CHAPTER

# 2

# Mandatory Spending Options

Mandatory spending—which totaled about $2.4 trillion in 2016, or about 60 percent of federal outlays, the Congressional Budget Office estimates—consists of spending (other than that for net interest) that is generally governed by statutory criteria and is not normally constrained by the annual appropriation process. Mandatory spending also includes certain types of payments that federal agencies receive from the public and from other government agencies. Those payments are classified as offsetting receipts and reduce gross mandatory spending.[1] Lawmakers generally determine spending for mandatory programs by setting the programs' parameters, such as eligibility rules and benefit formulas, rather than by appropriating specific amounts each year.

The largest mandatory programs are Social Security and Medicare. Together, CBO estimates, those programs accounted for about 60 percent of mandatory outlays, on average, over the past 10 years. Medicaid and other health care programs accounted for about 15 percent of mandatory spending over that same period. The rest of mandatory spending is for income security programs (such as unemployment compensation, nutrition assistance programs, and Supplemental Security Income), certain refundable tax credits, retirement benefits for civilian and military employees of the federal government, veterans' benefits, student loans, and agriculture programs.[2]

1. Unlike revenues, which the government collects through exercising its sovereign powers (for example, in levying income taxes), offsetting receipts are generally collected from other government accounts or from members of the public through businesslike transactions (for example, in assessing Medicare premiums or rental payments and royalties for extracting oil or gas from federal lands).

2. Tax credits reduce a taxpayer's overall tax liability (the amount owed). When a refundable credit exceeds the liability apart from the credit, the excess may be refunded to the taxpayer. In that case, that refund is recorded in the budget as an outlay.

## Trends in Mandatory Spending

As a share of the economy, mandatory spending more than doubled between 1966 and 1975, from 4.5 percent to 9.4 percent of gross domestic product (GDP). That increase was attributable mainly to growth in spending for Social Security and other income security programs, and to a lesser extent for Medicare and Medicaid. From 1975 through 2007, mandatory spending varied between roughly 9 percent and 10 percent of GDP. Such spending peaked in 2009 at 14.5 percent of GDP, boosted by effects of the 2007–2009 recession and policies enacted in response to it. Mandatory spending as a share of GDP dropped to 12.2 percent by 2014—as the effects of a gradually improving economy, the expiration of temporary legislation enacted in response to the recession, and payments from Fannie Mae and Freddie Mac partially offset the longer-run upward trend—and then started to rise again (see Figure 2-1). If no new laws were enacted that affected mandatory programs, CBO estimates, mandatory outlays would increase as a share of the economy, from 13.3 percent of GDP in 2016 to 15.2 percent in 2026.[3] By comparison, such spending averaged 9.4 percent of GDP over the past five decades.

Spending for Social Security and the major health care programs—particularly Medicare—drives much of the growth in mandatory spending.[4] CBO projects that, under current law, spending for Social Security and

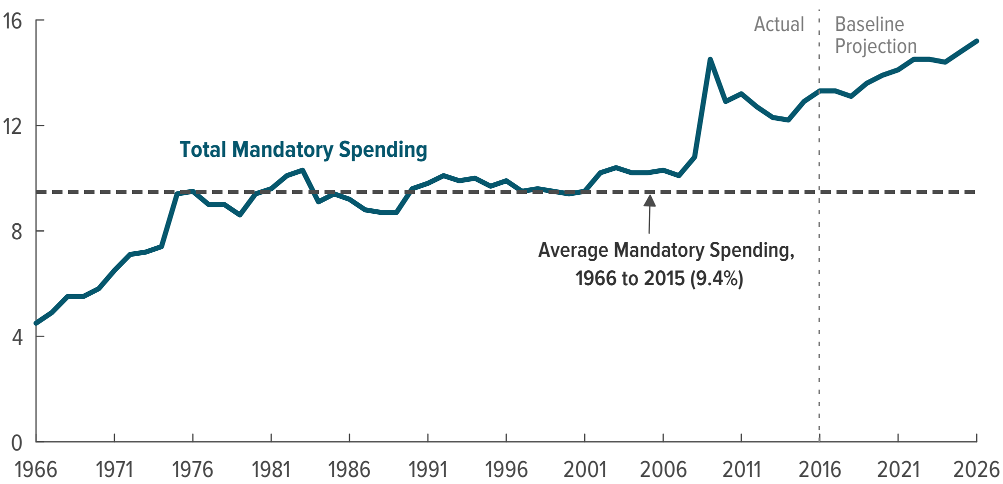
3. For more on the components of mandatory spending and CBO's baseline budget projections, see Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2016 to 2026* (August 2016), www.cbo.gov/publication/51908.

4. Outlays for the major health care programs consist of spending for Medicare (net of premiums and other offsetting receipts), Medicaid, and the Children's Health Insurance Program, as well as spending to subsidize health insurance purchased through the marketplaces established under the Affordable Care Act and related spending.

Figure 2-1.

**Mandatory Spending**

Percentage of Gross Domestic Product




Under current law, mandatory spending will continue to rise as a percentage of gross domestic product over the next decade.

Source: Congressional Budget Office (as of August 2016).

Data include offsetting receipts (funds collected by government agencies from other government accounts or from the public in businesslike or market-oriented transactions that are recorded as offsets to outlays).

the major health care programs will increase from 10.4 percent of GDP in 2016 to 12.6 percent in 2026, accounting for almost two-thirds of the total increase in outlays over that period. (Those percentages reflect adjustments to eliminate the effects of shifts in the timing of certain payments.) Factors driving that increase include the aging population and rising health care costs per person. In particular, over the next decade, as members of the baby-boom generation age and as life expectancy increases, the number of people age 65 or older is expected to rise by more than one-third, boosting the number of beneficiaries of those programs. Moreover, CBO projects that spending per enrollee in federal health care programs will grow more rapidly over the coming decade than it has in recent years. As a result, projected spending for people age 65 or older in the three largest programs—Social Security, Medicare, and Medicaid—increases from roughly one-third of all federal noninterest spending in 2016 to about 40 percent in 2026.

In contrast, outlays for all other mandatory programs would decline as a share of GDP, from 2.8 percent in 2016 to 2.5 percent by 2026. That projected decline would occur in part because benefit levels for many programs are adjusted for inflation each year, and in CBO's economic forecast, inflation is estimated to be well below the rate of growth in nominal GDP.

## Analytic Method Underlying the Estimates of Mandatory Spending

The budgetary effects of the various options are measured in relation to the spending that CBO projected in its March 2016 baseline.[5] In creating its mandatory baseline budget projections, CBO generally assumes that federal fiscal policy follows current law and that programs now scheduled to expire or begin in future years will do so. That assumption applies to most, but not all, mandatory programs. Following procedures established in the Balanced Budget and Emergency Deficit Control Act of 1985 and the Balanced Budget Act of 1997, CBO assumes that some mandatory programs scheduled to expire in the coming decade under current law will instead be extended. In particular, in CBO's baseline, all such programs that predate the Balanced Budget Act and that have outlays in the current year above $50 million are presumed to continue. For programs established after 1997, continuation is assessed on a program-by-program basis in consultation with the House and Senate Committees on the Budget. The Supplemental Nutrition Assistance Program is the largest expiring program assumed to be extended in the baseline.

5. See Congressional Budget Office, *Updated Budget Projections: 2016 to 2026* (March 2016), www.cbo.gov/publication/51384.

Another of CBO's assumptions involves the federal government's dedicated trust funds for Social Security and Medicare.[6] If a trust fund is exhausted and the receipts coming into it during a given year are not enough to pay full benefits as scheduled under law for that year, the program has no legal authority to pay full benefits. Benefits then must be reduced to bring outlays in line with receipts. Nonetheless, in accordance with section 257 of the Deficit Control Act, CBO's baseline incorporates the assumption that, in coming years, beneficiaries will receive full payments and all services to which they are entitled under Social Security or Medicare.

6. Social Security's beneficiaries receive payments from the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund. Medicare's Hospital Insurance Trust Fund pays for care in hospitals and other institutions under Part A; its Supplementary Medical Insurance Trust Fund pays for care by physicians and other providers under Part B and for prescription drugs under Part D. Both Medicare trust funds also pay benefits for people who join private Medicare Advantage plans under Part C.

## Options in This Chapter

The 26 options in this chapter encompass a broad array of mandatory spending programs, excluding those involving health care. (Chapter 5 presents options that would affect spending for health care programs, along with options affecting health-related taxes.) The options are grouped by program, but some are conceptually similar even though they concern different programs. For instance, several options would shift spending from the government to a program's participants or from the federal government to the states. Other options would redefine the population eligible for benefits or would reduce the payments that beneficiaries receive.

Six options in this chapter concern Social Security. Another five involve means-tested benefit programs (including nutrition assistance programs and the Supplemental Security Income program). The remaining options focus on programs that deal with education, veterans' benefits, federal pensions, agriculture, Fannie Mae and Freddie Mac, and natural resources. Each option's budgetary effect is estimated independently, with no consideration of how it might interact with other options.

**Mandatory Spending—Option 1** **Function 300**

## Change the Terms and Conditions for Oil and Gas Leasing on Federal Lands

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | 0 | * | -1.3 | -0.2 | -0.2 | -0.8 | -0.2 | -0.2 | -0.4 | -1.6 | -3.4 |

This option would take effect in October 2017.

* = between –$50 million and zero.

The federal government lets private businesses bid on leases to develop most of the onshore and offshore oil and natural gas resources on federal property. By the Congressional Budget Office's estimates, the federal government's gross proceeds from those leases will total $92 billion during the next decade, under current laws and policies; after paying a share of those receipts to states, the federal government is projected to collect net proceeds totaling $79 billion. Those net proceeds are counted in the budget as offsetting receipts—that is, as negative outlays.

This option would change the leasing programs in two ways. First, it would increase the acreage available for leasing by repealing the statutory prohibition on leasing in the Arctic National Wildlife Refuge (ANWR) and by directing the Department of the Interior to lease areas on the Outer Continental Shelf (OCS) that are unavailable under current administrative policies. Second, the option would change the terms of all new leases, imposing a fee that applied during years when oil or gas was not produced. (The latest available data indicate that such nonproducing leases accounted for about 75 percent of offshore leases at the end of fiscal year 2016 and about half of onshore leases at the end of fiscal year 2015.) The fee would be $6 per acre per year.

CBO estimates that those changes would reduce net federal outlays by $3 billion from 2018 through 2026. About three-quarters of that total would result from leasing in ANWR and the increase in leasing on the OCS, and the rest would result from the new fee on nonproducing leases.

One rationale for offering leases in ANWR and additional leases on the OCS is that increasing oil and gas production from federal lands and waters could boost employment and economic output. The leasing also could raise revenues for state and local governments; the amounts would depend on states' tax policies, the amount of oil and gas produced in each area, and the existing formulas for distributing some federal oil and gas proceeds to states. The primary argument against expanded leasing is that oil and gas production in environmentally sensitive areas, such as the coastal plain in ANWR and other coastal areas, could threaten wildlife, fisheries, and tourism. Moreover, increased development of resources in the near term would reduce the supply of oil and gas available for production in the future, when prices might be higher and households and businesses might value the products more highly.

One rationale for imposing a new fee on nonproducing oil and gas leases is that doing so could slightly increase the efficiency of oil and gas production: Firms would have an additional financial incentive to refrain from acquiring leases that they considered less likely to be worth exploring, and also to invest sooner in exploration and development of the leases that they did acquire. The incentive's effect would be small, however, because $6 per acre would usually be a small part of a parcel's potential value and a minor factor in a leaseholder's decisions about when to begin exploration and production.

An argument against the new fee is that it might lead businesses to reduce some of their bids on leases; furthermore, some parcels might go unleased entirely, generating no receipts for the government either from bids or from production royalties. However, CBO estimates that those effects on receipts would be smaller than the receipts from the new fee itself. The effect on bids would be small because a fee of $6 per acre would significantly affect bids for relatively few parcels—those that would generate low bids even without the fee because of uncertainty about the availability and production cost of oil and gas resources. Similarly, the effect on royalty payments would be small because the unleased parcels would be those with the lowest likelihood of successful development. Moreover, some parcels that went unleased under the option could be acquired later if their value increased; bids then would probably be higher, and royalty payments could be higher as well.

RELATED OPTION: Revenues, Option 28

RELATED CBO PUBLICATIONS: *Options for Increasing Federal Income From Crude Oil and Natural Gas on Federal Lands* (April 2016), www.cbo.gov/publication/51421; *Potential Budgetary Effects of Immediately Opening Most Federal Lands to Oil and Gas Leasing* (August 2012), www.cbo.gov/publication/43527; *Energy Security in the United States* (May 2012), www.cbo.gov/publication/43012

**Mandatory Spending—Option 2** **Function 300**

## Limit Enrollment in the Department of Agriculture's Conservation Programs

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | | | | | | | | | | | | |
| Phase out the Conservation Stewardship Program | 0 | * | -0.2 | -0.4 | -0.5 | -0.7 | -0.9 | -1.0 | -1.2 | -1.5 | -1.1 | -6.4 |
| Scale back the Conservation Reserve Program | 0 | * | * | * | -0.1 | -0.1 | -0.5 | -0.6 | -0.9 | -1.0 | -0.1 | -3.3 |
| Both alternatives above | 0 | * | -0.2 | -0.4 | -0.6 | -0.8 | -1.4 | -1.7 | -2.2 | -2.4 | -1.3 | -9.7 |

This option would take effect in October 2017.

* = between –$50 million and zero.

Under the Conservation Stewardship Program (CSP), landowners enter into contracts with the Department of Agriculture (USDA) to undertake various conservation measures—including ones to conserve energy and improve air quality—in exchange for annual payments and technical help. Those contracts last five years and can be extended for another five years. For every acre enrolled in the CSP, a producer receives compensation for carrying out new conservation activities and for improving, maintaining, and managing existing conservation practices. Current law limits new enrollment in the CSP to 10 million acres per year, at an average cost of $18 per acre; in 2015, USDA spent $1 billion on the program.

Under the Conservation Reserve Program (CRP), landowners enter into contracts to stop farming on specified tracts of land, usually for 10 to 15 years, in exchange for annual payments and cost-sharing grants from USDA to establish conservation practices on that land. One type of tract used in the program is a "conservation buffer"—a narrow strip of land maintained with vegetation to intercept pollutants, reduce erosion, and provide other environmental benefits. Acreage may be added to the CRP through general enrollments, which are competitive and held periodically for larger tracts of land, or through continuous enrollments, which are available at any time during the year for smaller tracts of land. Current law caps total enrollment in the CRP at 24 million acres by 2017; in 2015, USDA spent $2 billion on the roughly 24 million acres enrolled.

Beginning in 2018, the first part of this option would prohibit new enrollment in the CSP. Land enrolled now—and therefore hosting new or existing conservation activities—would be eligible to continue in the program until the contract for that land expired. By the Congressional Budget Office's estimates, prohibiting new enrollment would reduce federal spending by $6 billion through 2026.

Beginning in 2018, the second part of this option would prohibit both new enrollment and reenrollment in the general enrollment portion of the CRP; continuous enrollment would remain in effect under the option. Prohibiting general enrollment would reduce spending by $3 billion through 2026, CBO estimates. The amount of land enrolled in the CRP would drop to about 10 million acres by 2026.

One argument for prohibiting new enrollment in the CSP and thus phasing out the program is that some provisions of the program limit its effectiveness. For example, paying farmers for conservation practices they have already adopted may not enhance the nation's conservation efforts. Moreover, USDA's criteria to determine payments for conservation practices are not clear, and payments may be higher than necessary to encourage farmers to adopt new conservation measures.

An argument against phasing out the CSP is that, unlike traditional crop-based subsidies, the CSP may offer a way to support farmers while also providing environmental benefits. Furthermore, conservation practices often impose significant up-front costs, which can reduce the net economic output of agricultural land, and CSP payments help offset those costs.

One argument for scaling back the CRP is that the land could become available for other uses that would provide greater environmental benefits. For example, reducing enrollment could free more land to produce crops and biomass for renewable energy products.

An argument against scaling back the CRP is that studies have indicated that the program yields high returns—in the form of enhanced wildlife habitat, improved water quality, and reduced soil erosion—for the money it spends. Furthermore, USDA is enrolling more acres targeting specific environmental and resource concerns, perhaps thereby improving the cost-effectiveness of protecting fragile tracts.

RELATED OPTIONS: Mandatory Spending, Options 3, 4, 5, 6

Mandatory Spending—Option 3 Function 350

## Eliminate Title I Agriculture Programs

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | 0 | 0 | * | -0.3 | -4.5 | -4.1 | -4.2 | -4.0 | -4.0 | -4.3 | -4.8 | -25.4 |

This option would take effect in October 2018.

* = between zero and $50 million.

Since 1933, lawmakers have enacted and often modified various programs to support commodity prices and supplies, farm income, and producer liquidity. The Agricultural Act of 2014 (the 2014 farm bill) was the most recent comprehensive legislation addressing farm income and price support programs. Title I of that bill authorized those programs through 2018 for producers of major commodities (such as corn, soybeans, wheat, and cotton) and specialized programs for dairy and sugar.

Beginning with the 2019 marketing year—when most programs expire and after existing contracts end—this option would eliminate all Title I commodity support programs. (For example, that period begins on June 1, 2019, for wheat and September 1, 2019, for corn.) Under this option, the permanent agriculture legislation enacted in 1938 and 1949 also would be repealed. (That permanent legislation would offer producers price and income support at a relatively high level after the 2014 farm bill expired.)

Although authorization for the Title I programs expires in October 2018, the option would generate savings with respect to the Congressional Budget Office's baseline projections because, in its baseline, CBO is required by law to assume that those programs continue beyond their expiration date. Reductions in government spending with respect to CBO's baseline would begin in fiscal year 2020 and savings would rise sharply in fiscal year 2021, when most outlays for the 2019 marketing year appear in the baseline. CBO estimates that this option would reduce spending by $25 billion, with respect to that baseline, over the 2019–2026 period.

During the Great Depression of the 1930s, the 25 percent of the U.S. population who lived on farms had less than half the average household income of urban households; federal commodity programs came about to alleviate that income disparity. One argument for eliminating Title I commodity support programs is that the structure of U.S. farms has changed dramatically since then: The significant income disparity between farm and urban populations no longer exists. In 2014, about 97 percent of all farm households (which now constitute about 2 percent of the U.S. population) were wealthier than the median U.S. household. Farm income, excluding program payments, was 58 percent higher than median U.S. household income. Moreover, commodity payments today are concentrated among a relatively small portion of farms. Three-quarters of all farms received no farm-related government payments in 2014; most program payments, in total, went to mid- to large-scale farms (those with annual sales above $350,000).

Moreover, agricultural producers would continue to have access to other federal assistance programs, such as subsidized crop insurance and farm credit assistance. In addition, eliminating Title I programs would limit spending that may distort trade, thereby reducing the risk that the World Trade Organization might again challenge U.S. agricultural support (as it did with the U.S. cotton program).

An argument against eliminating commodity programs is that despite relatively high average income among farmers, the farm sector still faces significant challenges. Farm income fluctuates markedly and depends on the vagaries of the weather and international markets. Commodity programs try to stabilize crop revenues over time. Also, much of U.S. agricultural production is exported to markets where foreign governments subsidize their producers. Without support from commodity programs, U.S. producers may not be able to compete fairly in those export markets. Finally, many years of continual government payments from commodity programs have been capitalized into the fixed assets of farm operations (primarily land); abruptly removing that income stream would cause farmers' wealth to drop significantly.

RELATED OPTIONS: Mandatory Spending, Options 2, 4, 5, 6

Mandatory Spending—Option 4 Function 350

## Reduce Subsidies in the Crop Insurance Program

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2017–2021 | 2017–2026 |
| Change in Outlays | | | | | | | | | | | | |
| Reduce premium subsidies | 0 | -0.2 | -2.3 | -2.7 | -2.8 | -2.8 | -2.8 | -2.9 | -2.9 | -2.9 | -8.0 | -22.3 |
| Limit administrative expenses and the rate of return | 0 | -0.1 | -0.5 | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -1.7 | -4.7 |
| Both alternatives above | 0 | -0.3 | -2.8 | -3.3 | -3.4 | -3.4 | -3.4 | -3.5 | -3.5 | -3.5 | -9.7 | -27.0 |

This option would take effect in June 2017.

The Federal Crop Insurance Program protects farmers from losses caused by droughts, floods, pest infestations, other natural disasters, and low market prices. Farmers can choose various amounts and types of insurance protection—for example, they can insure against losses caused by poor crop yields, low crop prices, or both. The Department of Agriculture (USDA) sets rates for federal crop insurance so that the premiums equal the expected payments to farmers for crop losses. Of total premiums, the federal government pays about 60 percent, on average, and farmers pay about 40 percent. Private insurance companies—which the federal government reimburses for their administrative costs—sell and service insurance policies purchased through the program. The federal government reinsures those private insurance companies by agreeing to cover some of the losses when total payouts exceed total premiums.

Beginning in June 2017, this option would reduce the federal government's subsidy to 40 percent of the crop insurance premiums, on average. It also would limit the federal reimbursement to crop insurance companies for administrative expenses to 9.25 percent of estimated premiums and limit the rate of return on investment for those companies to 12 percent each year. Under current law, by the Congressional Budget Office's estimates, federal spending for crop insurance will total $88 billion from 2017 through 2026. Reducing the crop insurance subsidies as specified in this option would save $27 billion over that period, CBO estimates.

An argument in favor of this option is that cutting the federal subsidies for premiums would probably not substantially affect participation in the program. Private lenders increasingly view crop insurance as an important way to ensure that farmers can repay their loans, which encourages participation. In addition, the farmers who dropped out of the program would generally continue to receive significant support from other federal farm programs. However, if significantly fewer farmers participate, then some smaller crop insurance companies would probably go out of business.

Current reimbursements to crop insurance companies for administrative expenses (around $1.3 billion per year) were established in 2010, when premiums were relatively high. Recent reductions in the value of the crops insured (partly because of lower average commodity prices) have resulted in lower average premiums for crop insurance. However, administrative expenses have not shown a commensurate reduction. A cap of 9.25 percent, or about $915 million per year, is close to average reimbursements during the years before the run-up in commodity prices in 2010. Furthermore, according to a recent USDA study, the current rate of return on investment for crop insurance companies, 14 percent, was higher than that of other private companies, on average.

An argument against this option is that cutting the federal subsidies for premiums would probably cause farmers to buy less insurance. If the amount of insurance declined significantly, lawmakers might be more likely to enact special relief programs when farmers encountered*

[*Text corrected on December 13, 2016]

significant difficulties, which would offset some of the savings from cutting the premium subsidy. (Such ad hoc disaster assistance programs for farmers cost an average of about $700 million annually in the early 2000s.) In addition, limiting reimbursements to companies for administrative expenses and reducing the targeted rate of return to companies could add to the financial stress of companies in years with significant payouts for covered losses.

RELATED OPTIONS: Mandatory Spending, Options 2, 3, 5, 6

**Mandatory Spending—Option 5** **Function 350**

## Eliminate ARC and PLC Payments on Generic Base Acres

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | 0 | -0.1 | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 | -1.2 | -4.2 |

This option would take effect in June 2018.

The Agricultural Act of 2014 replaced the existing agricultural support programs with the Agriculture Risk Coverage (ARC) and Price Loss Coverage (PLC) programs. The law also removed upland cotton from the list of commodities eligible for payments available to producers with base acres (those acres with a proven history of being planted with covered commodities established with the Department of Agriculture under statutory authority granted by previous farm bills).[1] Finally, the 2014 law assigned upland cotton base acres to a new category called generic base acres and allows for ARC and PLC payments on generic base acres if producers plant a covered commodity on those acres.[2]

Beginning in crop year 2018, this option would eliminate ARC and PLC payments on generic base acres.[3] Most savings from eliminating ARC and PLC payments on generic base acres would begin in fiscal year 2020, when ARC and PLC payments for the 2018 crop year would be made.[4] Because of its likely effects on peanut planted acres, the option also would, starting in 2019, lead to lower outlays for the government's peanut marketing loan program. The Congressional Budget Office estimates that savings under this option would be $4 billion through 2026.

Linking payments on generic base acres to current (rather than historical) planting decisions is a departure from previous farm support programs, which had sought to decouple support payments from planting decisions to limit subsidies that may distort agricultural markets.[5] Arguments in this option's favor relate to removing such potential distortions, particularly as they relate to peanuts. Motivated by a high peanut PLC support price, growers have disproportionately planted peanuts on generic base acres to collect larger payments. The number of acres planted with peanuts increased by 27 percent in 2014 and by 20 percent in 2015, and ending stocks (the quantity of peanuts remaining in storage at the end of the crop year) for 2016 are projected to be slightly less than the record-high peanut stocks at the end of 2005.

The increase in acres planted with peanuts has had a large negative effect on U.S. peanut prices paid to farmers because the market for the crop is relatively small and inelastic.[6] Peanut prices decreased by 12 percent during the 2014–2015 marketing year and by an additional 12 percent in 2015–2016. As a result of those price declines, per-acre payment rates in 2014 and 2015 were higher for peanuts than for any other covered commodity. At the same time, the income of peanut growers who do not have base acres (albeit a small segment of peanut growers) has been dampened. This option would cut the link between program payments and planting decisions. Planted acreage for peanuts would be expected to contract, increasing the market price for peanuts and the

1. Only farmers who have established base acres may participate in the ARC and PLC programs. The most recent opportunity was in 2002.

2. Covered commodities include wheat, oats, barley, corn, grain sorghum, long-grain rice, medium-grain rice, legumes, soybeans, other oilseeds, and peanuts.

3. ARC and PLC payments are set to expire beginning with the 2019 crop year. However, following the rules for developing baseline projections specified by the Balanced Budget and Emergency Deficit Control Act of 1985, the Congressional Budget Office's 10-year baseline incorporates the assumption that lawmakers will extend those programs after they expire.

4. A crop year (also called a marketing year) begins in the month that the crop is first harvested and ends 12 months later. For example, the corn marketing year begins September 1 and ends the following August 31.

5. The World Trade Organization Agreement on Agriculture imposes limits on agricultural subsidies linked to production.

6. Around 60 percent of U.S. peanuts are typically marketed to the domestic food market (for peanut butter, candy, and snack nuts). The price of peanuts is inelastic (meaning that a 1 percent change in price results in a less than 1 percent change in consumption).

share of peanut growers' income that is not accounted for by government spending.

In addition, this option might avert potential World Trade Organization (WTO) challenges to the U.S. peanut program. Government support has enabled domestic peanut sellers to sell more peanuts internationally than they otherwise might have. That increase has drawn the attention of peanut-exporting countries, who might argue that such an arrangement violates WTO rules.[7]

One argument against this option is that some producers of covered commodities would receive less federal support. Although peanut prices paid to farmers might rise without payments on generic base acres, many growers appear to favor the income stability fostered by the federal programs.

7. Brazil successfully challenged U.S. subsidies for upland cotton through the WTO in 2002. Under threat of retaliatory trade measures involving other U.S. industries, the U.S. government changed its upland cotton support program. Many of those changes were enacted in the 2014 farm bill, including removing upland cotton from the list of covered commodities.

RELATED OPTIONS: Mandatory Spending, Options 2, 3, 4, 6

Mandatory Spending—Option 6 | Function 350

## Limit ARC and PLC Payment Acres to 50 Percent of Base Acres

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | 0 | 0 | -0.1 | -1.9 | -1.8 | -1.9 | -1.8 | -1.8 | -1.8 | -2.0 | -11.1 |

This option would take effect in June 2019.

The Agricultural Act of 2014 provides support to producers of covered commodities through the Agriculture Risk Coverage (ARC) and Price Loss Coverage (PLC) programs:[1]

- ARC guarantees revenue at either the county level (ARC-County, or ARC-CO—accounting for most coverage) or the individual farm level (ARC-Individual Coverage, or ARC-IC). The program pays farmers when actual crop revenue in a given crop year is below the revenue guarantee for that year.[2]

- PLC pays farmers when the national average market price for a covered commodity in a given crop year falls below a reference price specified in the law.

Eligibility under those programs is determined from a producer's planting history. Only producers who have established base acres (that is, a proven history of planting covered commodities on their farms) with the Department of Agriculture under statutory authority granted by previous farm bills may participate. In general, growers with base acres for covered commodities (corn base acres, for example) need not plant a crop to receive payments.[3]

When a payment for a crop is triggered, total payments are calculated by multiplying the payment rate (on a per-acre basis) by a producer's payment acres for that crop. For ARC-CO and PLC, the number of payment acres equals 85 percent of base acres; for ARC-IC, it is 65 percent of base acres.

Beginning with the 2019 crop year, this option would limit payment acres for ARC-CO and for PLC to 50 percent of base acres and would make a comparable cut to ARC-IC (to 42 percent of base acres).[4] Savings would largely begin in fiscal year 2021, when ARC and PLC payments for crop year 2019 would be made.[5] Total savings over the 2019–2026 period would be $11 billion, the Congressional Budget Office estimates.

One argument in favor of this option is that it would limit program payments to nonfarmer landowners and on land no longer used to grow crops. The economics literature suggests that nonfarmer landowners capture between 25 percent and 40 percent—and sometimes up to 60 percent—of program payments through increased land rents; to the extent that program payments raise land values, new farmers face higher costs to buy land. Also, the benefits of farm program payments tend to accrue to larger farms, which may speed consolidation and make it

1. Covered commodities include wheat, oats, barley, corn, grain sorghum, long-grain rice, medium-grain rice, legumes, soybeans, other oilseeds, and peanuts.

2. A crop year (also called a marketing year) begins in the month that the crop is first harvested and ends 12 months later. For example, the corn marketing year begins September 1 and ends the following August 31.

3. Exceptions include generic base acres and ARC-IC. For generic base acres (which are former upland cotton base acres), producers must plant a covered commodity on that acreage to receive payments. Also, producers participating in ARC-IC must plant the commodity to establish actual crop revenue.

4. Because producers entered into contracts with the Department of Agriculture to receive payments on 85 percent of base acres through the 2018 crop year, the Congressional Budget Office assumes that the limit to payment acres would begin in crop year 2019. Though ARC and PLC are set to expire beginning with the 2019 crop year, following the rules for developing baseline projections specified by the Balanced Budget and Emergency Deficit Control Act of 1985, CBO's 10-year baseline incorporates the assumption that lawmakers will extend those programs after they expire.

5. Because of the option's likely effects on peanut planted acres and the resulting domestic peanut supply, savings would include reduced outlays for the peanut marketing loan program, which would occur starting in 2020.

harder for new farmers to enter. Finally, because only covered commodities are eligible for ARC and PLC support, the availability of those payments tends to encourage farmers to plant crops they might not otherwise plant.

An argument against this option is that farming is an inherently risky enterprise. Many growers favor the income stability fostered by federal programs.

RELATED OPTIONS: Mandatory Spending, Options 2, 3, 4, 5

Mandatory Spending—Option 7 Function 370

## Raise Fannie Mae's and Freddie Mac's Guarantee Fees and Decrease Their Eligible Loan Limits

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | | | | | | | | | | | | |
| Increase guarantee fees | 0 | -0.8 | -0.3 | -0.1 | -0.3 | -0.5 | -0.5 | -0.7 | -1.0 | -1.4 | -1.6 | -5.6 |
| Decrease loan limits | 0 | -0.1 | -0.1 | * | -0.1 | -0.2 | -0.2 | -0.1 | -0.2 | -0.3 | -0.3 | -1.2 |
| Both alternatives above[a] | 0 | -0.9 | -0.4 | -0.1 | -0.4 | -0.6 | -0.6 | -0.7 | -1.0 | -1.4 | -1.8 | -6.0 |

This option would take effect in October 2017.

* = between –$50 million and zero.

a. If both alternatives were enacted together, the total effect would be less than the sum of the effects of each alternative because of interactions between them.

Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) that were federally chartered to help ensure a stable supply of financing for residential mortgages, including those for low- and moderate-income borrowers. Those GSEs carry out that mission through two activities in the secondary mortgage market (that is, the market for buying and selling mortgages after they have been issued): by issuing and guaranteeing mortgage-backed securities (MBSs) and by buying mortgages and MBSs to hold as investments. Under current law, the entities generally can guarantee and purchase mortgages up to $625,500 in areas with high housing costs and $417,000 in other areas, and regulators can alter those limits if house prices change. Those two GSEs provided credit guarantees for about half of all single-family mortgages that originated in 2015.

In September 2008—after falling house prices and rising mortgage delinquencies threatened the GSEs' solvency and impaired their ability to ensure a steady supply of financing to the mortgage market—the federal government took control of Fannie Mae and Freddie Mac in a conservatorship process. Because of that shift in control, the Congressional Budget Office concluded that the institutions had effectively become government entities whose operations should be reflected in the federal budget. By CBO's projections under current law, the mortgage guarantees that the GSEs issue from 2017 through 2026 will cost the federal government $12 billion. That estimate reflects the subsidies inherent in the guarantees at the time they are made—that is, the up-front payments that a private entity would need to receive (in an orderly market and allowing for the fees that borrowers pay) to assume the federal government's responsibility for those guarantees. CBO's estimates are constructed on a present-value basis. (A present value is a single number that expresses a flow of current and future payments in terms of an equivalent lump sum paid today; the present value of future cash flows depends on the discount rate that is used to translate them into current dollars.) By contrast, the Administration's projections focus on the cash flows between the enterprises and the Treasury. Those cash flows reflect a mix of existing and new business. Both CBO and the Administration expect the government to receive substantial net cash inflows from Fannie Mae and Freddie Mac over the 2017–2026 period.

This option includes two approaches to reduce the federal subsidies that Fannie Mae and Freddie Mac receive. In the first approach, the average guarantee fee that Fannie Mae and Freddie Mac assess on loans they include in their MBSs would increase by 10 basis points (100 basis points is equivalent to 1 percentage point), to more than 65 basis points, on average, beginning in October 2017. In addition, to keep guarantee fees constant after 2021—when an increase of 10 basis points that was put in place in 2011 is scheduled to expire—the average guarantee fee would be increased, with respect to the amount under current law, by 20 basis points after 2021. The increased collections of fees, which the GSEs would be required to pass through to the Treasury, would reduce net federal spending by $6 billion from 2017 through 2026, would cause new guarantees by Fannie Mae and Freddie Mac to fall by around 10 percent, and would change the mix of borrowers, CBO estimates. (The effect on spending is the sum of the present values of the decreases in subsidies for mortgages made in each of nine years after the option would take effect.)

In the second approach, the maximum size of a mortgage that Fannie Mae and Freddie Mac could include in their MBSs would be reduced, beginning with a drop to $417,000 in October 2017, followed by drops to $260,000 in 2021 and $175,000 in 2024. (Guarantee fees would remain as they are under current law.) That reduction in loan limits would save $1 billion from 2017 through 2026 because new guarantees would fall by about 20 percent, CBO estimates.

Taking both approaches together would lower federal subsidies for Fannie Mae and Freddie Mac by $6 billion from 2017 through 2026 and would result in a drop in new guarantees of about 25 percent, according to CBO's estimates. Because raising guarantee fees by 10 basis points would eliminate most of the federal subsidies for the GSEs, taking the additional step of lowering loan limits would have little effect on subsidies. For consistency, similar changes could be made to the limits on loans guaranteed by the Federal Housing Administration (FHA). The estimates presented here do not include the effects of lower limits on FHA loans, which would affect discretionary spending subject to appropriations.

Because some of the subsidies that Fannie Mae and Freddie Mac receive flow to mortgage borrowers in the form of lower rates, both approaches in this option would raise borrowing costs. The higher guarantee fees would probably pass directly through to borrowers in the form of higher mortgage rates. The lower loan limits would push some borrowers into the so-called jumbo mortgage market, where loans exceed the eligible size for guarantees by Fannie Mae and Freddie Mac and where rates might be slightly higher, on average.

The major advantage of those approaches to reduce federal subsidies for Fannie Mae and Freddie Mac is that they could restore a larger role for the private sector in the secondary mortgage market, which would reduce taxpayers' exposure to the risk of defaults. Lessening subsidies also would help address the current underpricing of mortgage credit risk, which encourages borrowers to take out bigger mortgages and buy more expensive homes. Consequently, the option could reduce overinvestment in housing and shift the allocation of some capital toward more productive activities.

A particular advantage of lowering loan limits, instead of raising fees, is that many moderate- and low-income borrowers would continue to benefit from the subsidies provided to the GSEs. More-affluent borrowers generally would lose that benefit, but they typically can more easily find other sources of financing. The $175,000 limit would allow for the purchase of a home for about $220,000 (with a 20 percent down payment), which was roughly the median price of an existing single-family residence in March 2016; thus, lowering loan limits as specified here would not affect most moderate- and low-income borrowers.

One disadvantage of reducing subsidies for the GSEs and thereby increasing the cost of mortgage borrowing is that doing so could weaken housing markets because new construction and new home sales have not completely recovered from their sharp drop several years ago. Moreover, mortgage delinquency rates remain elevated, and many borrowers are still "underwater" (that is, they owe more than their homes are worth). Posing another drawback, the slightly higher mortgage rates resulting from lower subsidies would limit some opportunities for refinancing—perhaps constraining spending by some consumers and thereby dampening the growth of private spending. Phasing in the specified changes more slowly could mitigate those concerns, although that approach would reduce the budgetary savings as well. Finally, by affecting the GSEs, this option would make FHA loans more attractive to some borrowers (without corresponding changes to the rules governing FHA loans), which could increase risks for taxpayers because FHA guarantees loans with lower down payments than do the GSEs.

RELATED OPTIONS: Discretionary Spending, Option 15; Revenues, Option 5

RELATED CBO PUBLICATIONS: *The Effects of Increasing Fannie Mae's and Freddie Mac's Capital* (October 2016), www.cbo.gov/publication/52089; *The Federal Role in the Financing of Multifamily Rental Properties* (December 2015), www.cbo.gov/publication/51006; *Transitioning to Alternative Structures for Housing Finance* (December 2014), www.cbo.gov/publication/49765; *Modifying Mortgages Involving Fannie Mae and Freddie Mac: Options for Principal Forgiveness* (May 2013), www.cbo.gov/publication/44115; *Fannie Mae, Freddie Mac, and the Federal Role in the Secondary Mortgage Market* (December 2010), www.cbo.gov/publication/21992; *CBO's Budgetary Treatment of Fannie Mae and Freddie Mac* (January 2010), www.cbo.gov/publication/41887

**Mandatory Spending—Option 8** **Function 500**

## Eliminate the Add-On to Pell Grants, Which Is Funded With Mandatory Spending

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | -1.6 | -6.0 | -6.2 | -6.3 | -6.4 | -6.5 | -6.6 | -6.7 | -6.8 | -6.9 | -26.5 | -60.0 |

This option would take effect in July 2017.

The Federal Pell Grant Program is the largest source of federal grant aid to low-income students for undergraduate education. For the 2016–2017 academic year, the program will provide $28 billion in aid to 7.8 million students, the Congressional Budget Office estimates. A student's Pell grant eligibility is chiefly determined on the basis of his or her expected family contribution (EFC)—the amount that the federal government expects a family to pay toward the student's postsecondary education expenses. The EFC is based on factors such as the student's income and assets. For dependent students (in general, unmarried undergraduate students under the age of 24 who have no dependents of their own), the parents' income and assets, as well as the number of people (excluding parents) in the household who are attending postsecondary schools, are also taken into account. To be eligible for the maximum grant, which is $5,815 for the 2016–2017 academic year, a student must have an EFC of zero and be enrolled in school full time. For each dollar of EFC above zero, a student's eligible grant amount is reduced by a dollar. Students with an EFC exceeding 90 percent of the maximum grant (that is, an EFC of $5,234 for the 2016–2017 academic year) are ineligible for a grant. Part-time students are eligible for smaller grants than those received by full-time students with the same EFC.

Since 2008, funding for the Pell grant program has had both discretionary and mandatory components. The discretionary component, which is set in each fiscal year's appropriation act, specifies a maximum award of $4,860 per student for the 2016–2017 academic year. That award is bolstered by mandatory funding, which provides an "add-on." The add-on for the 2016–2017 academic year is $955, resulting in the total maximum award of $5,815. Under current law, the add-on is indexed to inflation through the 2017–2018 academic year and remains constant thereafter.

This option would eliminate the add-on to Pell grants, thereby reducing the maximum grant awarded to students with an EFC of zero to $4,860 for the 2016–2017 academic year. There would be two effects. First, about 3 percent of people who will be eligible for Pell grants under current law would lose that eligibility—because to be eligible, people would now need an EFC that was below 90 percent of the new, smaller maximum grant. Second, people who remained eligible would see their grant size reduced by the amount of the add-on. CBO estimates that this option would result in a reduction of $60 billion in mandatory spending over the 2017–2026 period.

A few studies suggest that some postsecondary institutions have responded to past increases in the size of Pell grants by raising tuition or shifting more of their own aid to students who did not qualify for Pell grants. A rationale for reducing the maximum Pell grant, therefore, is that institutions might become less likely to raise tuition and more likely to aid students who had lost eligibility for a Pell grant or who were receiving a smaller Pell grant. In addition, this option would spread the reductions in grants among all recipients, minimizing the impact on any individual recipient.

But an argument against this option is that even with the grant at its current amount, the cost of attending a public four-year college is greater for most recipients than their EFC plus all financial aid—and for many recipients attending private colleges, the gap is even larger. Reducing Pell grants (and eliminating them for some students) would further increase that financial burden and might cause some students to choose a less suitable institution, less postsecondary education, or none at all. Moreover, among students who remained eligible for Pell grants under this option, grant amounts would be reduced uniformly, regardless of the students' financial need. By contrast, targeted reductions in grants might be more effective in protecting one of the program's goals: boosting the educational attainment of students from the lowest-income families.

RELATED OPTIONS: Mandatory Spending, Option 10; Discretionary Spending, Option 21; Revenues, Option 17

RELATED CBO PUBLICATIONS: *The Pell Grant Program: Recent Growth and Policy Options* (September 2013), www.cbo.gov/publication/44448; *Options to Change Interest Rates and Other Terms on Student Loans* (June 2013), www.cbo.gov/publication/44318

Mandatory Spending—Option 9 Function 500

## Limit Forgiveness of Graduate Student Loans

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Estimated Using the Method Established in the Federal Credit Reform Act** | | | | | | | | | | | | |
| Change in Outlays | | | | | | | | | | | | |
| Limit amount forgiven under the PSLF program | -0.1 | -0.3 | -0.4 | -0.5 | -0.6 | -0.7 | -0.8 | -1.0 | -1.1 | -1.2 | -1.8 | -6.7 |
| Extend repayment period for IDR plans | -0.2 | -0.4 | -0.6 | -0.8 | -1.0 | -1.2 | -1.5 | -1.7 | -2.0 | -2.1 | -3.1 | -11.6 |
| Both alternatives above[a] | -0.3 | -0.8 | -1.1 | -1.4 | -1.7 | -2.0 | -2.4 | -2.9 | -3.2 | -3.5 | -5.2 | -19.3 |
| **Estimated Using the Fair-Value Method** | | | | | | | | | | | | |
| Change in Outlays | | | | | | | | | | | | |
| Limit amount forgiven under the PSLF program | -0.1 | -0.2 | -0.3 | -0.3 | -0.4 | -0.5 | -0.6 | -0.7 | -0.8 | -0.8 | -1.2 | -4.6 |
| Extend repayment period for IDR plans | -0.1 | -0.3 | -0.5 | -0.6 | -0.8 | -0.9 | -1.1 | -1.3 | -1.5 | -1.6 | -2.3 | -8.7 |
| Both alternatives above[a] | -0.2 | -0.5 | -0.8 | -1.0 | -1.2 | -1.5 | -1.8 | -2.1 | -2.4 | -2.5 | -3.7 | -13.9 |

This option would take effect in July 2017.

By law, the costs of federal student loan programs are measured in the budget according to the method established in the Federal Credit Reform Act. The fair-value method is an alternative and is included in this table for informational purposes.

IDR = income-driven repayment; PSLF = Public Service Loan Forgiveness.

a. If both alternatives were enacted together, the total effect would be greater* than the sum of the effects of each alternative because of interactions between them. [*Text corrected after printing but before online release]

Various programs exist that forgive federal student loans. In one kind, called income-driven repayment (IDR) plans, after borrowers make monthly payments (which are calculated as a percentage of income) for a certain period, usually 20 years, the outstanding balance of their loans is forgiven. Another program is Public Service Loan Forgiveness (PSLF), which is for borrowers in an IDR plan who are employed full time in public service; that program provides debt forgiveness after only 10 years of monthly payments. Neither the IDR plans nor the PSLF program limits the amount that can be forgiven. The programs' biggest benefits go to people who borrow to attend graduate or professional school, because they tend to borrow larger amounts than people who borrow for undergraduate studies do.

This option includes two alternatives that would reduce loan forgiveness primarily for borrowers who took out federal student loans to pay for graduate school, starting with loans originated to new borrowers in July 2017. The first alternative would limit the amount that could be forgiven under the PSLF program to $57,500, shifting any remaining balance into an IDR plan with a longer repayment period. Because that limit is equal to the limit for federal student loans for undergraduate studies, and because there is no such maximum for graduate studies, the alternative would mostly affect students who borrow for graduate school. The second alternative would extend the repayment period—from 20 years to 25 years—for borrowers in an IDR plan who take out loans to finance graduate school. (The repayment period for borrowers with only undergraduate loans would continue to be 20 years.)

When estimating the budgetary effects of proposals to change federal loan programs, the Congressional Budget Office is required by law to use the method established in the Federal Credit Reform Act (FCRA). FCRA accounting, however, does not consider all the risks borne by the government. In particular, it does not consider market risk—the risk that taxpayers face because federal receipts from payments on student loans tend to be low when economic and financial conditions are poor and resources are therefore more valuable. Under an alternative method, the fair-value approach, estimates are based on market values—market prices when they are available, or approximations of market prices when they are not—which better account for the risk that the government takes on. As a result, the discount rates (or interest rates) used to calculate the present value of higher loan repayments under the option are higher for fair-value estimates than for FCRA estimates, and the savings from those higher repayments are correspondingly lower. (A present value is a single number that expresses a flow of current and future payments in terms of an equivalent lump sum paid today; the present value of future cash flows depends on the discount rate that is used to translate them into current dollars.)

Estimated according to the FCRA method, federal costs under the first alternative would be reduced by $7 billion from 2017 to 2026. According to the fair-value method, over the same period, federal costs would be reduced by $5 billion. Under the second alternative, CBO estimates, federal costs from 2017 to 2026 would be reduced by $12 billion according to the FCRA method and by $9 billion according to the fair-value method. If both alternatives were implemented, the total savings would be slightly greater than the sum of the savings if the alternatives were individually adopted because of interactions between the two alternatives.

An argument in favor of these alternatives is that reducing the amount of student debt that is forgiven—either by explicitly limiting the amount that would be forgiven or by extending the repayment period—would reduce students' incentive to borrow and encourage them to enroll in graduate programs whose benefits, in terms of improved opportunities for employment, justified the costs of the additional schooling. The first alternative would encourage prospective graduate students to limit their borrowing because their loans would no longer be forgiven without regard to the outstanding balance. The second alternative would increase by 25 percent the number of payments that affected borrowers made—and because income tends to increase with experience, it would probably boost the sums that they repaid by an even larger percentage.

A second argument in favor of these alternatives is that they focus on people who have borrowed for graduate studies, who often have relatively high income and are therefore more likely to be able to pay back their loans eventually. The PSLF program is especially generous to borrowers who, after 10 years of repayment, still have heavy debt but also have high income and do not have trouble making the monthly payments. Many borrowers in the PSLF program who have relatively high income and who, under the first alternative, would receive only a partial forgiveness of their debt after 10 years of repayment would probably be able to repay their remaining debt in full. Under the second alternative, all borrowers for graduate school in an IDR plan would eventually pay more than they would otherwise, and more of those borrowers would completely pay off their debt before the end of the repayment period. (Under either alternative, IDR plans would continue to not limit the amount that could be forgiven, so debt relief would be provided to borrowers who, despite making regular payments for 20 or 25 years, could not pay off their debt.)

An argument against the alternatives is that they would increase the risk that students would not be able to repay their loans. The increased risk might lead some students to choose less graduate education or to forgo it altogether. Furthermore, limiting forgiveness under the PSLF program could discourage borrowers with graduate debt from seeking employment in public service. And both alternatives would disproportionately affect prospective graduate students with fewer financial resources, such as those who come from low-income families. Such students would be less likely to attend graduate school and consequently would have lower future earnings; if they did choose to take out loans to attend graduate school, they would be likelier to have heavy student debt later in life.

RELATED OPTION: Mandatory Spending, Option 10

RELATED CBO PUBLICATION: *Options to Change Interest Rates and Other Terms on Student Loans* (June 2013), www.cbo.gov/publication/44318

Mandatory Spending—Option 10 Function 500

## Reduce or Eliminate Subsidized Loans for Undergraduate Students

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Estimated Using the Method Established in the Federal Credit Reform Act** | | | | | | | | | | | | |
| Change in Outlays | | | | | | | | | | | | |
| Restrict access to subsidized loans to students eligible for Pell grants | -0.3 | -0.7 | -0.8 | -0.8 | -0.9 | -0.9 | -0.9 | -1.0 | -1.0 | -1.0 | -3.5 | -8.3 |
| Eliminate subsidized loans altogether | -1.0 | -2.2 | -2.6 | -2.7 | -2.8 | -2.9 | -3.0 | -3.1 | -3.2 | -3.3 | -11.2 | -26.8 |
| **Estimated Using the Fair-Value Method** | | | | | | | | | | | | |
| Change in Outlays | | | | | | | | | | | | |
| Restrict access to subsidized loans to students eligible for Pell grants | -0.3 | -0.6 | -0.7 | -0.7 | -0.8 | -0.8 | -0.8 | -0.8 | -0.9 | -0.9 | -3.0 | -7.2 |
| Eliminate subsidized loans altogether | -0.8 | -1.8 | -2.2 | -2.3 | -2.4 | -2.5 | -2.6 | -2.7 | -2.8 | -2.9 | -9.6 | -23.1 |

This option would take effect in July 2017.

By law, the costs of federal student loan programs are measured in the budget according to the method established in the Federal Credit Reform Act. The fair-value method is an alternative and is included in this table for informational purposes.

The Federal Direct Student Loan Program lends money directly to students and their parents to help finance postsecondary education. Two types of loans are offered to undergraduates: subsidized loans, which are available only to undergraduates who demonstrate financial need, and unsubsidized loans, which are available to undergraduates regardless of need (and to graduate students as well).

For undergraduates, the interest rates on the two types of loans are the same, but the periods during which interest accrues are different. Subsidized loans do not accrue interest while students are enrolled at least half time, for six months after they leave school or drop below half-time status, and during certain other periods when they may defer making repayments. Unsubsidized loans accrue interest from the date of disbursement. The program's rules cap the amount—per year, and also for a lifetime—that students may borrow through subsidized and unsubsidized loans. By the Congressional Budget Office's estimates, subsidized and unsubsidized loans will each constitute about half of the dollar volume of federal loans to undergraduate students for the 2016–2017 academic year.

This option includes two possible changes to subsidized loans. In the first alternative, only students who were eligible for Pell grants would have access to subsidized loans. The Federal Pell Grant Program provides grants to help finance postsecondary undergraduate education; to be eligible for those grants, students and their families must demonstrate financial need. Under current law, only students with an expected family contribution (EFC)—the amount that the federal government expects a family to pay toward the student's postsecondary education expenses—of less than about $5,200 are eligible for a Pell grant, whereas recipients of subsidized loans may have a larger EFC, as long as it is less than their estimated tuition, room, board, and other costs of attendance not covered by other aid received. This change would therefore reduce the number of students who could take out subsidized loans. Specifically, CBO projects that about 30 percent of students who would borrow through subsidized loans under current law would lose their eligibility for those loans—and would instead borrow almost as much through unsubsidized loans. In the second alternative, subsidized loans would be eliminated altogether. CBO again expects that students would borrow almost as much through unsubsidized loans as they would have borrowed through subsidized loans.

Under either alternative, borrowers who lost access to subsidized loans would pay interest on unsubsidized loans from the date of loan disbursement, which would raise their costs. If a student who would have borrowed $23,000 (the lifetime limit) through subsidized loans, beginning in the 2017–2018 academic year, instead borrowed the same amount through unsubsidized loans, that student would leave school with additional debt of about $3,400. Over a typical 10-year repayment period, the student's monthly repayment would be $37 higher than if he or she had borrowed the same amount through subsidized loans.

When estimating the budgetary effects of proposals to change federal loan programs, CBO is required by law to use the method established in the Federal Credit Reform Act (FCRA). FCRA accounting, however, does not consider all the risks borne by the government. In particular, it does not consider market risk—the risk that taxpayers face because federal receipts from payments on student loans tend to be low when economic and financial conditions are poor and resources are therefore more valuable. Under an alternative method, the fair-value approach, estimates are based on market values—market prices when they are available, or approximations of market prices when they are not—which better account for the risk that the government takes on. As a result, the discount rates (or interest rates) used to calculate the present value of higher loan repayments under the option are higher for fair-value estimates than for FCRA estimates, and the savings from those higher repayments are correspondingly lower. (A present value is a single number that expresses a flow of current and future payments in terms of an equivalent lump sum paid today; the present value of future cash flows depends on the discount rate that is used to translate them into current dollars.)

Estimated according to the FCRA method, federal costs would be reduced by $8 billion under the first alternative and by $27 billion under the second alternative from 2017 to 2026. According to the fair-value method, over the same period, federal costs would be reduced by $7 billion under the first alternative and by $23 billion under the second.

An argument in favor of this option is that providing subsidies by not charging interest on loans for a period of time may unnecessarily and perhaps harmfully encourage borrowing; it may also make it hard for students to evaluate the cost of their education net of subsidies. Another argument in favor of the option is that some postsecondary institutions may increase tuition to benefit from some of the subsidies that the government gives students; reducing subsidies might therefore slow the growth of tuition. If institutions responded in that way, they would at least partially offset the effect of higher borrowing costs on students' pocketbooks. Also, the prospect of higher loan repayments upon graduation might encourage students to pay closer attention to the economic value to be obtained from a degree and to complete postsecondary programs more quickly. And for most college students, $37 a month in additional costs is small compared with the benefits that they obtain from a college degree.

An argument against this option is that students faced with a higher cost of borrowing might decide not to attend college, to leave college before completing a degree, or to apply to schools with lower tuition but educational opportunities not as well aligned with their interests and skills. Those decisions eventually could lead to lower earnings. Moreover, for any given amount borrowed, higher interest costs would require borrowers to devote more of their future income to interest repayments. That, in turn, could constrain their career choices or limit their ability to make other financial commitments, such as buying a home.

RELATED OPTIONS: Mandatory Spending, Options 8, 9; Discretionary Spending, Option 21; Revenues, Option 17

RELATED CBO PUBLICATIONS: *The Pell Grant Program: Recent Growth and Policy Options* (September 2013), www.cbo.gov/publication/44448; *Options to Change Interest Rates and Other Terms on Student Loans* (June 2013), www.cbo.gov/publication/44318

Mandatory Spending—Option 11 Function 600

## Eliminate Concurrent Receipt of Retirement Pay and Disability Compensation for Disabled Veterans

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | -9 | -13 | -15 | -15 | -18 | -17 | -16 | -18 | -19 | -52 | -139 |

This option would take effect in January 2018.

Military service members who retire—either after at least 20 years of military service under the longevity-based retirement program or early because of a disability—are eligible for retirement annuities from the Department of Defense (DoD). In addition, veterans with medical conditions or injuries incurred or that worsened during active-duty military service may be eligible for disability compensation from the Department of Veterans Affairs (VA).

Until 2003, military retirees eligible for disability compensation could not receive both their full retirement annuity and their disability compensation. Instead, they had to choose between receiving their full retirement annuity from DoD or receiving their disability benefit from VA and forgoing an equal amount of their DoD retirement annuity; that reduction in the retirement annuity is typically referred to as the VA offset. Because the retirement annuity is generally taxable and disability compensation is not, most retirees chose the second alternative.

As a result of several laws, starting with the National Defense Authorization Act for 2003, two classes of retired military personnel who receive VA disability compensation (including those who retired before the enactment of those laws) can now receive payments that make up for part or all of the VA offset, benefiting from what is often called concurrent receipt. Specifically, retirees whose disabilities arose from combat are eligible for combat-related special compensation (CRSC), and veterans who retire with at least 20 years of military service and who receive a VA disability rating of at least 50 percent are eligible for what is termed concurrent retirement and disability pay (CRDP). CRSC is exempt from federal taxes, but CRDP is not; some veterans would qualify for both payments but must choose between them.

Beginning in 2018, this option would eliminate concurrent receipt of retirement pay and disability compensation: Military retirees now drawing CRSC or CRDP would no longer receive those payments, nor would future retirees. As a result, the option would reduce federal spending by $139 billion between 2018 and 2026, the Congressional Budget Office estimates.

In 2015, of the roughly 2 million military retirees, about 55 percent were subject to the VA offset; about 50 percent of that latter group—or 575,000 retirees—got concurrent receipt payments totaling $10 billion. Spending for concurrent receipt—just over $1 billion in 2005—has climbed sharply because of both an expansion in the program's parameters and an increase in the share of military retirees receiving disability compensation. In particular, the share of military retirees receiving a longevity-based retirement annuity who also receive disability compensation rose from 33 percent in 2005 to just over 50 percent in 2015.

One argument for this option is that disabled veterans would no longer be compensated twice for their service, reflecting the reasoning underlying the creation of the VA offset. However, military retirees who receive VA disability payments would still receive higher after-tax payments than would nondisabled retirees who have the same retirement annuity because VA disability benefits are not taxed.

An argument against this option is that DoD's retirement system and VA's disability program compensate for different characteristics of military service: rewarding longevity in the former case and remunerating for pain and suffering in the latter. In addition, if fewer retirees applied for VA disability compensation because concurrent receipt was no longer available—since some consider the application process onerous—some veterans might bypass other VA services such as health care or vocational training. Moreover, some retirees would find the loss of income financially difficult.

RELATED OPTIONS: Mandatory Spending, Options 24, 25

RELATED CBO PUBLICATIONS: *Veterans' Disability Compensation: Trends and Policy Options* (August 2014), www.cbo.gov/publication/45615; *Costs of Military Pay and Benefits in the Defense Budget* (November 2012), www.cbo.gov/publication/43574

**Mandatory Spending—Option 12** **Function 600**

## Reduce Pensions in the Federal Employees Retirement System

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | | | | | | | | | | | | |
| Reduce the basic annuity | 0 | * | * | -0.1 | -0.1 | -0.2 | -0.3 | -0.4 | -0.4 | -0.5 | -0.3 | -2.1 |
| Eliminate the SRS | 0 | -0.1 | -0.2 | -0.4 | -0.5 | -0.6 | -0.7 | -0.7 | -0.8 | -0.8 | -1.1 | -4.7 |
| Total | 0 | -0.1 | -0.3 | -0.4 | -0.6 | -0.8 | -1.0 | -1.1 | -1.2 | -1.3 | -1.4 | -6.8 |

This option would take effect in January 2018.

SRS = Special Retirement Supplement; * = between –$50 million and zero.

In 2015, the federal government paid pension benefits, in the form of lifetime annuities, totaling about $82 billion to civilian retirees and their survivors. Roughly 14 percent of that amount was paid through the Federal Employees Retirement System (FERS), which covers about 30 percent of federal civilian retirees and over 90 percent of current civilian employees. (Most of the other retirees and workers are covered by pensions in the Civil Service Retirement System, which is not available to employees first hired after 1983.)

Annuities in FERS are based on the average of employees' earnings over the three consecutive years when they earned the most. Also, people who begin collecting that basic annuity when they are younger than 62 can receive the Special Retirement Supplement (SRS) until they turn 62, at which point they become eligible for Social Security benefits. The SRS is approximately equal to the Social Security benefits that the workers earned during their service under FERS. However, most employees do not receive the SRS, because most do not start collecting the basic annuity before they turn 62. To do so, employees in most occupations must have at least 30 years of service with the federal government and have reached age 56 or 57 (depending on the employee's year of birth), or have at least 20 years of service and have reached age 60. Federal employees in law enforcement, as well as a few other groups of employees, become eligible for the annuities regardless of their age once they complete 25 years of service.

This option includes two alternatives for reducing spending on FERS, both of which would apply only to federal workers who retire in January 2018 or later. In the first alternative, the basic annuity would be calculated on the basis of an employee's five consecutive years with the highest earnings. That change would save the federal government $2 billion over the 2018–2026 period, the Congressional Budget Office estimates. Annual savings would reach $500 million in 2026, and they would continue to grow, because an increasing fraction of retirees would be receiving benefits under the new, less generous formula as time went on. The second alternative would eliminate the SRS. That change would save the federal government $5 billion by 2026. If both alternatives were implemented, the total savings through 2026 would be $7 billion.

One argument for the option is that it would better align federal practices with practices in the private sector, where pensions are commonly based on a five-year average of earnings and supplements are rarely provided to workers who retire before they are eligible for Social Security. More broadly, the option would make the ratio of deferred compensation to current compensation in the federal government closer to the ratio in the private sector. A substantial number of private-sector employers no longer provide health insurance benefits for retirees and have shifted from lifetime annuities to defined contribution plans that require smaller contributions from employers; the federal government, by contrast, still offers many retirees health insurance, an annuity, and a defined contribution plan. As a result, federal employees receive a much larger portion of their compensation in retirement benefits than private-sector workers do, on average. Consequently, reducing pensions might be less harmful to the federal government's ability to compete with the private sector in attracting and retaining highly qualified personnel than a reduction in current compensation would be.

An argument against the option is that reducing retirement benefits would lessen the attractiveness of the overall compensation package provided by the federal government, hampering its ability to attract and retain a highly qualified workforce. Positions requiring professional and advanced degrees might become particularly difficult to fill, because federal workers with those qualifications already receive less compensation than their private-sector counterparts do, on average. Another argument against the option is that it would reduce the amount of income that federal workers receive in retirement. In 2018, for example, using a five-year average would reduce the FERS annuities of about 55,000 new retirees by an average of roughly 2 percent. The elimination of SRS would affect a much smaller portion of new retirees, because most federal employees do not retire until after reaching age 62. However, many of the workers who did retire before 62 would see a large reduction in their income until they reached that age. That period of reduced income could exceed 10 years for employees in law enforcement and the other groups of employees who can qualify for the annuities at an early age.

RELATED OPTION: Revenues, Option 43

RELATED CBO PUBLICATIONS: *Comparing the Compensation of Federal and Private-Sector Employees* (January 2012), www.cbo.gov/publication/42921; Justin Falk, *Comparing Benefits and Total Compensation in the Federal Government and the Private Sector*, Working Paper 2012-04 (January 2012), www.cbo.gov/publication/42923

**Mandatory Spending—Option 13** **Function 600**

## Convert Multiple Assistance Programs for Lower-Income People Into Smaller Block Grants to States

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Mandatory Outlays | | | | | | | | | | | | |
| SNAP | 0 | -30 | -28 | -27 | -26 | -25 | -24 | -23 | -22 | -22 | -111 | -227 |
| SSI | 0 | * | -4 | -4 | -5 | -10 | -6 | -1 | -7 | -7 | -13 | -43 |
| Child nutrition programs | 0 | -8 | -8 | -9 | -10 | -11 | -11 | -12 | -13 | -14 | -35 | -97 |
| Total | 0 | -37 | -41 | -41 | -40 | -45 | -40 | -36 | -42 | -44 | -160 | -367 |
| Change in Discretionary Spending for SSI | 0 | -5 | -5 | -5 | -5 | -6 | -6 | -6 | -6 | -6 | -21 | -50 |

This option would take effect in October 2017.

SNAP = Supplemental Nutrition Assistance Program; SSI = Supplemental Security Income; * = between zero and $500 million.

Several sizable federal programs assist people who have relatively low income. Such programs include the Supplemental Nutrition Assistance Program (SNAP; formerly the Food Stamp program), Supplemental Security Income (SSI), and a collection of child nutrition programs. Federal spending for SNAP, SSI, and child nutrition programs in 2016 was $156 billion, or roughly 4 percent of total federal spending.

SNAP provides benefits to help low-income households buy food. Federal outlays for the program were $73 billion in 2016. SSI provides cash assistance to elderly or disabled people who have low income and few assets; spending (most of it mandatory) for that program totaled $61 billion that year. Child nutrition programs subsidize meals provided to children at school, at child care centers, in after-school programs, and in other settings. In 2016, spending for those programs was $22 billion, most of it for the National School Lunch Program and the School Breakfast Program.

Beginning in October 2017, this option would convert SNAP, SSI, and the child nutrition programs to separate, smaller block grants to the states. Each of the three block grants would provide a set amount of funding to states each year, and states would be allowed to significantly change the structure of the programs. The annual funding provided would equal federal outlays for each program in 2007, increased to account for inflation for all urban consumers since then. (The 2007 starting amounts would include outlays for both benefits and administrative costs and, for child nutrition programs, would represent total spending for that set of programs. For SSI, the 2007 amount would be adjusted to account for 12 monthly benefit payments instead of 11.)

By the Congressional Budget Office's estimates, this option would reduce spending on SNAP by $227 billion from 2017 through 2026—or by 31 percent of the amount that would be spent under current law. For SSI, mandatory spending during that period would decline by $43 billion, or by 7 percent. For child nutrition programs, the reduction would be $97 billion, or 35 percent. In addition, funding to administer SSI is provided annually in discretionary appropriations; this option would eliminate those appropriations, resulting in $50 billion in discretionary savings during the 2017–2026 period, so long as appropriations were adjusted accordingly.

The budgetary effects of switching SNAP, SSI, and child nutrition programs to block grants would depend heavily on the formulas used to set the amounts of the grants. For this option, the inflation-adjusted value of the grants would remain at 2007 amounts. If, instead, the grants were fixed in nominal dollars (as is, for example, the block grant for Temporary Assistance for Needy Families), savings would be larger (and increasingly so) each year. By contrast, if the grants were indexed for both inflation and population growth—that is, if they were allowed to grow faster than specified—savings would be smaller (and increasingly so) each year. Savings also would be less if the starting values for the grants were based on larger amounts than the outlays in 2007—for example, the outlays for those programs in more recent years. And savings would be less if spending in 2018 and the following few years was adjusted downward from CBO's current-law projections more slowly instead of immediately reverting to the 2007 amounts adjusted for inflation.

Although the formula used to set the amount of each separate block grant in this option is the same, the effects on spending for the programs would differ. For SNAP, the effect on projected spending would be larger early on, whereas for the child nutrition programs and in general for SSI, the effects would be larger in the later years.

For SNAP, the estimated reduction in federal spending from converting to the specified block grant would decline, both in dollar terms and as a share of projected spending under current law. CBO projects that, under current law, spending on SNAP will decline over the 2017–2022 period and then slowly increase through 2026. The number of people receiving benefits will decline as the economy improves over the 10-year period, but the increase in per-person benefits in the later years will outweigh the effect of the decline in the number of participants. (SNAP benefits are adjusted annually for changes in food prices.) By contrast, under the option, spending on SNAP would increase over the 10-year period. Under current law, spending on SNAP will be $73 billion in 2018, CBO projects; this option would reduce that amount by an estimated $30 billion, or by 41 percent. In 2026, spending on SNAP under current law is projected to be $74 billion; the option would cut that figure by an estimated $22 billion, or by 30 percent.

For SSI, the estimated reduction in mandatory outlays from converting to the specified block grant would generally increase, both in dollar terms and as a share of projected spending under current law. (The reduction in spending would fluctuate in a few years because, as scheduled under current law, benefit payments in October shift to the previous fiscal year when the first day of the month falls on a weekend.) The option would result in greater reductions in the later years primarily because, by CBO's estimates under current law, participation in the program will increase. Under current law, mandatory spending on SSI will be $50 billion in 2018, CBO projects; this option would increase that spending by less than $500 million. In 2026, mandatory spending on SSI under current law is projected to be $69 billion; the option would cut that figure by an estimated $7 billion, or by 10 percent.

For child nutrition programs, the estimated reduction in federal spending from converting to the specified block grant would increase, both in dollar terms and as a share of projected spending under current law. In 2018, the estimated reduction in spending would be $8 billion, or about one-third; and in 2026, the estimated reduction would be $14 billion, or more than 40 percent. The savings would be greater in the later years of the period for two reasons: Most spending for the programs under current law is indexed to an inflator that adjusts benefits for changes in the price of food away from home—which CBO projects will be larger than the changes in prices to which the specified block grant is indexed. Also, by CBO's expectations under current law, participation in the programs will grow.

A rationale for this option is that block grants would make spending by the federal government more predictable. The programs that this option affects must, under current law, make payments to eligible people. Therefore, spending automatically increases or decreases without any legislative changes. For example, outlays for SNAP benefits more than doubled between 2007 and 2011, primarily because participation in the program increased mainly as a result of deteriorating labor market conditions. And even if the number of participants in a program does not change, the benefits paid per person can change if the income of participants changes.

Another rationale for the option is that state programs might better suit local needs and might be more innovative. States could define eligibility and administer benefits in ways that might better serve their populations. Moreover, allowing states to design their own programs would result in more experimentation, and some states could adopt approaches that had worked elsewhere.

A rationale against this option is that, from 2018 to 2026, it would cut mandatory federal spending for programs that support lower-income people by $367 billion (with an additional cut of $50 billion in discretionary spending, if appropriations were reduced as specified). Whom that cut in spending affected—and how—would depend on how states structured their programs and how state spending changed. But such a cut—amounting to 25 percent of the projected mandatory spending on SNAP, SSI, and child nutrition programs during those years—would almost certainly eliminate benefits for some people who would have otherwise received them, as well as significantly reduce the benefits of some people who remained in the programs.

Another rationale against this option is that block grants would be less responsive to economic conditions than the current federal programs. The automatic changes in spending on benefits under current law help stabilize the economy, reducing the depth of recessions during economic downturns. Those stabilizing effects would be lost under the option. Furthermore, if federal spending did not increase during a future economic downturn and more people qualified for benefits, states that could not increase their spending (probably at a time when their own revenues were declining) would have to reduce per-person benefits or tighten eligibility, perhaps adding to the hardship for families just when their need was greatest.

RELATED OPTIONS: Mandatory Spending, Options 14, 15, 17; Health, Option 2

RELATED CBO PUBLICATIONS: *Child Nutrition Programs: Spending and Policy Options* (September 2015), www.cbo.gov/publication/50737; *The Effects of Potential Cuts in SNAP Spending on Households With Different Amounts of Income* (March 2015), www.cbo.gov/publication/49978; *Supplemental Security Income: An Overview* (December 2012), www.cbo.gov/publication/43759; *The Supplemental Nutrition Assistance Program* (April 2012), www.cbo.gov/publication/43173

**Mandatory Spending—Option 14** **Function 600**

## Eliminate Subsidies for Certain Meals in the National School Lunch, School Breakfast, and Child and Adult Care Food Programs

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | -0.1 | -0.7 | -1.0 | -1.1 | -1.1 | -1.2 | -1.2 | -1.3 | -1.3 | -1.4 | -4.0 | -10.3 |

This option would take effect in July 2017.

The National School Lunch Program, the School Breakfast Program, and the Child and Adult Care Food Program provide funds that enable public schools, nonprofit private schools, child and adult care centers, and residential child care institutions to offer subsidized meals and snacks to participants.[1] In the 2016–2017 school year, federal subsidies are generally 59 cents for each lunch, 29 cents for each breakfast, and 7 cents for each snack for participants in households with income above 185 percent of the federal poverty guidelines (commonly known as the federal poverty level, or FPL). The programs provide larger subsidies for meals served to participants from households with income at or below 185 percent of the FPL and above 130 percent of the FPL, and still larger subsidies to participants from households with income at or below 130 percent of the FPL. As a result of the subsidies, participants from households with income at or below 130 percent of the FPL pay nothing for their meals.

Beginning in July 2017, this option would eliminate the subsidies for meals and snacks served to participants from households with income greater than 185 percent of the FPL. The Congressional Budget Office estimates that the option would reduce federal spending by $10 billion through 2026.

Under current law, federal subsidies for meals served to participants from households with income greater than 185 percent of the FPL can include base cash subsidies; certain commodities; and, for those schools participating in the National School Lunch Program that comply with federal nutrition guidelines, an additional cash subsidy. In the 2016–2017 school year, the base cash subsidies for meals served to participants from households with income greater than 185 percent of the FPL are 30 cents per lunch and 29 cents per breakfast; for after-school snacks provided to such participants, the amount is 7 cents. All participating schools and centers also receive commodities—food from the Department of Agriculture, such as fruit and meat—with a value of 23 cents per lunch. Schools whose meals that state authorities certify as complying with federal nutrition guidelines receive an additional cash subsidy of 6 cents per lunch in the 2016–2017 school year. (Additional subsidies are available for schools and centers in Alaska and Hawaii, schools in Puerto Rico, and participating schools that serve many meals to students from households with income at or below 185 percent of the FPL.)

The primary rationale for this option is that it would target federal subsidies to those most in need. Because the subsidies for meals served to participants from households with income greater than 185 percent of the FPL are small, the effect of the option on those participants and the members of their households would probably be minimal.

1. The Child and Adult Care Food Program provides funds for meals and snacks served in child and adult care centers as well as in day care homes. Reimbursement rates for meals served through participating child and adult care centers are equal to the reimbursement rates for meals served through the National School Lunch Program and the School Breakfast Program. Because reimbursement rates for meals served in day care homes are set differently, this option does not affect day care homes.

A rationale against this option is that schools and centers would probably offset part or all of the loss of the subsidies by charging participants from higher-income households higher prices for meals, and some of those participants might stop buying meals. In addition, schools and centers might leave the programs if they incur meal program costs that exceed the subsidies they receive for meals served to participants from households with income at or below 185 percent of the FPL.[2] Individuals at such institutions who would be eligible for free or reduced-price meals would no longer receive subsidized meals, and the meals served at those institutions would no longer have to meet any other requirements of the programs (including the nutrition guidelines).

2. About one-third of school food authorities surveyed claimed that expenses exceeded revenues in the 2012–2013 school year. See Food and Nutrition Service, *Special Nutrition Program Operations Study, School Year 2013–14*, Nutrition Assistance Program Report (October 2016), p. 173, http://go.usa.gov/xkSeh (PDF, 7.3 MB).

RELATED OPTIONS: Mandatory Spending, Options 13, 15

RELATED CBO PUBLICATION: *Child Nutrition Programs: Spending and Policy Options* (September 2015), www.cbo.gov/publication/50737

**Mandatory Spending—Option 15** **Function 600**

## Tighten Eligibility for the Supplemental Nutrition Assistance Program

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | -4.4 | -10.5 | -10.4 | -10.4 | -10.3 | -10.3 | -10.3 | -10.4 | -10.6 | -35.7 | -87.6 |

This option would take effect in October 2017.

The Supplemental Nutrition Assistance Program (SNAP; formerly the Food Stamp program) provides benefits to low-income households to help them purchase food. Eligibility is generally based on participation in other government assistance programs or on the income and assets of a household.

Most households that receive SNAP benefits—more than 90 percent in fiscal year 2014 (the most recent year for which such data are available)—are considered categorically eligible; that is, they automatically qualify for benefits because they participate in other federal or state programs. Most such households—three-quarters in 2014—qualify for benefits under what is termed broad-based categorical eligibility. Namely, all household members receive or are authorized to receive noncash benefits from the Temporary Assistance for Needy Families (TANF) program; such benefits could include child care, transportation assistance, or even a token benefit such as a pamphlet describing TANF. The remaining categorically eligible households—one-quarter in 2014—are ones in which all members receive cash assistance from TANF, Supplemental Security Income, or certain state programs that serve people with low income. Most households that qualify for SNAP because of categorical eligibility (including broad-based categorical eligibility) would also meet the federal income and asset requirements for eligibility.

Households that receive SNAP benefits but are not categorically eligible for the program—less than 10 percent of all participating households in 2014—qualify by meeting certain income and asset tests set by law that vary depending on households' characteristics. For households that do not include an elderly or disabled person, total income in the month of application must be less than or equal to 130 percent of the monthly federal poverty guidelines. (Those guidelines are commonly known as the federal poverty level, or FPL.) Also, their cash assets must be less than or equal to $2,250. For households that include an elderly or disabled person, different tests apply.

This option would reduce the monthly income limit for eligibility from 130 percent to 67 percent of the federal poverty guidelines and would eliminate broad-based categorical eligibility, reducing SNAP outlays by 15 percent in 2019—the first year in which the option would be fully implemented. Eligibility for households with elderly or disabled people or those receiving cash assistance from certain other programs (45 percent of households receiving SNAP in 2014, the Congressional Budget Office estimates) would be unchanged. CBO estimates that this approach would yield federal savings of $88 billion from 2018 to 2026. (Eliminating broad-based categorical eligibility while leaving the monthly income limit unchanged would yield federal savings of about $8 billion over the same period.)

A rationale for lowering the income limit for eligibility and eliminating broad-based categorical eligibility is that doing so would focus SNAP benefits on people most in need. Also, eliminating broad-based categorical eligibility would make the eligibility for and benefits from SNAP more consistent among states because states have different policies regarding other assistance programs.

An argument against this option is that it would eliminate benefits for many households in difficult financial situations, including some people below the federal poverty level. (Lowering the income limit for eligibility to 100 percent of the FPL would eliminate benefits for fewer households but would save less than lowering the limit to 67 percent of the FPL.) An additional argument against eliminating broad-based categorical eligibility is that doing so would increase the complexity and time involved in verifying information on SNAP applications, probably resulting in more errors. Adopting that approach would also increase the paperwork for applicants.

RELATED OPTIONS: Mandatory Spending, Options 13, 14

RELATED CBO PUBLICATIONS: *The Effects of Potential Cuts in SNAP Spending on Households With Different Amounts of Income* (March 2015), www.cbo.gov/publication/49978; *The Supplemental Nutrition Assistance Program* (April 2012), www.cbo.gov/publication/43173

Mandatory Spending—Option 16 Function 600

## Reduce TANF's State Family Assistance Grant by 10 Percent

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | -1.0 | -1.5 | -1.6 | -1.6 | -1.6 | -1.6 | -1.6 | -1.6 | -1.6 | -5.6 | -13.8 |

This option would take effect in October 2017.

Temporary Assistance for Needy Families (TANF) provides cash assistance, work support (such as subsidized child care), and other services to some low-income families with children. Almost all of the federal government's TANF funding is provided through a block grant called the state family assistance grant (SFAG), which totals $16 billion annually. The states administer TANF and have considerable latitude in determining the mix of cash assistance, work support, and other services that the program provides. The states also determine the requirements for participation in work-related activities that some recipients must meet to avoid receiving less cash assistance through the program.

Beginning in October 2017, this option would decrease the SFAG by 10 percent. That change would reduce federal spending by $14 billion through 2026, the Congressional Budget Office estimates.

One rationale for this option is that it might prevent some families from becoming dependent on federal aid if states responded to the reduction in SFAG funding by making their work requirements more stringent to reduce their spending on cash assistance. The more stringent work requirements would probably result in some families' receiving cash assistance for shorter periods. And in some cases, families might find work more quickly, either to compensate for the loss of cash assistance or to comply with the work requirements. However, some states might respond to the reduction in funding by decreasing their spending on work support, which could make finding and keeping jobs harder.

A rationale against this option is that it would reduce the amount of assistance available to low-income families with children. Because federal spending on TANF has stayed about the same since 1998 (the program's first full year), the purchasing power of that funding has fallen by about 25 percent. As real (inflation-adjusted) spending on TANF has decreased, so has the number of families who get cash assistance from the program—from 3.2 million families in 1998 to 1.3 million in 2015. In comparison, roughly 6.9 million families had income below the poverty threshold in 2015, CBO estimates. Reducing real spending on the program by an additional 10 percent would further limit the number of families that it served or the amount of assistance that it provided.

RELATED CBO PUBLICATION: *Temporary Assistance for Needy Families: Spending and Policy Options* (January 2015), www.cbo.gov/publication/49887

Mandatory Spending—Option 17 Function 600

## Eliminate Supplemental Security Income Benefits for Disabled Children

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Mandatory Outlays | 0 | -10 | -11 | -11 | -11 | -12 | -12 | -11 | -13 | -13 | -42 | -104 |
| Change in Discretionary Spending | 0 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -4 | -9 |

This option would take effect in October 2017.

The Supplemental Security Income (SSI) program provides cash assistance to people who are disabled, aged, or both and who have low income and few assets. The Congressional Budget Office estimates that 15 percent of SSI recipients in 2016 will be disabled children under age 18, receiving an average monthly benefit of $664. Those children must have marked and severe functional limitations and usually must live in a household with low income and few assets.

This option would eliminate SSI benefits for disabled children. CBO estimates that making that change would reduce mandatory spending by $104 billion through 2026. Also, because annual discretionary appropriations cover SSI's administrative costs, this option would generate $9 billion in discretionary savings over the same period so long as total appropriations were adjusted accordingly.

One rationale for this option is that providing SSI benefits to children may discourage their parents from working. Unlike Temporary Assistance for Needy Families, a welfare program that aims to help families achieve self-sufficiency, SSI imposes no work requirements on parents and does not explicitly limit how long they may receive benefits as long as the child remains medically and financially eligible. Furthermore, SSI benefits decrease by 50 cents for each additional dollar parents earn above a certain threshold, depending on household size and other factors. (For example, in calendar year 2016, for a single parent with one child who is disabled and with no other income, SSI benefits are generally reduced after the parent earns more than $1,551 per month.) Those program traits create a disincentive for parents to increase work and thereby boost earnings.[1]

Another rationale for this option is that, rather than provide a cash benefit to parents without ensuring that they spend the money on their disabled children, policymakers could choose to support those children in other ways. For example, states could receive grants to make an integrated suite of educational, medical, and social services available to disabled children and their families. To the extent that funds that would have been used to provide SSI benefits for children were instead used for a new program or to increase the resources of other existing programs, federal savings from this option would be correspondingly reduced.

A rationale against this option is that this program serves a disadvantaged group. SSI is the only federal income support program geared toward families with disabled children, and SSI benefits reduce child poverty rates. Families with disabled children are typically more susceptible to economic hardship than other families because of

1. Research has not shown that parents significantly reduce work in anticipation of receiving SSI benefits for their child. However, in one study, parents who stopped receiving their child's SSI benefit significantly increased their work hours and fully offset the loss of the benefit. It remains unclear exactly how increased parental work affects the outcomes of disabled children. See Manasi Deshpande, "The Effect of Disability Payments on Household Earnings and Income: Evidence From the SSI Children's Program," *Review of Economics and Statistics*, vol. 98, no. 4 (October 2016), pp. 638–654, http://dx.doi.org/10.1162/REST_a_00609.

both direct and indirect costs associated with children's disabilities. (Direct costs can include additional out-of-pocket health care expenses, spending on adaptive equipment, and behavioral and educational services. Indirect costs for the parents of disabled children can include lost productivity and negative health effects.)

RELATED OPTION: Mandatory Spending, Option 13

RELATED CBO PUBLICATION: *Supplemental Security Income: An Overview* (December 2012), www.cbo.gov/publication/43759

**Mandatory Spending—Option 18** **Function 650**

## Link Initial Social Security Benefits to Average Prices Instead of Average Earnings

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | | | | | | | | | | | | |
| Pure price indexing | 0 | * | -1 | -3 | -6 | -9 | -14 | -20 | -26 | -34 | -11 | -114 |
| Progressive price indexing | 0 | * | -1 | -2 | -4 | -6 | -9 | -12 | -17 | -22 | -7 | -72 |

This option would take effect in January 2018.

* = between –$500 million and zero.

Social Security benefits for retired and disabled workers are based on their average lifetime earnings. The Social Security Administration uses a statutory formula to compute a worker's initial benefits, and through a process known as wage indexing, the benefit calculation in each year accounts for economywide growth of wages. Average initial benefits for Social Security recipients therefore tend to grow at the same rate as do average wages, and such benefits replace a roughly constant portion of wages. (After people become eligible for benefits, their monthly benefits are adjusted annually to account for increases in the cost of living but not for further increases in average wages.)

One approach to constrain the growth of Social Security benefits would be to change the computation of initial benefits so that the real (inflation-adjusted) value of average initial benefits did not rise. That approach, often called "pure" price indexing, would allow increases in average real wages to result in higher real Social Security payroll taxes but not in higher real benefits. Beginning with participants who became eligible for benefits in 2018, pure price indexing would link the growth of initial benefits to the growth of prices (as measured by changes in the consumer price index for all urban consumers) rather than to the growth of average wages. (That link would operate through reducing three factors that determine the primary insurance amount. The factors would be reduced by the real wage growth in each year. Those three factors are now 90 percent, 32 percent, and 15 percent; the earnings amounts at which the factors change are called bend points. For example, with real wage growth of 1 percent, the three factors would be reduced by 1 percent, so in 2018 they would be 89.1 percent, 31.68 percent, and 14.85 percent, respectively.)

Pure price indexing would reduce federal outlays by $114 billion through 2026, the Congressional Budget Office estimates. By 2046, scheduled Social Security outlays would be reduced by 16 percent from what would occur under current law; when measured as a percentage of total economic output, the reduction would be 1 percentage point because outlays would decline from 6.3 percent to 5.3 percent of gross domestic product. People newly eligible for benefits in 2046, CBO estimates, would experience a reduction in benefits of about one-third from the benefits scheduled under current law.

Under pure price indexing, each cohort of beneficiaries would receive successively smaller benefit payments than those scheduled to be paid under current law; the growth of average real wages would determine the extent of the reduction. For example, if real wages grew by 1 percent annually, workers newly eligible for benefits in the first year the policy was in effect would receive 1 percent less than they would have received under the current rules; those becoming eligible in the second year would receive about 2 percent less; and so on. The actual incremental reduction would vary from year to year, depending on the growth of real earnings.

Another approach to constrain the growth of initial Social Security benefits, called progressive price indexing, would keep the current benefit formula for workers who had lower earnings and would reduce the growth of initial benefits for workers who had higher earnings. (That approach would be implemented by adding a new bend point and reducing the factors that determine the primary insurance amount above that bend point.) The present formula for calculating initial benefits is structured so that workers with higher earnings receive higher benefits, but the benefits paid to workers with lower earnings replace a larger share of their earnings.

Under progressive price indexing, initial benefits for the 30 percent of workers with the lowest lifetime earnings would increase with average wages, as they are scheduled to do under current law, whereas initial benefits for other workers would increase more slowly, at a rate that depended on their position in the distribution of earnings. For example, for workers whose earnings put them at the 31st percentile of the distribution, benefits would rise only slightly more slowly than average wages, whereas for the highest earners, benefits would rise with prices—as they would under pure price indexing. Thus, under progressive price indexing, initial benefits for most workers would increase more quickly than prices but more slowly than average wages. As a result, the benefit structure would gradually become flatter, and after about 70 years, all newly eligible workers in the top 70 percent of earners would receive the same monthly benefit.

Progressive price indexing would reduce scheduled Social Security outlays less than would pure price indexing, and beneficiaries with lower earnings would not be affected. Real annual average benefits would still increase for all but the highest-earning beneficiaries. Benefits would replace less of affected workers' earnings than under current law but would replace more than they would under pure price indexing.

A switch to progressive price indexing would reduce federal outlays by $72 billion through 2026, CBO estimates. By 2046, outlays for Social Security would be reduced by 9 percent; when measured as a percentage of total economic output, the reduction would be 0.6 percentage points because outlays would fall from 6.3 percent to 5.7 percent of gross domestic product.

Under both approaches, the reductions in benefits with respect to current law would be largest for beneficiaries in the distant future. Those beneficiaries, however, would have had higher real earnings during their working years and thus a greater ability to save for retirement on their own to offset those reductions.

An advantage of both approaches in this option is that average inflation-adjusted benefits in the program would not decline. If lawmakers adopted pure price indexing, future beneficiaries would generally receive the same real monthly benefit paid to current beneficiaries, and they would, as average longevity increased, receive larger total lifetime benefits.

But because benefits would not be as closely linked to average wages, a disadvantage of both approaches is that affected beneficiaries would not share in overall economic growth to the same extent. As a result, benefits would replace less of workers' earnings than they do today.

RELATED OPTIONS: Mandatory Spending, Options 19, 20, 21

RELATED CBO PUBLICATIONS: *Social Security Policy Options, 2015* (December 2015), www.cbo.gov/publication/51011; letter to the Honorable Paul Ryan providing CBO's analysis of the Roadmap for America's Future Act of 2010 (January 27, 2010), www.cbo.gov/publication/41860; *Long-Term Analysis of S. 2427, the Sustainable Solvency First for Social Security Act of 2006* (attachment to a letter to the Honorable Robert F. Bennett, April 5, 2006), www.cbo.gov/publication/17701

Mandatory Spending—Option 19 Function 650

## Make Social Security's Benefit Structure More Progressive

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | | | | | | | | | | | | |
| Implement 90/32/5 PIA factors | 0 | * | * | -0.2 | -0.3 | -0.6 | -0.8 | -1.3 | -1.9 | -2.5 | -0.5 | -7.6 |
| Implement 100/25/5 PIA factors | 0 | * | -0.3 | -0.8 | -1.5 | -2.7 | -4.2 | -6.2 | -8.6 | -11.5 | -2.6 | -35.8 |

This option would take effect in January 2018.

PIA = primary insurance amount; * = between –$50 million and zero.

The amount of Social Security benefits paid to a disabled worker or to a retired worker who claims benefits at the full retirement age is called the primary insurance amount (PIA). The Social Security Administration calculates the PIA by applying a progressive benefit formula to a worker's average indexed monthly earnings (AIME), a measure of average taxable earnings over that worker's lifetime. That amount is separated into three brackets (or portions) by using two bend points. In calendar year 2016, the first bend point is $856 and the second bend point is $5,157. The PIA consists of any average indexed earnings in each of the three brackets multiplied by three corresponding PIA factors: 90 percent, 32 percent, and 15 percent. (Bend points grow each year with average wages, whereas PIA factors remain constant.)

For example, a worker with an AIME of $1,000 would have a PIA of $816 because the 90 percent rate would apply to the first $856, and the 32 percent rate would apply to the remaining $144. A worker with an AIME of $6,000 would have a PIA of $2,273 because the 90 percent rate would apply to the first $856, the 32 percent rate would apply to the next $4,301 ($5,157 minus $856), and the 15 percent rate would apply to the remaining $843 ($6,000 minus $5,157). Because the PIA formula is progressive, it replaces a larger share of lifetime earnings for the worker with a lower AIME than it does for the worker with a higher AIME. (For an AIME of $1,000, the PIA would be 82 percent of the worker's AIME; for $6,000, the PIA would be 38 percent.)

This option would make the Social Security benefit structure more progressive by cutting benefits for people with higher average earnings while either preserving or expanding benefits for people with lower earnings. Starting with people newly eligible in 2018, the first approach in this option would affect only beneficiaries with an AIME above the second bend point. That approach would reduce the 15 percent PIA factor by 1 percentage point per year until it reached 5 percent in 2027.

The more progressive second approach in this option would reduce benefits for a larger fraction of beneficiaries with relatively high lifetime earnings while increasing benefits for people with lower lifetime earnings. The second approach would lower both the 15 percent and 32 percent PIA factors and would increase the 90 percent factor. The factors would change gradually over 10 years until they reached 5 percent, 25 percent, and 100 percent, respectively. (The 15 percent and 90 percent factors would change by 1 percentage point per year, while the 32 percent factor would change by 0.7 percentage points per year.)

The first approach in this option would affect about 13 percent of all newly eligible beneficiaries, the Congressional Budget Office estimates, and would reduce total federal outlays for Social Security over the 10-year period by about $8 billion. The second approach would increase benefits for about 45 percent of new beneficiaries and reduce benefits for about 55 percent, achieving total federal savings of $36 billion over the 10-year period. In 2046, the first and second approaches would reduce Social Security outlays from what would occur under current law by 3 percent and 7 percent, respectively. When measured as a percentage of total economic output, the reduction in Social Security outlays under the two approaches would be 0.2 percentage points and 0.4 percentage points as the outlays would fall from 6.3 percent to 6.1 percent and to 5.8 percent of gross domestic product, respectively.

An argument in favor of this option is that it would protect or expand Social Security benefits for people with low average earnings while trimming payments to higher-income beneficiaries. This option would help make the Social Security system more progressive at a time when growing disparities in life expectancy by income level are making the system less progressive. (Beneficiaries with higher income typically live longer and experience larger improvements in their life expectancy than lower-income beneficiaries. As a result, higher-income groups receive benefits for more years than lower-income beneficiaries.) The second approach in this option would increase progressivity more than the first approach by boosting benefits to lower-income people.

A disadvantage of this option is that it would weaken the Social Security system's link between earnings and benefits. In addition, the second approach would reduce benefits for beneficiaries with an AIME above the 45th percentile. In particular, CBO projects that in 2018 the second approach would reduce benefits for people with an AIME higher than about $2,200, or approximately $26,000 in annual indexed earnings.

RELATED OPTIONS: Mandatory Spending, Options 18, 20, 21

RELATED CBO PUBLICATIONS: *Social Security Policy Options, 2015* (December 2015), www.cbo.gov/publication/51011; *CBO's 2015 Long-Term Projections for Social Security: Additional Information* (December 2015), www.cbo.gov/publication/51047

**Mandatory Spending—Option 20** **Function 650**

## Raise the Full Retirement Age for Social Security

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | 0 | 0 | 0 | 0 | 0 | -0.2 | -0.9 | -2.2 | -4.3 | 0 | -7.6 |

This option would take effect in January 2023.

The age at which workers become eligible for full retirement benefits from Social Security—the full retirement age (FRA), also called the normal retirement age—depends on their year of birth. For workers born in 1937 or earlier, the FRA was 65. It increased in two-month increments for each successive birth year until it reached 66 for workers born in 1943. For workers born between 1944 and 1954, the FRA holds at 66, but it then increases again in two-month increments until it reaches age 67 for workers born in 1960 or later. As a result, workers who turn 62 in 2022 or later will be subject to an FRA of 67. The earliest age at which workers may start to receive reduced retirement benefits will remain 62; however, benefit reductions at that age will be larger for workers whose FRA is higher. For example, workers born in 1954 (whose FRA is 66) will receive a permanent 25 percent reduction in their monthly benefit amount if they claim benefits at age 62 rather than at the FRA, whereas workers born in 1960 (whose FRA is 67) will receive a 30 percent benefit reduction if they claim benefits at 62.

Under this option, the FRA would continue to increase from age 67 by two months per birth year, beginning with workers turning 62 in 2023, until it reaches age 70 for workers born in 1978 or later (who turn 62 beginning in 2040). As under current law, workers could still choose to begin receiving reduced benefits at age 62, but the reductions in their initial monthly benefit from the amounts received at the FRA would be larger, reaching 45 percent when the FRA is 70. This option would not reduce the benefits for workers who qualify for Social Security Disability Insurance (DI).

An increase in the FRA would reduce lifetime benefits for every affected Social Security recipient, regardless of the age at which a person claims benefits. A one-year increase in the FRA is equivalent to a reduction of about 6 percent to 8 percent in the monthly benefit, depending on the age at which a recipient chooses to claim benefits. Workers could maintain the same monthly benefit by claiming benefits at a later age, but then they would receive benefits for fewer years.

This option would shrink federal outlays by $8 billion through 2026, the Congressional Budget Office estimates. By 2046, the option would reduce Social Security outlays from what would occur under current law by 7 percent; when measured as a percentage of total economic output, the reduction would be 0.5 percentage points, because outlays would fall from 6.3 percent to 5.8 percent of gross domestic product.

Because many workers retire at the FRA, increasing that age is likely to result in beneficiaries' working longer and claiming Social Security benefits later than they would if a policy with identical benefit cuts at each age was implemented by adjusting the benefit formula. Any additional work would increase total output and boost federal revenues from income and payroll taxes. It also would result in higher future Social Security benefits, although the increase in benefits would be smaller than the increase in revenues. The estimates shown here for this option over the next decade do not include those effects of additional work.

A rationale for this option is that people who turn 65 today will, on average, live significantly longer and collect Social Security benefits for more years than retirees did in the past, increasing average lifetime Social Security benefits. In 1940, life expectancy at age 65 was 11.9 years for men and 13.4 years for women. Since that time, life expectancy has risen by more than six years for 65-year-olds, to 18.1 years for men and 20.6 years for women. Therefore, a commitment to provide retired workers with a certain monthly benefit beginning at age 65 today is significantly costlier than that same commitment made to recipients in 1940.

A disadvantage of this option is that it would increase the incentive for older workers nearing retirement to stop working and apply for DI benefits. Under current law, workers who retire at age 62 in 2046 will receive 70 percent of their primary insurance amount (what they would have received had they claimed benefits at their FRA); if they qualify for DI benefits, however, they will receive the full amount. Under this option, workers who retired at 62 in 2046 would receive only 55 percent of their primary insurance amount; they would still receive 100 percent if they qualified for DI benefits. (The estimates of how this option affects the budget account for the higher resulting applications and awards for the DI program.) To eliminate that added incentive to apply for disability benefits, policymakers could narrow the difference by also reducing scheduled disability payments.

Some proposals to raise the FRA also would increase the early eligibility age (EEA)—when participants may first claim retirement benefits—from 62. Increasing only the FRA would reduce monthly benefit amounts and would increase the risk of poverty at older ages for people who did not respond to the increase in the FRA by delaying the age at which they claimed benefits. Increasing the EEA along with the FRA would make many people wait longer to receive retirement benefits, so their average monthly payments would be higher than if only the FRA was increased; higher benefits would help people who lived a long time. However, for people who would depend on retirement benefits at age 62, increasing the EEA could cause financial hardship, even if the total lifetime value of benefits would be generally unchanged. Increasing the EEA together with the FRA would cause federal spending to be lower in the first few decades of the policy and higher in later decades than if only the FRA was increased.

RELATED OPTIONS: Mandatory Spending, Options 18, 19, 21, 23; Health, Option 9

RELATED CBO PUBLICATIONS: *Social Security Policy Options, 2015* (December 2015), www.cbo.gov/publication/51011; *Policy Options for the Social Security Disability Insurance Program* (July 2012), www.cbo.gov/publication/43421; *Raising the Ages of Eligibility for Medicare and Social Security* (January 2012), www.cbo.gov/publication/42683; “Raise the Earliest Eligibility Age for Social Security,” in *Reducing the Deficit: Spending and Revenue Options* (March 2011), www.cbo.gov/publication/22043; Jae Song and Joyce Manchester, *Have People Delayed Claiming Retirement Benefits? Responses to Changes in Social Security Rules,* Working Paper 2008-04 (May 2008), www.cbo.gov/publication/19575

**Mandatory Spending—Option 21** **Function 650**

## Reduce Social Security Benefits for New Beneficiaries

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | | | | | | | | | | | | |
| Reduce benefits by 5 percent | 0 | * | -2 | -4 | -7 | -10 | -14 | -18 | -23 | -28 | -12 | -105 |
| Reduce benefits by 15 percent | 0 | * | -2 | -4 | -8 | -15 | -23 | -33 | -45 | -58 | -15 | -190 |

This option would take effect in January 2018.

* = between –$500 million and zero.

Social Security is the largest single program in the federal budget, providing a total of $905 billion in benefits in 2016 to retired and disabled workers, their eligible dependents, and survivors of deceased workers. The Congressional Budget Office estimates that the average monthly benefit is now $1,365 for retired workers and $1,178 for disabled workers. The benefits that people receive in the year they are first eligible for benefits—at age 62 for retired workers and five months after the onset of disability for disabled workers—are based on those workers' average lifetime earnings. The formula used to translate average earnings into benefits is progressive; that is, the ratio of benefits to earnings is higher for people with lower average earnings than for people with higher average earnings. One way to achieve budgetary savings would be to adjust that formula to reduce benefits for all new beneficiaries.

This option includes two ways to adjust the benefit formula to reduce Social Security benefits by two amounts, 5 percent and 15 percent. Both alternatives would phase in the reductions starting with people who would be newly eligible in 2018. Under the 5 percent reduction, benefits would be permanently lowered by 2.5 percent for newly eligible beneficiaries in 2018 and by 5 percent for newly eligible beneficiaries beginning in 2019. (Benefits for newly eligible beneficiaries in 2018 would remain 2.5 percent lower throughout their lifetime.) Under the 15 percent reduction, benefits would be permanently reduced by 2.5 percent for people newly eligible in 2018, 5 percent for people newly eligible in 2019, and so on, up to 15 percent for people newly eligible beginning in 2023.

Serving as a benchmark, this option shows that policymakers might achieve substantial savings by cutting benefits for new Social Security beneficiaries only. This option would not affect current beneficiaries or those who will become eligible before 2018. CBO estimates that, between 2018 and 2026, federal outlays would be reduced by $105 billion under the 5 percent alternative and by $190 billion under the 15 percent reduction. Federal savings from those changes in the formula would continue to grow in later years as more beneficiaries were subject to the lower benefits. By 2046, Social Security outlays would be about 4 percent lower under the 5 percent benefit reduction and 12 percent lower under the 15 percent alternative than under current law, CBO estimates. When measured as a percentage of total economic output, Social Security outlays would fall from 6.3 percent to 6.0 percent of gross domestic product under the 5 percent alternative and to 5.5 percent of gross domestic product under the 15 percent reduction.

An advantage of this option is its simplicity. The current benefit structure would be retained, and equal percentage reductions would be applied to all benefits, including those paid to survivors and dependents, which are based on the same formula used to compute workers' benefits.

One rationale against this option is that both reductions would be applied soon, leaving people approaching retirement little time to adjust to the change. A more moderate approach would reduce Social Security benefits only for people becoming eligible for benefits 5 or 10 years in the future. However, delaying the option's start date would reduce the resulting budgetary savings. For example, if the 15 percent benefit reduction was implemented starting in 5 years (in 2022), increasing by 3 percent each year, total savings between 2017 and 2026 would amount to $40 billion.

Because benefit reductions would apply to all new beneficiaries, another disadvantage of the two alternatives in this option is that people with lower benefits would generally experience a larger percentage reduction in total income. In particular, such people are less likely than others to have savings and sources of income outside Social Security, such as pensions, so a reduction in Social Security benefits would result in a larger reduction in total income for that group and a greater relative decline in their standard of living. A more progressive approach would reduce Social Security benefits by larger percentages for people with higher benefits.

If the goal instead was to achieve the level of 10-year savings attained by the 5 percent or 15 percent alternatives by cutting benefits for all current and future beneficiaries, the required reduction would be considerably smaller: All benefits would need to be lowered by about 1 percent or about 2 percent, respectively.

RELATED OPTIONS: Mandatory Spending, Options 18, 19, 20

RELATED CBO PUBLICATIONS: *Social Security Policy Options, 2015* (December 2015), www.cbo.gov/publication/51011; *CBO's 2015 Long-Term Projections for Social Security: Additional Information* (December 2015), www.cbo.gov/publication/51047

Mandatory Spending—Option 22 Function 650

## Require Social Security Disability Insurance Applicants to Have Worked More in Recent Years

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | 0 | -0.6 | -1.6 | -2.7 | -3.8 | -4.9 | -6.0 | -7.2 | -8.3 | -9.5 | -8.6 | -44.5 |

This option would take effect in January 2018.

To be eligible for benefits under Social Security Disability Insurance (DI), disabled workers must generally have worked 5 of the past 10 years. Specifically, workers over age 30 must have earned at least 20 quarters of coverage in the past 10 years (which is the time span used to evaluate that requirement, also known as the look-back period). In calendar year 2016, a worker receives one quarter of coverage for each $1,260 of earnings during the year, up to four quarters; the amount of earnings required for a quarter of coverage generally increases annually with average wages.

This option would raise the share of recent years that disabled workers must have worked while shortening the look-back period by requiring disabled workers older than 30 to have earned 16 quarters in the past 6 years—usually equivalent to working 4 of the past 6 years. That change in policy would apply to people seeking benefits in 2018 and later and would not affect blind applicants, who are exempt from the recency-of-work requirement. This option would reduce the number of workers who received DI benefits by 6 percent in 2026, the Congressional Budget Office estimates, and would lower federal outlays for Social Security by $45 billion from 2018 through 2026. In relation to current law, outlays for Social Security in 2046 would be lower by roughly 1 percent. (Those estimates do not include any effects of this option on spending for other federal programs—such as Medicare, Medicaid, and Supplemental Security Income, or SSI—as well as spending on subsidies for health insurance purchased through the marketplaces established under the Affordable Care Act. Over the 10-year period, those effects would roughly offset. On one hand, disabled workers who no longer qualify for DI under this option would lose their eligibility for Medicare until age 65, thus reducing spending for Medicare. On the other hand, some disabled workers who lose DI and Medicare benefits under this option would become eligible for SSI, Medicaid, or health insurance subsidies, increasing spending for those programs.)

An argument in favor of this option is that it would better target benefits toward people who cannot work because of a recent disability. To qualify for disability benefits, applicants must be judged to be unable to perform "substantial" work because of a disability—but knowing whether applicants would have worked if they were not disabled is impossible. Under current law, even people who have not been in the labor force for five years can qualify for disability benefits. By comparison, this option would allow people who were out of the labor force for only two years or less to qualify for benefits.

A reason to keep the existing work provision is that the option could penalize some people who would have been working were they not disabled. For example, some people might leave the workforce for more than two years to care for children or pursue additional education and then become disabled while out of the workforce or shortly after returning to work. Such people could qualify for disability benefits under current law but would not qualify under this option. Similarly, some people who were in the labor force but unable to find work for over two years before becoming disabled would become ineligible for benefits under the option. To lessen the penalty for those workers, an alternative approach could raise the number of recent years that disabled workers must have worked while lengthening the look-back period by requiring workers to have worked 8 of the past 12 years. That approach would result in similar budgetary savings.

RELATED OPTION: Mandatory Spending, Option 23

RELATED CBO PUBLICATIONS: *Social Security Disability Insurance: Participation and Spending* (June 2016), www.cbo.gov/publication/51443; *Social Security Policy Options, 2015* (December 2015), www.cbo.gov/publication/51011; *Policy Options for the Social Security Disability Insurance Program* (July 2012), www.cbo.gov/publication/43421

**Mandatory Spending—Option 23** **Function 650**

## Eliminate Eligibility for Starting Social Security Disability Benefits at Age 62 or Later

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | -0.1 | -0.4 | -0.8 | -1.3 | -1.8 | -2.3 | -2.9 | -3.6 | -4.3 | -2.6 | -17.4 |

This option would take effect in January 2018.

Under current law, people are eligible for Social Security Disability Insurance (DI) until they reach full retirement age—currently 66 years for workers who turn 62 in 2016. The full retirement age will rise gradually, starting at 66 and 2 months for workers born in 1955 (who will turn 62 in 2017) and eventually reaching 67 for people born in 1960 (who will turn 62 in 2022) or later. Workers who claim retirement benefits at age 62 rather than at their full retirement age receive lower benefits for as long as they live. By contrast, workers who claim DI benefits at age 62 are not subject to a reduction. Instead, they receive in each year approximately the same retirement benefits that they would have received had they claimed retired-worker benefits at their full retirement age.

That difference in benefits encourages some people between age 62 and their full retirement age to apply for DI at the same time that they apply for Social Security retirement benefits. If their DI application is approved, they receive higher benefits for the rest of their life than if they had applied only for retirement benefits. (Some people claim retirement benefits during the five-month waiting period that the DI program imposes on applicants. If they receive retirement benefits during the waiting period and then are approved for the DI program, their DI benefits and future retirement benefits are reduced a little. For example, if they receive retirement benefits for five months, their future DI and retirement benefits are generally reduced by 2 percent.)

Under this option, workers would not be allowed to apply for DI benefits after their 62nd birthday or to receive DI benefits for a qualifying disability beginning after that date, even if they applied before age 62. Under such a policy, individuals who would have become eligible for DI benefits at age 62 or later under current law would instead have to claim retirement benefits if they wanted to receive Social Security benefits based on their own earnings. Benefits for those people over their lifetime would be as much as 30 percent lower than the DI and retirement benefits they would receive under current law. (The actual reduction in lifetime benefits would depend on their year of birth and the age at which they claimed retirement benefits.)

In 2026, this option would affect about 700,000 people who would have received disability benefits under current law. The option would reduce federal outlays by $17 billion between 2018 and 2026, the Congressional Budget Office estimates. Those savings would be the net result of a $77 billion reduction in DI outlays and a $60 billion increase in Social Security retirement benefits as people shifted from the DI program to the retirement program. By 2046, Social Security outlays (including both DI and retirement benefits) would be reduced by about 1 percent from what they would be under current law. (Those estimates do not include any effects of this option on spending for other federal programs—such as Medicare, Medicaid, and Supplemental Security Income, or SSI—as well as spending on subsidies for health insurance purchased through the marketplaces established under the Affordable Care Act. Over the 10-year period, those effects would roughly offset. On one hand, disabled workers older than 62 would lose their eligibility for Medicare until age 65, thus reducing spending for Medicare. On the other hand, some disabled workers who lose DI and Medicare benefits under this option would become eligible for SSI, Medicaid, or health insurance subsidies, increasing spending for those programs.)

A rationale for this option is that it eliminates the incentive for people applying for retirement benefits to apply for disability benefits at the same time in hopes of securing a financial advantage. Moreover, workers who became disabled between age 62 and the full retirement age would still have access to Social Security retirement benefits, although those benefits would be less than the disability benefits available under current law.

An argument against this option is that it would substantially reduce the support available to older people who, under current law, would be judged too disabled to perform substantial work. Among the workers who began receiving disability benefits in 2014, about 8 percent were age 62 or older when they applied or became disabled. Those people would have received significantly lower benefits from Social Security if they had been ineligible for DI and had applied for retirement benefits instead. In addition, some people would have lost coverage through Medicare because that program's benefits are generally not available to people under age 65, whereas most recipients of DI become entitled to Medicare benefits 24 months after their DI benefits begin.

The option's net effect on older people's participation in the labor force is unclear. On one hand, the option would induce some people to work longer than they will under current law: Although DI benefits are available only to people judged unable to perform substantial work, some people could find employment that would accommodate their disabilities. If DI benefits were not available, those people would work longer than they would under current law. On the other hand, the option would induce some people planning to work until age 62 or later to leave the labor force at age 61 so that they could apply for DI benefits. (The estimates presented here do not include any effects of changes in labor supply.)

RELATED OPTIONS: Mandatory Spending, Options 20, 22

RELATED CBO PUBLICATIONS: *Social Security Disability Insurance: Participation and Spending* (June 2016), www.cbo.gov/publication/51443; *Supplemental Security Income: An Overview* (December 2012), www.cbo.gov/publication/43759; *Policy Options for the Social Security Disability Insurance Program* (July 2012), www.cbo.gov/publication/43421

Mandatory Spending—Option 24 Function 700

## Narrow Eligibility for Veterans' Disability Compensation by Excluding Certain Disabilities Unrelated to Military Duties

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | 0 | -2.0 | -2.9 | -2.9 | -2.9 | -3.2 | -3.0 | -2.7 | -3.0 | -3.1 | -10.7 | -25.7 |

This option would take effect in January 2018.

Veterans may receive disability compensation from the Department of Veterans Affairs (VA) for medical conditions or injuries that occurred or worsened during active-duty military service. Such service-connected disabilities range widely in severity and type, from migraines and treatable hypertension to the loss of limbs. VA also provides dependency and indemnity compensation—payments to surviving spouses or children of a veteran who died from a service-related injury or disease. The Department of Defense (DoD) has a separate disability compensation system for service members who can no longer fulfill their military duties because of a disability.

Not all service-connected medical conditions and injuries are incurred or exacerbated in the performance of military duties. For example, a qualifying injury can occur when a service member was at home or on leave, and a qualifying medical condition, such as multiple sclerosis, can develop independently of a service member's military duties. In 2015, VA paid 716,000 veterans a total of $3.7 billion, the Congressional Budget Office estimates, to compensate for seven of the medical conditions that, according to the Government Accountability Office (GAO), military service is unlikely to cause or aggravate. Those conditions are arteriosclerotic heart disease, chronic obstructive pulmonary disease, Crohn's disease, hemorrhoids, multiple sclerosis, osteoarthritis, and uterine fibroids.

Beginning in January 2018, this option would cease veterans' disability compensation for those seven medical conditions GAO identified. Under the option, veterans now receiving compensation for those conditions would have their compensation reduced or eliminated, and veterans who applied for compensation for those conditions in the future would not be eligible for it. The option would not alter DoD's disability compensation system, which focuses on fitness for military duties rather than compensation for disabilities.

By CBO's estimates, this option would reduce outlays by $26 billion from 2018 to 2026. Most of the savings would result from curtailing payments to current recipients of disability compensation. A broader option could eliminate compensation for all disabilities unrelated to military duties, not just those conditions GAO identified. For arthritis, for instance, which may not result from military duties, VA could determine whether the condition was related to military activities. An option with that broader reach could generate significantly larger savings but could be harder to administer depending on how VA sets its eligibility criteria.

An argument in support of this option is that it would make the disability compensation system for military veterans more comparable to civilian systems. Few civilian employers offer long-term disability benefits, and among those that do, benefits do not typically compensate individuals for all medical problems that developed during employment.

An argument against this option is that military service is not like a civilian job; instead, it confers unique benefits to society and imposes extraordinary risks on service members. By that logic, the pay and benefits that service members receive should reflect the hardships of military life, including compensating veterans who become disabled in any way during their military service.

RELATED OPTIONS: Mandatory Spending, Options 11, 25

RELATED CBO PUBLICATION: *Veterans' Disability Compensation: Trends and Policy Options* (August 2014), www.cbo.gov/publication/45615

**Mandatory Spending—Option 25** **Function 700**

## Restrict VA's Individual Unemployability Benefits to Disabled Veterans Who Are Younger Than the Full Retirement Age for Social Security

| Billions of Dollars | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Total 2017–2021 | Total 2017–2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Change in Outlays | 0 | -2.9 | -4.0 | -4.2 | -4.3 | -4.5 | -4.7 | -4.8 | -5.0 | -5.2 | -15.4 | -39.6 |

This option would take effect in January 2018.

In 2015, more than 4 million veterans with medical conditions or injuries that occurred or worsened during active-duty military service were receiving disability compensation from the Department of Veterans Affairs (VA). The amount of compensation they receive depends on the severity of their disabilities (which are generally rated between zero and 100 percent in increments of 10), their number of dependents, and other factors—but not on their income or civilian employment history.

In addition, VA may supplement the regular disability compensation payments for veterans whom it deems unable to engage in substantial work. To qualify for those supplemental benefits, termed individual unemployability (IU) payments, veterans must have low earnings and generally must be rated between 60 percent and 90 percent disabled. A veteran qualifying for the IU supplement receives a monthly disability payment equal to the amount that he or she would receive if rated 100 percent disabled. In 2015, for veterans who received the supplement, it boosted monthly VA disability payments by an average of about $1,250. In September 2015, about 350,000 veterans received IU payments.

VA's regulations require that IU benefits be based on a veteran's inability to maintain substantial employment because of the severity of a service-connected disability and not because of age, voluntary withdrawal from work, or other factors. More than 60 percent of veterans receiving the IU supplement were 65 or older in September 2015, up from about one-third in September 2010. That rise is attributed largely to the aging of Vietnam War veterans.

Under this option, beginning in January 2018, VA would stop making IU payments to veterans older than Social Security's full retirement age, which varies from 65 to 67 depending on beneficiaries' birth year. Therefore, at recipients' full retirement age, VA disability payments would revert to the amount associated with the rated disability. By the Congressional Budget Office's estimates, the savings from this option would be $40 billion between 2018 and 2026.

One rationale for this option is that most veterans older than Social Security's full retirement age would not be in the labor force because of their age, so a lack of earnings for those veterans would probably not be attributable to service-connected disabilities. In particular, in 2015, about 35 percent of men ages 65 to 69 were in the labor force; for men age 75 or older, that number dropped to 11 percent. In addition, most recipients of IU payments who are older than 65 would have other sources of income: They would continue to receive regular VA disability payments and might also collect Social Security benefits. (Recipients of the IU supplement typically begin collecting it in their 50s and probably have worked enough to earn Social Security benefits.)

An argument for retaining the current policy is that IU payments should be determined solely on the basis of a veteran's ability to work and that considering age would be unfair. In addition, replacing the income from the IU supplement would be hard or impossible for some disabled veterans. If they had been out of the workforce for a long time, their Social Security benefits might be small, and they might not have accumulated much in personal savings.

RELATED OPTIONS: Mandatory Spending, Options 11, 24

RELATED CBO PUBLICATION: *Veterans' Disability Compensation: Trends and Policy Options* (August 2014), www.cbo.gov/publication/45615

**Mandatory Spending—Option 26** **Multiple Functions**

## Use an Alternative Measure of Inflation to Index Social Security and Other Mandatory Programs

| | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Billions of Dollars** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** | **2017–2021** | **2017–2026** |
| Change in Outlays | | | | | | | | | | | | |
| Social Security | 0 | -1.8 | -4.4 | -7.1 | -10.1 | -13.2 | -16.4 | -19.5 | -22.8 | -26.1 | -23.4 | -121.4 |
| Other benefit programs with COLAs[a] | 0 | -0.5 | -1.3 | -2.0 | -2.7 | -3.8 | -4.3 | -4.8 | -5.8 | -6.6 | -6.5 | -31.8 |
| Effects on SNAP from interactions with COLA programs[b] | 0 | * | 0.1 | 0.1 | 0.2 | 0.3 | 0.3 | 0.4 | 0.4 | 0.5 | 0.5 | 2.3 |
| Health programs | 0 | -0.3 | -0.8 | -1.5 | -2.1 | -3.0 | -3.9 | -4.7 | -5.6 | -6.2 | -4.6 | -27.9 |
| Other federal spending[c] | 0 | * | -0.1 | -0.2 | -0.3 | -0.3 | -0.5 | -0.6 | -0.9 | -0.8 | -0.5 | -3.6 |
| Total | 0 | -2.6 | -6.4 | -10.6 | -15.0 | -20.0 | -24.8 | -29.2 | -34.6 | -39.3 | -34.5 | -182.4 |
| Change in Revenues[d] | 0 | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 | -0.2 | -0.8 |
| Decrease in the Deficit | 0 | -2.6 | -6.3 | -10.5 | -14.9 | -19.9 | -24.7 | -29.1 | -34.5 | -39.1 | -34.3 | -181.6 |

Sources: Congressional Budget Office; staff of the Joint Committee on Taxation.

This option would take effect in January 2018.

This estimate does not include the effects of using the chained consumer price index for parameters in the tax code.

COLA = cost-of-living adjustment; SNAP = Supplemental Nutrition Assistance Program; * = between –$50 million and $50 million.

a. Other benefit programs with COLAs include civil service retirement, military retirement, Supplemental Security Income, veterans' pensions and compensation, and other retirement programs whose COLAs are linked directly to those for Social Security or civil service retirement.

b. The policy change would reduce payments from other federal programs to people who also receive benefits from SNAP. Because SNAP benefits are based on a formula that considers such income, a decrease in those other payments would lead to an increase in SNAP benefits.

c. Other federal spending includes changes to benefits and various aspects (eligibility thresholds, funding levels, and payment rates, for instance) of other federal programs, such as those providing Pell grants and student loans, SNAP, child nutrition programs, and programs (other than health programs) linked to the federal poverty guidelines. (The changes in spending on SNAP included here are those besides the changes in benefits that result from interactions with COLA programs.)

d. The effects on revenues include changes in the revenue portion of refundable tax credits for health insurance purchased through the marketplaces established under the Affordable Care Act, as well as shifts in taxable compensation that would result from changes in the take-up of employment-based insurance.

Cost-of-living adjustments (COLAs) for Social Security and many other parameters of federal programs are indexed to increases in traditional measures of the consumer price index (CPI). The CPI measures overall inflation and is calculated by the Bureau of Labor Statistics (BLS). In addition to the traditional measures of the CPI, that agency computes another measure of inflation—the chained CPI—designed to account for changes in spending patterns and to eliminate several types of statistical biases that exist in the traditional CPI measures. (Nonetheless, the chained CPI does not resolve all statistical issues with traditional CPI measures.)

Beginning in 2018, this option would use the chained CPI for indexing COLAs for Social Security and parameters of other programs. The chained CPI has grown an average of about 0.25 percentage points more slowly per year over the past decade than the traditional CPI measures have, and the Congressional Budget Office expects that gap to persist. Therefore, the option would reduce federal spending, and savings would grow each year as the effects of the change compounded. Outlays would be reduced by $182 billion through 2026, CBO estimates, and the net effect on the deficit would be about the same. (This option would not change the measure of inflation used to index parameters of the tax code, as would be done in the related option cited below; the small revenue effects estimated here stem from changes in the revenue portion of refundable tax credits for health insurance purchased through the marketplaces established under the Affordable Care Act, as well as shifts in taxable compensation that would result from changes in the take-up of employment-based insurance.)

COLAs for Social Security and the pensions that the government pays to retired federal civilian employees and military personnel are linked to the CPI, as are outlays for veterans' pensions and veterans' disability compensation. In most of those programs, the policy change would not alter benefits when people are first eligible to receive them, either now or in the future, but it would reduce their benefits in later years because the annual COLAs would be smaller, on average. The effect would be greater the longer people received benefits (that is, the more years of the reduced COLAs they experienced). Therefore, the effect would ultimately be especially large for the oldest beneficiaries as well as for some disabled beneficiaries and military retirees, who generally become eligible for annuities before age 62 and thus can receive COLAs for a longer period.

Growth in the CPI also affects spending for Supplemental Security Income, Medicare, Medicaid, the health insurance marketplaces, Pell grants, student loans, the Supplemental Nutrition Assistance Program, child nutrition programs, and other programs. The index is used to calculate various eligibility thresholds, payment rates, and other factors that affect the number of people eligible for those programs and the benefits they receive. Therefore, switching to the chained CPI would reduce spending by both decreasing the number of people eligible for certain programs and reducing the average benefits that those people receive.

One argument for switching to the chained CPI in Social Security and other federal programs is that the chained CPI is generally viewed as a more accurate measure of overall inflation than the traditional CPI measures, for two main reasons. First, the chained CPI more fully accounts for how people tend to respond to price changes. Consumers often lessen the effect of inflation on their standard of living by buying fewer goods or services that have risen in price and by buying more goods or services that have not risen in price or have risen less. Measures of inflation that do not account for such substitution overstate growth in the cost of living—a problem known as substitution bias. BLS's procedures for calculating the traditional CPI measures account for some types of substitution, but the chained CPI more fully incorporates the effects of changing buying patterns.

A second reason to believe that the chained CPI is a better measure of inflation is that it is largely free of a problem known as small-sample bias. That bias, which is significant in the traditional CPI measures, occurs when certain statistical methods are applied to price data for only a limited number of items in the economy.

One argument against using the chained CPI, and thereby reducing COLAs in Social Security and other federal retirement programs, is that the chained CPI might not accurately measure the growth in prices that Social Security beneficiaries and other retirees face. The elderly tend to spend a larger percentage of their income on items whose prices can rise especially quickly, such as health care. (However, determining how rising health care prices affect the cost of living is problematic because accurately accounting for changes in the quality of health care is challenging.) The possibility that the cost of living may grow faster for the elderly than for the rest of the population is of particular concern because Social Security and pension benefits are the main source of income for many retirees.

Another potential drawback of this option is that a reduction in COLAs would ultimately have larger effects on the oldest beneficiaries and on disabled beneficiaries who received benefits for a longer period. For example, if benefits were adjusted every year by 0.25 percentage points less than the increase in the traditional CPI measures, Social Security beneficiaries who claimed benefits at age 62 would face a reduction in retirement benefits at age 75 of about 3 percent compared with what they would receive under current law, and a reduction at age 95 of about 8 percent. To protect vulnerable people, lawmakers might choose to reduce COLAs only for beneficiaries whose income or benefits were greater than specified amounts. Doing so, however, would reduce the budgetary savings from the option.

Finally, policymakers might prefer to maintain current law because they want benefits to grow faster than the cost of living so that beneficiaries would share in overall economic growth. An alternative option would be to link benefits to wages or gross domestic product. Because those measures generally grow faster than inflation, such a change would increase outlays.

RELATED OPTION: Revenues, Option 4

RELATED CBO PUBLICATIONS: Testimony of Jeffrey Kling, Associate Director for Economic Analysis, before the Subcommittee on Social Security, House Committee on Ways and Means, *Using the Chained CPI to Index Social Security, Other Federal Programs, and the Tax Code for Inflation* (April 18, 2013), www.cbo.gov/publication/44083; *Using a Different Measure of Inflation for Indexing Federal Programs and the Tax Code* (February 2010), www.cbo.gov/publication/21228; "Technical Appendix: Indexing With the Chained CPI-U for Tax Provisions and Federal Programs" (supplemental material for *Using a Different Measure of Inflation for Indexing Federal Programs and the Tax Code,* February 2010), www.cbo.gov/publication/21228