent in private pensions (although some protection against inflation is not uncommon). Critics also raise the question of equity. As long as cuts in Social Security benefits remain on the table, many people believe that it would be unfair to protect federal retirement benefits from reductions.

Supporters of federal workers and retirees point out that these programs were integral parts of the employment contract between the federal government and its employees and therefore constitute earned benefits. Cutting them would probably hurt the government's reputation as an employer. Annual surveys comparing government and private-sector wages indicate that federal workers may be accepting lower cash wages in exchange for better retirement benefits in deciding to work for the government. In essence, these workers pay for their more generous retirement benefits by accepting lower wages during their working years.[11] Moreover, as some observers maintain, cutting benefits promised to current annuitants may prompt forward-looking workers to demand higher compensation now to offset the increased uncertainty of their deferred benefits.

In sum, this view holds that any reduction in the benefits that the government has promised its workers would be an inherently unfair abrogation of the labor contract between them. That action would also make it more difficult for the government to attract and retain high-quality employees.

Cutting military pensions poses a different kind of problem. Because military personnel receive pensions only if they serve at least 20 years, retirement benefits are a major incentive for experienced people to stay in the armed forces.[12] But full benefits can be received at any age. That fact combined with the cliff-vesting feature of military pensions (people qualify for pensions only if they serve 20 years but then qualify fully) may induce many military personnel to leave the service as soon as they become vested. Although this inducement serves to maintain a young and vigorous military force, it may also lead some service members whom the military would like to retain to retire in early middle age, when their skills and experience make them most valuable.

Imposing an age requirement for receiving pensions could mitigate this effect, although it would generate little budgetary savings unless it affected current retirees retroactively.[13] Limiting pensions for higher-income retirees through a global means test could also reduce early retirements. An unwanted side effect, however, might be its destruction of the effectiveness of pensions as a retention tool.

A further argument against means-testing federal pensions is that they are already subject to a form of means test. To the extent that they exceed the contributions employees make during their working years, federal pensions are fully taxable under the federal individual income tax. In 1990, for example, 20 percent of civilian pensions went to federal income taxes. Recipient families with incomes below $20,000 paid less than 15 percent of their pensions in taxes; those with incomes above $100,000 paid roughly 30 percent (see Table 6).

Any consideration of how to treat federal civilian pensions must distinguish between the Civil Service Retirement System (CSRS), the original pension system begun in the 1920s, and the Federal Employees' Retirement System (FERS), which replaced CSRS in 1984. Most federal civilian workers hired after 1983 participate in FERS, along with workers hired earlier who elected to transfer to the new system.

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11. This argument will be less valid in the future, however, if the government moves toward pay comparability under the Federal Employees Pay Comparability Act of 1990. That act calls for cash wages of federal workers to increase until they are comparable with the wages of similar workers in the private sector.

12. In fact, all military retirees may be recalled to active duty, and their pensions are technically "retired and retainer pay." This feature makes military pensions qualitatively different from civilian pensions. Furthermore, because of this feature, military retirees who go to work for the federal government receive reduced military pensions during that employment.

13. A 1985 change in the military retirement system reduces until age 62 the retirement benefits of people who entered the military after July 31, 1986, and retire with fewer than 30 years of service.

Table 6.
Average Federal Civilian and Military Pensions per Recipient Family Before and After Federal Income Taxes, by Family Income and Type, 1990

Family Category	Average Pension per Recipient Family (1990 dollars) Before Taxes	After Taxes	Effective Tax Rate (Percent)
Civilian Pensions			
All Families	14,340	11,460	20.1
Income (1990 dollars)[a]			
1 to 9,999	5,170	4,890	5.4
10,000 to 19,999	9,160	7,940	13.3
20,000 to 29,999	12,230	10,260	16.1
30,000 to 39,999	14,230	11,500	19.2
40,000 to 49,999	17,760	14,040	21.0
50,000 to 74,999	19,480	14,930	23.3
75,000 to 99,999	19,670	14,780	24.9
100,000 to 149,999	25,190	17,570	30.3
150,000 or more	25,490	18,140	28.9
Type[b]			
With children	11,500	10,770	6.3
Elderly	14,550	11,380	21.8
Other	14,780	11,820	20.0
Military Pensions			
All Families	13,460	10,900	19.0
Income (1990 dollars)[a]			
1 to 9,999	3,400	3,260	4.1
10,000 to 19,999	7,220	6,550	9.3
20,000 to 29,999	10,490	9,200	12.4
30,000 to 39,999	11,370	9,680	14.8
40,000 to 49,999	12,850	10,680	16.9
50,000 to 74,999	14,280	10,990	23.0
75,000 to 99,999	23,550	18,200	22.7
100,000 to 149,999	19,680	14,720	25.2
150,000 or more	33,770	24,110	28.6
Type[b]			
With children	11,860	11,380	4.0
Elderly	13,200	10,270	22.2
Other	14,320	11,180	21.9

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTE: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

Workers covered by CSRS receive retirement benefits as a pension funded by equal contributions from the worker and the government totaling 14 percent of wages. These contributions cover roughly 56 percent of the costs of the pension. CSRS participants do not qualify for Social Security benefits from their government service, nor do they receive contributions from the government to retirement savings accounts. In contrast, FERS offers three different retirement resources: a smaller pension fully funded by government and worker contributions equal to 11.4 percent and 0.8 percent of wages, respectively; Social Security benefits; and savings in the Thrift Savings Plan, accumulated through worker and government deposits.

Conceivably, any plan to reduce benefits might exempt federal pensions because they constitute deferred compensation rather than entitlements in the ordinary sense. If the plan reduced Social Security benefits, however, exempting pensions would affect CSRS and FERS participants differently. Because FERS replaced part of the pension benefits in CSRS with participation in Social Security, reducing Social Security benefits without making commensurate reductions in CSRS pensions would favor CSRS participants over FERS participants. Concerns about equity between the two retirement plans would argue that benefit cuts in Social Security be accompanied either by equivalent cuts in CSRS pensions or compensating increases in FERS benefits.

Means-Tested Income Support Programs

Some federal entitlements provide support in cash and in kind for low-income families who also satisfy certain categorical requirements.[14] The federal part of Supplemental Security Income pays cash benefits to elderly and disabled people with monthly incomes and certain assets below federally specified national limits. Aid to Families with Dependent Children goes to families with children who have monthly incomes and assets below limits set by individual states. Households with monthly incomes below the federal poverty guidelines qualify for food stamps. The earned income tax credit provides refundable tax credits for workers with low incomes.

All four programs impose strict limits on the incomes of recipient families, and the first three also limit the total nonhousing wealth a family may have to qualify for benefits. Because these constraints already exist, subjecting the programs to more global forms of means-testing could duplicate the current tests at significantly higher income levels. Such a process would impose costs for administration and compliance and yet have little effect on spending.

Supplemental Security Income

In 1974, SSI replaced separate programs aiding elderly, blind, and permanently disabled people. Since then, its caseload has grown from less than 3 million to nearly 6 million people. Benefit payments have grown from $4 billion to $25 billion in 1994.

The program guarantees people who are blind, disabled, or at least 65 years old incomes, in 1994, of $446 per month for individuals and $669 for couples. To qualify for those benefits, recipients must have incomes that fall below the guarantee levels. The program also limits certain assets to no more than $2,000 for individuals and $3,000 for couples.

The federal government pays the full cost of the guarantees, which are adjusted annually for inflation based on changes in the consumer price index. States may supplement the federal guarantee at their own expense, and about half the states choose to do so.

In 1990, roughly 4 percent of U.S. families received SSI payments--including state supplements--averaging slightly more than $3,800 (see Table 7). One in eight families with incomes below $10,000 received benefits. Elderly families were more than twice as likely as younger families to benefit from the program; one-fifth of elderly families with incomes below $10,000 were beneficiaries. Overall, recipient families got one-fourth of their total income from SSI. The poorest families relied on the program for half of their support.

14. This discussion omits a number of smaller means-tested entitlements including nutrition and student loan programs. Those programs account for less than 5 percent of total entitlement spending. Medicaid, although also a means-tested benefit, is omitted here and covered instead in the section on federal health insurance programs.

Aid to Families with Dependent Children

The AFDC program offers cash assistance to families with children deemed to be needy under standards set by each state. Families with monthly incomes and assets under a state's limits qualify for benefits that, for a three-person family in 1994, range from a maximum of $120 per month in Mississippi to a maximum of more than $900 per month in Alaska. Generally, the program does not automatically adjust benefits to keep pace with inflation.

The federal and state governments share the costs of the program, with the wealthiest states bearing half the cost of spending for their residents and poorer states paying as little as one-sixth. In 1994, the program will pay nearly $23 billion in benefits to a monthly average of nearly 14 million recipients. The federal government will pay 55 percent of those costs. Because costs are split between states and the federal government, any savings that a means test would generate would also be split between the two entities.

The AFDC program provided average benefits of about $3,600 to 13 percent of all families with children in 1990 (see Table 7). The poorest families were most likely to participate: over half of families with children and incomes below $10,000 received benefits. For those families, AFDC made up two-thirds of their total income.

Food Stamps

The Food Stamp program provides low-income households with coupons that they can use like cash to purchase food products. A four-person household with countable income below the federal poverty guidelines and specified assets of less than $2,000 qualifies for up to about $380 worth of food stamps monthly. Today, participation in the Food Stamp program stands at record levels. In the average month in 1994, more than 27 million people will receive food stamps; total benefits in 1994 will exceed $24 billion. The federal government pays the full cost of food stamps.

One-tenth of all families and one-third of those with incomes below $10,000 received food stamps in 1990 with an average value of nearly $1,500 (see Table 7). Families with children were more likely than other families to participate in the program; one-sixth of those families got stamps worth an average of $2,000. For recipient families, food stamps added significantly to family income--on average, nearly one-sixth of the total.[15] Families with incomes below $10,000 received one-fifth of their income from the program.

Earned Income Tax Credit

The Congress had several purposes in mind when it enacted the EITC in 1975: providing financial assistance to low-income working families with children, offsetting Social Security payroll taxes, and improving the incentive to work. It has since made the credit more generous on a number of occasions, most recently in the Omnibus Budget Reconciliation Act of 1993. That act increased benefits and extended them to families and individuals without children.

In 1996, when the changes are fully phased in, the EITC will offer tax credits of as much as $3,560 annually to taxpayers with adjusted gross incomes (AGIs) of up to about $11,600 and smaller amounts to those with AGIs up to about $28,500. (AGI is the measure of income subject to federal income taxes before subtracting personal exemptions and standard or itemized deductions.) In 1996, over 18 million taxpayers will receive about $23 billion from the EITC. Approximately $3 billion of that amount will be in reduced taxes; $20 billion will be in refundable payments.

The framework for benefits under the EITC consists of three income ranges: a phase-in range of earnings, over which the credit increases to a maximum; a plateau range of AGI, over which the credit equals that maximum; and a phaseout range of AGI, over which the credit declines to zero.[16] For example, in 1996, the credit for a family with two children will equal 40 percent of wages up to $8,900, for a maximum of

15. This analysis measures food stamps at their face value. Family income equals cash income from all sources plus the value of food stamps received. It excludes the value of Medicare, Medicaid, and other income received in kind.

16. The plateau and phase-out ranges actually apply to the larger of AGI or earnings, but AGI is generally at least as large as earnings.

Table 7.
Percentage of Families Receiving Means-Tested Benefits, Average Benefits per Recipient Family, and Benefits as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990

Family Category	Percentage of Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Benefits as a Percentage of Recipient Family's Income
	Supplemental Security Income		
All Families	4	3,820	24
Income (1990 dollars)[a]			
1 to 9,999	13	3,260	50
10,000 to 19,999	5	4,440	32
20,000 to 29,999	3	4,720	19
30,000 to 39,999	1	b	b
40,000 to 49,999	1	b	b
50,000 to 74,999	1	b	b
75,000 to 99,999	1	b	b
100,000 to 149,999	1	b	b
150,000 or more	1	b	b
Type[c]			
With children	3	4,640	21
Elderly	8	2,880	23
Other	3	4,300	29
	Aid to Families with Dependent Children[d]		
All Families	6	3,340	26
Income (1990 dollars)[a]			
1 to 9,999	17	2,910	47
10,000 to 19,999	7	4,000	30
20,000 to 29,999	3	3,980	16
30,000 to 39,999	1	b	b
40,000 to 49,999	1	b	b
50,000 to 74,999	1	b	b
75,000 to 99,999	1	b	b
100,000 to 149,999	1	b	b
150,000 or more	e	b	b
Type[c]			
With children	13	3,610	28
Elderly	1	b	b
Other	2	2,220	21

$3,560.[17] Families with wages above $8,900 and with wages and AGI of less than $11,620 will receive the maximum credit. The credit will decline by 21.06 percent of any wages or AGI above $11,620; it falls to zero for families with wages or AGI of $28,524 or more. The formulas for determining EITC benefits are more generous for families with children than for childless families and more generous for families with two or more children than for those with one child.

One-tenth of all families and more than one-fourth of families with children received the EITC in 1990, before major increases that were enacted in 1990 and

17. The income levels used to calculate the EITC are adjusted for inflation. Consequently, the values shown here are estimates based on CBO's projections of inflation.

Table 7.
Continued

Family Category	Percentage of Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Benefits as a Percentage of Recipient Family's Income
	Food Stamps		
All Families	10	1,490	15
Income (1990 dollars)[a]			
1 to 9,999	31	1,310	22
10,000 to 19,999	14	1,790	13
20,000 to 29,999	4	1,510	6
30,000 to 39,999	1	b	b
40,000 to 49,999	e	b	b
50,000 to 74,999	e	b	b
75,000 to 99,999	e	b	b
100,000 to 149,999	e	b	b
150,000 or more	e	b	b
Type[c]			
With children	17	2,020	19
Elderly	5	680	8
Other	6	680	8

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Too few families received benefits to allow estimation of a statistically meaningful value.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

d. Because the data do not distinguish accurately between recipients of Aid to Families with Dependent Children (AFDC) and recipients of general assistance, some recipients of general assistance are included with recipients of AFDC.

e. Less than 0.5 percent.

1993 (see Table 8). Benefits averaged $600, nearly two-thirds of the maximum credit of $953 in that year. The EITC increased the income of the average recipient by 3 percent. Families with incomes below $10,000, however, received a 9 percent boost in income from the credit.

Whether the EITC encourages or discourages work on the part of families depends on their level of income. The credit offers a work incentive to families with wages in the phase-in range by increasing their earnings up to 40 percent. The credit may be a disincentive to work for families with incomes in the phaseout range.

Table 8.
Percentage of Families Receiving the Earned Income Tax Credit, Average Credit per Recipient Family, and Credit as a Percentage of Family Income, by Family Income and Type, 1990

Family Category	Percentage of Families Receiving Credit	Average Credit per Recipient Family (1990 dollars)	Credit as a Percentage of Recipient Family's Income
All Families	10	600	3
Income (1990 dollars)[a]			
1 to 9,999	12	590	9
10,000 to 19,999	22	650	4
20,000 to 29,999	9	470	2
30,000 to 39,999	4	570	2
40,000 to 49,999	2	630	1
50,000 to 74,999	2	600	1
75,000 to 99,999	2	510	1
100,000 to 149,999	2	600	1
150,000 or more	1	b	b
Type[c]			
With children	28	600	3
Elderly	d	b	b
Other	d	b	b

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Too few families received benefits to allow estimation of a statistically meaningful value.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

d. Less than 0.5 percent.

For families at that level, each additional dollar of income reduces their credit by as much as 21 cents--leaving them with 79 cents of net income before other taxes.[18]

18. The increased income from the credit provides recipients with an incentive to work less. That incentive reinforces the disincentive to work for families in the phaseout range and offsets incentives to work more for families in the phase-in range.

Further Means-Testing of Income Support Programs

Additional means-testing of the income support programs discussed above seems to be a two-edged sword. Assistance programs designed to aid low-income families already impose limits on both the incomes and assets of recipients. Including those programs in a broad-based means test could thus be duplicative and result in

little impact on program costs. At the same time, global approaches offer at least one advantage: instead of the monthly tests now used in each program other than the EITC, the programs would be subject to annual tests.[19] As a consequence, beneficiaries who qualified for assistance for only part of a year and who had substantial annual incomes could lose some or all of their benefits.[20] This approach would target the limited resources available toward the long-term poor rather than the temporarily poor.

Whether a policy of additional global means-testing would defeat the aims of the programs would depend on each family's circumstances. For example, an annual means test could require an unemployed single mother who received assistance during the first half of a year and then found a well-paying job during the second to repay some of that assistance. An otherwise similar mother whose fortunes were reversed--she was employed at a good wage during the first half of the year before losing her job and qualifying for welfare--could face a serious problem: she might have to repay some of those benefits because of her annual income but might not have the resources to do so.

On the one hand, setting benefit levels on the basis of a retrospective means test of annual income would avoid the problem of families having inadequate resources to repay benefits. On the other hand, it might deny assistance to families who were truly in need. In large part, the monthly means tests currently imposed on some entitlements recognize that families can need outside assistance for short periods, even if they can meet their needs by themselves most of the time.

Government-Sponsored Health Insurance

Two major government programs provide health insurance for elderly, disabled, and poor people. Medicare offers assistance to people who are age 65 or older or permanently disabled who qualify on the basis of their own or others' work experience. Medicaid provides health care to people with low incomes and assets as well as to families who have spent large shares of their incomes on medical care.

Medicare

Established in 1965, Medicare provides health care to elderly and disabled people through two separate programs. Hospital Insurance (HI), or Part A of Medicare, pays for hospital inpatient services, home-based health care, and skilled nursing. Supplementary Medical Insurance (SMI), or Part B, pays for doctors and outpatient services.

Payments from the HI trust fund are financed primarily through payroll taxes; a combination of enrollee premiums (roughly one-quarter of costs) and general revenues supports SMI benefits. In 1994, Medicare will provide roughly $161 billion in medical care to more than 34 million beneficiaries.

Medicare is the second largest entitlement program, exceeded only by Social Security. In 1990, nearly one-fourth of all families in this country received Medicare benefits at an average cost to the federal government of about $3,800 (see Table 9).[21] Virtually all elderly families--96 percent--participated in the program, compared with just 5 percent of younger families. Elderly families with higher incomes were somewhat less likely to get Medicare benefits, probably because their members were still working and receiving health insurance through their employers.

The program distributes HI benefits without regard to need, and the arguments supporting that policy are similar to those used for Social Security. The program is a social insurance program paid for by payroll taxes, say supporters. Through it, workers insure themselves against a portion of the health care costs that they expect to incur as retirees. According to that view,

19. Because the EITC is based on wages and total income from the previous year, it already imposes an annual means test.

20. Note, however, that many families with temporarily low incomes would have enough assets to disqualify them from receiving assistance.

21. This analysis values Medicare benefits at their insurance value--that is, the total cost of the program divided by the number of beneficiaries--minus premiums paid for SMI benefits. This approach assigns a constant value to every beneficiary, regardless of how much medical care is consumed, and therefore avoids attributing the highest values to the sickest participants in the program. The Congressional Budget Office assigned a value for 1990 of about $2,940. Chapter 5 discusses the problem of valuing health benefits.

Table 9.
Percentage of Families Receiving Health Benefits, Average Value per Recipient Family, and Benefits as a Percentage of Family Income, by Program, Family Income, and Family Type, 1990

Family Category	Percentage of Families Receiving Benefits	Average Value per Recipient Family (1990 dollars)	Value as a Percentage of Recipient Family's Income
Medicare			
All Families	24	3,830	13
Income (1990 dollars)[a]			
1 to 9,999	34	3,200	48
10,000 to 19,999	30	3,830	26
20,000 to 29,999	25	4,100	17
30,000 to 39,999	21	4,270	12
40,000 to 49,999	17	4,140	9
50,000 to 74,999	15	4,170	7
75,000 to 99,999	17	4,160	5
100,000 to 149,999	18	4,290	4
150,000 or more	20	4,380	1
Type[b]			
With children	6	3,500	11
Elderly	96	3,930	13
Other	4	3,100	15
Medicaid			
All Families	10	3,950	28
Income (1990 dollars)[a]			
1 to 9,999	29	3,480	56
10,000 to 19,999	12	4,550	33
20,000 to 29,999	5	4,730	19
30,000 to 39,999	3	4,350	13
40,000 to 49,999	3	4,040	9
50,000 to 74,999	2	4,570	8
75,000 to 99,999	2	3,840	5
100,000 to 149,999	1	c	c
150,000 or more	1	c	c
Type[b]			
With children	16	4,310	29
Elderly	10	2,310	17
Other	5	4,570	36

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The value of health benefits equals the insurance value of the benefits net of any premiums paid.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

c. Too few families received benefits to allow estimation of a statistically meaningful value.

enrollees have paid for their benefits, just like any other form of insurance.

Yet past contributions fall considerably short of paying for the benefits of current enrollees. Those benefits are funded through a pay-as-you-go mechanism, which has been unable to keep pace with the program's rapid growth in numbers of beneficiaries and real costs per beneficiary. As a consequence, current workers--including those with low and moderate earnings--are paying for the health care costs of HI enrollees, some of whom may be quite affluent. Proponents of cuts in the program or increased cost sharing by beneficiaries assert that higher-income participants should bear more of the program's costs.

Similar arguments apply to the SMI portion of Medicare. SMI beneficiaries pay only about one-fourth of program costs; the remainder comes from general revenues. People who advocate restraints on entitlements question why taxpayers should be paying three-fourths of SMI costs for enrollees with substantial incomes. Both the Bush and Clinton Administrations have acted on that question. Each has proposed that higher-income enrollees pay a greater share of SMI costs through higher monthly premiums.

Others are more cautious about introducing SMI premiums that would be related to income, in part because of the short-lived Medicare Catastrophic Care Act (MCCA). The MCCA was designed to provide catastrophic health insurance and drug benefits to all Medicare enrollees. It paid for those benefits by imposing premiums on all beneficiaries and substantial income tax surcharges on those with moderate to high incomes. (The surcharge would have fallen on the 40 percent of Medicare enrollees who had federal individual income tax liability of at least $150.)

The logic that the recipients of the benefits should actually pay more of the costs of expanding the program was initially persuasive to the Congress and the President. But the redistributive aspects of the program's financing, which required higher-income recipients to pay more than the costs of their expected additional benefits, created a political maelstrom that resulted in the MCCA's repeal.

Medicaid

Under the Medicaid program, states provide health care to low-income families with children as well as to poor elderly and disabled people.[22] The federal and state governments share the costs of the program on the same basis as they share the costs of AFDC.[23] States must provide Medicaid to all AFDC families and most SSI recipients. However, the law permits 12 states that provided Medicaid under more restrictive eligibility standards before the establishment of SSI in 1972 to continue to use those standards.

Beginning in 1986, the Congress extended mandatory Medicaid coverage to children and pregnant women in families with low incomes.[24] States also have the option of offering Medicaid benefits to other low-income families who are considered medically needy; 36 states did so in 1992. States determine what medical services are covered under their Medicaid plans as well as the levels of reimbursement to providers. In 1994, nearly 34 million people will receive an estimated $140 billion worth of Medicaid benefits.

In 1990, 10 percent of all U.S. families participated in the Medicaid program and received benefits with an average insurance value of nearly $4,000 per family (see Table 9).[25] Because of the program's eligibility rules, families with children were more likely than average to participate: 16 percent of them received assistance through the program compared with 7 percent of families without children. Medicaid assisted nearly a third of all families with incomes below $10,000 and 60 percent of families in that income range who had children.

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22. People participating in the Medicare program can also receive Medicaid benefits if their incomes are low enough. In such cases, Medicaid pays most out-of-pocket costs that Medicare does not pay.

23. Because the federal and state governments share the costs of Medicaid, they would also share any savings generated by means-testing the benefits of the program.

24. Changes have been phased in over time, extending mandatory coverage to all poor children under age 19 but only for those born after September 1983. Consequently, not until 2002 will all poor children under age 19 be eligible for coverage.

25. CBO's analysis assigns insurance values to Medicaid benefits on the basis of recipiency status and state. Recipients are classified as either elderly, nonelderly disabled, nonelderly adult nondisabled, or child nondisabled. Chapter 5 discusses the problem of valuing health benefits.

Regulations governing eligibility for Medicaid benefits already impose strict limits on both the income and assets recipient families may have. Further subjecting beneficiaries to a more global means test at higher income levels would, for the most part, duplicate current tests and add substantial new administrative costs. And if the test was an annual one--as it most likely would be--families in some categories could be hurt.

A small number of families who now qualify for benefits on the basis of low monthly incomes for part of a year would be made ineligible under an annual income test. Using an annual test could deny health care to people during periods when their resources were truly inadequate to pay for health services. Alternatively, such families could receive health care under Medicaid when they needed it but then have to pay the govern-

Table 10.
Characteristics of Families Receiving Entitlement Benefits, by Family Income and Type, 1990

Family Category	Recipient Families (Thousands)	All Families (Thousands)	Percentage of All Families Receiving Benefits	Average Benefits per Recipient Family (1990 dollars)	Percentage of All Benefits
All Families	50,270	103,280	49	10,320	100
Income (1990 dollars)[a]					
1 to 9,999	13,340	18,810	71	7,880	20
10,000 to 19,999	12,630	22,160	57	10,340	25
20,000 to 29,999	8,230	17,860	46	11,220	18
30,000 to 39,999	5,410	13,140	41	11,350	12
40,000 to 49,999	3,390	9,390	36	11,460	7
50,000 to 74,999	4,200	12,470	34	11,910	10
75,000 to 99,999	1,480	4,290	35	13,060	4
100,000 to 149,999	760	2,370	32	14,640	2
150,000 or more	450	1,570	29	16,190	1
Type[b]					
With children	13,720	34,890	39	8,200	22
Elderly	21,710	22,140	98	13,970	58
Other	14,840	46,250	32	6,930	20

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, the outlay portion of the earned income tax credit, Medicare, Medicaid, and federal civilian and military pensions. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

See Box 1 on page 8 for a discussion of how to interpret data on the receipt of benefits.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

ment back for the cost of that care if they were deemed able to do so based on their annual incomes. Families who had to pay back those costs--or who had to pay taxes on the value of their benefits--could well lack the resources needed to do so.

That sort of payback requirement could have other adverse effects as well. It might pose a substantial disincentive for families to earn additional income during years in which they received Medicaid assistance, given that some part of the added earnings would go to repay the costs of that assistance. It might also cause some people not to seek health care when appropriate, particularly in the case of preventive care for children.

The Distribution of All Entitlement Benefits

Examining individual entitlements to see how and to whom they give benefits fails to provide a complete picture of which families receive how much in total entitlement payments. Many families receive payments from more than one program, either because participation in one program makes a family automatically eligible for benefits from another or because programs may have similar eligibility requirements. All recipients of AFDC, for example, qualify for Medicaid assistance. In addition, they are almost certainly eligible for food stamps, since the income limits for AFDC are generally lower than those for the Food Stamp program. Similarly, a vast majority of the elderly get both Social Security and Medicare because the program requirements are much the same. Determining the full extent of the entitlements that families receive requires combining all of the programs and examining the distribution of their total benefits.

In 1990, just under half of all families participated in one or more of 11 major federal entitlements. More than 50 million families received a total of about $360 billion in cash payments from Social Security, unemployment compensation, veterans' compensation and pensions, AFDC, SSI, or federal civilian or military pensions, and more than $150 billion more of in-kind benefits from the Food Stamp program, Medicare, and Medicaid. On average, the government spent roughly $10,000 per recipient family.

Benefits in 1990, however, were not distributed evenly among families with different incomes (see Table 10). On the one hand, low-income families were more likely to receive benefits than their counterparts with higher incomes: nearly three-fourths of families with cash incomes below $10,000 were beneficiaries, compared with less than one-third of families with incomes above $100,000. On the other hand, among recipient families, those with high incomes had higher average benefits than those with low incomes--$15,200 for families with cash incomes above $100,000 versus $7,900 for families with incomes below $10,000.

Who received benefits and how much they received also differed widely among types of families (see Table 10). Virtually all families (98 percent) with at least one member age 65 or older received some benefits, compared with 39 percent of families with children and 32 percent of other families (no elderly family members or children). Among recipient families, average benefits were nearly twice as large for elderly families. They received about $14,000 versus roughly $8,200 for families with children and $6,900 for other families. And slightly more than two-fifths of all recipient families were elderly, whereas the remaining families split about evenly between those with and without children. Overall, three-fifths of all entitlement outlays went to elderly families, and about one-fifth each went to families with children and other families.

Chapter Three

Options for Curtailing Entitlements and Their Effects on the Budget

Limiting entitlement benefits for higher-income recipients could have significant effects on the federal budget and on the incomes of beneficiaries. The extent of those effects depends largely on the specific approach taken. This study examines three such options. One would subject entitlements to the federal individual income tax, a second would reduce benefits at increasing rates for middle- and high-income families, and a third would deny benefits entirely to families with the highest incomes. For simplicity's sake, the ensuing discussion refers to these approaches as the tax option, the benefit reduction option, and the benefit denial option.

As specifically formulated for this study, the three options would have substantially different budgetary effects. The varying effects arise because the options reduce the net benefits of different numbers of recipients and use markedly different rates of benefit reduction. The tax option would affect the largest number of recipients, but it would tax away relatively small fractions of their benefits. In contrast, the benefit reduction option would make larger cuts in the benefits of fewer recipients. The benefit denial option would affect only about 1 percent of recipients; however, those affected would, on average, lose more than three-fourths of their benefits.

The broader reach of the tax option would have the greatest budgetary effect, increasing revenues by nearly $260 billion over the 1995-1999 period. The benefit reduction option formulated for this analysis would save about $190 billion over the same period. The benefit denial option would save roughly $45 billion.[1]

The relative sizes of these effects stem directly from the particular forms of the options that the Congressional Budget Office examined. Those options were chosen because they represent actual proposals. Modifying the options in various ways would change the effects they produced. Each option could be adjusted to make its budgetary impact more comparable with the others or to affect a similar number of beneficiaries.[2]

For example, if the tax option exempted the benefits of couples with incomes below $13,000 and of other taxpayers with incomes below $10,000, it would generate, over the 1995-1999 period, budgetary savings roughly equal to those of the benefit reduction option. Denying entitlements to all couples with incomes of more than $62,000 and other families with incomes of more than $50,000 would also yield cuts in entitlements similar to those of the benefit reduction option. Yet despite the similar budgetary savings that the modified options would generate, they would still affect different beneficiaries and would take different amounts away from the families who were affected. Those considerations are of major importance to policymakers as they make decisions about changing entitlements.

Make Entitlements Subject to the Individual Income Tax

The first option would broaden the measure of income used in the federal individual income tax to include all

1. Appendix A discusses CBO's methods for estimating the budgetary savings from the policy options.

2. Appendix B shows the budgetary savings and distributional effects of the tax and benefit denial options after adjusting them to make their savings comparable with those from the benefit reduction option discussed in this chapter.

entitlements. The income tax now excludes from taxable income all cash welfare payments from federal and state governments as well as the value of in-kind benefits such as food stamps and health care assistance. Also untaxed are significant portions of Social Security payments and veterans' compensation and pensions. This option would make more entitlement benefits subject to federal taxes. It would not affect recipients of unemployment benefits or federal civilian and military pensions because those benefits are already fully subject to federal income taxes.

The tax option CBO formulated for this analysis would include as taxable income 85 percent of all Social Security and Railroad Retirement benefits for all taxpayers. Excluding 15 percent of those benefits approximates the way the income tax treats pensions to which employees contribute: the worker's own contributions (which are made out of after-tax earnings) are not taxed when pension benefits are distributed. The employee's share of the payroll tax comes out of his or her after-tax earnings. For most retirees, the taxes they pay during their working years equal no more than 15 percent of the benefits they receive in retirement.

Under current law, nearly four-fifths of the recipients of Social Security and Railroad Retirement pay no taxes on their benefits. Less than 10 percent of them pay taxes on 85 percent of their benefits.[3]

Taxing all entitlements brings up the question of how to place a value on health benefits (or other assistance received in kind rather than in cash). The whole issue produces widespread disagreement. This analysis uses the insurance value of each program--the total cost to the government of providing benefits divided by the number of people enrolled in the program. That approach allocates costs among beneficiaries without regard to the services any one individual uses or the value any one enrollee places on benefits. The method is straightforward, but it could create practical problems for low-income recipients who may not have the money to pay taxes on benefits that they receive in kind.[4]

The option's treatment of Medicare benefits would parallel that of Social Security: it would tax 85 percent of the insurance value of hospital (Part A) benefits--which are financed through payroll taxes that workers and employers both pay--plus the insurance value of benefits under Supplementary Medical Insurance (Part B) that are not funded through premiums. Because hospital costs have escalated rapidly in recent years and because contributions to Medicare began only in 1966, almost every elderly Medicare enrollee has paid much less in payroll taxes than 15 percent of the actuarial value of his or her Part A benefits. As a result, excluding 15 percent of the value of Part A benefits is a more generous tax treatment than excluding 15 percent of Social Security benefits--although the percentage is the same. Because about one-fourth of funding for the SMI part of Medicare comes from premiums paid by enrollees, this option would include as taxable income the difference between the insurance value of SMI coverage and those premiums.

The option would also tax the full value of other entitlement benefits, including Aid to Families with Dependent Children, Supplemental Security Income, veterans' compensation and pensions, the face value of food stamps, and the insurance value of Medicaid. Federal and state governments finance all of these programs through general tax revenues; beneficiaries do not contribute directly to the programs from which they receive assistance. For that reason, the tax option gives none of these benefits the type of partial exemption provided for Social Security and Medicare.[5]

Budgetary Savings

Expanding the coverage of the income tax to include entitlement benefits that are now untaxed would significantly increase the amount of income subject to tax. As a consequence, federal revenues would rise by about $18 billion in fiscal year 1995 and by nearly $260 bil-

3. Current law includes in adjusted gross income the lesser of the following two calculations: one-half of Social Security and Railroad Retirement benefits *or* one-half of the excess of the taxpayer's modified adjusted gross income (AGI plus nontaxable interest plus one-half of Social Security and Railroad Retirement benefits) over a threshold of $32,000 for married couples filing jointly, $25,000 for single taxpayers, and zero for married people filing separately. Taxpayers with modified AGI over a second threshold ($44,000, $32,000, and zero, respectively) must include in AGI the lesser of 85 percent of benefits or 85 percent of modified AGI over the second threshold. Before 1994, a maximum of one-half of benefits was counted in AGI.

4. Chapter 5 discusses this issue more completely.

5. The benefits from other entitlement programs, such as the income-replacement portion of workers' compensation, could be taxed, but they are excluded from this analysis because of the lack of requisite data.

lion over the 1995-1999 period (see the top line of Table 11).

Nearly one-half of the additional revenues would come from the increase in the portion of Social Security benefits subject to the income tax. Almost three-fourths of the rest of the gain would come from taxing the insurance value of Medicare. Taxing means-tested benefits would produce less than one-eighth of the five-year savings. By 1999, the added revenues from taxing all entitlements would offset about 7 percent of total federal spending for entitlements.

Making only some entitlements taxable would reduce the added revenues, but those losses would be relatively small as long as Social Security and Medicare were among the programs still included. Taxing only those two programs would raise revenues by nearly $220 billion over five years--roughly 85 percent of the gains that would come from taxing all entitlements. Taxing only Social Security would lower the increase in revenues, however. Over the 1995-1999 period, new revenues from including only Social Security would be about $100 billion, less than 40 percent of the gains if all benefits were taxed. Government pensions (minus contributions by workers) and unemployment compensation are already fully taxable, so no additional revenues can be obtained from taxing them.

Excluding some benefits from a person's taxable income would reduce the gains in revenues by more than the revenues that would come from taxing the

Table 11.
Additional Federal Revenues from Broadening Taxable Income to Include Entitlements, Fiscal Years 1995-1999 (In billions of dollars)

Programs Affected	1995	1996	1997	1998	1999	1995-1999
All Programs[a]	18.0	52.6	57.0	62.3	68.1	258.0
All Programs Except Medicaid	16.7	48.0	52.1	56.8	62.1	235.7
All Programs Except Medicare and Medicaid	9.5	24.6	25.5	26.5	27.4	113.5
Cash Social Insurance Programs Only	9.1	23.3	24.0	24.9	25.7	107.0
Social Security and Medicare Only	15.6	44.4	48.4	52.9	58.0	219.3
Social Security Only	8.5	21.4	22.2	23.0	23.8	98.9
Means-Tested Programs Only	0.3	1.2	1.3	1.4	1.5	5.7

SOURCE: Congressional Budget Office.

NOTE: The table covers the following entitlements: cash social insurance (Social Security and Railroad Retirement, unemployment compensation, and veterans' compensation and pensions); health programs (Medicare and Medicaid); and means-tested programs (Supplemental Security Income, Aid to Families with Dependent Children, and the Food Stamp program).

a. Unemployment compensation is already fully taxable.

omitted benefits alone. Counting the benefits from other programs as taxable income increases an individual's income--the base to which tax rates are applied--and may move that taxpayer into a higher tax bracket. Thus, if benefits from all programs were taxed, benefits from one program would be taxed at a higher rate than would apply if only its benefits were being taxed. For example, including both Social Security and Medicare benefits in a person's taxable income would increase revenues by roughly 20 percent more than the sum of the increases generated by including each benefit by itself. This example illustrates why total gains in revenues cannot easily be taken apart to estimate the effects of making specific benefits taxable.

Taxing means-tested benefits would affect only a small fraction of beneficiaries and generate relatively little revenue. If only AFDC, SSI, and food stamps were taxable, gains in revenues over the 1995-1999 period would be less than $6 billion. Because the participants in these programs have low incomes, they generally pay no income taxes. And those beneficiaries who would pay taxes probably participate in the programs for only part of the year: they may be poor for a few months but have somewhat higher annual incomes.

Modifying the Tax Option

Four types of modifications to this option would change its budgetary savings and how it affected beneficiaries--both who would be affected and how much their after-tax benefits would fall. One change would exclude from taxable income a base amount of entitlements for each taxpayer. For example, couples filing jointly might be able to exclude the first $7,000 of their income from entitlements; other taxpayers might be able to exclude the first $4,000. This adjustment would protect the poorest beneficiaries, but it would substantially reduce the added tax payments for taxpayers at all income levels.

The second type of modification would establish a threshold that income would have to exceed before benefits would be taxable, the same way that Social Security benefits are not taxable for people whose incomes are below a specific threshold. For example, families with adjusted gross incomes--including their benefits--below $10,000 might be exempt from taxes on their benefits. But as their incomes rose, an increasing share of their entitlements would be taxed. When a family's income reached $20,000 or more, all of its benefits would be taxed. This adjustment would keep families with the lowest incomes from losing some of their after-tax benefits. It would also lessen the benefits that other low-income families would lose.

A third change would make only a fraction of a family's benefits subject to taxation (again, like Social Security). Compared with taxing all benefits, this change would reduce the option's impact on all recipients--no one would have all of his or her benefits taxed. In addition, counting only part of a family's benefits would protect those recipients with the lowest incomes: by taxing only a fraction of their benefits, the system would not move them above the point where they would have to start paying taxes on those benefits.

A final alteration would exempt some entitlements from taxation--for example, means-tested benefits such as Medicaid, food stamps, and AFDC. This approach would reduce the number of families who would have to pay taxes on their entitlements by exempting the neediest families.

Reduce Entitlements for Middle- and High-Income Recipients

The Concord Coalition recently proposed that federal entitlements be reduced rapidly as incomes rose.[6] It suggested two possible mechanisms: one indirect (supernormal tax rates imposed under the individual income tax) and one direct (new programmatic structures that would reduce benefits). Under the coalition's proposal, families with incomes above $40,000 would lose benefits according to a graduated scale: those with incomes between $40,000 and $50,000 would lose 10 percent, with that share increasing by 10 percentage points for each $10,000 of income up to 85 percent of benefits above $120,000 of total income.

6. Concord Coalition, *The Zero Deficit Plan* (Washington, D.C.: Concord Coalition, 1993).

The Concord Coalition's plan would consider nonentitlement income first in determining the rate by which benefits should be reduced. In addition, the plan would reduce benefits only to the extent that they caused total income to exceed $40,000. Some examples may be helpful.

- A family who received $15,000 of Social Security and $30,000 of nonentitlement income would lose $500 of its benefits--10 percent of the $5,000 by which its total income exceeded $40,000. (Remember that the plan counts nonentitlement income first.)

- A family who had $15,000 of Social Security and $45,000 of nonentitlement income would lose $2,500 of its Social Security benefits--10 percent of the $5,000 that fell in the $40,000-$50,000 income range and 20 percent of the $10,000 that fell in the $50,000-$60,000 category.

- A family who had $15,000 of Social Security and $120,000 or more of nonentitlement income would lose $12,750 of its Social Security benefits--85 percent of the $15,000.

The coalition's plan would treat married couples and larger families the same as single people and would adjust for inflation all of the dollar values it used as limits and ranges. The plan also calls for implementing the proposal gradually over six years.

The option that CBO analyzed mimics the Concord Coalition's proposal in all ways but two: it would omit certain benefits for which adequate data do not exist, and it would start to reduce benefits immediately, not gradually over time. Specifically, the option that CBO simulated would cover Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, AFDC, SSI, the face value of food stamps, and the insurance value--minus any premiums paid--of Medicare and Medicaid.[7] The option would go into effect fully on January 1, 1995. (Gradually phasing in the reductions would reduce the budgetary savings discussed below.)

7. As in the tax option, this approach would include 85 percent of the insurance value of Medicare Part A benefits plus the insurance value of Part B benefits minus the premiums paid by participants.

Budgetary Savings

The benefit reduction option would reduce the federal government's total outlays for entitlements by about $9 billion in fiscal year 1995 and by about $190 billion between 1995 and 1999 (see the top line of Table 12).[8] Roughly 60 percent of the savings would come from recapturing Social Security benefits; nearly 30 percent would stem from recovering Medicare costs from the affected enrollees. Only about 3 percent of the option's five-year savings would come from including means-tested benefit programs in the reduction scheme.

Dropping some programs from this option would reduce the budgetary savings it might generate. Excluding health insurance programs, for example, would lower the savings in outlays by about one-third. Reducing only Social Security and Medicare benefits would retain nearly 90 percent of the savings. Applying reductions only to Social Security would save slightly more than $100 billion during the 1995-1999 period.

Modifying the Benefit Reduction Option

Modifications to this option could change the number of beneficiaries who would be affected and the amount of budgetary savings that the option would generate. Raising the level of income at which benefit reductions first begin would exempt more families from cuts in their entitlements. In addition, it would lessen the size of the cuts for those families who would lose less than 85 percent of their benefits. Reducing the fraction of benefits that a family in any income range would lose and raising the upper threshold for the maximum cut of 85 percent would have similar effects. Lowering the maximum loss of benefits below 85 percent would lessen the option's effect--but only for families with the highest incomes.

Any of the above changes would reduce the option's budgetary savings. Of course, reversing the changes--that is, lowering the income level at which cuts start, raising the rate at which benefits are reduced,

8. These estimates do not include any loss of revenues from reducing the amounts of Social Security and unemployment compensation that are subject to taxation.

Table 12.
Budgetary Savings from Reducing Entitlement Benefits for Middle- and High-Income Recipients, Fiscal Years 1995-1999 (In billions of dollars)

Programs Affected	1995	1996	1997	1998	1999	1995-1999
All Programs[a]	9.4	45.4	42.2	44.9	47.9	189.8
All Programs Except Medicaid	9.3	44.4	41.2	43.8	46.6	185.3
All Programs Except Medicare and Medicaid	6.3	30.0	27.4	28.7	30.0	122.4
Cash Social Insurance Programs Only	6.3	29.6	26.9	28.1	29.4	120.3
Social Security and Medicare Only	8.4	39.8	37.1	39.5	42.3	167.1
Social Security Only	5.4	25.4	23.3	24.4	25.6	104.1
Means-Tested Programs Only	0	0.5	0.5	0.6	0.7	2.3

SOURCE: Congressional Budget Office.

NOTE: The table covers the following entitlements: cash social insurance (Social Security and Railroad Retirement, unemployment compensation, and veterans' compensation and pensions); health programs (Medicare and Medicaid); and means-tested programs (Supplemental Security Income, Aid to Families with Dependent Children, and the Food Stamp program).

a. The option including all programs is similar to the proposal of the Concord Coalition.

or taking more than 85 percent of benefits from high-income families--would increase budgetary savings and affect recipients more.

Deny Entitlements to High-Income Recipients

Members of Congress have recently called for legislation to deny entitlement benefits to families with very high incomes.[9] CBO therefore examined an option to take away all entitlements from recipients who have taxable incomes above certain thresholds (which would be adjusted for inflation). Furthermore, unlike the Concord Coalition's proposal to increase rates of benefit reduction gradually over an $80,000 range of income, this option would phase in the complete loss of benefits over a range of just $10,000. For the sake of consistency with the benefit reduction option, this one was formulated so as not to affect federal civilian or military pensions.

Unlike the benefit reduction option, the denial option would treat married couples and single individuals differently. It would establish different income thresholds for denying benefits. In 1995, single people with nonentitlement taxable incomes of more than $110,000 would lose all of their entitlement benefits, as would couples with incomes above $130,000. Singles and couples with total incomes including entitlements below $100,000 and $120,000, respectively, would lose no benefits. All other recipients (singles with incomes be-

9. For example, during the 103rd Congress, Senator Hank Brown proposed an amendment to H.R. 3167 that would have denied emergency unemployment benefits to people with taxable incomes exceeding $200,000.

Table 13.
Budgetary Savings from Denying Entitlement Benefits to High-Income Recipients, Fiscal Years 1995-1999 (In billions of dollars)

Programs Affected	1995	1996	1997	1998	1999	1995-1999
All Programs	4.1	10.1	9.3	10.0	10.7	44.2
All Programs Except Medicaid	4.1	10.1	9.3	9.9	10.6	44.0
All Programs Except Medicare and Medicaid	2.7	6.4	5.8	6.1	6.4	27.4
Cash Social Insurance Programs Only	2.7	6.4	5.8	6.1	6.4	27.4
Social Security and Medicare Only	4.0	9.8	9.1	9.7	10.4	43.0
Social Security Only	2.6	6.2	5.6	5.9	6.2	26.5
Means-Tested Programs Only	0	0	0	0	0	0

SOURCE: Congressional Budget Office.

NOTE: The table covers the following entitlements: cash social insurance (Social Security and Railroad Retirement, unemployment compensation, and veterans' compensation and pensions); health programs (Medicare and Medicaid); and means-tested programs (Supplemental Security Income, Aid to Families with Dependent Children, and the Food Stamp program).

tween $100,000 and $110,000 and couples with incomes between $120,000 and $130,000) would lose 50 percent of their benefits that fell between the two thresholds; they would lose all of their entitlements that raised their total income above the upper limits.

Thus, for example, a couple with $110,000 of nonentitlement income and $50,000 of entitlements would keep all of the first $10,000 of entitlements (up to the threshold of $120,000, the range in which no benefits are lost); half of the next $10,000 (that part of total income falling between $120,000 and $130,000, which is subject to a 50 percent reduction); and none of the remaining $30,000.

Budgetary Savings

Of the three options that CBO examined, eliminating the benefits that high-income families receive would have the smallest budgetary effect. The benefit denial option would save about $44 billion over five years, less than one-fourth as much as the other options (see the top line of Table 13).[10]

As was the case for the benefit reduction option, roughly three-fifths of those savings would derive from Social Security, with another third coming from Medicare. Hardly any savings would come from means-tested programs or from either unemployment compensation or veterans' programs. If the option covered only Social Security and Medicare, it would lose virtually no savings. Including only Social Security would reduce savings by about 40 percent.

One major drawback to this option is its potential for imposing an effective tax rate of more than 100 percent on nonentitlement income. Consider a woman

10. As in the benefit reduction option, the budgetary savings under the denial option would be offset by losses of revenue from reducing taxable benefits. Because this option would affect people who face above-average marginal tax rates and for whom 85 percent of Social Security benefits are currently taxable, the revenue offset would be a larger fraction of gross savings than under the benefit reduction option.

whose high level of income causes the loss of some but not all of her entitlements. If she got a raise and her nonentitlement income rose by a dollar, this option would reduce her entitlements by a dollar, leaving her pretax income unchanged. But that additional dollar of income from her raise would be subject to income and perhaps payroll taxes that could exceed 40 percent. Thus, the effective tax on her additional dollar of income would be more than $1.40--$1.00 in reduced entitlements and $0.40 in income and payroll taxes--leaving her less well off than before her raise. This high (140 percent) tax rate would, however, affect only recipients who lost benefits and whose nonentitlement incomes fell below the top of the range over which benefits were phased out. The narrower that range, the fewer the people who would be affected and the fewer the disincentives for recipients to earn more income.

Modifying the Benefit Denial Option

Two modifications to this option could change how many beneficiaries would be affected and the budgetary savings that would be realized. First, lowering by a modest amount the income threshold above which benefits were reduced would generate more savings (by denying entitlements to more beneficiaries) while continuing to protect the entitlements of lower-income families. Second, broadening the income range over which benefits were phased out would lower the budgetary savings somewhat by reducing the number of people who were denied benefits. In addition, although the latter change would lessen the disincentives to work for some individuals, its net effect might be to discourage work because it would subject more recipients to high tax rates.

Chapter Four

Distributional Effects

The three options that were analyzed and discussed in Chapter 3 differ not only in the amount of budgetary savings they would generate but also in the distribution of their impact--how they would affect different kinds of recipient families with different levels of income.[1] The tax option would affect the largest number of families, and its effects would be felt at all income levels: at least three-fifths of the families in every category of income except the lowest and nearly two-thirds of all recipient families would pay taxes on their benefits (see Table 14). In contrast, the denial option (families with the highest incomes lose all benefits) would affect only 1 percent of families who now receive entitlements, and virtually none of those affected would have incomes below $100,000. The benefit reduction option, which would lower entitlements going to middle- and high-income families, would cut benefits for about one-fifth of all recipients, almost all of whom would be in families with cash incomes above $30,000. These distributional effects could differ markedly, however, if the parameters of the options were changed so that the budgetary savings they generated were comparable.[2]

These effects of the three options are reflected in the distribution of their total savings among categories tax option would come from families with cash incomes of families. About one-fourth of the revenues from the below $20,000; nearly three-fourths would come from those with incomes below $50,000 (see Table 15). In contrast, nearly 90 percent of the savings from denying benefits to families with the highest incomes would be from families with incomes above $150,000, and virtually none would come from those with incomes under $100,000. Two-thirds of the savings from the option to reduce benefits would come from families with incomes above $75,000.

Because of the design of the three options, the impact of each would be progressive--that is, the share of benefits lost by affected families would increase sharply with income (see Table 16). Losses of benefits under the tax option would reflect the progressivity of the individual income tax. Families with incomes below $10,000 would lose about 4 percent of the value of their benefits, and those with incomes above $150,000 would give up about 19 percent of their benefits.

The other two options would have generally higher rates of benefit losses over wider ranges. The option to reduce benefits would curtail them by less than 2 percent for families with incomes below $40,000 while taking more than 80 percent from families with incomes above $150,000. The option denying benefits to the highest-income families would take about one-third of benefits from families with incomes between $100,000 and $150,000 and nearly 90 percent of the benefits going to families with incomes above $150,000.

The recently enacted Omnibus Budget Reconciliation Act of 1993 reduced after-tax Social Security benefits going to upper-income families. The tax option

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1. The options examined in this chapter would affect benefits from Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid.

2. Appendix A discusses CBO's methods for estimating the distributional effects of the policy options. Appendix B contains tables similar to those in this chapter for alternative versions of the three options that reduce total entitlements by roughly the same percentage.

Table 14.
Percentage of Recipient Families Losing Benefits Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type

Family Category	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
All Families	64	22	1
Income (1995 dollars)[a]			
1 to 9,999	48	0	0
10,000 to 19,999	71	b	0
20,000 to 29,999	72	1	0
30,000 to 39,999	69	20	0
40,000 to 49,999	64	74	0
50,000 to 74,999	61	75	0
75,000 to 99,999	62	74	b
100,000 to 149,999	67	77	9
150,000 or more	79	89	67
Type[c]			
With children	34	20	b
Elderly	85	25	2
Other	60	21	1

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Less than 0.5 percent.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

would extend those reductions to lower- and middle-income families.

Effects on Different Types of Families

The three options would affect different types of recipient families in widely varying ways. About five out of every six elderly families would pay taxes on their benefits under the tax option, compared with one-third of families with children and three-fifths of other families (see Table 14). The option to deny benefits to recipient families with the highest incomes would disproportionately affect elderly families compared with nonelderly families, although the option would cut benefits for just 2 percent of the elderly. In comparison, the option to reduce benefits for middle- and high-income families would affect between one-fifth and one-fourth of families of each type.

Table 15.
Distribution of Budgetary Savings Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type (In percent)

Family Category	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
All Families	100	100	100
Income (1995 dollars)[a]			
1 to 9,999	5	0	0
10,000 to 19,999	19	b	0
20,000 to 29,999	21	b	0
30,000 to 39,999	16	1	0
40,000 to 49,999	10	6	0
50,000 to 74,999	14	26	0
75,000 to 99,999	6	21	b
100,000 to 149,999	4	25	11
150,000 or more	3	21	89
Type[c]			
With children	9	12	b
Elderly	73	72	94
Other	18	15	5

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Less than 0.5 percent.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

In many instances, childless families and families with children would experience very different effects under the options. The tax and benefit denial options would affect childless families more than families with children, cutting much larger percentages of the benefits of the former. Under the option to reduce benefits, losses would be similar for all types of families (see Table 16).

Under the tax option, for example, affected families with children would pay 5 percent of their benefits in new taxes, compared with about 11 percent for childless families. Under the benefit reduction option, all three family types would face reductions in their benefits of about one-fifth.

Effects Among Programs

All three options would affect some entitlements more than others. Not surprisingly, recipients of means-

Table 16.
Percentage of Average Benefits Lost by Families Losing Benefits Under Three Policy Options to Cut Net Entitlement Costs, by Family Income and Type

Family Category	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
All Families	10	23	77
Income (1995 dollars)[a]			
1 to 9,999	4	0	0
10,000 to 19,999	7	b	0
20,000 to 29,999	11	b	0
30,000 to 39,999	12	2	0
40,000 to 49,999	11	6	0
50,000 to 74,999	12	19	0
75,000 to 99,999	14	38	b
100,000 to 149,999	15	64	37
150,000 or more	19	81	89
Type[c]			
With children	5	20	b
Elderly	11	23	80
Other	10	22	57

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Too few families would be affected to allow estimation of a statistically meaningful value.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

tested benefits would be both less likely to face cuts in their benefits and subject to smaller losses if they were affected than recipients of other entitlements (see Table 17 on page 44). Even so, the option to tax benefits would affect more than half of all families receiving Aid to Families with Dependent Children or food stamps and two-thirds of the families on Medicaid. Those families who owed additional taxes, however, would pay taxes amounting to less than one-tenth of their benefits.[3]

In contrast, the option to reduce benefits would affect less than one-tenth of families receiving any means-tested benefit--although those who were affected would lose more of their benefits. And virtually no families getting means-tested help would be affected by the option to deny benefits to high-income families.

Families who receive entitlements that are not subject to means tests would be more likely to lose benefits

3. Measuring the budgetary savings that should be credited to individual entitlements requires what is necessarily an arbitrary allocation of those savings. This analysis assumes that the taxes paid on total benefits or the reductions in total benefits are distributed among the various programs in proportion to the benefits received. Thus, for example, an individual who has to give up 10 percent of his or her total benefits to taxes or in reduced payments is assumed to lose 10 percent of the benefits he or she would receive from each program.

under any of the three options than families who receive means-tested benefits. In addition, those who are affected would lose more. At least three-quarters of the recipients of Social Security, veterans' benefits, or Medicare would be subject to higher taxes under the tax option, and their after-tax benefits would drop by an average of between 9 percent and 14 percent. The benefit reduction option would affect between one-fourth and two-fifths of families participating in those programs, reducing their benefits, on average, by between 20 percent and 25 percent. No more than 2 percent of families in any program would lose benefits under the denial option, but the average reduction would be about 40 percent for veterans' benefits and about 80 percent for Social Security and Medicare.

The fraction of families who would be affected and the average loss of benefits they would sustain combine to determine what part of a program's total benefits each option would save (see the last panel of Table 17). The burden of the tax option would be spread more evenly among the eight programs that the Congressional Budget Office examined than would the costs of the other policies, although significant variation occurs under each option. From each program the tax option would take at least 2 percent of benefits (from the Food Stamp program) and as much as 12 percent (from veterans' benefits). The benefit reduction option would leave food stamps virtually unaffected but would cut veterans' benefits by 10 percent. The denial option would get the bulk of its savings from Social Security and Medicare--it would reduce payments from each by about 2 percent. The different levels of budgetary savings of the three options reflect the variation among the programs in how much benefits would be reduced.

Table 17.
How Three Policy Options to Cut Net Entitlement Costs Affect the Benefits Lost by Recipient Families, by Program (In percent)

	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
	Recipient Families Losing Benefits		
Cash Social Insurance Programs			
Social Security[a]	82	24	2
Unemployment compensation	b	32	c
Veterans' benefits[d]	78	39	1
Means-Tested Assistance			
Supplemental Security Income	83	7	c
Aid to Families with Dependent Children[e]	59	5	c
Food stamps	57	2	c
Health Programs			
Medicare	84	23	2
Medicaid	67	6	c
All Benefits	64	22	1
	Benefits Lost by Families Losing Benefits		
Cash Social Insurance Programs			
Social Security[a]	9	23	78
Unemployment compensation	b	25	48
Veterans' benefits[d]	14	21	40
Means-Tested Assistance			
Supplemental Security Income	8	18	f
Aid to Families with Dependent Children[e]	5	13	f
Food stamps	5	f	f
Health Programs			
Medicare	13	23	80
Medicaid	7	16	f
All Benefits	10	23	77

Table 17.
Continued

	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
	Benefits Lost by All Recipient Families		
Cash Social Insurance Programs			
Social Security[a]	8	7	2
Unemployment compensation	b	9	c
Veterans' benefits[d]	12	10	c
Means-Tested Assistance			
Supplemental Security Income	7	2	c
Aid to Families with Dependent Children[e]	4	1	c
Food stamps	2	c	c
Health Programs			
Medicare	11	6	2
Medicaid	5	1	c
All Benefits	7	5	1

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTE: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

a. Includes Railroad Retirement benefits.

b. The tax option would not affect recipients of unemployment compensation because that entitlement is already subject to income taxation.

c. Less than 0.5 percent.

d. Veterans' benefits comprise veterans' compensation and veterans' pensions.

e. Because the data do not distinguish accurately between recipients of Aid to Families with Dependent Children (AFDC) and recipients of general assistance, some recipients of general assistance are included with recipients of AFDC.

f. Too few families would be affected to allow estimation of a statistically meaningful value.

Chapter Five

Implementing a Global Means Test

Establishing a global means test would require decisions about its structure and administration. Would each entitlement program administer the test, or would the Congress create a new central agency to oversee all entitlements? Would the Internal Revenue Service (IRS) administer the test through the tax system?

Should participants lose benefits according to a prospective scheme (based on the resources they anticipate having in a future period) or should the reductions be retroactive (based on their income over a past period)? What is the appropriate "unit"--individual, couple, family, or other--over which to determine resources and hence eligibility for benefits? What resources should count in measuring means? How should the system value benefits provided in kind when determining taxes on benefits or any reductions of them? And at what rate should participants lose benefits as their resources increase?

Answers to these questions will determine the success of the means test in terms of the ease and costs of its administration. They will also significantly influence its effectiveness in constraining program expenditures, its fairness in limiting benefits, and its effects on the behavior of recipients.

Because the federal individual income tax already exists, answers to most of the questions are obvious for the option that would tax benefits from entitlements. That approach would simply require that agencies administering the programs tell recipients at the end of each year the value of their benefits that should be reported as taxable income.[1] The appropriate accounting period, tax unit, measurement of means, and rate of taxation of benefits would all be defined by regulations governing the income tax.

The major unanswered question involves the value that should be assigned to in-kind benefits in measuring taxable income. Beyond the difficulties raised by that issue is also the drawback that the IRS would incur higher administrative costs to process informational returns from program agencies and returns filed by people who previously had not been required to file. Nevertheless, the appropriate administrative machinery is already in place. The questions raised above are more difficult to answer for the benefit reduction and denial options.

Administering Agency

Three alternatives are available to administer a global means test of entitlements. The Congress could give responsibility for the test to individual agencies that currently run the various programs, create a new agency that would impose a means test on all covered entitlements, or require the IRS to perform means-testing through tax returns. Each approach has strengths and weaknesses.

1. The IRS already has a form--Form 1099-G--by which government agencies tell participants in some programs the amount of benefits provided to them during the previous year.

Several outcomes are virtually certain regardless of which approach is used. Imposing a global means test would raise administrative costs, increase program complexity, make compliance by beneficiaries more difficult, and require potentially complex end-of-year reconciliation. Whether budgetary savings warrant experiencing these problems depends on how effective the means test would be, how many beneficiaries the test would affect, and by how much benefits could be reduced.

Administration by Individual Agencies

As the providers of benefits, the individual agencies responsible for entitlement programs might appear to be the logical choices to administer means tests. Those agencies collect information about their beneficiaries, calculate levels of benefits, and actually make payments. What they generally do not have is complete information about all of the resources--either current or prospective--available to participants in their programs.

Programs could remedy this lack by requiring recipients to report their resources in full or estimate the resources they expect to have over some future period. Social Security beneficiaries subject to that program's earnings test now provide the same kind of estimates of income if they expect to have earnings above certain thresholds. Judging by the experience of that program, such reporting could impose significant compliance costs on recipients. In addition, processing those data could markedly increase agencies' costs for administration. A further problem would arise because many beneficiaries receive payments from more than one program. In those cases, agencies would duplicate each other's data collection efforts.

Having individual agencies administer a means test would pose two additional problems in determining benefits for recipients. First, because participants would generally be unable to forecast their resources accurately, agencies would have to reconcile the payments people made during a year after complete, accurate information became available. The experience of the Social Security earnings test indicates that many cases would require reconciliation in the form of payments or collections; in fact, the Social Security Administration (SSA) has to correct four out of every five cases in which the earnings test applies. The SSA reports that it spends about $200 million annually to administer the earnings test.[2]

The second problem lies in ordering the benefits from the different programs in determining an individual's or a family's need. Income from other entitlements would have to be part of any means test, since ignoring such income would overstate that need. At the same time, if participants accurately report the benefits they receive from multiple programs and, as a consequence, each program cuts their payments, their actual resources--including the now-lower entitlements--would be less than their estimates. As a result, they would qualify for higher payments.

The Congress could mitigate this problem by ordering programs for the purpose of counting resources. For example, Social Security benefits might be based only on nonentitlement income, Medicare on nonentitlement income plus Social Security benefits, and so on. Although this solution might not eliminate the problem, it could reduce the need to recalculate benefits for all entitlements.

Single Administering Agency

Having a single agency administer a global means test for all entitlements would eliminate duplicate data collecting and program ordering to determine benefits. The "cost" of those advantages would be the establishment of a new agency with massive data requirements.[3] Potential beneficiaries who could anticipate having their benefits reduced by the means test would have to report their expected resources to the agency. The agency would determine whether to reduce a person's

2. Imposing a means test on entitlements could cost more or less than the SSA spends on the earnings test. On the one hand, the denial option, which is imposed only on the wealthiest beneficiaries, would require information and adjustment of benefits for relatively few people. The reduction option, on the other hand, would affect many more. In contrast, although the tax option would involve nearly all beneficiaries, its imposition would simply be an extension of the current income tax and would be unlikely to incur large additional collection costs.

3. Because the SSA already has the machinery in place to administer an earnings test, as well as data files containing significant information about Social Security and Medicare participants, it might be a strong candidate to administer a global means test. Imposing that added responsibility, however, might further overburden an agency that is already struggling to manage its own programs adequately.

benefits, apply the appropriate cut to each entitlement, and report net benefits to the agencies administering the individual programs.

Because the central agency would have to calculate benefits for each program and keep track of information on all of the beneficiaries of all the federal government's entitlements, it would have huge--and expensive--data needs. Furthermore, the need for year-end reconciliation would still exist, albeit at a somewhat lower cost because reconciliation would be centralized. Finally, this approach to administering a means test could require an additional bureaucracy, which might seem contrary to current efforts to cut back on the activities of the federal government.

Administration Through the Tax System

A third alternative would use the system set up for the federal individual income tax to administer a means test on all entitlements. People who anticipated reductions in their benefits would have to either notify program agencies to make the cuts or make periodic installment payments to the IRS to return overpayments to the government. At the end of the year, each agency would give beneficiaries statements reporting the amount of benefits that had been paid--just as W-2 forms report income from wages and 1099 forms report income from nonwage sources.[4] Recipients would file tax returns, reporting not just income from private sources but also entitlement payments. They would also calculate whether their benefits had been too large or too small. Discrepancies would result in the government's either requiring repayment or making additional payments.

This approach creates a variety of problems. First, it would further complicate federal income tax returns, which many people already find incomprehensible. Including all entitlements would add a new dimension to this complexity. In addition, many individuals who do not now have to file tax returns would be faced with that annual task. Both the additional returns and their added complexity would impose costs on the IRS, requiring either additional resources from the Congress or the reallocation of currently allocated funds.

Yet because the IRS is already in place, this approach is likely to be cheaper than the other alternatives for administering the means test. Nevertheless, given the IRS's claim that too little money is now available for tax enforcement, any expansion of the agency's responsibilities could further limit its ability to enforce the tax code. That limitation could, in turn, tempt more people to evade taxes.

Finally, making income tax forms more complex could erode voluntary compliance with the tax law, long the backbone of the income tax. The IRS has cited this argument in consistently opposing efforts to include nonrevenue objectives in its mission.

Should a Means Test Be Prospective or Retrospective?

One issue alluded to above and common to all administrative approaches is whether a means test should be prospective or retrospective--that is, based on the resources available during or before the period in which people receive benefits. A prospective approach would offer a better measure of a person's well-being when benefits were paid. It would thus reduce benefits for those who actually had sufficient resources to withstand the cuts. At the same time, prospective accounting requires beneficiaries to estimate their future income, bringing in the potential for a costly reconciliation process to correct errors in those estimates. The federal income tax uses a prospective measure of resources, as do the Congressional Budget Office's simulations of all three options.

Retrospective measures of resources, in contrast, would be less subject to error, particularly if each beneficiary had to file supporting documentation such as a prior year's tax return. But retrospective accounting would not allow a timely measure of whether recipients could bear the cost of their benefits being reduced. The approach would not recognize the changed needs of people whose incomes dropped from one year to the next--including those who retired, became unemployed, or lost spouses through death or divorce.

4. Although a similar reporting system could be established for an administering agency other than the IRS, the IRS has in place the necessary mechanisms to receive and process such reports. Another agency would almost certainly incur higher costs to obtain similar results.

A retrospective approach would, however, address at least one problem endemic to any means test: the incentive for people to shift resources to minimize their loss of benefits. Although beneficiaries could still adjust their incomes over time, they might find it more difficult to anticipate how they would need to change their incomes to receive the maximum benefits possible.

Type of Unit

Means-testing could be based on the income of an individual, a couple, or a more broadly defined family. The choice of unit for a means test determines which recipients would be affected and the amount of benefits they would lose. The decision is a vital one: if means-testing does not adequately take into account differences between units in defining needs and hence in reducing benefits, families may have incentives to split up into separate units or combine into larger ones to avoid or limit the loss of their payments. CBO's simulations use federal income tax units as the basis for benefit reductions.

Individual entitlements use a variety of units to determine eligibility and levels of benefits. Most programs that do not have means tests, such as Medicare, unemployment compensation, and veterans' compensation, provide benefits to individuals--rather than to groups of people--who qualify through their histories of employment or military service. Social Security is similar in that it makes payments to individuals, but eligibility for the program and the benefits it pays to spouses and dependents may depend on the earnings histories of workers.

Programs that now have means tests provide benefits to units ranging from individuals to households. The Food Stamp program defines units most broadly as all members of a household who purchase food and consume meals in common. Aid to Families with Dependent Children goes to parents and their minor children; other "essential" people may be part of the unit in particular cases. Elderly and disabled people receive Supplemental Security Income payments as individuals or couples, generally on the basis of their own resources. (The program reduces benefits for people living in the homes of their children, parents, or others.)

Because families generally consume as a unit, family income and wealth may provide better measures of need than individual income and wealth. Using family resources to determine whether individuals qualify for benefits would prevent programs from providing assistance meant for the poor to individuals who have a low level of personal income and few assets but who are part of wealthier families. Some people would argue, for example, that an unemployed single teenage mother living with her well-to-do parents should not receive welfare.

Regardless of how units are defined for means tests, the actual structure of the tests should minimize the incentives for potential recipients to change their living arrangements or behavior to curtail reductions in their benefits. Resource thresholds above which cuts in benefits begin should vary with the size of a family and its composition to avoid inducing families to split up to qualify for larger payments. For example, the benefit reduction option would violate that maxim by having the same thresholds of income for individuals as for married couples. Under that option, a retired couple in which each spouse had $20,000 of pension and investment income and $10,000 of Social Security would lose $3,000 of their Social Security benefits; if they divorced, they would keep all of their benefits. Setting up different levels of benefit reduction for individuals and families of different sizes could reduce or remove incentives for family breakup. Designers of such a structure must use great care, however, to avoid creating factors that could inadvertently lead to other unwanted behavioral changes.

A related issue is the question of people transferring resources between units to avoid losing benefits. People who want Medicaid to pay the costs of nursing home care, for example, may try to transfer their assets to other family members in order to qualify for coverage. One solution would be to define the units for the means test more broadly. But that approach would eliminate the problem only if units were defined to include all people to whom assets could be assigned. A more appropriate solution might restrict the transfer of assets for the purpose of obtaining assistance, although

it would be difficult to prove that any given transfer had that motive.[5] Policymakers face a related pitfall as well: they must take care to avoid structuring the rules of an entitlement in such a way that although they limit who receives benefits, they do so at the cost of failing to meet the principal goals of the entitlement.

Measuring Resources

The decision of which resources to count in a means test will determine how effective the test will be in limiting who receives benefits. Means tests for food stamps, AFDC, and SSI consider cash income, assets, and, in some cases, the value of income received in kind (such as housing assistance or medical care, or benefits other than cash that employers provide, such as the payment of health insurance premiums). Most programs allow people to exclude some income. The Food Stamp program, for example, exempts 20 percent of earned income to cover the costs of employment.

Asset tests generally cover only financial assets, ignoring the value of owner-occupied houses and most personal property. A major exception involves automobiles: programs count the value of vehicles as assets, although cars and trucks used for business or commuting may not be counted.

Cash income is generally the principal basis for measuring resources in any means test. Contention arises, however, about the appropriate period over which to measure income and whether to allow deductions for specific sources of income or types of expenditures. Programs that currently use a means test typically have a one-month period on the grounds that families need assistance right away when their incomes are low, especially when they have no assets to fall back on.

This issue is less relevant for means tests designed to limit benefits going to middle- and high-income families. For them, attaining a minimal standard of living is not in question. For similar reasons, analysts see less need to allow people with high incomes to exclude the cost of basic subsistence from their incomes in counting their net resources.

Some options to means-test entitlements propose using adjusted gross income to measure resources. Adjusted gross income has three major advantages over other measures. First, the Individual Income Tax Code fully defines it in law. Second, the information needed to calculate AGI is readily available--the law already requires employers and other payers of income to provide it. Third, reporting and verification of incomes would be straightforward: beneficiaries could report their AGIs simply by submitting copies of their tax return, and the administering agency could verify the accuracy of those reports by comparing the copies with returns filed with the IRS.

A significant shortcoming of AGI as a measure of resources offsets these advantages, however. Because the tax code excludes some forms of income from AGI, AGI is at best only a rough measure of well-being. It does not include means-tested benefit payments, tax-exempt interest, part or all of Social Security payments, most employment-based benefits, cash gifts, or most forms of in-kind income. The tax code also allows deductions for qualified business expenses, contributions to individual retirement accounts, and alimony, among other items. These shortcomings could be overcome by adding excluded or deductible income to AGI.

Analysts disagree about whether to count income received in kind as part of a person's resources when applying a means test. One problem involves valuation. Recipients of such income are clearly better off than otherwise identical people who are not getting income in kind, but how much better off is hard to measure. A worker with cash wages of $20,000 whose employer provides health insurance that would cost $100 a month has greater total income than a neighbor who has the same $20,000 cash earnings but must pay for his or her own health insurance. Is the insurance worth $100 a month because it would cost that much to buy? Is it worth less if the worker would have spent less than $100 monthly on health insurance if he or she had been paid the $100 in cash? Or is it worth more if the value of the insurance is not subject to income and payroll taxes?

5. The Medicaid program presumes that any transfer of assets occurring within 36 months of an application (or institutionalization, if later) was made to qualify for Medicaid benefits. The program penalizes such transfers. For assets placed in trusts, this "look-back" period is 60 months.

Again, these issues matter more for families at the bottom of the income distribution--who have relatively little discretionary income--than for those at the top. Regardless of how in-kind benefits are valued, simply ignoring those benefits would understate the family's well-being.

A potentially important issue in measuring the incomes of the wealthy concerns unrealized income. A stockholder whose portfolio increases in value by $100,000 during a year has income of $100,000 from that source, even if he or she does not sell the stocks and realize the gains. Economists would argue that an accurate measure of income should include all such inflation-adjusted gains (and losses) whether realized or not.

Measuring unrealized gains is straightforward for assets like stocks and bonds that are frequently marketed and for which prices are known. But measuring unrealized gains for assets like owner-occupied homes, businesses, and other properties is more difficult. Because of problems in valuing such assets, it may be best to omit unrealized gains from means tests for entitlements. Omitting such gains, however, could induce some recipients--particularly those with higher incomes--to hold assets that appreciate rather than assets that provide current income. Such behavior would reduce the budgetary savings generated by the means-testing options.

An alternative way to account for unrealized gains would be to include assets as part of a broader measure of resources. But valuing assets is also difficult. Assets should clearly count in assessing well-being and determining whether cuts in entitlements may be warranted. In general, however, accurate values exist only for financial assets; including other assets would be problematic at best. Programs that currently use a means test circumvent this problem by counting only financial assets, which may be appropriate for families with low incomes. But for wealthier families, who have the ability to shift their wealth among assets, counting only some as resources would create incentives for families to switch their assets into exempt forms.

Those kinds of incentives would result in a misallocation of resources: there would be too much investment in exempt assets and too little in those subject to means tests. Whether that misallocation would be significant depends on how many investors found it worthwhile to shift their assets to retain entitlement payments that the government would otherwise take away. But these potential responses could significantly reduce the savings from means-testing benefits.

A final issue concerning assets involves the politics of means-testing. Two-thirds of all U.S. families own their home, and for many it is their most important and largest asset. Many people would consider it heretical to impose a means test that counted the value of one's home in determining eligibility for an entitlement. Homeowners in general--and the elderly in particular--might think it unfair to deny them Social Security, Medicare, and other benefits simply because they owned valuable homes.

The simplest solution to this difficulty would be to exclude homes in measuring assets--or at least provide large exemptions. That solution has at least one major drawback, though. It would consider as equally deserving otherwise similar homeowners and nonhomeowners, despite what could be huge differences in well-being.

Taxing or Reducing In-Kind Benefits

Benefits received in kind present two particular problems: how to value them and how to tax or reduce them. Taxing or means-testing food stamps, Medicare, or Medicaid would require assigning values to these benefits that would be part of recipients' taxable income or provide the basis for benefit reductions. Little agreement can be found among analysts about how to value in-kind benefits, particularly medical insurance. Yet even if policymakers could agree about how to assign value, actually collecting taxes on or reducing such benefits could pose problems. For Medicare and Medicaid, there would be no practical way to reduce benefits, so any reduction would have to take the form of beneficiaries paying premiums. Low-income enrollees in particular might have difficulty finding the money for those payments.

Any proposal to curtail entitlements, including the three options discussed in this study, would have to confront the question of how to value entitlement

benefits. Most observers agree that counting food stamps at their face value is appropriate. Food stamp allotments are generally less than what families spend on food. If families were given cash instead of stamps, most would continue to spend as much on food as before, indicating that they valued a dollar's worth of food stamps the same as a dollar in cash. Consequently, the analysis in the preceding chapters counted food stamps at their face value.

Medicare and Medicaid are more difficult to value. One approach would measure health benefits from these programs at their insurance value--the cost per enrollee to the government of providing those benefits. Using the insurance value avoids the problem of imputing a greater value to benefits for those who are sick and therefore use the most services.

At the same time, this approach may well overstate the value of benefits to enrollees, particularly those who are relatively healthy with low or moderate incomes of which benefits constitute a large part. Many economists would prefer a measure of the value each individual places on the benefits he or she receives, but because it would be specific to each individual, such a measure is not only impractical but probably impossible to obtain in the real world.

In analyzing the effects of the policy options that Chapter 3 discusses, CBO counted health benefits at their insurance value. That measure has the virtue of being easy to determine but may pose problems for some beneficiaries. For example, if benefits were subject to taxation, some low-income families would find themselves having to pay taxes on their benefits that they could not pay because their benefits were provided in kind, not in cash. Exemptions could protect beneficiaries against this occurring, but the exemption would reduce the revenues to be gained from the option.

The benefit reduction option would pose an additional problem. It would be impractical to take away a fraction of medical services from people with incomes high enough to require cuts in benefits. Consequently, reductions in Medicare and Medicaid benefits would have to take the form of charging premiums equal to the difference between the full value of the program and the value of the benefits that a recipient should receive. Such premiums would be affordable for most families who would be subject to reductions in their benefits. Some recipients, however, might be unable to pay the premiums assessed against them as a result of the in-kind income they receive from these programs.

Rate of Benefit Reduction

A final issue in structuring a means test is the rate at which benefits decrease as income rises. A means test acts as a tax on resources, levied on beneficiaries in the form of cuts in their entitlements. As such, it has many of the characteristics of a tax. In particular, the faster a means test reduces benefits as income increases--that is, the higher the resulting tax rate on income--the more savings it will generate but also the greater incentive it will give to recipients in the benefit phaseout range to act to avoid its effects.

In the case of a means test, that avoidance can take the form of shifting income to exempt sources, bunching income over time to be able to receive benefits in some periods when income is low, reducing savings to lower both income and assets, or accepting lower income from sources that are counted for the test. Of particular interest are the disincentives that means-testing would create for people to work and to save.

Reducing benefits at too rapid a rate would induce some people to save less. Recipients facing the possible reduction or elimination of their Social Security benefits because of income they receive from savings might choose to save less in order to maintain their benefits.[6] Whether such a disincentive would have much effect on saving behavior depends not only on the rate of benefit reduction but also on two other factors: how much people would save in the absence of a means test and the income levels above which their benefits would be cut.

Younger people who anticipated receiving benefits from entitlements in the future might also respond to benefit reductions. Such people would tend to consume more and save less for their retirement years to prevent the loss of Social Security, Medicare, and other benefits. Others who anticipated having high incomes in retirement might choose to increase their savings to offset

6. An offsetting effect would occur if people anticipated the reduction of their benefits in retirement and chose to save more to offset the loss.

the loss of entitlement benefits. Given the country's already low rate of saving, any policy that might cause people to save even less warrants careful examination and should be adopted with caution.

Means-testing entitlements may also discourage people from working. Workers who were faced with large proposed rates of reduction or the denial of benefits might choose to work fewer hours or to take lower-paying, less productive jobs to protect their entitlements. Income experiments conducted during the 1960s and 1970s suggest that a family's principal worker would have little reaction to such disincentives but secondary workers in the family would be much more likely to cut back their work hours. Some evidence indicates that recipients of Social Security work less than they would otherwise choose to because of the earnings test applied in that program (although it appears that many do so only because they misunderstand the test).[7]

These disincentives to work might be significant for some recipients of entitlements, yet the bulk of benefits go to--and consequently the bulk of savings from any of the options considered here come from--the elderly. The elderly are highly unlikely to work, even without the added disincentives posed by a means test on entitlements.[8] Even so, the possible drop in people's work efforts that means-testing might provoke deserves careful consideration.

7. In 1994, recipients under age 65 face a loss of benefits equal to one-half of all earnings in excess of $8,040. Beneficiaries ages 65 to 69 have their benefits reduced by one-third of their earnings in excess of $11,160. Recipients age 70 or older face no earnings test. Beneficiaries who lose benefits recoup some of that loss later because subsequent benefits are higher than they otherwise would have been. Many beneficiaries seem to think that either any earnings or any earnings in excess of the limits will cause them to lose all of their benefits. As a result, they may react much more strongly than they would if they had an accurate understanding of the program's rules.

8. Among people over age 65 in 1992, only 16 percent of men and 9 percent of women reported being in the labor force. Among those working, more than a third worked less than full time.

Chapter Six

Comparing the Policy Options

The three policy options discussed in this study would differ substantially in the budgetary savings they generated, the way they distributed costs among the recipients of entitlements, and the problems of administration they posed. Modifying the options so that they would have similar budgetary savings would reduce the differences among them in their effects on beneficiaries, but the direction of those differences would not change (see Appendix B).

In principle, the three options are all variations on what is essentially a taxation theme: each would impose additional taxes based on a family's entitlement and nonentitlement income. The options differ only in terms of the tax rates and income brackets over which they would apply. The choice of rates and brackets determines the amount of savings and the distribution of costs among beneficiaries.

The option that counts all entitlements as taxable income for the federal individual income tax would affect the most recipients, but it would impose the smallest costs on those families who paid higher taxes. About $260 billion in new revenues over five years is the estimated gain from the approach (see Table 18).

The option would raise taxes for nearly two-thirds of all families receiving entitlements; its effects would be felt by nearly three times as many families as would be affected under either of the other two options. But the families affected by the tax option would, on average, pay taxes equal to only one-tenth of their benefits--less than half the average losses under the other two options.

The tax option would be the least progressive of the three, a consequence of the relatively small variation in tax rates among families. The average fraction of benefits lost by affected families with incomes above $100,000 would be just twice that for affected families with incomes below $30,000.

Taxing all entitlements would be the easiest of the three options to administer because it would simply be an addition to the existing federal tax system. Even so, it would raise the costs of collecting taxes. Nearly one-third of U.S. families would have to report additional income on their tax returns. In addition, many families who do not now have to file returns, particularly elderly families, would become new filers.

At the other extreme, the option of denying all entitlement benefits to families with the highest incomes would affect the fewest people but impose the greatest costs on those who were affected. The denial option, as formulated for this study, would take benefits away from just 1 percent of recipient families. Those families would, however, lose an average of three-fourths of their benefits.

As Chapter 3 describes, this option would save less than the other two options, about $44 billion over five years. To increase those savings would require modifying the option so that it affected many more families. Yet even if the savings it produced matched those obtained by the benefit reduction option, the number of families losing benefits would still be smaller than under the other options--less than one-third--and average losses would be three times as large (see Appendix B).

Table 18.
Comparing the Effects of Three Policy Options to Cut Net Entitlement Costs

Family Category	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
	Budgetary Savings over Five Years (Billions of dollars)		
All Families	258.0	189.8	44.2
	Percentage of Recipient Families Affected		
All Families	64	22	1
Income (1995 dollars)[a]			
1 to 29,999	63	b	0
30,000 to 99,999	64	56	b
100,000 or more	71	82	29
	Average Percentage of Benefits Lost by Families Losing Benefits		
All Families	10	23	77
Income (1995 dollars)[a]			
1 to 29,999	8	c	0
30,000 to 99,999	12	15	c
100,000 or more	17	71	77

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Less than 0.5 percent.

c. Too few families would be affected to allow estimation of a statistically meaningful value.

Nevertheless, the option's effects would still be highly progressive: few families with incomes of less than $50,000 would lose benefits.

Finally, denying benefits to high-income families would require either entirely new administrative mechanisms or substantial changes to existing bureaucracies. New or existing agencies would, however, have to deal with relatively few cases--only the most affluent families would be required to submit information about their incomes. Furthermore, most affected families would lose all of their benefits. Consequently, relatively few cases would require adjustment to account for unexpected changes in income.

Reducing the benefits given to middle- and high-income families would produce savings and effects on beneficiaries that fall between the other two options. The reduction option would affect about one-fifth of all recipient families, and they would lose an average of nearly one-quarter of their benefits. That amount is more than twice the average loss under the tax option but less than one-third the loss under the benefit denial option.

The option would be highly progressive, although not as progressive as the denial option. Families with incomes above $100,000 who were affected would lose an average of more than two-thirds of their benefits. In comparison, families with incomes between $30,000 and $100,000 would lose less than one-sixth of theirs, and few families with incomes below $30,000 would be affected. As the option was conceived in this study, it would save about $190 billion over five years, three-quarters as much as the tax option but more than four times as much as the denial option.

Like the denial option, reducing benefits would require substantial new administrative machinery, but unlike the denial approach, the increase in costs and effort would be much greater. Because potentially more families would be affected, a greater fraction of beneficiaries would have to file information about their incomes with the administering agency.

Appendixes

Appendix A

Calculating Budgetary Savings and Distributional Effects

The budgetary savings in this analysis derive from the economic and budget assumptions contained in the Congressional Budget Office (CBO) publication *The Economic and Budget Outlook: Fiscal Years 1995-1999*, released in January 1994. They are also based on CBO's simulations of options for reducing net entitlement spending. This appendix describes the methodology used to estimate those savings and the distributional effects of the options.

Constructing the Database

CBO based the simulations it conducted for this study on data from the March 1991 Current Population Survey (CPS), a microdata file created by the Bureau of the Census that is representative of the noninstitutionalized U.S. population in 1990. CBO adjusted the basic CPS file to reflect the distribution of income from federal tax returns as shown in the Internal Revenue Service's 1990 Statistics of Income and to mirror information about the receipt of entitlements derived from administrative records of the various entitlement programs.

The resulting file, referred to here as the transfer income file, contains records for about 150,000 people in nearly 60,000 households and represents the noninstitutionalized domestic population of the United States in 1990. Tabulations of this file provided the information presented in Chapter 2 about the distribution of entitlement benefits.

Simulating Policy Options

CBO developed a microsimulation model based on data from the transfer income file to estimate the effects of alternative policy options. Simulation consisted of three steps.

1. Because each policy option was formulated to become effective in 1995, the model deflated all policy parameters denominated in dollars from 1995 dollars to 1990 dollars based on the consumer price index. Thus, for example, the $40,000 threshold for 1995 cuts in the benefit reduction option was deflated to about $34,200, the comparable value for 1990.

2. Using the deflated parameters, the model applied each option to each federal tax unit in the transfer income file to determine whether that unit would be subject to higher federal income taxes or reduced transfer benefits if the option was enacted.

3. CBO tabulated the tax increases or benefit cuts among categories of income, types of families, and entitlement programs to assess the overall effect of each option on the entire U.S. population.

The resulting tabulations estimate how the options and 1995 tax law--had they been in place--would have affected recipients of entitlement benefits in 1990. In particular, CBO estimated the percentage of total spending for each entitlement program that each option

would recoup in either higher taxes or reduced benefits. Chapter 4 presents the results of those simulations.

To project the effects of the policy options, CBO assumed that the distribution of people among types of families and of incomes among families would remain essentially unchanged through the 1990s, at least for that portion of the population receiving entitlement benefits. In particular, CBO assumed that there would be little change in the composition of the population receiving entitlements and that the incomes of that population would grow roughly at the rate of inflation.

If those assumptions held, there would be no change over the decade in the fraction of families affected by each option, the fraction of their benefits that they would lose, and the share of total spending from each entitlement program that would be taken in higher taxes or reduced benefits. Although the assumptions undoubtedly will not hold precisely, they offer a sensible benchmark for estimating budgetary savings.

Estimating Budgetary Savings

CBO estimated the budgetary savings that each option would generate by multiplying the percentage reduction in benefits from each entitlement program--as estimated by the microsimulations described above--times the baseline outlay projections for each program. To develop the estimates shown in Chapter 3, CBO used differing assumptions for each option and type of entitlement about the distribution of revenues or savings among fiscal years.

Budgetary Savings and Distributional Effects of Options with Equivalent Budgetary Savings

The Congressional Budget Office (CBO) modeled the options examined in the body of this analysis after actual proposals for entitlement savings. As Chapter 3 indicates, the options would have widely divergent budgetary effects, ranging from savings of about $44 billion over five years under the benefit denial option to increased revenues of roughly $260 billion over the same period under the tax option.

This appendix describes the budgetary savings and distributional effects of three options similar in construct to those described in Chapter 3 but with modifications to the tax and benefit denial options that make them generate budgetary savings similar to those of the benefit reduction option. Comparing the distributional effects of equivalent options gives a better indication of which beneficiaries would bear the costs of reducing net spending for entitlements.

Modifying the Options

The modifications to the tax and benefit denial options focused on exemptions and thresholds. Exempting from taxation some or all of the benefits of low-income recipients would reduce the budgetary savings of the tax option and limit its effects on the lower end of the income distribution. Lowering the thresholds above which the benefit denial option would take away all benefits from higher-income recipients would increase budgetary savings and spread the costs of those savings farther down the income distribution.

The Tax Option

For the tax option, low-income beneficiaries would have to count only some or none of their benefits as taxable income. Therefore, they would suffer no or only small effective cuts in their entitlements. In particular, married couples who filed joint tax returns and had combined adjusted gross income (AGI) and entitlement income--which will be termed "modified AGI"--of less than $13,000 in 1995 would have none of their benefits included in their taxable income. For other tax units, the threshold would be $10,000.

A tax unit with modified AGI greater than the threshold would count as taxable income the smaller of its entitlement income or the amount by which its modified AGI exceeded the threshold. Thus, a couple with $5,000 of nonentitlement income and $7,000 from Social Security would count none of the Social Security income as taxable because its modified AGI of $12,000 would not exceed the threshold. If the couple also received Medicare benefits valued at $6,000, it would include $5,000 of entitlements as taxable income, the amount by which its modified AGI of $18,000 exceeded the $13,000 threshold. This modification to the tax option would exempt the poorest recipients from taxes on their benefits and would limit the effects of taxes on other low-income beneficiaries. For some families with incomes above the threshold, however, each additional dollar of earnings would add two dollars to taxable income, thus doubling the marginal tax rates those families would face.

The Benefit Denial Option

To obtain greater budgetary savings from this option, CBO lowered its income thresholds substantially. Rather than taking away all benefits from couples with 1995 incomes above $130,000 and from other tax units with incomes above $110,000, the income thresholds were cut by more than half to $60,000 and $52,000, respectively.

Left unchanged was the $10,000 interval below these cutoff thresholds to which a 50 percent rate of benefit reduction applied. Thus, a couple with a total income, including entitlements, of less than $50,000 would lose no benefits; a couple with an income between $50,000 and $60,000 would lose half of the benefits that caused its total income to exceed $50,000. A couple for whom nonentitlement income alone exceeded $60,000 would get no benefits.

Budgetary Savings

As modified, the three options would generate roughly similar budgetary savings, although some differences would arise. Variations occur because the effects of the options would be spread differently over fiscal years and because their growth over time would depend on the mix of programs affected.[1]

The unmodified benefit reduction option would save about $9 billion in 1995, rising to less than $50 billion in 1999 and just slightly less than $190 billion over five years (see Table B-1). The modified tax option would raise federal revenues by about $13 billion in 1995, increase 1999 revenues by slightly more than $50 billion, and generate budgetary savings of about $192 billion over the 1995-1999 period. The modified benefit denial option would save somewhat more over the period--almost $207 billion--primarily because it would have significantly larger savings in the first year than the other options. When fully effective, all three options would reduce net annual outlays for affected entitlements by about 5 percent.

1. In addition, CBO defined the modifications to the tax and benefit denial options in even thousands of dollars. Finer adjustments to the values for the exemptions and thresholds under those options could generate budgetary savings that were more nearly equal for the three options.

Distributional Effects

The general pattern of distributional effects of the three options observed for the initial forms described in Chapter 4 would still obtain for the modified versions. Differences between the options, however, would be smaller. The tax option would still affect many more recipient families than the other options and take less of their benefits in taxes. The benefit denial option would take larger shares of entitlement income away from fewer beneficiaries.

The tax option would affect nearly twice as many recipient families as the benefit reduction option and six times as many as the denial option (see Table B-2). Two-fifths of all recipient families would pay higher taxes; only at the bottom of the income distribution would fewer than half of the families see their tax bills rise. In contrast, the denial option would affect hardly any families with incomes below $40,000, and less than one-fourth of families with incomes between $50,000 and $75,000 would lose benefits. Elderly recipients would be half again as likely as the average recipient to lose benefits under either the tax or denial options, but only slightly more likely to be affected by the reduction option.

The elderly would bear more of the total cost of the tax and denial options than of the reduction option, primarily because the former options protect families with children (see Table B-3). Both the tax and the denial options would generate five-sixths of their savings from the elderly and less than one-twentieth from families with children. In comparison, the reduction option would obtain less than three-fourths of its savings from the elderly and one-eighth from families with children.

At the same time, the benefit reduction and denial options would impose costs primarily on families at the top of the income distribution, whereas the tax option would be more broadly based, in part because 85 percent of Social Security benefits are already taxable for high-income families. Roughly half of the savings from both the reduction and denial options would come from families with incomes above $100,000 and more than 90 percent from families with incomes above $50,000. In contrast, the tax option would get half of its revenues from families with incomes below $40,000 and nearly 90 percent from those with incomes below $100,000.

Affected families would lose the greatest fraction of benefits under the denial option and the smallest under the tax option (see Table B-4). Families affected by the benefit denial option would lose an average of three-fifths of their benefits, compared with one-fourth for those affected by the reduction option and one-ninth for those paying higher taxes under the tax option. A similar pattern obtains for each type of family and for families in each of the income categories above $50,000. Affected families with lower incomes would lose more under the tax option than under the other two options, principally because the tax option would subject more of their benefits to loss. Similar relationships among options can be observed for individual programs (see Table B-5).

Table B-1.
Estimated Gains in Revenues and Reductions in Spending Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, Fiscal Years 1995-1999 (In billions of dollars)

Policy Option	1995	1996	1997	1998	1999	1995-1999
Broaden Definition of Taxable Income to Include Entitlements	13.5	39.0	42.4	46.5	50.8	192.2
Reduce Entitlement Benefits for Middle- and High-Income Recipients[a]	9.4	45.4	42.2	44.9	47.9	189.8
Deny Entitlement Benefits to High-Income Recipients	19.3	47.5	43.7	46.5	49.7	206.7

SOURCE: Congressional Budget Office.

NOTE: The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Medicare, Medicaid, Supplemental Security Income, Aid to Families with Dependent Children, and the Food Stamp program.

a. This option closely resembles the proposal of the Concord Coalition to reduce spending for entitlements and is identical to the option to reduce benefits for middle- and high-income recipients discussed in Chapter 3.

Table B-2.
Percentage of Recipient Families Losing Benefits Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, by Family Income and Type

Family Category	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
All Families	42	22	7
Income (1995 dollars)[a]			
1 to 9,999	7	0	0
10,000 to 19,999	33	b	0
20,000 to 29,999	63	1	b
30,000 to 39,999	62	20	b
40,000 to 49,999	57	74	3
50,000 to 74,999	56	75	23
75,000 to 99,999	55	74	45
100,000 to 149,999	62	77	60
150,000 or more	77	89	78
Type[c]			
With children	12	20	1
Elderly	60	25	11
Other	42	21	7

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Less than 0.5 percent.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

Table B-3.
Distribution of Budgetary Savings Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, by Family Income and Type (In percent)

Family Category	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
All Families	100	100	100
Income (1995 dollars)[a]			
1 to 9,999	0	0	0
10,000 to 19,999	9	b	b
20,000 to 29,999	22	b	b
30,000 to 39,999	20	1	b
40,000 to 49,999	12	6	b
50,000 to 74,999	18	26	17
75,000 to 99,999	8	21	29
100,000 to 149,999	6	25	30
150,000 or more	5	21	23
Type[c]			
With children	4	12	2
Elderly	80	72	84
Other	17	15	14

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of premiums.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Less than 0.5 percent.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

Table B-4.
Average Percentage of Benefits Lost by Families Losing Benefits Under Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs, by Family Income and Type

Family Category	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
All Families	11	23	60
Income (1995 dollars)[a]			
1 to 9,999	2	0	0
10,000 to 19,999	7	b	0
20,000 to 29,999	10	b	b
30,000 to 39,999	13	2	b
40,000 to 49,999	12	6	7
50,000 to 74,999	13	19	27
75,000 to 99,999	15	38	72
100,000 to 149,999	16	64	92
150,000 or more	19	81	99
Type[c]			
With children	5	20	40
Elderly	12	23	61
Other	10	22	57

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTES: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

The table covers the following entitlements: Social Security and Railroad Retirement, unemployment compensation, veterans' compensation and pensions, Supplemental Security Income, Aid to Families with Dependent Children, the Food Stamp program, Medicare, and Medicaid. Food stamps are measured at face value; Medicare and Medicaid benefits are assigned their insurance value net of any premiums paid.

a. Family income comprises all cash income plus the face value of food stamps; it excludes the value of other benefits received in kind. Families with zero or negative income are included only in totals.

b. Too few families would be affected to allow estimation of a statistically meaningful value.

c. Families with children are all families with at least one member under age 18. Elderly families are all families without children who have at least one member age 65 or older. Other families are all families not in the first two categories.

Table B-5.
How Three Policy Options Generating Equivalent Budgetary Savings in Net Entitlement Costs Affect the Benefits Lost by Recipient Families, by Program (In percent)

	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
	Recipient Families Losing Benefits		
Cash Social Insurance Programs			
Social Security[a]	56	24	9
Unemployment compensation	b	32	4
Veterans' benefits[c]	57	39	14
Means-Tested Assistance			
Supplemental Security Income	25	7	2
Aid to Families with Dependent Children[d]	18	5	1
Food stamps	21	2	e
Health Programs			
Medicare	57	23	10
Medicaid	20	6	1
All Benefits	42	22	7
	Benefits Lost by Families Losing Benefits		
Cash Social Insurance Programs			
Social Security[a]	10	23	60
Unemployment compensation	b	25	78
Veterans' benefits[c]	15	21	50
Means-Tested Assistance			
Supplemental Security Income	7	18	38
Aid to Families with Dependent Children[d]	5	13	f
Food stamps	4	f	f
Health Programs			
Medicare	16	23	63
Medicaid	7	16	f
All Benefits	11	23	60

Table B-5.
Continued

	Broaden Taxable Income to Include Entitlements	Reduce Benefits to Middle- and High-Income Recipients	Deny Benefits to High-Income Recipients
	Benefits Lost by All Recipient Families		
Cash Social Insurance Programs			
Social Security[a]	6	7	7
Unemployment compensation	b	9	5
Veterans' benefits[c]	10	10	9
Means-Tested Assistance			
Supplemental Security Income	2	2	1
Aid to Families with Dependent Children[d]	1	1	e
Food stamps	1	e	e
Health Programs			
Medicare	10	6	7
Medicaid	2	1	1
All Benefits	5	5	5

SOURCE: Congressional Budget Office based on data from the Census Bureau's March 1991 Current Population Survey, the Internal Revenue Service's 1990 Statistics of Income, and administrative statistics from individual entitlement programs.

NOTE: Families are groups of related people living together. Individuals not living with relatives are considered one-person families.

a. Includes Railroad Retirement benefits.

b. The tax option would not affect recipients of unemployment compensation because that entitlement is already subject to income taxation.

c. Veterans' benefits comprise veterans' compensation and veterans' pensions.

d. Because the data do not distinguish accurately between recipients of Aid to Families with Dependent Children (AFDC) and recipients of general assistance, some recipients of general assistance are included with recipients of AFDC.

e. Less than 0.5 percent.

f. Too few families would be affected to allow estimation of a statistically meaningful value.

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