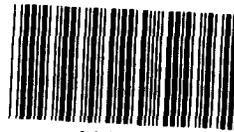


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**U.S. GENERAL ACCOUNTING OFFICE:  
COMMENTS ON THE PRESIDENT'S  
FEBRUARY 18, 1981, BUDGET PROPOSALS  
AND ADDITIONAL COST-SAVING MEASURES**



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**MARCH 3, 1981  
OPP-81-2**

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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-198312

PREFACE

*addressed*

This report is designed to further assist the Congress during its consideration of the FY 1982 budget by providing the views of the General Accounting Office on budget reduction proposals provided by the Administration on February 18, 1981.

At the end of each discussion the material notes the GAO official to contact for more detailed information. When the Administration presents its specific budget proposals to enact the overall recommendations it proposed on February 18th, the GAO officials noted should be contacted to provide more detailed information regarding our views on each proposal.

In some cases the information contained in this report is similar to budget reduction proposals and strategies that GAO discussed in its February 17, 1981, report commenting on Congressional Budget Office options for reducing the Federal budget and discussing other cost-containment proposals based on GAO's work. In many instances, however, new views and material are presented.

Comptroller General  
of the United States



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**CHAPTER 1**  
**GENERAL GAO DISCUSSIONS**



STATEMENT ON  
GRANT CONSOLIDATION

Over the past two decades, the number and variety of Federal assistance programs and their dollar amounts have increased at a phenomenal rate. The number of categorical grant programs available to State and local governments (now about 500) has almost tripled since 1963, while funding has increased twelve-fold in that period to the current \$89 billion level. Although all programs were well intended and designed to emphasize and direct resources to meet specifically defined national needs, their proliferation has come under increasing criticism in recent years by recipients, program managers, the research and academic communities, as well as the general public for the attendant red tape, distortion of recipient priorities, and limited success in achieving national goals.

To cope with the problems resulting from the multiplicity of Federal assistance programs, attempts have been made to improve coordination of program planning and administration. However, the sheer number and variety of programs with administrative responsibilities for programs serving similar objectives highly fragmented among Federal agencies presents a virtually insurmountable barrier to effective coordination. The key to significantly improving the administration of Federal domestic assistance programs lies in the legislative consolidation of separate categorical programs serving similar objectives into broader

categories of assistance and the placing of like programs in a single agency. Accordingly, we strongly endorse the Administration's consolidation initiative recognizing that the specific implementation details are not yet available.

One of our earliest reports in this area, "Fundamental Changes Are Needed In Federal Assistance To State And Local Governments," highlighted our long-standing position that the consolidation of fragmented and restrictive categorical grants into broader purpose programs is fundamental to improving the administration of Federal assistance programs at all levels of government. The categorical grant system has fostered an unwieldy and fragmented system for delivering public services. Further, categorical grants are often too restrictive to meet actual service needs at the State and local level and the burden of mounting a coordinated effort to deliver federally assisted services falls on the grantee. This causes management problems at the State and local level as grantees attempt to reconcile grant programs with separate and, at times, conflicting standards and requirements.

In addition to creating a variety of administrative problems, the proliferation of categorical programs has considerable impact on State and local priorities. By providing assistance in narrowly defined areas of national priorities, the Federal Government induces State and local involvement into programmatic ventures that they otherwise may not have funded from their own funds. Yet, because of matching and maintenance of effort requirements as well as the long-term costs which can be involved in operating

federally assisted programs, State and local funds have also been enticed into these new areas. In this new era of State and local budgetary constraints, the dividend of fiscal growth is no longer available to cushion the cost impact of Federal grants. Localities in cutback situations find that federally funded programs and basic services not eligible for Federal grants compete with each other for shrinking local dollars.

Federal grants available for a broader range of purposes would increase State and local discretion and move toward supporting rather than changing State and local priorities. In our 1975 report, we concluded that consolidation of Federal grants into broader purpose programs was justified in order to promote increased efficiency and effectiveness in the delivery and administration of Federal assistance.

Block grants seek to achieve this goal by providing assistance for a broad range of purposes in a functional area, thereby maximizing flexibility and easing administrative burdens at State and local levels. Nevertheless, the bulk of Federal assistance is still provided in the form of categorical grants and only five Federal grant programs are generally recognized as block grant in nature.

Legislative consolidation of Federal assistance programs is an extremely difficult task. Congressional committees tend to favor categorical grant programs because they are easier to track and enactment of a bill to address a specific need holds far more political appeal than a broader purpose consolidated program. Any effort to consolidate categorical programs is almost immediately

interpreted as an attack on the Congressional committees that created the programs, the agencies that administer them, and the clientele groups that prosper. In addition, program administrators at all three levels of government have become comfortable with and learned how to deal with our complex categorical structure. The earmarking of funds also serves to lessen the political pressure associated with State and local funding decisions. Accordingly, the few consolidation proposals that have been made by past administrations have experienced limited success.

Loss of accountability is the most frequent objection raised by opponents of the block grant approach. We would certainly agree that accountability for the proper expenditure of funds is an important Federal interest but would not see it as being lost through the block grant approach. Increased State and local flexibility and discretion does not necessarily lead to reduced accountability.

It could be argued that block grants would increase accountability by removing the current fragmentation in the Federal assistance system. Currently, it is often hard to determine just who is accountable, particularly when grant programs bypass elected officials. While block grants may not insure the accomplishment of specific, narrowly defined objectives to the extent of categoricals, they would, if properly designed, promote greater State and local program management and oversight and thus improve the process of government itself.

On a more technical note, we would agree with the Administration that matching requirements may not be necessary under the

proposed block grants but would disagree that maintenance of effort requirements are not needed. In a recent report, "Proposed Changes In Federal Matching And Maintenance Of Effort Requirements For State And Local Governments," we noted that localities facing budget reductions most often choose to continue their matching contributions to retain Federal grant funds while cutting, disproportionately, services funded solely from local revenues to maximize local budget savings while minimizing programmatic impact. As a result, a local priority shift towards federally funded programs occurs. We recommended that the Congress use matching requirements more sparingly and only where a specific Federal interest can be articulated. This would help restore State and local discretion in allocating their own funds. Maintenance of effort requirements on the other hand, usually serve a clear Federal interest and need to be changed to more effectively prevent the substitution of Federal for State and local funds. However, we believe that maintenance of effort requirements need to be made more flexible to avoid penalizing or inhibiting bona fide State and local budget reductions.

Contact. William J. Anderson, 275-6059

## Budgetary Savings with Better Debt Management

GAO Views. Debts owed the Federal Government are enormous and growing each year. Federal agencies reported that receivables due from U.S. citizens and organizations were \$126 billion at the start of fiscal 1980--a 23 percent increase over the previous fiscal year. It was anticipated that an estimated \$6.3 billion would be uncollectible--also a 23 percent increase over fiscal year 1979. Federal agencies reported that they wrote off as uncollectible receivables of more than \$1 billion in fiscal 1979. Unfortunately these gloomy statistics are materially understated because the accounting systems of many systems of many agencies do not provide accurate information on receivables, expected losses, and writeoffs.

We have reported on a variety of problems contributing to the collection of debts owed the Government. There are two basic reasons why debt collection in the Federal Government has not kept pace with the increasing number of debts. First, many agencies have not aggressively pursued the collection of debts owed the Government. Second, present collection methods are expensive, slow, and ineffective when compared with commercial practices. We have identified specific weaknesses in debt collection programs and have recommended a number of specific corrective actions to improve the recording, and collection of debts to the Government. Unfortunately, our recommendations have not always been implemented. Until all Federal agencies aggressively pursue the collection of debts owed to the Government, hundreds of millions of dollars will continue to be lost.

Based on our many reviews and numerous discussions with agency officials, we conclude that top management does not devote sufficient attention to the collection of outstanding debts. In our view, they have been more concerned with delivering services and disbursing funds. Debt collection has received a low priority with only limited personnel often involved in the collection of these debts.

In response to these reports and congressional interest, OMB established a special debt collection project to address these problems. GAO has worked closely with OMB and the Treasury to improve the current reporting system which provides information on debts owed the Government. The project should help the executive branch monitor agency debt collection performance.

In addition, legislative action is needed to remove the impediments that now preclude most Federal agencies from using more effective commercial practices to collect debts. We have been actively working with the Congress and we have supported legislation to eliminate these impediments.

Recovery of these funds along with improved credit management and debt collection systems can result in significant budgetary savings.

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Relevant GAO Reports. CD-80-1, FGMSD-78-61, FGMSD-78-59, and FGMSD-80-46.

Contact. John Simonette, 275-1581.

## Savings Available By Resolving Audit Findings

GAO Views. The Government could save billions of dollars if Federal departments and agencies would act on auditors' findings and recommendations. Basically, these savings could be achieved by recovering Federal funds from recipients who either misused them or did not use them at all, avoiding costs discovered during contract proposal audits, and by improving operations.

It has been about 2 years since our first report on this problem. While Federal departments and agencies have made some improvements in their systems to resolve audit findings, progress overall has been disappointing. For example, in October, 1978, we reported that 34 agencies had \$4.3 billion of audit findings that were unresolved. On January 23, 1981, we reported that unresolved audit findings at the same 34 agencies had escalated \$10 billion from \$4.3 billion to \$14.3 billion.

Because of the significance of this problem, we have made specific recommendations to OMB to help them improve this situation. There is a great potential for savings by acting on auditors' findings. The new administration must be willing, however, to commit itself to improvements in this area to achieve the potential savings.

Relevant GAO Report. FGMSD-79-3 and AFMD-81-27.

Contact. George Egan, 275-5824.

### Federal Finance Bank Reform

The Director of the Office of Management and Budget has testified that reform of the Federal Financing Bank (FFB) is needed. We totally agree.

GAO has consistently opposed the off-budget status of the Federal Financing Bank as well as other questionable budget practices which combine to produce an inadequate and incomplete picture of Federal credit assistance activity. The current relationship between Federal credit agencies and the FFB causes misleading changes in the Federal budget totals, and creates incentives for the inappropriate use of Federal credit assistance. None of these effects are related to the basic financial conduit role that the Bank is intended to play.

Most notably among the questionable budget practices are the budget treatment accorded Certificates of Beneficial Ownership, FFB purchases of agency assets, and FFB acquisition of the Federally guaranteed loans. The combined effect of these practices resulted in a cumulative net understatement of Federal outlays that totalled \$62 billion at the end of fiscal year 1980. When the transactions between the Federal Financing Bank and off-budget agencies are taken into account the figure becomes \$64 billion.

The Federal Financing Bank now holds about \$64 billion worth of Certificates of Beneficial Ownership (CBO) issued mainly by the Farmer's Home Administration. Though these instruments are debt

securities and represent debt transactions, they are defined legislatively as asset sales. Therefore, proceeds from sale of CBO's to the FFB are treated as an offset to the agency's loan outlays. This practice should be eliminated by removing language in the relevant agencies' authorizing statutes which specifically define CBO transactions as asset sales.

Federal Financing Bank purchases of government guarantee loans is another troublesome consequence of its off-budget status. This practice results in conversion of guaranteed loans into direct loans which are not recorded as outlays. It also reduces or eliminates sharing of risk, creates the potential for oversubsidization of program beneficiaries, and encourages the use of credit assistance when this device may not be appropriate.

The most serious problems would be avoided by (1) including the FFB's receipts and disbursements in the budget totals, and (2) assuring correct budget treatment of the sale of CBO's.

GENERAL STATEMENT ON  
ENTITLEMENTS AND INDEXED PROGRAMS

There is a growing consensus on the need to cut the rate of growth in Federal spending. Consequently, the Congress today is searching for ways to reduce the budget. To assist the Congress in this effort, we offer in this report seven basic approaches to controlling that portion of the budget consisting of entitlements and indexed spending. The seven methods that the Congress should consider include:

- eliminate a program altogether,
- limit the indexing of program benefits,
- tighten eligibility criteria to target available funds to the most needy,
- reduce the level of benefits,
- place a cap on the program's total spending,
- limit spending to amounts annually appropriated, and
- improve the efficiency with which a program is administered.

Except for program elimination, these seven approaches are not mutually exclusive. We expect that the Congress will use all of these approaches in one form or another in its effort to restrain Federal spending. Any particular decision to limit the size or growth of entitlement and indexed spending, whether made on program by program or on a more aggregate basis, will

involve difficult choices about precisely where and how to limit such spending.

On February 18, 1981, the President proposed a multi-year plan for economic recovery which includes proposals for reducing Federal domestic spending. The President's proposal suggests that entitlement spending can be limited by tightening eligibility criteria for some programs, lowering benefit levels of others, capping, and other means. However, the President's plan dealt in only a minor way with the indexing of Federal spending (the automatic adjustment for cost of living changes).

In contrast, this paper describes several approaches for limiting the growth of indexed programs. In particular, there are three approaches for altering the present practice of automatic, full indexing utilizing the Consumer Price Index (CPI) that we believe merit early consideration as part of the congressional action on spending reductions.

1. Give the President and the Congress the discretion to modify the amount of the index through the budget process. The President could be authorized to recommend a specific percentage adjustment to benefit levels that would take effect unless the Congress acted to change it. This is the same procedure now used to adjust Federal white collar pay. This alternative has the advantage of returning

some flexibility to the cost of living increases. Any reduction could adversely affect the lives of truly needy recipients. One way of overcoming this problem is to the authorize the President to use differential rates of indexation at different benefit levels. However, it will require decisions by the President and the Congress each year on a matter which, in addition to its budgetary significance, involves great political sensitivity.

2. Limit the adjustment to the level of the average increase in worker pay or the CPI, whichever is less. This alternative moves away from the exclusive use of a price index. The argument for making such a change is based on equity considerations. While, at present, income from indexed entitlement programs is protected against inflation, not all entitlement programs are indexed and wage earners income is certainly not protected. The result is that in periods of rapid inflation and slow productivity growth, present formulas redistribute income in favor of the indexed groups--and the burden on the wage earning population is increased. Switching to this alternative would have wage-earners and entitlement recipients share equally in the burdens imposed by falling real incomes. There are two problems with this approach. First, during

periods of high inflation, declining real benefits could adversely affect the lives of truly needy recipients. Second, a return to greater price level stability and higher productivity growth would normally see wages increasing at a faster rate than the CPI. Under this proposal, those receiving entitlements would not share in these benefits of higher productivity. Thus, the sacrifices made by these program recipients during less favorable times would not be balanced, as in the case of wage earners, by higher rewards in good times.

3. Substitute for the present CPI an index judged more efficient in measuring changes in the cost of living of those receiving entitlements or make adjustments in the index to compensate for its alleged statistical deficiencies. Proponents argue that if such measures could be found, adopting them would preserve the benefits inherent in automatic adjustment processes, without incurring the social costs associated with over-compensating program recipients. If there were, at present, agreement on how best to adjust the present CPI so that it more accurately measured changes in the cost of living, such changes should be adopted whether or not the CPI is used to index entitlement programs. Unfortunately, there is, at present, no consensus on how best to make such changes, nor is

there agreement on what cost of living index, other than the CPI, should be used to adjust entitlements during inflationary periods.

Despite specific drawbacks, any of these three indexing options would enable the Congress to gain increasing control over the growth of this segment of the budget. We believe the first option is preferable because it permits the President to recommend and the Congress to consider the cost of living increases as part of the budget process. In this way, the action has the full visibility of the budget process.

While many entitlement programs are indexed, some entitlement programs are not. The three approaches to limiting the costs of indexing discussed above would thus not apply to such non-indexed entitlements. However, there are a number of other ways to restrain the growth of entitlement programs, whether indexed or not.

In numerous reports on individual entitlement programs, we have suggested how such programs could be administered more efficiently, how entitlement spending could be focused better to serve the most needy, and how needless duplication and overlap in entitlements could be eliminated. For example, we have recommended eliminating benefits to students under Social Security, since the same types of benefits are available to needy students under Federal education aid programs; and we have suggested modifying the laws providing for Federal retirement in order to eliminate

certain inequities and inconsistencies in the provision of benefits to retirees. We expect to make further recommendations based on work still in process.



**GAO'S VIEWS ON BUDGETARY SAVINGS  
IN THE DEFENSE AREA**

President's

Proposal - REDUCE OVERHEAD AND PERSONNEL COSTS  
OF THE FEDERAL GOVERNMENT  
DEPARTMENT OF DEFENSE - MILITARY

We agree that more attention and in many cases more funding is needed to improve current readiness conditions. We support the President's view that part of his proposed defense growth can be financed by savings that can be realized from increased efficiency and reductions in overhead and personnel. As discussed below, and in more detail in the following pages, we have identified many potential sources for savings.

Realignments could reduce the size of the overall Defense structure  
The Department of Defense has realized savings in Defense expenditures in the past through the realignment and closure of military bases. Further base closures and realignments may also be warranted to reduce Defense expenditures. GAO has performed many congressionally requested reviews of these closures. Although we have often raised questions about the adequacy of the studies supporting the closing decisions, we have generally found the closings to be cost effective.

In addition to base closures, significant savings can be obtained by consolidating base support services. GAO believes that savings of hundreds of millions of dollars annually are possible, primarily in personnel costs. For example, our past consolidation studies have shown personnel reductions of 10 to 30 percent.

Increased contracting out of government commercial and industrial-type activities offers significant opportunities for reducing facility overhead and base personnel costs in the Department of Defense. The Department has conducted more Circular A-76 cost comparisons than any other Federal agency, and it has been estimated that about 60 percent of the comparisons show that it is more economical to contract out. With annual operating costs for over 15,000 government commercial and industrial-type activities at about \$17 billion, the potential exists for substantial savings. While GAO generally has found contracting out to be cost effective, we have cautioned the Department of Defense that before making such a decision a complete analysis should be made of the options available for support of these activities including consolidation. Only then can a decision be made on whether it is more cost effective to contract the function out or do it in-house.

Reduction in consultants are possible. Despite continuous attention focused on consulting service contracts at Federal agencies, serious and pervasive problems continue to exist. In a recent report, GAO found questionable need for and use of consulting services, extensive sole source awards which precluded effective

price competition, and significant contract modifications, both in numbers and dollars, resulting in increased costs and delays in end product delivery. We have recommended improvements to agencies and the Office of Management and Budget.

Multiyear contracting is a viable acquisition method which could substantially reduce procurement costs and should therefore be used where feasible and applicable. It can increase competition and reduce contract prices by enabling a contractor to (1) spread its planning, startup, and other preproduction costs over a long period, (2) take advantage of economic order lots, and (3) reduce its administrative costs.

Increased competition could better ensure that the Department of Defense obtains acceptable products and services at the lowest prices. For example, we projected that between \$146 million and \$432 million in new fiscal year 1979 sole-source award contracts could have been competitively awarded.

More attention to the precise role of some major weapons could eliminate uncertainty as to the capabilities proposed for the weapons. In other cases, some of the requirements proposed for weapon systems were questionable or not fully established. Elimination of such uncertainties could minimize development time and reduce cost. Examples of individual weapon systems where we found this to be the case include the Low Altitude Defense System, the AH-64 Attack Helicopter, the Light Airborne Multipurpose System, the KC-135 Aircraft, some Navy Cruise Missiles, and the Air Force/Navy Trainer Aircraft Programs.

Earlier consideration of logistics in weapons systems planning can save hundreds of millions of dollars. Because ownership costs run in the billions and greatly exceed acquisition costs, the Secretary of Defense must make it clear to system planners that they are to give early emphasis to logistics and life-cycle costs in addition to system capabilities and design costs. Also, the Department of Defense spends billions of dollars for noncombat-mission aircraft which serve as backup aircraft to combat units. GAO's analysis has shown that aircraft totaling about \$5.7 billion are not properly justified. A hard look at this area by the Secretary of Defense is needed. If these aircraft are in fact required for combat purposes, they should be justified as such and approved in that context by the Secretary of Defense, the Office of Management and Budget, and the Congress.

Productivity enhancing opportunities at the Department of Defense are possible. However, to make substantial improvements there must be more incentives for contractors to invest in plant and equipment modernization and automation. This need was recognized in the President's message. An additional area involves the many industrial in-house activities that are in need of modernization and productivity-enhancing investments.

These industrial in-house activities are currently operating at low rates resulting in costly and inefficient operations. By realigning these activities the Department of Defense could realize savings of about \$200 million. (This refers to aeronautical depot activities)

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In addition to the above areas, discussed in the President's message, we have identified several other areas where potential savings are substantial.

Further consolidating supply activities can save millions of dollars annually. The Defense Logistics Agency grew out of Congressional and Department of Defense concern on economizing supply actions, and the time has come to expand the Agency's role and consider other consolidations. For example, the Department of Defense has a project under consideration to transfer the management of an additional 1.3 million consumable items to the Defense Logistics Agency at an estimated annual savings of \$73 million. GAO supports this action.

Another example is the partial implementation of a single manager for ammunition. By the Department of Defense's own statements, about \$200 million has been saved in the last 3 years. GAO believes very conservatively that another \$200 million is available by fully implementing the single manager concept. Such action would reduce pipeline time and unnecessary paperwork between wholesale and retail managers.

Apply the single manager concept to transportation. It is timely to establish a unified transportation command, thus saving millions of dollars annually. The House and Senate reports on the fiscal year 1980 Defense Appropriation Bill directed DOD to develop an implementation plan for consolidating the Military Sealift Command and the Military Traffic Management Command and for creating a Defense Traffic Management Agency. GAO supports this and estimates that over \$58 million can be realized annually plus one-time savings of millions more in reduced inventory costs.

Better visibility and interchangeability of wholesale and retail inventories can reduce investment and make better use of assets thereby saving several hundreds of millions of dollars. Currently, wholesale managers lose visibility over assets at the retail level. As a result, quite often GAO has found that stocks are (1) requisitioned unnecessarily, (2) repaired when not needed, or (3) repositioned when alternative actions could have been taken by the inventory manager. Savings realizable from vertical management are in the areas of reduced investment in safety levels, not transferring stocks when demand can be satisfied by other means, and avoiding unnecessary billing and invoicing between wholesaler and retailer.

Realignments to Reduce the Size of the Military Bases Structure

GAO Supplementary Discussion

GAO Views. The Department of Defense (DOD) has realized savings in Defense expenditures in the past through the realignment and closure of military bases. Further base closures and realignments may also be warranted to reduce Defense expenditures.

GAO has issued a number of congressionally-requested reports on DOD's announced base closures or realignments since DOD announced its last major base realignment plan in March 1979. In many cases these reports have concluded that DOD's estimates of savings were overstated and that costs were understated or not recognized at all. In some cases GAO has questioned whether DOD or the military service had a sufficient basis for deciding on the action. As a result, DOD has ordered some of the realignments to be deferred and restudied. And some of the realignments have not begun according to the March 1979 plan. Thus, DOD's past estimates of savings due to its announced realignments and closures may have been overstated.

Another factor bears on the reliability of DOD's estimates of savings based on base closures or realignments. Generally, DOD computes costs and savings on the premise that the computation should only include costs and savings to DOD activities. Thus, any costs or savings directly resulting from these realignments borne by a government agency other than DOD would be excluded. Generally, the additional expenditures resulting from the actions of the Office of Economic Adjustment would not be included and therefore offset against any net savings resulting from the realignments and closures.

In addition to the savings available through base structure realignments, major cost savings can be achieved through DOD consolidation of military base support functions. Base support, which includes facilities maintenance, utilities, trash and sewage disposal, to name just a few, cost about \$12 billion in fiscal year 1978. About 63 percent of this amount represents the pay and allowances for the 550,000 civilian, active duty military, and reserve personnel which provide these support services.

In several GAO studies over the past years, we have identified personnel reductions ranging from about 10 percent through consolidated quality control functions on Okinawa to 30 percent reductions through consolidated security services at Kelley Air Force Base.

Other examples include 18 percent personnel reductions through consolidated Army and Air Force Civilian Personnel Offices in Okinawa, 23 percent by consolidating Army and Air Force procurement offices in Okinawa, and a 33 percent reduction by consolidating Air Force logistics staffs, also on Okinawa. While recurring savings in the instances indicate significant savings if translated into DOD-wide consolidations, additional savings are available through redistributed equipment and reduced military construction requirements.

Further the services and DOD have identified major potential savings in such areas as the Navy's Pay/Personnel Administrative Support System (with anticipated savings of about \$10 million yearly), and DOD-wide consolidated civilian payroll systems (with anticipated savings of \$40 million in 7 years).

Major base support savings are achievable if DOD is willing to coordinate its available cost-reduction programs and override parochial service interests. Through personnel cost savings alone, the potential is great. Using a conservation projection of only 5 percent compared to the 10 to 30 percent savings noted, DOD could save \$370 million per year.

#### Relevant GAO Reports.

Base Realignment: LCD-81-22, January 23, 1981; LCD-81-21, January 27, 1981; LCD-81-11, October 24, 1980; LCD-80-104, September 11, 1980; LCD-80-80, June 23, 1980; LCD-80-54, May 9, 1980; LCD-80-50, April 14, 1980; LCD-80-46, March 20, 1980; LCD-80-24, November 29, 1979; LCD-79-333, October 10, 1979; LCD-79-332, September 14, 1979; LCD-79-331, August 30, 1979; LCD-79-329, August 23, 1979; LCD-79-328, August 15, 1979; LCD-79-326, August 30, 1979; LCD-79-325, August 6, 1979; LCD-79-324, July 31, 1979; LCD-79-322, August 8, 1979; LCD-79-318, July 20, 1979.

Base Support Consolidation: LCD-80-92, September 5, 1980; LCD-78-223, April 12, 1979; LCD-79-113, October 15, 1979; LCD-76-347, March 28, 1977; B-178736, July 6, 1973; B-176139, December 6, 1973; B-164217, December 12, 1972.

Contact. James G. Mitchell, 275-3591.

CONTRACTING OUT--OMB CIRCULAR A-76

GAO SUPPLEMENTARY DISCUSSION

GAO Views. In 1955 the then Bureau of the Budget established a national policy of "contracting out" to the private sector for commercially available goods and services used by the Federal Government, including the Department of Defense (DOD), as opposed to providing them "in-house" using Government personnel and facilities. Since then, the policy has been a subject of controversy involving the Congress, departments and agencies, industry, and Federal labor unions. Private sector firms, for example, view in-house performance as multibillion dollar Government competition with private enterprise, and Federal unions view contracting out as uneconomical and a threat to the jobs and financial security of affected civil servants.

The policy is currently stated in Office of Management and Budget (OMB) Circular A-76, revised March 29, 1979. It provides, when private performance is feasible and no overriding factors such as military necessity require in-house performance, that a rigorous comparison of contract versus in-house costs be used to decide how the work will be done.

Circular A-76 requires agencies to inventory their commercial and industrial activities and establish schedules for their periodic review. When appropriate, cost comparisons must be conducted to determine the most economical source of performance--contract or in-house.

The DOD Commercial and Industrial-type Activities (CITA) Program

The DOD has established a CITA program to implement Circular A-76. It currently operates over 15,000 commercial and industrial-type activities at an estimated annual operating cost of about \$17 billion.

To date, DOD has conducted more A-76 cost comparisons than any other Federal agency. About 60 percent of the comparisons show that it is more economical to convert in-house activities to contract arrangements.

Between April 1978 and October 1980, DOD converted over 200 activities of a commercial or industrial nature from performance by DOD personnel to performance by private contractors. The conversions involved a wide assortment of functions, ranging from individual types of services (laundry and drycleaning; keypunch; custodial; food; guard; maintenance of facilities, motor vehicles or aircraft; aircraft fueling; etc.), to total installation support for a number of services, to the operation and maintenance of whole installations, such as radio transmitting sites. The conversions eliminated about 7,800 employee positions in the 200 activities and are expected by DOD to result in an esti-

mated cost advantage to the Government of about \$130 million over a 3-year period. Many other studies resulted in the activities remaining in-house, but with fewer personnel spaces resulting from the use of more efficient and cost effective organizations.

#### Congressional policy and recurring restrictions

The Congress has expressed concern in each of the last 4 years about implementation of the contracting-out policy in DOD. For example, in fiscal year 1978, the Congress placed a moratorium on the contract conversions of many base operating support services. In fiscal year 1981, it authorized conversions subject to certain specified restrictions. In part, these restrictions precluded conversions (1) to circumvent any civilian personnel ceiling, or (2) unless the Secretary of Defense certified to the Congress that the Government's costs were based on the most efficient and cost effective organization for in-house performance.

Another current congressional restriction waives the applicability of Circular A-76 to the contracting out of certain research and development activities.

The overall management of DOD's personnel resources is governed by a congressional policy that DOD convert higher cost forms of manpower (military, civilian, or contract) to lower cost forms of manpower, when consistent with military requirements. The policy is stated in Section 502 of DOD's Appropriation Authorization Act, 1975. Although expressed in 1975, it continues to mandate consideration by the Secretary of Defense. The legislative history of the act provides some evidence that, in determining relative costs, DOD will follow the cost comparison guidelines of Circular A-76 to achieve the desired objective.

#### The GAO position

Current DOD activities under Circular A-76 provide an opportunity to reduce overhead and personnel costs. All DOD in-house activities will be scheduled for review within the 5-year period extending through 1984.

Although Circular A-76 is controversial, and the procedures established to implement it have not been totally accepted by many interested parties including GAO, this office does support the general policy precepts it sets forth.

Relevant GAO Reports. PSAD-81-4, PSAD-80-79, PSAD-78-118

Contact: George J. Wooditch, 275-3181 or  
Warren Nagel, 275-3132

Proposed Reduction in Consultants  
GAO Supplementary Discussion

GAO Views

On March 20, 1980, GAO issued a report on controls over consulting service contracts at Federal agencies. GAO examined contracts from six agencies: The Departments of Energy, Commerce, Transportation, Labor, and Housing and Urban Development, and the Office of Education. During Congressional hearings on this report, GAO was asked to perform a similar review at the Department of Defense. Audit work has been completed and we are now responding to agency comments on the report. Since our DOD work was done as a result of a Congressional request, it is not available for release at this time. The statements which follow are based primarily on our earlier work.

GAO believes that despite continuous attention focused on consulting service contracts at Federal agencies, serious and pervasive problems continue to exist. GAO feels these problems are rooted in the lack of understanding of what constitutes consulting services and the corresponding problems associated with application of meaningful management controls. In a recent report, GAO found questionable need and use of consulting services, extensive sole source awards which precluded effective price competition, and significant contract modifications, both in numbers and dollars, resulting in increased costs and delays in end product delivery. GAO recommended improvement of management controls over Federal agencies' use of consulting services. In addition, GAO recognized the need for a better and more uniform understanding of OMB's consulting service definition. Consulting services represents only a small part of the larger overall universe of management support services at Federal agencies. GAO believes that it makes little sense to focus attention and establish special controls over only consulting services as defined by OMB when the same types of problems exist in all types of contract management support services. For example, in fiscal year 1981, Federal agencies estimated \$400 million in consulting services, while the same Federal agencies reported \$3 billion in management and professional services and special studies and analyses. By applying management controls to consulting services alone, the balance of the larger universe of management support services does not get the attention or scrutiny needed to reduce and avoid abuses.

GAO is in the process of completing audit work on management support services at the Department of Defense. This review has established that similar problems as found in our review of other Federal agencies exist at DOD.

As evidence of the impact of our recent work in the consulting services area, two Executive branch actions can be cited. In April 1980 OMB issued Bulletin No. 80-9 which cut FY 81 spending on consulting service contracts by 15%. This resulted in a government wide \$62 million reduction and more than \$20 million at the Department of Defense. More recently (January 1981) OMB issued a second Bulletin No. 81-8 which provides for submission of plans to reduce consulting services and management and professional services and special studies and analysis for FY 81. This latter action indicates that OMB is now agreeing that the broader universe of management support service contracts needs to be controlled.

Relevant GAO Reports. PSAD-80-35

Contact: Carl Bogar, 275-3161

MULTIYEAR CONTRACTING  
GAO SUPPLEMENTARY DISCUSSION

GAO views

A multiyear contract is a commitment by the Government to purchase services or supplies from a contractor for a period extending beyond the fiscal year in which the contract is made. It is a long-term arrangement where the parties are released from their mutual obligations only upon termination of the contract.

The GAO maintains that multiyear contracting is a viable acquisition method which could reduce procurement costs and should be used therefore where feasible and applicable.

One of the greatest advantages in using multiyear contracting is the potential for savings in contract prices and administrative costs. With regard to contract prices, the contractor who holds a multiyear contract is able to spread his planning, startup, and other preproduction costs over a longer period of time, and more opportunity for increased efficiency and productivity should exist over this extended period. GAO conducted a study in 1977 which included an evaluation of instances where multiyear contracting was introduced into certain Defense Logistics Agency and Air Force procurements. The resulting report (PSAD-78-54; January 10, 1978) identified annual savings of \$3 million, or about 21 percent of 26 multiyear contracts valued at \$14 million, exclusive of any administrative cost savings. Although not identified in this analysis, administrative costs would also be saved by eliminating costs attributable to repetitive soliciting and evaluating bids and awarding the contract.

Another advantage often cited by Federal agency and contractor personnel is that multiyear contracting could lead to increased competition for Government contracts. Many officials feel that with a longer time period for investment amortization allowed by the multiyear contract, a larger number of contractors, including small and minority-owned businesses, would be encouraged to compete for Government contracts. Today, the uncertainties of future business inherent in the annual procurement process discourage such businesses from competing for Government contracts because they are reluctant or unable to make capital investments they have no assurance of recovering. Multiyear contracting could remove much of this uncertainty.

Still another advantage which has been repeatedly cited is that the quality of contractor performance and service should improve. Contractor performance may be improved by reducing the uncertainty of continued Government business; providing continuity in the delivery of recurring service and supply needs; and enabling the contractor to maintain a stable, well trained work force.

Multiyear contracting should not be used for every procurement. We believe that the following three criteria should exist in any multiyear contract situation:

- there will be a continuing requirement for the supplies or service consistent with current plans for the proposed contract period;

- the furnishing of such supplies or services will require substantial initial investment in plant or equipment, or the incurrence of a substantial contingent liabilities for the assembly, training or transporting of a specialized work force; and
- the use of such a contract will promote the best interests of the United States by encouraging effective competition and promoting economies in operation

Relevant GAO Reports. PSAD-78-54, PSAD-80-13, PSAD-81-14, PSAD-80-9, PSAD-79-55, PSAD-77-171.

Contact: Sidney Wolf, 275-3176 (multiyear contracting)  
Carl Bogar, 275-3161 (red tape and commercial products)

President's Proposal

Adoption of Multi-year Contracting - Chapter 8, p. 8-1

GAO Supplementary Discussion

Because of statutory restrictions and a general reluctance on the part of the Congress, substantial potential savings which would be available through multi-year contracting have not been realized. This technique is crucial to achieving the kinds of savings cited earlier.

In the acquisition of major weapons systems, the "up front" commitment to a program, demonstrated through multi-year contracting, produces program stability and permits economical production quantities to be scheduled. These factors, in turn, provide the incentive to a contractor to invest in labor saving capital equipment that produces cost reductions and increases productivity. Further, more total units of equipment can be procured at the same total cost.

Savings resulting from utilizing multi-year contracting are not limited to major acquisitions. The estimated range of 10 to 30 percent we find is also likely to be realized in the procurement of supplies and services. Commercial type commodities such as copying equipment much of which is now leased at a very high cost to the Government. Multi-year procurement authority in such cases would open the possibility of increasing initial competition because of the assurance of business continuation over a several-year period (such as 3 to 5 years). Similar to major acquisition procurements, the stability resulting from multi-year contracting provides an incentive to contractors to make labor saving capital investments and develop efficient means of producing supplies or delivering services. Additionally, using multi-year contracting might attract more small and minority owned businesses to participate in Government procurement. Today the uncertainties of future business inherent in the annual procurement process discourage such entities from participating either because they are reluctant or unable to make capital investments they have no assurance of recovering.

GAO has long advocated, most recently in testimony before a congressional committee, the adoption of multi-year contracting. We believe that the Defense Department can and should take the initiative, by concrete case-by-case documentation of the savings opportunities in its annual budget presentation, to focus action attention on this long overdue improvement in the business of procurement.

Testimony before Defense Industrial Base Panel, House Armed Services Committee, November 17, 1980.

Contact. Walton H. Sheley, Jr., 275-3456

COMPETITION

GAO SUPPLEMENTARY DISCUSSION

GAO Views. The Congress has historically required that Government purchases of goods and services be accomplished using full and free competition to the maximum extent practicable. Offering all qualified firms the opportunity to compete helps to minimize favoritism and collusion and provides assurance that acceptable products and services are obtained at the lowest prices.

In October 1979 testimony before the House Budget Committee GAO stated that the trend has been to less competition and less price competition in DOD negotiated awards. The value of negotiated price competitive awards (which includes small business and labor surplus area set-asides) decreased from 25 percent in fiscal year 1971 to 19 percent in fiscal year 1978. During the same period the value of all contract awards negotiated competitively (including price as well as design, technical, or other competition) fell from 31 to 29 percent. Concurrently, the value of noncompetitive (or sole source) contract awards rose from 58 percent to 64 percent, (and remained at that level in fiscal year 1979).

GAO believes that DOD could better ensure obtaining acceptable products and services at the lowest prices by decreasing the dollar value of noncompetitive awards and increasing the amount of awards based on competition. This approach is also likely to reduce procurement costs. Recent GAO reports show that various improvements are needed.

1. Review of Noncompetitive Procurement of Aeronautical Spare Parts (B-200136, 10/31/80). This assignment examined the procedures used at the Oklahoma City Air Logistics Center to determine the competitive status of replenishment spare part buys. We found that many noncompetitive purchases of high-dollar value replenishment spare parts can occur because data packages needed for competition are not assembled expeditiously. We recommended that procedures be established to assure prompt assembly of complete reprocurement data packages so savings associated with competition can be realized at an early stage in the procurement history of these high-dollar value items.

2. Implementation of Federal Policy on Acquiring and Distributing Commercial Products is Faltering Badly (PSAD-80-13, January 14, 1980). This review assessed implementation of the Government's policy which requires Federal agencies, to the extent practical, to rely on commercial off-the-shelf products to satisfy their needs as opposed to products manufactured to meet unique Federal or military specifications. The policy was supposed to be fully implemented by August 1979.

Federal supply agencies--including the Defense Logistics Agency--procure, stock, and distribute billions of dollars of products. Although the major Federal supply agencies recognize the potential savings and benefits of this policy, none has aggressively pursued this matter. Implementation has faltered so badly that successful achievement of policy objectives is doubtful. We found that DOD's implementation is fragmented among various programs. It needs an integrated approach for implementing the policy.

3. Air Force Procurements of Spare and Repair Parts for the ARC-164 Radio (PSAD-80-59, 7/14/80)--At the request of Senator Sam Nunn GAO reviewed why certain ARC-164 components and parts are procured from the prime contractor,

instead of competitively. According to the Air Force noncompetitive procurements from prime contractor are necessary to insure reliability and maintainability. GAO recommended that the Air Force (1) compute savings attributable to competing for the remaining ARC-164 requirements as well as costs associated with establishing other production sources and (2) if warranted by potential cost reduction, compete future ARC-164 procurements.

Other past GAO reports covering Department of Defense activities have pointed out the following problems adversely affecting competition which need to be corrected: (1) restrictive specifications or purchase descriptions have been used repeatedly, (2) the causes for receipt of low numbers of bids have not been evaluated to increase competition for future procurements, (3) advertising in the Commerce Business Daily has not been timely, and the published description of supplies or services required has been insufficient to elicit bids, (4) the complexity of invitations has discouraged suppliers from bidding, (5) bidders have been given insufficient time to bid, and (6) excessive use of urgency to justify not getting competition.

Ongoing reviews using random statistical samples are identifying widespread problems.

1. Review of the Feasibility of Obtaining Competition in Awarding DOD Non-competitive Procurement (950575) - As requested by the Chairman, Task Force on Government Efficiency, House Budget Committee, this review includes analysis of a statistical sample of noncompetitive contracts. A significant number of cases representing at least \$146 million, have been found where DOD could have obtained competition. We anticipate a report to Congress including suggestions to correct these problems.

2. Review of the Department of Defense's Use of Management Support Service and Consulting Service Contracts (950601) (Request of the Chairmen, Subcommittee on Human Resources, House Committee on Post Office and Civil Service and the Subcommittee on Civil Service and General Services, Senate Committee on Governmental Affairs) - GAO is reviewing a random statistical sample of 256 DOD consulting service contracts to determine the extent to which problems identified in GAO's earlier review of consulting service contracts at six civilian agencies (PSAD-80-35) exist on DOD. Many of the previously identified issues are surfacing, including frequent sole-source follow-on contracts.

Relevant GAO Reports. B-200136, 10/31/80, PSAD-80-13, PSAD-80-59, PSAD-80-9, PSAD-80-48, PSAD-80-35.

Contact: Sidney Wolin, 275-3176

GAO Supplementary Discussion

Annual reviews conducted by GAO of selected weapon systems culminate in reports issued to the Congress each February. These reports identify issues that would have a direct impact upon the weapon system's mission effectiveness--that is, how well the weapon can be expected to accomplish its intended purpose when threatened by a major hostile force. The reports also address issues which impact upon program acquisition matters requiring management decisions or improvements.

Issues identified under the mission effectiveness category include operational and performance limitations, survivability and vulnerability, operational requirements, and reliability. Operational requirements for weapon systems are characteristics that are deemed necessary to fulfill a needed defense capability. They are usually specified well before initiating development work but are frequently modified during development. In some cases the precise role of the weapon system is an issue resulting in uncertainty as to the capabilities proposed for the weapons. In other cases, some of the requirements proposed for a few of the weapon systems where their roles were not an issue were questionable or not firmly established. Examples of individual weapon systems where we found this to be the case include the Low Altitude Defense Ballistic Missile System, the AH-64 Attack Helicopter, the Light Airborne Multipurpose System, the KC-135 Aircraft, and the Air Force/Navy Trainer Aircraft Programs.

Under the program acquisition issues requiring management decisions or improvements, GAO has identified matters relating to the program's affordability, the concurrency of development and production, the adequacy of testing, cost effectiveness and management. With regard to affordability, it is widely recognized that it has become a major issue associated with all major weapon systems. It generally applies to exceedingly high cost programs that tend to disrupt the procurement expectations for other programs and result in compromises between military requirements and the availability of funds. This leads to uneconomical rates of production and stress on the defense budget when there are more systems in the development and production phases than can be properly funded. All systems for which funds are being requested are subject to stretch outs and perhaps curtailment if appropriate dollars are not available. Priorities need to be established within the Department of Defense to identify in some disciplined way what is more urgent.

Another area that adversely impacts on the cost of acquiring and operating weapon systems is the way weapon systems are designed. Many of today's military systems cannot be adequately operated, maintained, or supported because the Department of Defense does not pay enough attention to logistic support, human factors, and quality assurance during the design

phase of the acquisition process. These problems deter the system's effectiveness to defend our country in case of war. We suggested that management needs to improve its planning process when systems are in the early stages of design so that these important factors are given full consideration at that time rather than waiting, as is so often the case, until the systems become operational.

#### GAO REPORTS

PSAD-81-17  
MASAD-81-1  
MASAD-81-2  
MASAD-81-3  
MASAD-81-6  
MASAD-81-9  
MASAD-81-11  
C-MASAD-81-1  
C-MASAD-81-2  
C-MASAD-81-3  
C-MASAD-81-4  
C-MASAD-81-5  
C-MASAD-81-6  
C-MASAD-81-7  
C-MASAD-81-8  
C-MASAD-81-9  
C-MASAD-81-10  
C-MASAD-81-11

Contact. Walton H. Sheley, Jr., 275-3456

President's Proposal - Earlier consideration of logistics in weapons systems  
planning  
Consider Life Cycle Logistics  
and Backup Equipment Requirements  
Early in the Weapon Planning Cycle

GAO Views. On newer systems far better attention is being given by the services to the concept of "integrated logistics support," but even stronger Secretary of Defense emphasis is needed. Examples of current opportunities are the following:

- On the Navy's F/A-18 aircraft, operational and support costs can be reduced by several hundreds of millions of dollars if the Navy adopts several alternative concepts. For example, buying initial spares and installed components concurrently could save as much as \$160 million.
- Requirements for noncombat mission-related aircraft, such as quantities of F-14, F-15, F-16, F-18, and A-10 aircraft used for training, peacetime attrition, and backup during depot maintenance, were being justified by DOD on the basis of data which were outdated, inflated, and unsubstantiated or which did not recognize improvements in maintenance, technology, and support concepts.

However, DOD has taken the position that regardless of their peacetime uses, in wartime all aircraft will be used to their maximum advantage, and any cutback in aircraft procurement would reduce combat capability. It is GAO's position that if DOD believes these additional aircraft are needed for combat purposes, they should be justified as such and approved in that context by the Secretary of Defense, the Office of Management and Budget, and the Congress. Lacking this kind of justification, there are serious questions about the use of billions of dollars to acquire aircraft that may not be needed.

- A number of opportunities exist to consider more economical support concepts for the F-16. Since this is a multi-national fighter being used by the North Atlantic Treaty Organization countries, there is an opportunity not only to centralize our needs, but also to build on host-nation support. One example--reduction in the intermediate maintenance equipment--would save an estimated \$56 million.

The Secretary of Defense must make it clear that he will not tolerate an attitude on the part of DOD managers which assumes that if a system can be funded, logistics will have to be provided, regardless of cost effectiveness at a later time. It must become a way of life to give the same attention to

logistics concerns and life cycle costs at the outset of systems development, as are given to systems capabilities and design cost considerations.

Relevant GAO Reports: LCD-80-65, June 6, 1980; LCD-80-83, July 22, 1980; LCD-80-89, August 20, 1980.

GAO Contact: Martin Ferber, 275-3697

GAO views. Improvement in national productivity is needed to aid the fight against inflation. GAO has issued a number of reports aimed at measuring and improving productivity within the Department of Defense. These reports indicate that, even though the Department of Defense has made some progress toward increasing productivity, many opportunities for additional increases and monetary savings still exist.

Our past reports on productivity have dealt with areas such as work measurement, use of numerically controlled equipment, source data automation, the productivity of various maintenance activities and productivity increases through capital investment. We have found, for example, that while the Department of Defense devotes considerable resources to work measurement, the services are not uniformly applying the standards and are not providing sufficient management emphasis to realize work measurement's full potential. In several other reports we pointed out the potential for increased savings through the use of numerically controlled equipment. However, the Department of Defense has not provided the attention and direction in this area that we believe is needed. Expanded use of source data automation--collecting data in computer readable form at the point and time an activity occurs--would be a further spur to increased productivity.

A number of reports have dealt with the productivity problems of the services' various maintenance activities. For example, the Department of Defense spends about \$2.5 billion a year on depot maintenance for aircraft. Many of its industrial in-house activities are currently work-loaded at low rates resulting in costly and inefficient operations as indirect costs are spread over low production.

This problem is massive and complex. A master plan and uniform cost accounting are essential to eliminate unneeded capacity and overheads and properly integrate Government-owned and private facilities. While it is difficult to estimate potential savings with precision, even if they were only 10 percent of current costs, they could exceed \$200 million annually.

In the area of capital investment, we have pointed out that the Department of Defense's program for simplifying access to capital investment funds, while conceptually sound was ineffective because of poor management. Ongoing work indicates that two of the services have overcome their difficulties and are successfully using the program.

We have also pointed out factors that affect the defense industry's productivity. Defense contractors, for example, are sometimes reluctant to make long-term facilities improvement investments. The inherent uncertainty of many Department of Defense program's funding and production schedules combined with slow depreciation rates provide little or no

incentive for capital investment by contractors. Incentives must be improved to realize the benefits of plant and equipment modernization.

Additionally, the Government uses the procurement process to implement various socio-economic programs which have been enacted into law as well as to obtain supplies and services. The resultant burden on both the Government and contractor organizations is enormous. The Congress should take the initiative to reexamine the full range of socio-economic programs applied to the procurement process.

We have also recommended that the Secretary of Defense identify those aspects of contract administration that could be relaxed to reduce costs and paperwork and should accelerate the implementation of management policies for major weapon systems acquisitions as set forth in OMB Circular A-109.

Relevant GAO reports. FGMSD-80-41, 4/18/80; FGMSD-78-44, 7/25/78; LCD-75-432, 12/23/75; LCD-76-401, 8/31/76; LCD-77-441, 9/23/77; LCD-78-406, 7/12/78; LCD-78-427, 1/17/79; LCD-80-23, 12/5/79; LCD-80-70, 6/17/80; LCD-80-82, 8/7/80; PSAD-80-6, 11/8/79.

GAO contact. Paul Math, 275-3663.

## Further Consolidation of Supply Activities

GAO Views. While there has been substantial progress in consolidating supply activities by establishing single managers, there is still strong services' resistance in areas with great potential. A firm decision by the Secretary of Defense would set in motion procedures providing substantial savings within 2 years.

In the 1950s, the Congress directed DOD to consolidate the purchase, issue, and use of common supplies. This was incorporated in the so-called "McCormick-Curtis Amendment" of 1958 which mandated consolidation of common supply and support functions to eliminate duplication and achieve economies.

A series of commodity single managers were established (including medical, clothing, subsistence, industrial, electronics, and general supplies). Each procured, stored, and distributed supply items to the four services. In 1961 this group was brought together by the then Secretary in an agency known as "The Defense Supply Agency" (DSA), responsible for some 1.8 million items of supply. Major reductions in inventory investment and personnel economies quickly ensued. Since then the Office of the Secretary of Defense (OSD) civilian managers have repeatedly advocated further consolidation of consumable items by assigning the remaining 1,300,000 consumable items to the Defense Logistics Agency (DLA) (the successor to DSA) for procurement, storage, and issue. These OSD officials estimate that \$100 million annually can be saved in operating costs (about 4,000 people). Substantial reductions in inventories are also possible.

While the above is the most dramatic opportunity for supply consolidation, there are two others which have been addressed in recent GAO reports that deserve early consideration:

- Eliminating Marine Corps logistics overlap with other services has already saved several million dollars, but further savings are possible. In response to an earlier GAO report, the Marine Corps took steps, saving about \$65 million, by reassigning some 157,000 items to other service agencies for management, thus eliminating separate Marine Corps staff and facilities. However, there are at least another 39,000 items managed by the Marine Corps which others could efficiently manage for it. In addition, there are opportunities for the transfer to other services of duplicative maintenance activities; use of other services'

depot overhaul facilities for selected items; and transfer of war reserve stocks to the storage facilities of other services.

--Centralized ammunition management is a long-sought goal which has not been fully achieved. Despite progress, much remains to be done. The current single manager's control is limited and the Office of the Secretary of Defense's proposal to expand the single manager concept has encountered considerable resistance from the services. Thus, there remain millions of dollars to be saved by installing a single system capable of providing intensive management of this critical commodity.

Relevant GAO Reports. LCD-80-74, June 30, 1980; LCD-80-1, November 26, 1979.

GAO Contact. Richard Helmer, 275-3637

APPLICATION OF THE SINGLE MANAGER  
CONCEPT TO TRANSPORTATION

GAO Views. It is timely to establish a unified command instead of the three services managing transportation separately. Studies have shown potential savings of over \$58 million annually from reduced personnel and facilities costs from consolidating these functions for just two of the three service single managers. Additional one-time savings in inventory costs from increased efficiency have also been projected.

Since the National Security Act of 1947, DOD has designated the Navy to be the single manager for ocean transportation (1956) and the Air Force to handle airlift service (1956). In 1965 DOD designated the Army to be the single manager for land transportation and common user terminals.

In 1979 the Blue Ribbon Defense Panel established by the then Secretary examined this multiservice approach to transportation. It recommended that transportation be further consolidated under a "Unified Logistics Command." Today, however, the three managers operate basically as originally established.

The House and Senate reports on the fiscal year 1980 Defense Appropriation Bill directed DOD to develop an implementation plan for consolidating the Military Sealift Command and the Military Traffic Management Command for creating a Defense Traffic Management Agency. We understand that a recently completed Harbridge House, Inc., study which DOD contracted for in response to this congressional directive, recommends the establishment of a Unified Traffic Management Command under the Joint Chiefs of Staff. However, to make this a truly Unified Traffic Management Command, the Secretary of Defense should consider assigning to it the traffic management functions of the Military Airlift Command.

Relevant GAO Reports. LCD-77-227, November 8, 1977.

GAO contact. Henry Connor, 275-6546

CONSOLIDATED USE OF WHOLESALE  
AND RETAIL INVENTORIES

GAO Views. Since 1974 we have been emphasizing the need to maintain visibility and interchangeability of stocks held both at major depots (wholesale levels) and at using installations (retail levels), such as shipyards, bases, and operating activities. This concept--vertical stock fund management--has the advantage of reducing total inventory investment and obtaining better use of assets.

Vertical stock fund management requires that a single stock fund manager (located at the inventory control point) maintains ownership and asset visibility of inventory at both the wholesale and retail levels. This contrasts to horizontal or multiple stock fund management which provides that inventory at the wholesale level is owned and controlled by wholesale stock fund managers while the same type inventory located at the retail level is owned and controlled by the retail stock fund manager--in essence there are two funds.

Without vertical stock fund management the wholesale managers lose visibility over assets and as a result stocks may be requisitioned unnecessarily, repaired when not needed or repositioned. For example, in past studies GAO has reported that:

- the Air Force was spending unnecessary millions of dollars to repair parts when more than sufficient quantities were already available. We first reported this finding in 1964 and the Air Force Audit Agency has repeatedly confirmed that millions of dollars can be saved if appropriate inventory management is applied.
- the Army could save some \$18 million by using serviceable parts which were then in overstock, instead of repairing them, based on tests conducted at just two Army depots.
- the Navy had purchased parts valued at \$5.3 million, while the Philadelphia Naval Shipyard had \$11 million of identical items on stock excess to its needs.

Savings realizable from vertical management are in the areas of reduced investment in safety levels, not transferring stocks when demand can be satisfied by other means, and avoiding unnecessary billing and invoicing between wholesaler and retailer.

In January 1981, we reported that the Navy could reduce supply support for combat ships, and also enhance readiness, by improved policies and practices for establishing and maintaining stock levels. Savings--\$137 million. Also, in January 1981, we reported that the Army, through improved retail inventory management, could save \$126 million.

Relevant GAO Reports. LCD-81-16, January 19, 1981; LCD-81-9, January 15, 1981; LCD-80-70, June 17, 1980; LCD-79-205, January 31, 1979; LCD-77-202, June 7, 1977.

GAO Contact. Henry Connor, 275-6546



**CHAPTER 2**  
**DISCUSSIONS ON**  
**SPECIFIC ADMINISTRATION COST-SAVING PROPOSALS**

**SECTION A.**

**REVISE ENTITLEMENTS TO ELIMINATE UNINTENDED BENEFITS**

President's Proposal: Targeted Reform of Food Stamps

GAO Supplementary Discussion

GAO Views: Regarding the possible annual savings by eliminating the duplication between food stamp and school lunch subsidies, GAO agrees that substantial savings might be possible by eliminating this duplication. Based primarily on fiscal year 1976 information, GAO estimated in a June 13, 1978, report that the duplication would be at least \$112 million, but this estimate was intentionally conservative. All the assumptions on which GAO's calculation was based were made so as to avoid overstating potential savings; different assumptions would significantly increase the savings estimate. Other factors--growth in program participation and increased food costs and benefits--which have changed and will change dramatically between 1976 and 1986 would also increase the estimated savings. GAO has not evaluated the details behind the President's estimated savings but believes that the general principle on which it is based--overlap between food stamp and school lunch benefits--is valid. Further overlaps--and potential savings--are available regarding the summer food service, child care feeding, free special milk, and breakfast programs. GAO has no estimates of what such potential savings might currently amount to. GAO's 1978 report recommended, among other things, that USDA study the administrative feasibility of considering child-feeding benefits when determining food stamp eligibility and benefits.

Regarding income verification, GAO testified in October 1979 in connection with the proposed 1980 food stamp amendments that retrospective accounting is generally advantageous because it uses actual, rather than estimated, income information for making benefit determinations. GAO also commented, however, that retrospective accounting could result in a household receiving benefits after it no longer needs them. This could happen, for example, when household income increases after a previously unemployed worker returns to work.

In a review completed in 1977, GAO assessed the efforts being made to identify and recover overissuances of food stamp benefits and estimated that the Government was losing over half a billion dollars annually because of errors, misrepresentations, and suspected fraud by recipients, and by errors by local food stamp offices. For every \$100 of the more \$5 billion in annual benefits being issued nationally at the time, overissuances accounted for about \$12; only about 12 cents of that \$12 had been recovered. The 8 local projects GAO reviewed were doing little to identify and recover the value of overissuances.

GAO reported in 1979 that, if some semblance of integrity is to be maintained in this program, food stamp recipient fraud cannot be allowed to continue unchecked. Administrative adjudication and penalty assessment were proposed as effective deterrents. GAO said that better financial incentives were needed for States and local projects to devote more effort to identifying and recovering overissuances and punishing recipient fraud. The

subsequently enacted Food Stamp Act of 1977 and the August 1979 amendments to the act provided additional tools for dealing with fraud and other overissuances. However, GAO believes that further steps are needed as discussed in a subsequent report issued in 1980 on the efforts being made to control fraud, abuse, and mismanagement in domestic food assistance programs.

The 1980 report dealt with the numerous recommendations GAO had made for dealing with fraud, abuse, and mismanagement in domestic food assistance programs. Some significant improvements were apparent in the regulation of retailers accepting food stamps, and in the handling and controls over food stamps, but more were needed in other areas where little had been accomplished.

The work requirements of the food stamp program are intended to affect the program in two ways--by helping recipients find jobs so that they will no longer need assistance and by terminating benefits to those recipients who are able but not willing to work. GAO found, unfortunately, that those responsible for administering the requirements seemed to regard them as administrative paperwork rather than as a tool for reducing the program's size.

The Food Stamp Act of 1977 also requires that the workfare concept, in which food stamp recipients will be required to work on public service jobs for the value of their benefits, be tested in pilot projects. GAO is currently completing its assessment of the first year's operation of the demonstration and will recommend changes to make operation of the concept more effective.

Relevant GAO Reports: CED-78-113, CED-79-5, CED-77-112, CED-80-33,  
CED-78-60

GAO Contact: Stanley Sargol (447-7883)

President's  
Proposal - Eliminating the Social Security  
Minimum Payment Amount

GAO Supplementary Discussion

GAO Views.

Congress can save the Social Security trust fund \$650 million in fiscal years 1982 through 1986 by eliminating the minimum benefit provision of the Social Security Act for new beneficiaries.

The minimum benefit provision, intended to help the poor, has in recent years mainly benefited retired government workers with pensions and homemakers supported by their spouse's incomes. Our study of beneficiaries who were awarded minimum benefits during 1977 showed approximately 44 percent of sampled beneficiaries received no additional income from the minimum provision because of offsets required in other Federal programs. More than half of the remaining 56 percent had income or support from other sources.

The need for the minimum benefit was greatly reduced in 1974 with the enactment of the Supplemental Security Income program. This program established a Federal minimum income level for the aged, blind, or disabled. Before the program, the minimum social security benefit may have been the only source of income for many people, but now most needy elderly are eligible for Supplemental Security Income.

A few minimum beneficiaries are not eligible for the Supplemental Security Income program even though they may be needy. This group includes individuals who selected early retirement and widow/widowers age 60 through 64. They are not eligible for the Supplemental Security Income program because they are not aged, blind, or disabled. The President's proposal could be amended to authorize a limited Supplemental Security Income payment which would replace the lost portion of the social security benefit provided they are needy and otherwise meet the program's eligibility requirements except for age.

If the minimum benefit provision of the Social Security Act were eliminated, our work shows that the net savings would be \$405 million for fiscal years 1982 through 1986 after a \$245 million increase in Supplemental Security Income to replace the portion of the Social Security benefit lost.

Relevant GAO Reports.

Minimum Social Security Benefit: A Windfall That Should  
Be Eliminated  
(HRD-80-29, December 10, 1979)

Implementing GAO's Recommendations On The Social Security  
Administration's Programs Could Save Billions  
(HRD-81-37, December 31, 1980)

GAO Contact: Peter McGough, FTS 987-3138

Eliminating Social Security Payments  
to Adult Students

GAO Supplementary Discussion

GAO Views.

Congress should amend the Social Security Act to discontinue payments to post-secondary students and take the necessary steps to assure that the Department of Education will have sufficient financial resources to meet any increased demand for aid arising from discontinuance of these benefits.

The basic purpose of the Social Security program is to provide some minimum family income in the event of the taxpayer's retirement, disability, or death. However, Social Security student benefits divert tax money from that basic purpose. During the 1979-1980 school year, it diverted \$1.95 billion. Student benefits are being paid while, even after imposition of increased taxes upon Social Security contributors, there is doubt the system can fulfill its basic purpose without still further increases.

Our report also supports a phase out of the student benefits program because it

- duplicates financial assistance provided by other programs paying education benefits, and
- gives many students more money than their school costs warrant, inequitably curtails--or bars altogether--benefits to other students, and deprives non-students.

Were student benefits to post-secondary students to be terminated effective Fall 1981, our work shows that the estimated net first year savings to the Social Security taxpayers would be \$1.4 billion, and the net savings to all taxpayers in that year would be about \$1.1 billion.

If the program were to be phased out over a 5-year period--fiscal years 1982 through 1986--the estimated savings to the trust fund would be \$5 billion. Net savings to the taxpayer for the same period would be \$4.2 billion after an increase in cost to the Department of Education Basic Grant Program to meet any increased demand for aid arising from discontinuance of Social Security student benefits.

Relevant GAO Reports.

Social Security Student Benefits For Post-Secondary  
Students Should Be Discontinued  
(HRD-79-108, August 30, 1979)

Implementing GAO's Recommendations On The Social Security  
Administration's Programs Could Save Billions  
(HRD-81-37, December 31, 1980)

GAO Contact: Peter McGough, FTS 987-3138

President's  
Proposal - Tightening Eligibility for Disability  
Insurance

GAO Supplementary Discussion

--Individuals misclassified as disabled

GAO Views. We agree with the Administration's position that the Social Security Administration (SSA) should begin an intensive review of cases to insure that only the truly disabled receive disability benefits.

We found that SSA investigates only a small percentage of its disability program beneficiaries each year to determine whether they are still eligible. Persons not investigated are not subject to any follow-up reexamination or reevaluation and can if they choose, continue to collect benefits until they voluntarily return to work, die, or reach retirement age. As a result, as many as 584,000 beneficiaries may not be currently disabled but still be receiving disability benefits. These beneficiaries represent over \$2 billion annually in Trust Fund costs. Although it may not be realistic to expect that all these beneficiaries could be removed from the rolls because of appeals, substantial savings would be achieved if SSA focused on this problem.

The Congress legislated P.L. 96-265 which requires, effective January 1, 1982, that SSA review all nonpermanent disabled beneficiaries at least once every three years. While this may be the ultimate solution when implemented, we have made several recommendations that can have immediate effects on reducing the number of ineligible recipients.

In commenting on GAO's draft report SSA stated that it was in general agreement with GAO's findings and acknowledged that much remains to be done to correct this complex situation. SSA has initiated and expanded efforts to review disability cases by budgeting to review additional disability cases in fiscal years 1981 and 1982.

Expected GAO Report. Spring 1981

--"Megacap"

GAO Views. We endorse the concept of establishing a "megacap" on disability benefits to preclude people from making more money from disability payments than they earned while working. We believe that benefits in excess of 60 to 70 percent of a worker's pre-disability income acts as a strong disincentive to ever return to work.

Presently, inequities exist between Federal programs--some programs are coordinated and offset, i.e., workers' compensation and disability insurance, while others are not, i.e., Federal Employees Compensation Act and disability insurance. Persons with comparable disabilities, therefore, can receive more or less in total benefits depending on the programs under which they are covered. The Government needs to establish a policy that will be uniform and the applicability of which will be equitable to the disabled.

The Senate Finance Committee requested that we study the prevalence of multiple benefits from various Federal and State benefit programs. We are in the process of determining the number of persons receiving multiple benefits and the potential savings that might result should a cap be instituted. However, our work has not progressed to the point where we can provide details. Programs covered by our study include VA compensation, Civil Service, and military disability programs. Preliminary information indicates that the VA compensation program is by far the most prevalent program paying benefits concurrently with SSA disability payments.

GAO Contact: Peter McGough, FTS 987-3138

Cost Reduction and Improved  
Management of Welfare Programs

GAO Supplementary Discussion

--Retrospective Accounting and Monthly Reporting

GAO Views.

GAO has issued two reports to Congressional Committees that included discussion of mandatory monthly recipient income reporting and recipient retrospective accounting. The first report, issued on June 23, 1978, to the Senate Committee on Human Resources, outlined GAO's concerns about key features and details of the Carter administration's Better Jobs and Income Act (S. 2084 and H.R.9030, introduced September 12, 1977; neither was subsequently enacted).

On monthly reporting, GAO was concerned because the decision to require it was based largely on tests of this technique in an experiment conducted in Denver, Colorado, and Denver's experimental population may not have typified the bill's target population. Also, (1) the expected volume of reports might be difficult to process in a timely, accurate way, and benefit payments might be suspended and delayed and (2) certain types of recipients experience infrequent changes in income and other circumstances so monthly reporting would serve no real value. GAO believed that the concept should be more fully tested and that consideration should be given to requiring such reports only of high-risk clients.

On retrospective accounting, the previous administration proposed basing an applicant's eligibility and payment level on his or her income 6 months prior to the date of application. The retrospective approach would be less error prone and thereby produce more savings than the generally used prospective (anticipated future income) approach, it would be less responsive to an applicant's current needs, and could produce hardships. Shortening the retrospective period could reduce the incidence of hardship, but, according to HHS estimates, could also increase costs and make more applicants eligible for the program. GAO believed more analyses seemed needed toward a goal of maximizing program savings yet minimizing recipient hardships.

The second report, issued on July 20, 1978, to the Chairman, House Committee on Ways and Means, set out GAO's concerns on various key administrative features of two welfare reform bills, H.R.10711 and S.2777, intended to improve the welfare system through change to the AFDC, Food Stamps, and Supplemental Security Income programs; neither was enacted.

H.R.10711 proposed, among other things, that AFDC recipients report changes in income or other circumstances pursuant to regulations issued by the Secretary of HHS, but did not specify the frequency of recipient reporting. While GAO did not

believe monthly reporting should be required for all recipients, even though an HHS study in Colorado indicated that monthly reporting was an effective method to obtain accurate information on recipient circumstances, GAO believed States should be required to adopt monthly reporting for recipients with frequent changes in circumstances, for example, those recipients with earned income.

S.2777 proposed that States decide whether to use monthly prospective or retrospective accounting, but the bill did not establish the day of the month to begin the accounting period. This could vary from the day of application to any day of the month. GAO believed that the same accounting method and period for all States is necessary to facilitate the exchange of data to identify and prevent fraud and abuse. Also, the bill did not synchronize the AFDC accounting method with that of the Food Stamp program. Food Stamps uses prospective accounting and provides benefits to most AFDC recipients. GAO believes it would simplify administration if the two programs used the same accounting method, preferably retrospective.

The bill also proposed that States be permitted, but not required, to require recipients to report monthly any changes in income or other circumstances. Allowing States to decide does not provide the uniformity GAO believed is desirable and attainable in the AFDC program. States should be required to adopt monthly reporting for recipients whose circumstances are most likely to change, such as wage earners; monthly reporting is unnecessary for those who are not likely to have frequent circumstance changes.

GAO has not formally projected potential savings through adoption of monthly reporting and retrospective accounting, but believes that higher costs associated with monthly retrospective accounting and applying monthly reporting only to AFDC wage earners would likely result in lower savings.

#### Relevant GAO Reports.

Review of The Better Jobs And Income Bill  
(HRD-78-110, June 23, 1978)

Comments on Welfare Reform Legislation  
(HR8-BILL-10, July 20, 1978)

Contact. Peter McGough, FTS 987-3138

## --Standardizing of the AFDC Work Expense Disregard

### GAO Views.

GAO has issued two reports to a member of Congress that discussed, in part, the work-related expense disregard and the earned income disregard. The first report, issued on August 3, 1977, compared Wisconsin's 21 percent flat allowance for work-related expenses with those of other States in Federal Region V and other selected larger States. GAO's analysis showed that the dollar amounts allowed for work-related expenses varied among the States because of different methods used for treating work-related expenses.

Wisconsin arrived at the flat allowance for all work-related expenses, except child care, in 1974 by randomly sampling AFDC cases and reviewing them for work-related expenses claimed; the results showed these expenses averaged 21 percent of an individual's gross income.

Title IV-A of the Social Security Act requires States to consider an individual's reasonable work-related expenses in determining eligibility for and amount of AFDC benefits. Each State can establish its own criteria for reasonable work-related expenses. However, as a result of an April 23, 1974, U.S. Supreme Court decision, Shea v. Vialpando (416 U.S. 251), States are not allowed to limit the dollar amount of work-related expenses that may be deducted. In the Court's opinion, any limitation placed on the dollar amount would act as a disincentive to an individual seeking or retaining employment.

The second report, issued on June 22, 1978, discussed in part the effect of both the \$30 and one-third income disregard and the work-related expense disregard in Wisconsin and elsewhere. GAO reviewed five selected studies of the effect of the disregard provisions on recipient work response that provided some evidence that recipient employment rates in the areas studied did increase as a result of the provisions. However, the studies also found that recipients did not work themselves off the welfare rolls, the major intent of the provisions, which resulted in increased caseloads and program costs. GAO's samples of working AFDC recipients in California and Wisconsin showed essentially the same result.

GAO also tested the effect of the provisions of one bill, the President's welfare reform proposal, of some 17 bills, which in part would have changed the provisions, that had been introduced in the 95th Congress to overcome the widely recognized weaknesses of the current disregards. This test, on selected AFDC cases in California and Wisconsin, found that welfare grants would generally be reduced or eliminated. The elimination of

work-related expenses as a disregard, provided in the President's proposal, was a significant factor in eliminating the grant awards. GAO has not formally projected potential savings from any proposed change to the disregard provisions.

Relevant GAO Reports.

Wisconsin's Aid to Families With Dependent Children Program  
(HRD-77-125, August 3, 1977)

Wisconsin's Aid to Families With Dependent Children and  
Child Support Enforcement Programs Could be Improved  
(HRD-78-130, June 22, 1978)

GAO Contact: Peter McGough, FTS 987-3138

President's  
Proposal - Increasing the Cost Effectiveness of the  
Medicaid Program

This proposal would feature the "capping" of Federal contributions to the \$29 billion State operated Medicaid programs to pay for the health care of the poor. Coupled with this proposal Federal law would be modified to provide the States with more flexibility in managing their programs.

GAO Supplementary Discussion

GAO Views. Although the details of this proposal are vague particularly with regard to modifications to existing Federal requirements, we believe that there are potential advantages and disadvantages.

In terms of advantages we believe the proposal could:

- Eliminate the open-ended nature of the existing Medicaid program which pays for virtually any health related service for which the State claims reimbursement. Historically, budgetary controls over Medicaid have been non-existent because the Federal Government must underwrite a specified portion of what the States spend if such expenditures are in accordance with the approved State Medicaid plans.
- Provide for a counter incentive to the existing incentive for States to maximize Federal reimbursement through Medicaid to support their municipal, county, or State health care institutions even though these may be more costly in providing services. Further in a recent review 1/ we noted that at least two States were particularly lax in identifying and recovering millions of dollars of Medicaid overpayments to such public institutions. Because of the Federal dollars involved, the States have little incentive to do so.
- Offer the potential for modifying the existing Federal "Freedom of Choice" provision which has hampered State initiatives to reduce their costs by acquiring such items as laboratory services on the basis of competitive bids or other direct contracting methods. 2/ Although relief from such restrictions on an experimental basis has passed both the House and Senate at various times, it has not been enacted into law.

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1/"States Should Intensify Efforts to Promptly Identify and Recover Medicaid Overpayments and Return the Federal Share," HRD-80-77, June 10, 1980.

2/"Savings Available for Contracting for Medicaid Supplies and Laboratory Services" HRD-78-60, July 6, 1978.

--Offer the States the flexibility to implement a comprehensive preassessment and service program designed to maintain individuals in the community where this would result in less cost than if institutionalized in a nursing home. Certain combinations of existing Medicaid eligibility policies create financial incentives to use nursing homes rather than community services and a GAO report proposed several strategies for assuring that avoidable nursing home care is minimized. 1/

In terms of disadvantages we believe they can be categorized into two areas--(1) the lack of specifics on how savings are to be realized and (2) possible transfer of costs to the Federal Medicare program. Additional comments on each of these follows.

#### No Specifics on How Savings Are to be Realized

One of the major problems in addressing the Administration's Medicaid capping proposal is the lack of specificity regarding where savings and/or extra funds will come from to offset the projected decrease in Federal funding. These offsets can only come from three sources--the States, medical services providers, and Medicaid recipients.

The States. The States could decide to spend additional State and/or local funds on Medicaid. Currently, many States are strapped to meet their current Medicaid funding requirements and we believe it is unlikely that most States will be able to put additional resources into the Medicaid program. The same is true for local governments.

Medical Services Providers. Reductions in expenditures to help offset decreases in Federal Medicaid funding could be obtained from providers in three ways. First, by eliminating or reducing payments to providers resulting from fraudulent activities. While we believe all reasonable efforts should be made to eliminate fraud from the Medicaid program, we do not believe expenditure reductions which would result from eliminating fraud would approach those required to offset projected decreased Federal Medicaid funding.

The second way to reduce payments to providers is by eliminating expenditures for medically unnecessary services, commonly referred to as program abuse. It is generally believed that a significant portion of Medicaid funds are spent on unnecessary or excessive services. It is also generally recognized that it is very difficult to draw the line between what constitutes necessary services and what does not. Regarding control of fraud and abuse, the Congress enacted legislation in October 1980 which requires States to have Medicaid Management Information Systems (MMIS), for which

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1/"Entering a Nursing Home--Costly Implications for Medicaid and the Elderly" PAD-80-12, November 26, 1979.

increased Federal sharing is available. These claims processing systems are designed to provide the States with the information necessary to identify potential cases of fraud and abuse. States with operating MMIS have estimated savings resulting from their use in the range of 3 to 5 percent of program costs. Thus, current law has, in effect, built in these potential savings. Thirty-two States have operational MMIS. The impact the elimination of the increased Federal sharing for MMIS would have on the development, installation, and operation of MMIS in States without systems is not known. Also, the State fraud control units could lose some Federal funding. Interruption of incentive funding of the fraud control units in the fall of 1980 resulted in their decreased activity.

The third way to reduce payments to providers is by lowering the amount that providers are paid for particular services. In general, providers currently complain that they are not fairly compensated by Medicaid for their services. Many providers, especially noninstitutional providers, do not participate in Medicaid. For example, in Ohio about 50 percent of the payments for physician services were received by about 5 percent of the physicians in the State during the year ended June 30, 1977. If payment levels are reduced, provider participation could be further reduced. This would reduce the availability of services to recipients and could result in increased costs if recipients are forced to go to generally higher cost providers, such as hospital outpatient departments, to obtain physician services. In fiscal year 1981, total Federal Medicaid expenditures for hospital outpatient services were about 60 percent of the total amount paid to physicians.

Medicaid Recipients. Reductions in expenditures to offset decreased Federal Medicaid funding could come from recipients in three ways. First, reductions can occur from eliminating payments for services provided to ineligibles. The Administration proposal cited the current estimate that about \$1.2 billion per year is spent on Medicaid ineligibles. However, as we have reported <sup>1/</sup> these estimated erroneous payments do not directly relate to the amount of money that can be saved by eliminating errors. This results because many of the errors are of a technical nature, the correction of which does not result in lower program costs. For example, if a State permits a person to have no more than \$500 in liquid assets and that person has \$550, the entire payment made for the person on the sampled claim was counted as erroneous. To become eligible, the person merely has to dispose of \$50. We analyzed the cases found ineligible in Ohio during the April-September 1976 period and found that 56 percent of the reported erroneous payments represented payments where correction of the error would not result in program savings. Of the remaining

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<sup>1/</sup>"Ohio's Medicaid Program: Problems Identified Can Have National Importance" (HRD-78-98A, Oct. 23, 1978).

44 percent, elimination of many of the errors would not necessarily result in savings because many persons ineligible because of excess resources would not have to apply them to the cost of medical services. Instead, these persons could dispose of the excess by such means as purchasing personal items. While a number of changes have been made to the program which estimates Medicaid erroneous payments, we believe a large portion of the reported \$1.2 billion figure would still represent cases where the correction of the error would not result in program savings.

The second way reductions to offset reduced Federal funding could come from recipients is by eliminating coverage of certain types of service or by requiring the recipient to pay part of the cost of services. For fiscal year 1981 it is estimated that almost 85 percent of Federal Medicaid funds will be paid for hospital, nursing home, and physicians' services. It would be virtually impossible not to cover these services but restrictions could be placed on the amount of these services that are covered (for example, limit the number of days of hospital care that will be paid per recipient per year). Many States have already instituted such restrictions. As far as requiring recipient copayments, the question boils down to how much can you require the recipient to pay before in effect you have eliminated the benefit because the individual cannot afford to pay it. Currently, some States require copayments for some types of services and long-term institutionalized recipients are required to apply all their income except \$25 a month to the cost of care.

The third way reductions to offset decreased Federal funding could come from recipients is by restricting eligibility. If people require medical services, especially institutional services, we assume they will still receive them. If the people cannot pay for the services they receive, the costs of these services will have to be paid through some other means such as increased charges to those who can pay, whether privately or publicly funded.

#### Transfer of Medicaid Costs to Medicare

In considering the budget impact of "capping" the Federal contributions to the State operated Medicaid programs, we believe it also appropriate to consider the vulnerability and the related budgetary implications of the States' ability to shift their Medicaid costs to the federally financed Medicare program. This vulnerability exists because there are about 4 million aged, blind, and disabled persons eligible for both programs (dual beneficiaries) and the benefits overlap. We believe that there is a potential for a high level of cost shifting from Medicaid to Medicare in two areas--(1) Part A inpatient hospital deductible and (2) Medicare skilled nursing facility benefits.

### Part A inpatient deductible

For 1981, the inpatient hospital deductible under Part A of Medicare is \$204 for each spell of illness or benefit period. The Social Security Amendments of 1967, removed a Federal requirement that State Medicaid programs pay this deductible expense for the dual beneficiaries; however, based on one of our recent studies, 1/ all State Medicaid programs have continued to pay the inpatient deductible for individuals eligible for both programs. Consider, however, the possible consequences if the States elected not to pay this expense for the dual beneficiaries. Since most dual beneficiaries could not pay the \$204, this amount would eventually be charged by the hospital to Medicare as a Medicare bad debt which is presently reimbursable. Assuming about 1 million dual beneficiaries are hospitalized in a year, the total impact on the Medicare program would be about \$200 million.

### Nursing home care

Nursing home care represents the costliest Medicaid benefit, consuming 41 cents of each Medicaid dollar. In 1978, of the total national nursing home bill of about \$16 billion, Medicaid paid about 46 percent or about \$7.3 billion. In contrast, Medicare paid about 2 percent, or about \$400 million. There are a number of reasons for this, the primary one being that Medicare's skilled nursing home benefit is focused on acute post-hospital oriented care whereas Medicaid is focused on the long-term chronic illnesses.

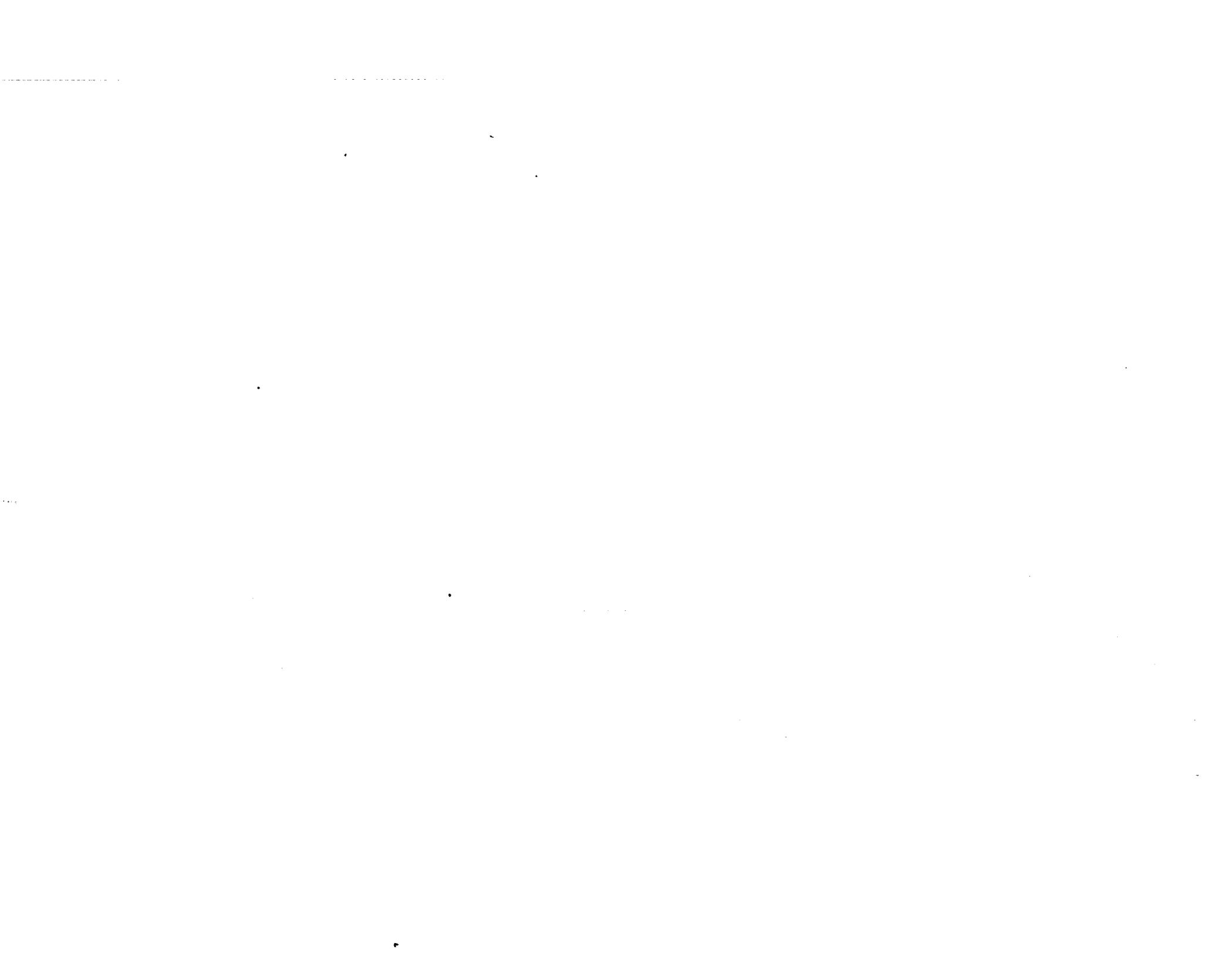
However, we believe that another factor is that many skilled nursing homes that participate in Medicaid do not participate in Medicare. We estimate that of the 900,000 skilled and jointly certified skilled and intermediate care beds participating in Medicaid--about 400,000 (or less than half) participate in Medicare. If persons eligible for both Medicare and Medicaid cannot be placed in skilled nursing home beds which participate in both programs, Medicaid currently has to pay the entire nursing home bill. If States were to require facilities participating in their Medicaid programs to also participate in Medicare, thus increasing the supply of Medicare nursing home beds, Medicare could become first payer for dual-eligibles now unable to be placed in nursing homes under Medicare.

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1/"More Can Be Done to Achieve Greater Efficiency in Contracting for Medicare Claims Processing" (HRD-79-76, June 29, 1979).

While it is likely that the increase in Medicare certified beds would have the effect of decreasing the costs of Medicare's inpatient hospital benefit, we believe that some States could transfer portions of their nursing home expenses to the federally financed Medicare program.

GAO Contact: Thomas Dowdal, 987-3138



Eliminate section 11(b) tax exempt financing - This financing mechanism has resulted in substantially higher total costs for section 8 than either public housing or FHA-TANDEM, without offering any obvious advantages. This results from the combination of tax exempt bonds with the usual real estate tax incentives.

Finance state housing with taxable bonds - Disallowing tax exempt bonds for State housing finance agencies in favor of taxable bonds would substantially improve the economic efficiency of this production alternative.

Disallow partially-assisted section 8 projects - The costs of providing subsidized housing are significantly increased by allowing partially-assisted projects, since very large TANDEM and tax subsidies are incurred on behalf of all units, not just those serving needy households. The result is that a large portion of TANDEM funds benefit middle income households.

Another way to control long-term Federal expenditures for housing subsidies would be to reduce HUD's costs for disposing of acquired properties. In December 1979 we reported that it would cost HUD about \$1 billion over a 15-year section 8 rental assistance commitment period to sell its April 30, 1979, inventory of over 280 projects with over 24,000 housing units. There are indications that HUD acquired multifamily projects can be disposed of in a less costly manner and still ensure they are maintained for low- and moderate-income people. In July 1979 the National Housing Law Project in Berkeley, California, issued a report which addressed various financial alternatives and techniques for providing economic relief to troubled subsidized projects. The study concluded that under certain conditions the acquisition of distressed projects by local housing authorities is the least costly alternative to the Government. In a current review we are taking a closer look at alternatives to the use of section 8 subsidies to sell acquired projects. Preliminary indications are that selling HUD-owned properties to local housing authorities is least costly to the Government, but that local housing authorities may not always be willing to take the properties without at least some section 8 commitments. Even if sold to local housing authorities with some section 8 commitments, when considering all costs to the Government, it appears less costly than selling the units to the private sector with section 8 fund commitments.

Relevant GAO Reports: CED-80-59, PAD-80-13, CED-81-54 (due for release 3/13/81), and CED-80-31.

GAO Contact: William Gainer, 426-1645.

## Medicaid Cost Effectiveness

### Other Health Care Cost Proposals

The rapid escalation in Medicaid expenditures over the past decade can be attributed in part to the program's coverage of nursing home care. Nationally, nursing home expenditures have grown at a rate of 20 percent a year and are projected to reach \$45 billion by 1985. Medicaid, which pays almost half of this bill, in FY 1978 spent \$7.2 billion for nursing home care. By FY 1980 this had increased to \$10.4 billion or 39 percent of total Medicaid expenditures of \$26.7 billion.

GAO issued a report and testified on one of the major problems in Medicaid's payments for nursing home care. Many nursing home residents, whose care is subsidized by Medicaid, would have preferred and could have remained in the community if the necessary long-term care services had been available. Estimates of the number of residents who fall in this category range from 10 to 40 percent.

Two major areas which contribute to the costly and avoidable utilization of nursing homes are:

- Medicaid's eligibility policies which create financial incentives to use nursing homes rather than community services,
- Inadequate Medicaid assessment procedures for determining an applicant's need for nursing home care.

GAO, in its report, proposed several strategies for assuring that avoidable nursing home care is minimized. One approach would be to require a comprehensive preadmission assessment for all applicants to nursing homes whose care would be covered by Medicaid or Medicare. The objective of the assessment would be to determine whether other non-institutional services would be equally appropriate.

Relevant GAO report.      Entering a Nursing Home --Costly Implications for Medicaid and the Elderly      PAD 80-12, November 26, 1979

Contact.                      Joe Delfico, 275-3581

GAO Supplementary Discussion

GAO Views: While the proposed reduction in the level of subsidized housing units for 1982 and future years will have the desired effect of significantly reducing budget authority and outlays, it does not deal directly or in an effective way with the two major problems cited, namely (1) the sharply increasing per unit cost of subsidized housing, and (2) the inequity of many years standing of providing housing subsidies to only a fraction of the total eligible households.

We believe the inequity issue is particularly unfortunate and deserving of high priority attention. While we have not proposed fundamental policy changes in the manner in which housing subsidies are distributed, we have recommended to HUD that the Secretary establish a task force or designate a study group within the agency to conduct research directed to finding ways in which a greater degree of equity can be achieved among the many households determined to be in need. HUD has not responded favorably to our recommendation.

Within the present concepts and designs for subsidized housing programs, a number of actions could be taken to reduce the per unit cost of subsidized housing and/or enable the limited available funds to reach more eligible households. Some examples are:

Build more modest size section 8 housing with fewer amenities - New section 8 housing is often better than most housing in the market areas where it is located. It is larger than it needs to be and may contain such costly amenities as central airconditioning, balconies and/or patios, carpeting, and garbage disposals.

Get better use out of subsidized housing units - We noted in a recent review of the section 8 New Construction Program that over half of the 862 family housing units we visited were underused. The root of the problem was the lack of effective incentives for project owners/managers to achieve optimum occupancy levels and the lack of effective monitoring by HUD.

Improve program administration - A wide variety of actions are needed by HUD to improve program administration and thereby reduce the costs and improve the efficiency of subsidized housing programs. These include improving procedures for setting fair market rents for the section 8 program, increasing cost consciousness by HUD program personnel, and taking steps to increase the incentives for high quality management and long-term ownership of new section 8 projects.

Place more emphasis on public housing - We believe a larger proportion of assisted housing units should be built with this mechanism and that the Congress should provide direct funding shifts to achieve this objective. Public housing is cheaper in the short run, and also in the long run when off-budget costs such as tax expenditures are considered.

GAO Supplementary Discussion

GAO Views: GAO supports the proposal to increase the maximum allowable rent contributions paid by tenants living in federally subsidized housing from 25 percent to 30 percent of their adjusted incomes, and has previously made a similar recommendation. The Housing and Community Development Amendments of 1979 authorized, among other things, an increase in the maximum rental contribution required from program beneficiaries from 25 to 30 percent of income. HUD, however, considered the provision to be discretionary and rejected it because of the agency's feeling that it would place an added burden on lower income tenants. HUD's position ignores the large number of needy households for which there are currently no subsidized housing dollars. Consequently, GAO recommended that the tenant contributions toward rents be increased as authorized by the 1979 legislation.

GAO also believes that additional steps can be taken to reduce the Federal costs of subsidizing rent contributions. For example, in November 1979 GAO reported that the 1974 Housing and Community Development Act requirement that both higher and lower income eligible families be assisted had not been widely implemented by HUD and public housing agencies. Only one of the six public housing agencies included in our review had begun to select tenants from a broad economic income range. GAO estimated that about \$33 million in additional rental revenue would have been earned by the other five authorities in 1 year if they had housed the required broad range of low-income families.

In conjunction with increasing tenant rent contributions, GAO also believes that complete and accurate reporting and verification of income is needed to ensure that only eligible families are assisted and that the level of assistance is properly calculated. Since 1971 GAO has issued a number of reports which have identified shortcomings in tenant income reporting and verification. These reports generally conclude that some tenants pay less than their fair share, and that poor verification of tenants' reported incomes exacerbates this problem.

In December 1979 GAO also reported that a change in HUD's policy regarding rent charged to tenants in HUD-acquired, formally subsidized projects was also resulting in increased losses to HUD's mortgage insurance funds. This change, made in May 1979, limited the rent charged at such projects to 25 percent of the tenants' income. Prior to this change tenants in HUD acquired projects were charged the established rent and utilities. The 25 percent limitation has reduced project revenues and increased losses. The resulting losses are absorbed by HUD's mortgage insurance funds. A rescission of this policy, requiring tenants to pay the already subsidized rents in effect prior to HUD's acquisition, would result in a reduction in HUD's mortgage insurance losses, and a resultant decrease in Federal outlays for assisted housing.

Relevant GAO Reports: RED-75-321, CED-80-2, CED-80-31, and CED-80-59.

Contact: Steven J. Wozny, 426-1780.

EXTENSION OF TIMETABLE FOR COMPLETING PUBLIC HOUSING MODERNIZATION

GAO Supplementary Discussion

GAO Views: The Administration proposes to stretch out the timetable for implementing the Public Housing Modernization program on the basis that the original funding for the program was so ambitious that it is questionable whether the money could have been used effectively. GAO agrees that the funds requested for modernization are much greater than what has been spent in the past. Moreover, our prior work indicates that there had been no plan for the comprehensive modernization of public housing. Although HUD is currently rewriting its regulations to develop guidelines for implementing a comprehensive modernization program, it is too soon to tell how effective this program will be or the impact of extending the timetable over a longer period of time.

HUD testimony before the Subcommittee on Housing and Community Development, House Committee on Banking, Finance and Urban Affairs on March 3, 1980, discussed the need for a comprehensive modernization initiative. HUD officials testified that a study of the physical condition of public housing projects indicated that one million of the 1.2 million existing public housing units were basically sound, and that of the remaining 200,000 units, about 90,000, mainly large, inner-city, family projects, would require substantial architectural and design changes, as well as repairs, which may cost as much as \$2.3 billion (\$25,000 a unit) to make them decent, safe, and sanitary. The other 110,000 units could require major upgrading costs of about \$935 million (\$8,500 a unit). Thus, the total cost to modernize the 200,000 units could amount to over \$3 billion over a period of years. In addition, the one million basically sound units may require about \$1 billion of maintenance or repair work, thereby raising the total to \$4 billion. HUD officials said further that based on this preliminary analysis of the cost to modernize public housing projects it was clear that HUD's current level of modernization funding could not improve the poor physical condition in the 200,000 units. Therefore, according to HUD, it needs a more comprehensive approach to solve this problem.

HUD officials told us that, under new regulations for the comprehensive improvement assistance program, qualifying public housing authorities would be given funds to hire an architect/engineer firm to scope out the type and extent of modernization and repair work needed to bring the project or units up to decent, safe, and sanitary conditions. This type of work can range from changing the exterior architectural appearance to replacing kitchen and bathroom furnishings and fixtures. Once the type and extent of the work are determined the public housing authority will be given contract authority to do the work as a total package. HUD officials said that this approach makes it a comprehensive initiative as contrasted to previous modernization programs where public housing authorities normally did the work in segments over a period of years. These regulations are currently pending Secretary Pierce's approval.

Relevant GAO Reports: CED-0-163.

Contact: Steven J. Wozny, 426-1780.

President's  
Proposal - Potential Savings by Taxing  
All Unemployment Benefits

GAO Supplementary Discussion

GAO Views. GAO has issued a report on inequities and work disincentives in the current system of unemployment compensation. In this report, we recommended that the Congress consider including unemployment compensation in taxable income.

The original decision to make UC nontaxable income was not part of any legislation, but the result of a 1938 Internal Revenue Service ruling. Because relatively few people were subject to Federal income taxes in 1938, the exclusion was a matter of administrative convenience with little economic impact. The situation today, however, is much different because most workers pay taxes.

To give recipients an incentive to seek employment and treat UC consistent with unemployment benefits paid in private plans, the Congress passed the Revenue Act of 1978 (Public Law 95-600). This act revised the tax exempt status of UC for a small percentage of the recipients. Compensation will be taxed if adjusted gross income exceeds \$25,000 for those married, filing jointly; \$20,000 for single taxpayers; and, regardless of income, for those married, filing separately. The act became effective in 1979, and it was reflected in tax returns filed by April 15, 1980.

We believe including UC in taxable income has merit both in increasing equity and in providing recipients with a financial incentive to work. When compensation is nontaxable, recipients in a high tax bracket benefit more from the tax-free nature of UC than recipients in a lower tax bracket. Further, recipients with working spouses benefit most from this inequity. As one of two worker in the family, these recipients would normally be in a higher tax bracket than if they were sole wage earners.

In addition to the equity issue, taxing UC reduces the percentage of income replaced and increases recipients' incentive to seek employment. The decision of whether or not to tax UC is complicated and has different ramifications for different classes of tax filers. In light of the equity and incentive advantages of taxing UC, we believe the Congress should also consider the effect of expanding the act's coverage to include recipients at all income levels.

Relevant GAO Reports. HRD-79-79

Contact: Victor F. Bouril, 523-8701

President's  
Proposal - End Overuse and Excessive Benefits Under  
The Federal Employees Injury Compensation Program

GAO Supplementary Discussion

--Increase the compensation rate to 80% of gross pay but make  
the entire amount subject to Federal income taxes

GAO Views. We have a proposed report ("Federal Employees' Compensation Act: Benefit Adjustments Needed to Encourage Reemployment and Reduce Costs," HRD-81-19) currently in final processing in which we address this issue in the President's proposal. We concur with the concept of the proposal but do not believe it goes far enough. It should be noted that the proposal is the same as one the Department of Labor had been contemplating at the time of our review.

The proposal to tax Federal compensation benefits would lessen inequities among beneficiaries and would increase somewhat the financial incentive to return to work. Furthermore, establishing a single percentage of preinjury pay would eliminate the increased benefits for dependents, a provision of the current benefit structure which we believe is not warranted. However, the proposal to increase benefits from 66-2/3 and 75 percent to 80 percent would not restore the original congressional intent to provide sufficient economic incentive to return to work because such benefits would still replace close to 100 percent of preinjury net pay.

Under the proposal, beneficiaries at or below GS-11, step 1, would receive increased workers' compensation which would be close to their preinjury net take-home pay. This would eradicate what little economic incentive to return to work that currently exists at these levels. Compensation benefits for higher graded beneficiaries would be reduced somewhat, but at the GS-14 and 15 levels they would still remain above preinjury net take-home pay.

Although we are not sure what the benefit level should be, we believe that, if the 66-2/3 percent called for in the initial legislation had validity, it would be a more reasonable level to work toward, than one which allows for compensation close to 100 percent of take-home pay.

Both Labor and OPM commented on our draft report and neither were in agreement with our position to establish a benefit level closer to the 66-2/3 percent established in the initial legislation. Their rationale and our evaluation of their position will be fully discussed in our soon to be issued report.

What it boils down to, however, is that almost any benefit level above or below what now exists or what is proposed by Labor can be argued pro and con. In our view, when the 66-2/3 percent of gross pay benefit level was included in the initial Federal workers' compensation legislation, that level was considered as a

reasonable balance between the somewhat conflicting goals of adequate income protection and sufficient incentives to return to work. Further, the 66-2/3 percent level seems to better recognize a basic concept of workers' compensation that there ought to be some sharing of the risk between both employee and employer for work-related illness or injury.

relevant GAO Report. HRD-81-19

--Reinstate the 3-day waiting period before a claimant can receive compensation benefits

GAO Views. We recommended in our June 11, 1979, report that in order to reduce the number of minor and frivolous claims for compensation which divert Labor's efforts from more serious claims, to reduce the cost to taxpayers, and to give Federal employees an incentive to return to work, the Congress require that the 3-day waiting period for traumatic injuries be applied before continuation of pay, rather than 45 days later.

Our report showed that the number of lost-time injury claims filed by Federal workers escalated sharply after the Federal Employees' Compensation Act was amended in 1974 to allow employees' pay to continue uninterrupted for 45 days after an injury. Previously, employees had to wait 3 days before receiving compensation. In fiscal year 1974 about 12,000 claims for compensation were filed for job-related lost-time traumatic injuries. Labor estimated that the number of claims would increase to 101,000 for fiscal year 1979. We believe that as many as 46 percent of all claims might be eliminated by a 3-day waiting period.

Relevant GAO Report. "Multiple Problems with the 1974 Amendments to the Federal Employees' Compensation Act," HRD-79-80, June 11, 1979.

--Reduce the pay that a person can get for up to 45 days while a claim for compensation for a work-related injury is being processed from 100% to 80% of full salary

GAO views. In 1973, we found that Labor's system for paying compensation, at that time, faltered and lags occurred when the involved parties did not promptly meet their responsibilities. We stated that, even if Labor were to increase its staff to handle the increased number of claims, the overall lag would not be reduced significantly since a large part of it would still be external and beyond Labor's control. We concluded that what is needed, then, is a new system.

We suggested that one alternative would be to have each agency pay its employees' claims. Under this system the agency would keep the disabled employee in a pay status at a reduced rate of pay pending the filing of a claim by the employee and its review and approval by Labor.

Such a system would result in immediate compensation payments and would eliminate lags since payment would not be contingent upon claim processing's being completed. A period of 90 days in which to file, process, and approve a claim appeared to be reasonable, inasmuch as Labor approved nearly every claim within 90 days after the injury.

We recommended that the Congress favorably consider legislation that would reduce the lag in compensation payments outlined in this report. We favored the first alternative system, discussed here, because it is a faster way to pay disabled Federal employees.

The continuation-of-pay provision of the 1974 amendments to the Federal Employees Compensation Act did not provide for a reduced rate of pay.

Relevant GAO Report. "Need For A Faster Way to Pay Compensation Claims to Disabled Federal Employees," B-157593, Nov. 21, 1973.

--Convert FECA compensation recipients to the civil service annuity rolls after age 65, instead of the current practice of providing life-long compensation

GAO Views. In the previously mentioned proposed report that is in final processing, we also address this issue which was also proposed by Labor at the time of our review. We agree that the proposal is basically sound, but we believe it does not allow for early enough transfer from compensation to retirement and, therefore, does little to end the substantial economic incentive for workers to effectively retire on compensation rather than on Civil Service retirement.

As discussed in our report, OPM data show that most Federal employees retire within 3 years of their eligibility--i.e., at age 55 after 30 years of service. It would seem reasonable to transfer Federal workers' compensation beneficiaries from the workers' compensation program to the Civil Service retirement program somewhat closer to the time they would have been eligible to retire rather than at a predetermined age 65.

According to Labor, in commenting on our proposed report, any discussion of the current average retirement age for Federal employees should consider the (1) impact that changing economic and social conditions might have on that figure and (2) requirements of the Age Discrimination in Employment Act. OPM also takes exception with our proposed recommendation that conversion from compensation to retirement benefits should occur earlier than age 65. OPM states that our rationale fails to recognize that only about 23 percent of new Federal employees stay in Federal service until voluntary retirement age, and thus might have spent most of their careers in the private sector under the social security system, working until age 65, had they not become disabled.

We recognize that changing economic and social conditions could have an impact on the average retirement age for Federal employees. It should be noted, however, that over the past several years, even with the periods of increasing inflation, the trend has been toward earlier retirement--in both the Federal and private sectors. We are also well aware of the requirements of the Age Discrimination in Employment Act and believe our recommendation is consistent with them.

We do not concur with OPM's position and believe our proposal to transfer workers' compensation beneficiaries to the retirement program, for example, at age 58 for a person eligible to retire at age 55, is not out of line with what is occurring in the private sector. A survey of private industry employees who retired during calendar year 1978 showed that 62 percent were younger than age 65. Social Security Administration statistics show that about 30 percent of those who are eligible retire at age 62, with almost 50 percent retiring before age 65. Also, the long-term Federal workers' compensation roll does not generally consist of the young or short-term Federal employee. Of the 239 beneficiaries in our sample, 166 (69 percent) were 41 years of age or older when injured. Of the 186 beneficiaries for whom years of Federal service data were available, 100 (54 percent) had 20 or more years of Federal service. Our review also showed, that for these 186 beneficiaries 73 (39 percent) were eligible for Civil Service retirement at the time of our review, and an additional 32 (17 percent) were within 5 years of eligibility.

In our proposed report we recommend that the Secretary of Labor make revisions to Labor's legislative proposals, and if these revisions are not made or if the proposed legislative package is not introduced, we recommend that the Congress

--Integrate the Federal workers' compensation and Federal retirement programs to provide for the transfer of compensation beneficiaries to the retirement program within 3 years of the time the employee would be eligible to retire. This would help ensure the act's objectives are accomplished and better define the roles and responsibilities of these programs.

Relevant GAO Report. "Federal Employees' Compensation Act: Benefit Adjustment Needed to Encourage Reemployment and Reduce Costs," HRD-81-19.

GAO Contact: Peter McGough, FTS 987-3138

President's  
Proposal - Eliminating Trade Adjustment Assistance  
Payments to People Already Receiving  
Unemployment Insurance Benefits

GAO Supplementary Discussion

GAO Views. GAO has issued several reports to the Congress on trade adjustment assistance to workers. The latest report, issued on January 15, 1980, assessed the worker adjustment assistance program nationwide and found that weekly cash payments have helped few import-affected workers adjust to the changed economic conditions during their layoff because the payments were received by most in the form of a lump-sum payment after they had returned to work. The various processing delays that caused late payments to a great extent are inherent in the design of the program. Furthermore, most workers indicated that they experienced no severe economic hardship as a result of their layoff--which for most was not permanent--and were able to rely on regular unemployment insurance benefits and other income sources to meet their financial needs.

This was not the case for all workers. Some remained unemployed even after exhausting their unemployment insurance benefits. In our opinion, the adjustment assistance program should be targeted to these workers. Such an approach would target program benefits to workers experiencing long-term unemployment or permanent job loss and, at the same time, save millions of dollars now paid--often retroactively--to workers who do not experience permanent unemployment, most of whom return to work before exhausting unemployment insurance benefits. In addition, this approach would provide a longer period of income protection for those who experience the most difficulty in finding employment.

GAO recommended that the Congress amend the Trade Act of 1974 to require that import-affected workers exhaust unemployment insurance benefits before receiving up to 52 weeks of cash payments under the Trade Act. To minimize the possibility that the additional weeks of income protection under this approach would provide a disincentive to employment, GAO also recommended that the act be amended to provide that Trade Act benefits be continued at an amount comparable to that received under unemployment insurance, rather than 70 percent of a worker's average weekly gross wage as now prescribed.

In the report GAO estimated that at least \$165 million would have been saved if workers would have been required to exhaust unemployment insurance benefits before receiving Trade Act cash payments. That estimate was based on workers eligible for benefits under petitions certified by Labor as of December 1977. However, the universe of petitions from which GAO drew the sample excluded petitions covered by previous GAO reviews (petitions in various industries in the New England States, some petitions involving Pennsylvania apparel workers, and some petitions covering workers in the

auto industry). The savings would have been somewhat more if also projected to these workers.

Recent Labor data indicates that the number of workers filing for benefits is continuing to increase rapidly. Therefore, it is reasonable to assume that potential savings which would result from adopting GAO's recommendations are substantially more than estimated in GAO's report. GAO has not formally projected potential savings through 1986, but we have no reason to dispute the Administration's projections.

Relevant GAO Reports. HRD-80-11, HRD-78-153, HRD-78-53, HRD-77-152, ID-77-28.

Contact: C. I. (Bud) Patton, 523-8701

President's  
Proposal - Place the Black Lung Trust Fund  
On a Self-Sustaining Basis

GAO Supplementary Discussion

GAO Views. As stated in the Administration's budget proposal, GAO's review of a random sample of 200 SSA re-reviewed and approved black lung claims indicated that, in 88.5 percent of the cases, medical evidence was not adequate to establish disability or death from black lung. SSA approved claims on the basis of affidavits, inconclusive medical evidence, and presumptions based on years of coal mine employment--all of which were legal under existing legislation.

Projecting the results of our sample, we estimated that successful claimants received retroactive lump-sum payments of about \$353.6 million, of which \$312.9 million was for claims that were not based on adequate medical evidence of disability or death from black lung. The same claimants also receive about \$79 million annually in monthly payments, of which \$69.8 million was not supported by adequate medical evidence of disability or death by black lung.

The Federal Coal Mine Health and Safety Act of 1969, as amended, permitted SSA to (1) accept statements by survivors of miners to establish disability or death from black lung, (2) approve claims when there was contradictory or inconclusive medical evidence, and (3) use presumptions based on years of coal mine employment to establish disability from black lung.

We believe that medical evidence should be the basis for determining disability and death from black lung. We also believe awarding benefits based on years of employment seems more appropriate for pension programs than disability programs.

SSA is no longer responsible for processing new black lung claims. However, the Department of Labor is responsible for the continuing administration of the black lung program. Although we believe that medical evidence should be used as the basis for determining eligibility for black lung benefits, we did not make any legislative recommendation in our report. That review covered only SSA's administration of the program. We are currently completing work on our Review of Labor's Administration of the Black Lung Benefits Program. Accordingly we are deferring any legislative recommendation until the completion of our current review.

We are currently making a Review of the Black Lung Disability Trust Fund. The principal objectives of this review are to determine (1) whether the Labor black lung trust fund model is analytically sound, (2) alternative solvency solutions for financing the trust fund, (3) what impact an increased excise tax will have on coal sales, and (4) what impact the charging of the entire cost of the

black lung benefits program back to the coal industry through the trust fund will have on coal sales and the trust fund.

Relevant GAO Report. "Legislation Allows Black Lung Benefits to be Awarded Without Adequate Evidence of Disability," HRD-80-81, July 28, 1980.

Ongoing GAO Work. Review of Labor's Administration of the Black Lung Benefits Program (Code 201635) Review of Black Lung Disability Trust Fund (Code 201610).

GAO Contact: Peter McGough, FTS 987-3138

Retirement Annuities

GAO Supplementary Discussion

GAO Views. GAO strongly endorses annual in lieu of biannual, cost-of-living adjustments for Federal retirees. We have advocated this since 1976 in reports to the Congress and in letters to and testimony before key congressional committees.

GAO has long been concerned about the inequities, illogical and inconsistent benefits, and the affordability of Federal staff retirement systems. The cost-of-living adjustment process is one of several extremely costly and generous features which raise serious questions about the continued viability of those systems. Many of the changes we have advocated, such as repeal of the 1-percent "kicker" and the so-called "look-lack" and "look-forward" provisions, have been adopted. Even with these changes, however, the inflation protection afforded to Federal retirees is far superior to that enjoyed by retirees of private industry and State and local governments.

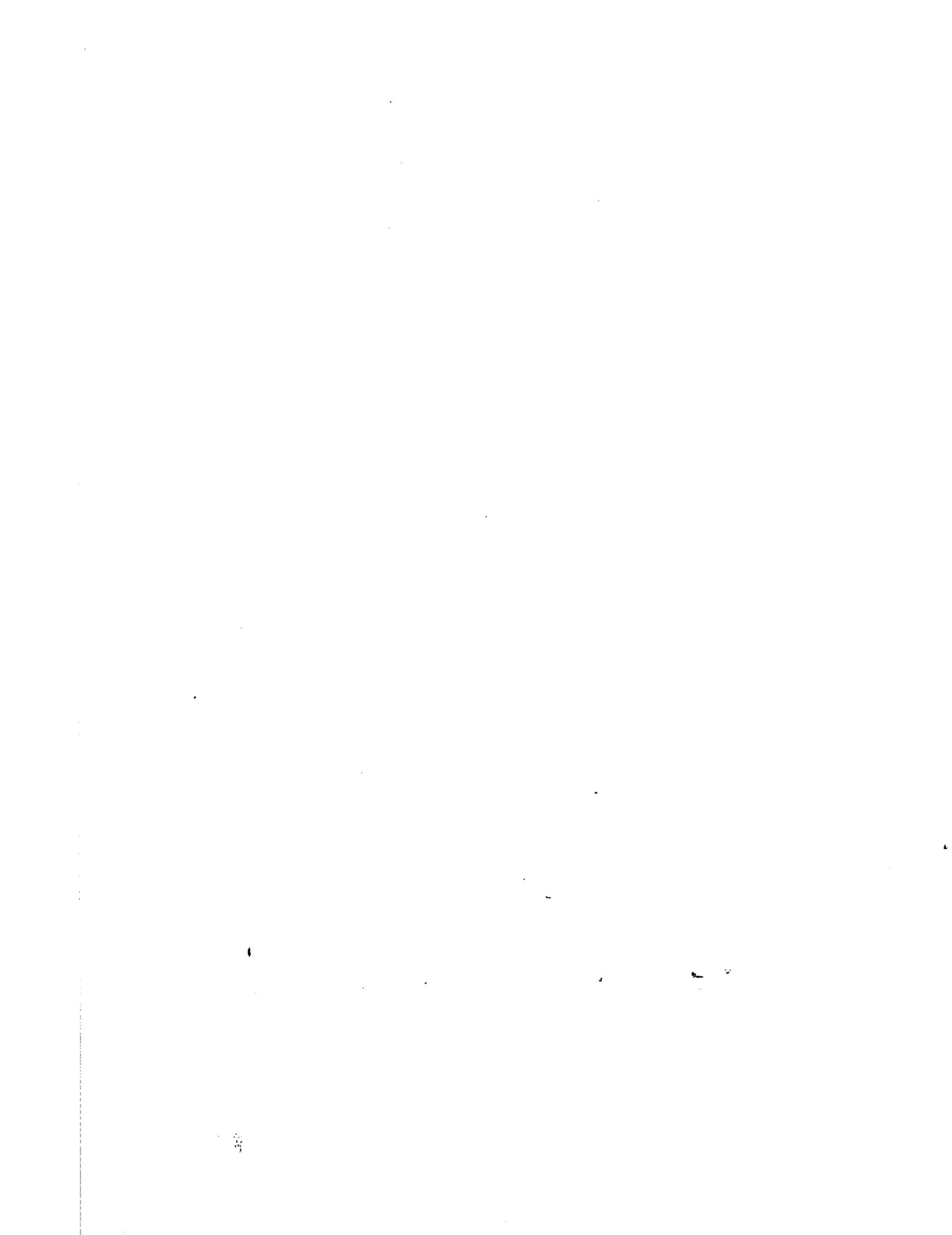
Federal retirees are the only group we are aware of who receive unlimited cost-of-living adjustments automatically twice a year. This is highly inequitable to others not similarly treated, costly, and should not be continued.

A new policy of annual adjustments would be more equitable and more consistent with prevailing non-Federal practices, with the process used under social security and many other Federal income security programs, and with the process used for adjusting the pay of active Federal employees. Also, it would reduce annual retirement outlays considerably. Moreover, from the Federal retiree's perspective, it would still fully protect the purchasing power of retirement income as the Consumer Price Index rises.

To fully satisfy the objective of making the Federal adjustment process more rational, more consistent with prevailing non-Federal practices, and less costly, however, an additional change needs to be made to limit the annual adjustment to something less than the full percentage increase in the Consumer Price Index. This is one of GAO's additional recommendations which are discussed later.

Relevant GAO Reports. FPCD-76-80, July 27, 1976; FPCD-78-2, November 17, 1977; B-130150, January 30, 1980; B-130150, July 1, 1980.

GAO Contact. Robert Shelton, 275-5743



**SECTION B.**  
**REDUCE MIDDLE-UPPER INCOME BENEFITS**

President's Proposal: Child Nutrition - Elimination of Subsidies  
for Middle and Upper Income Households

GAO Supplementary Discussion

GAO Views: In evaluating previous proposals to cut subsidies for the school feeding programs, we concluded that the Department of Agriculture could not determine the nutritional impact on those children dropping out of the program as a result of decreased subsidies. GAO still believes that insufficient evaluation has been conducted on these programs. A lack of evaluation makes it difficult--if not impossible--to determine the impact of cuts or additions to the subsidies. One possibility might be that cuts in predominately high income school districts might result in so few children eating school lunches that it would be prohibitively expensive to continue food operations for a small number of needy children. Prior GAO recommendations for evaluations of the child feeding programs have not been fully acted upon. Such evaluations would facilitate program and budget decisions such as the current proposals.

Ideally, program benefits should be determined by nutritional need. The current set of nutrition programs were developed over a number of years as particular needs were identified. While these programs generally compliment one another, they also are duplicative and compete with one another. A better approach for nutrition program implementation would be to identify nutritional need through a monitoring process, target programs to meet that need, and perform evaluation to determine if that need has or is being met. Although three monitoring programs exist, they operate separately and do not provide the necessary information. USDA and HHS have spent almost 3 years in developing a monitoring proposal which has not yet been finalized.

GAO has some concerns with the proposal to eliminate nutrition education and training grants. Food information and education programs offer an opportunity for improving nutritional status with relatively minimal cost. Food choices are becoming increasingly difficult due to the thousands of food items available, the increased cost of food, and changing lifestyles which promotes fewer meals eaten at home. These factors make good nutrition difficult to achieve at a time when the health benefits of nutrition are becoming increasingly documented.

GAO's current review of the nutrition and education training grants shows that this opportunity is recognized by the States but that improved management and administration could develop the program into an integrating force to bring public and private education efforts together to reduce duplication of information resources and to promote more effective use of existing food assistance programs.

Relevant GAO Reports: CED-79-5, CED-78-144, CED-78-145  
CED-78-75, CED-80-68, CED-80-138

GAO Contact: Bill Gahr (275-5525)



**SECTION C.**  
**RECOVER CLEARLY ALLOCABLE COSTS FROM USERS**  
**(INCREASE IN GOVERNMENTAL RECEIPTS)**

### User Fees

One of the Administration's budget criteria is the recovery of "clearly allocable costs from users," for which a number of user fee proposals are made. While GAO has some questions regarding these proposals, it agrees with the principle that those who benefit from publicly-provided goods and services should bear the associated costs. GAO suggests, however, that there may be other areas where user fees could be successfully applied, in addition to those cited by the Administration.

User fees need not be restricted to the recovery of "clearly allocable costs." They can also be used to sell or lease publicly-owned or controlled resources to users. For example, revenues collected from the sale of offshore drilling rights are not restricted to the Administrative costs of allocating these rights to users. They are more closely related to the value users place on these rights. Similar "user fees" could be applied in other areas.

One of these other areas, for example, is the broadcast spectrum, a scarce resource whose value to users likely exceeds the government's associated regulatory costs. Leasing portions of the spectrum to users at market value would generate revenues that could be used to offset these regulatory costs, with the balance placed in the general fund of the Treasury. There are arguments on both sides of the issue of spectrum charges, and GAO does not take a position either way. However, GAO does believe that the possibility of instituting such charges deserves congressional attention. (See, "Selected FCC Regulatory Policies: Their Purpose and Consequences for Commercial Radio and TV," CED-79-62, July 4, 1979, particularly pages 168-176.) There may be other areas where the government

is foregoing revenues it could collect for the use of scarce resources under its control. These would also deserve congressional attention.

GAO believes that it is both equitable and efficient that those who receive clearly identifiable benefits from the government pay for those benefits. While the fees they pay would usually be based on costs to the government, this need not always be the case. The government can subsidize beneficiaries of its activities by simply not charging the market value of the goods or services it bestows on them, regardless of the costs it actually incurs. Unless some public purpose is achieved by this subsidization (e.g., equity considerations may call for the subsidization of low income individuals), it should be eliminated where administratively feasible. For a discussion of GAO's position on this and other aspects of user charge policy, see: "The Congress Should Consider Exploring Opportunities to Expand and Improve The Application of User Charges By Federal Agencies" (PAD-80-25, March 28, 1980).

Contact. Craig A. Simmons, 275-3588

President's  
Proposal - ELIMINATE INLAND WATERWAY SUBSIDIES

GAO Supplementary Discussion

GAO Views. GAO agrees with the principle of full recovery of future expenditures on inland waterways, since this would be both equitable and efficient.

GAO pointed out in its November 1975 report that if user charges were kept at a rate that would not exceed 10 percent of existing barge rates--a rate sufficient to recover the waterways' 1973 operation and maintenance costs--some traffic diversion could be expected but most of the inland waterways shippers we interviewed did not believe this would result in any major diversion.

In a later report, GAO pointed out that the efficiency of inland waterways can be increased by changing the form of the charge from the present fuel tax to the use of congestion charges. Charges for waterways that cost more to construct and operate should be higher than charges for less expensive waterways. A fuel tax cannot accomplish this. However, segment charges which vary from one waterway to another can accomplish this.

In some cases, the operating costs of a waterway may be quite low relative to initial construction costs. In such cases, efficiency in waterway use can be enhanced by using a two-part tariff, which imposes a (commonly annual) fixed charge for access to the waterway, and a lower charge for each use of it. The fuel tax is, again, less efficient in these cases.

Finally, congestion charges should be used when demand for the use of a waterway exceeds its capacity. Such charges will even out demand, reducing or eliminating peak loads. Congestion charges may have to take the form of a tax, since they would not be associated with any cost incurred by the Government. The legal restrictions on implementing congestion charges should be fully explored prior to implementation.

Relevant GAO Reports: RED-76-35, PAD-80-25.

Contact: Hugh Wessinger, 275-5489 or Craig Simmons, 275-3588

Eliminating Subsidies for Airport and Airway Users (pg. 3-3)

GAO agrees that airport and airway users should pay for the services they receive from the government. It is both equitable and efficient that this be done. It is important, however, that the costs recovered are clearly identified, and that consideration be given to the method of cost recovery.

The costs recovered from users should not include past expenditures made by government to construct existing facilities. Only future construction costs, as well as operating and maintenance costs, should be included. Also, the charges imposed on users should be closely tied to the costs incurred on their behalf. If costs are not closely related to fuel consumption or the number of passengers carried, for example, then fuel and ticket taxes may not be the most equitable or efficient forms of user fees. The services provided by government should be clearly separated and, where practicable, charged for individually.

An additional cost consideration is that of delay created by peak use of limited facilities. Efficient use of these facilities can be promoted by employing time and location related fees to reduce congestion. For a more detailed discussion of such fees, see GAO's report: "Aircraft Delays At Major U.S. Airports Can Be Reduced" (CED-79-102, September 4, 1979).

GAO does not see the need for continuing the cross-subsidization of general aviation by commercial aviation. Unless there is some public benefit that is associated with general aviation, there is no equity or efficiency basis for the continuance of this subsidy. GAO suggests that the proposal to continue this cross-subsidization be closely scrutinized.

In summary, GAO agrees with the proposed cost recovery, but suggests that the method of charging users be examined more closely. It may be the case that equity and efficiency would be better served by some system of fees different from the various taxes that have been proposed. Also, the continued cross-subsidization of general aviation by commercial aviation should be examined. For a general discussion of equity and efficiency consideration associated with user fees, see GAO's report: "The Congress Should Consider Exploring Opportunities To Expand And Improve The Application of User Charges By Federal Agencies" (PAD-80-25, March 28, 1980).

Contact. Craig A. Simmons, 275-3588

President's  
Proposal - ESTABLISH BOAT AND YACHT OWNER FEES

Supplementary GAO Discussion

GAO Views. In an April 1980 report, GAO recognized the Coast Guard's inability to meet its legislative responsibilities with its limited resources. GAO identified serious problems with the number and condition of the Coast Guard's vessels, the number and experience of its personnel, and the condition of its shore facilities. Estimates of future needs show the need for substantial increases in funds to provide additional vessels and personnel to meet the Coast Guard's increased duties. GAO provided 5 alternatives for the Senate oversight committee to consider, considering that funds might not be available. One alternative was to charge users for Coast Guard Services.

GAO agrees with the Administration's proposal to establish boat and yacht owner fees. Such fees could be used to help cover the costs of operating the Coast Guard at the current level of services it provides. Given its large future needs, the fees could also be used to finance some of the vessel and personnel needs the Coast Guard has projected.

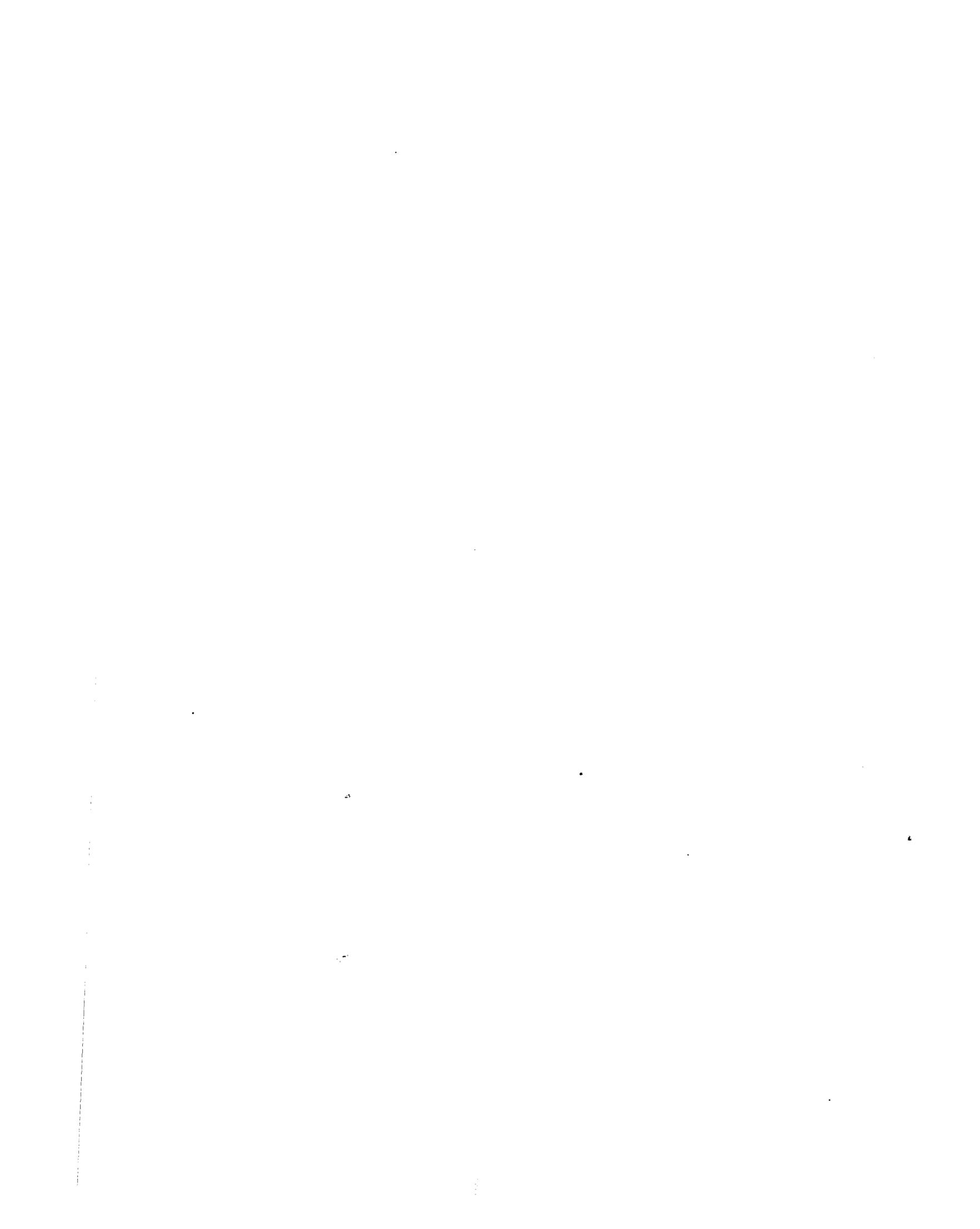
GAO's April report did, however, recognize certain disadvantages or difficulties in implementing a user charge system:

- Mariners requiring assistance at sea may hesitate to contact the Coast Guard if they know they are to be charged for services performed. As a result, mariner safety may be jeopardized.
- The users of some Coast Guard services--radio navigation services, aids to navigation, law enforcement, etc.--may be difficult to identify and it may be difficult to establish equitable charges for some services.
- Costs to implement and administer a user charge system (billing and collection, rate revisions, etc.) could be costly. Also, collection of charges may be a protracted and difficult task.

GAO believes the potential disadvantages or difficulties outlined should be taken into consideration in extending the user charge concept to the various Coast Guard programs.

Relevant GAO Reports: CED-80-76

GAO Contact: David L. Jones, 755-9100



**SECTION D.**  
**APPLY SOUND CRITERIA TO ECONOMIC SUBSIDY PROGRAMS**

President's Proposal: Reduction in Federal Subsidies  
for the Dairy Industry

GAO Supplementary Discussion

GAO Views. Most of the rapid increase in the milk support price has resulted from the formula for computing the parity price for milk. The formula does not adequately consider many economic factors affecting milk market conditions and includes some factors which have little to do with milk production. Alternative milk-pricing standards that could help solve or reduce the surplus problem and more effectively and equitably accomplish program objectives include: a dairy parity price standard; a cost-of-production standard; and a standard based on a comprehensive formula that systematically and simultaneously considers changes in cost of production, milk product stocks, and demand.

GAO believes that a comprehensive formula could eventually be used to adjust the dairy price-support level. Since research needs to be done before this approach could be used, the basis for setting the support price could be changed to either a dairy parity price standard or a cost-of-production standard. GAO believes that the dairy parity price standard would be the least disruptive to the industry.

GAO therefore recommended that the Congress authorize the Secretary of Agriculture, in conjunction with producer and consumer groups and with input from Congress, to perform research to develop a comprehensive formula that will balance the interests of producers, consumers, and taxpayers and then if appropriate, implement the formula. Until the formula can be developed, the Secretary should be authorized to (1) base the milk support price on 100 percent of the dairy parity price using a base period comparable with other national indexes, and (2) adjust the price-support level when Government purchases of dairy products exceed specified levels.

GAO favors the President's proposal to eliminate the mandatory increase in dairy price-support currently required by law on April 1, 1981. Producer returns have been more than adequate to maintain productive capacity. Dairy product prices have generally increased faster than average prices for all farm products while the average cost of producing milk has been relatively stable in recent years, actually decreasing during 1977 and 1978. GAO is not aware of details of the Administration's long-term reforms which are to be part of the comprehensive farm program package for this legislative session. However, GAO favors the proposed program's two basic objectives to avoid excess production and Government held surpluses and provide sufficient price support for the dairy industry to ensure adequate supplies of dairy products.

Relevant GAO Reports: CED-80-88, July 21, 1980

GAO Contact: Bert L. Williams (447-4949)

President's  
Proposal - ALCOHOL FUELS AND BIOMASS LOANS

GAO Supplementary Discussion

GAO Views. Although GAO has not specifically reviewed the Farmers Home Administration (FmHA) program, it recently completed work on the use of alcohol as a motor vehicle fuel. Based on this work, the administration's justification for terminating funds for biomass-derived alcohol fuels (that is, ethanol) projects seems correct. The justification essentially boils down to the following: (1) the technology for producing alcohol fuels is well-proven, (2) existing Federal and State subsidies amount to at least \$18 per barrel, and (3) removal of oil price controls makes alcohol fuels competitive with other energy forms. The administration further points out that the loan program could lead to excessive production of alcohol fuels from grain crops thereby causing adverse effect on food prices and agricultural export revenues.

As pointed out in the report on ethanol as a motor vehicle fuel, technological problems are not a major impediment to the current ethanol industry. The technology to be employed on projects supported by the Federal funding in question is well-proven. Moreover, existing tax policies provide a major subsidy to alcohol fuels. The waiver of the Federal excise tax on gasoline (when blended to produce gasohol) provides a subsidy of \$16.80 a barrel. This subsidy is supplemented in 25 States by further State gasoline tax waivers which provide additional subsidies of up to \$42 a barrel--in one State the subsidy is \$58.80 a barrel in total.

GAO believes that alcohol fuels should be more competitive with petroleum-based fuels in the future, even without the subsidies that are being proposed for termination. As noted in a June 1980 report, the existing price differential between ethanol and gasoline could be expected to decline as a result of the increasing gasoline prices and an expected decline in the real price of ethanol. The decontrol of oil prices should accelerate gasoline price increases and further enhance the competitive position of alcohol.

Further, excessive alcohol production from grain crops could have an adverse effect on food prices. Alcohol production beyond a level of 2 billion gallons a year could disrupt the agricultural industry and cause sharp increases in the prices for food and feed grains. Alcohol production at a level sufficient for a nationwide gasohol program (about 11 billion gallons) would have to use cellulose technology which is currently in the research and development phase and which is not planned for use in plants currently planned for construction.

Finally, another form of alcohol fuels (methanol)--which is derived primarily from coal and hence would not be affected by this proposed reduction--has greater potential than ethanol to

replace gasoline. Methanol can be produced in much vaster quantities and potentially at considerably less cost. Accordingly, there is a concern that excessive subsidies for ethanol production and use could result in an economically unjustified commitment of resources to ethanol, which has less potential than methanol. Reducing ethanol subsidies, therefore, could serve to head off this potential problem.

Relevant GAO Reports. EMD-80-73 and EMD-80-88

GAO Contact: Thomas E. Melloy, 353-5711

REDUCTION IN FEDERAL FINANCIAL ASSISTANCE TO COOPERATIVES

AND PRIVATE COMPANIES ASSISTED BY THE

RURAL ELECTRIFICATION ADMINISTRATION (REA)

GAO Supplementary Discussion

GAO Views: GAO has issued two recent reports on REA. The latest report issued on November 28, 1980, stated that electric generation and transmission cooperatives could need from \$12-16 billion in capital financing by fiscal year 1990 and that without a change in present policies, nearly all of this financing could come from the Federal Government. This is because the Federal Financing Bank, which is a wholly owned Government corporation that receives its funds from the U.S. Treasury, is being used to fund almost all the loans REA guarantees for electric generation and transmission cooperatives.

GAO recommended that REA require borrowers to rely more on the private sector for their financial resources. GAO pointed out that alternative credit sources were available and recognized that such financing could involve somewhat higher interest rates. However, GAO expressed the belief that greater reliance on private credit is needed to (1) avoid placing a major burden upon the U.S. Treasury, (2) help ensure that power supply systems have an alternative source of credit in the event the Government is unable or unwilling to fund the cooperatives' increasing capital requirements, and (3) be more in line with the Congress' objective of encouraging private credit sector involvement in the REA guarantee program.

GAO also stated that if the private credit sector became more involved in REA's guarantee program, then the law should be changed to (1) reduce the percentage of REA's loan guarantee to something less than 100 percent and (2) permit REA to charge a loan guarantee fee. With the 100 percent loan guarantees now authorized by law, private lenders would not be exposed to risk and thus the normal incentives for them to carefully evaluate the applicant's prospects and provide adequate loan servicing would be absent. GAO believes the guarantee fee is needed to fund a reserve for losses.

In its May, 30, 1980, report, GAO stated that many rural electric distribution systems continue to need REA subsidized loans and that some may need even more assistance to help them charge electric rates comparable to those of their urban counterparts. But GAO stated that other electric distribution systems now assisted by REA subsidies could qualify for and obtain long-term credit at reasonable rates and terms from other sources and still charge comparable electric rates. The problem is that REA needs criteria to (1) identify financially sound electric distribution systems able to qualify for non-REA credit and (2) determine whether such distribution systems need subsidized

loans to charge reasonable electric rates. In addition, GAO found that REA's loan-making criteria do not adequately correlate the type and/or amount of subsidized loans REA will provide with the borrower's needs. As a result, borrowers that have high costs, which generally lead to higher electric rates, can receive the same subsidy or even less than borrowers with low costs and rates. GAO recommended that REA develop criteria to address these problems.

GAO also reported that many REA distribution borrowers had low equity levels which hinders their ability to obtain private credit. GAO said that REA could do more to encourage borrowers to achieve the minimum equity levels necessary to qualify for private credit and recommended that REA (1) establish minimum equity goals for borrowers, (2) require borrowers to develop plans to achieve established equity goals, and (3) ensure that borrowers' electric rates are, where practical, sufficient to generate the income needed to meet the equity level objectives in the plans.

Relevant GAO reports: CED-81-14, CED-80-52.

Contact: Thomas J. Storm (447-6947)

Department of Agriculture

President's  
Proposal - REDUCTION IN FARMERS HOME ADMINISTRATION

DIRECT LENDING ACTIVITIES

GAO Supplementary Discussion

GAO Views: On January 30, 1981, GAO reported that USDA's Office of Inspector General (OIG) had found that many of its past audits of FmHA programs had reported the same general problems--inadequate review of loan applications, inadequate servicing of loans and delinquent accounts, and inadequate review of borrowers to determine if they should be graduated to commercial credit sources. The OIG attributed many of these continuing problems to the imbalance between the size and complexity of FmHA programs and the size and skills of its staff. GAO concluded that if FmHA was to correct program deficiencies, it would need a better balance between its staffing and program activities. This could be accomplished either by increasing FmHA staffing or reducing its lending activities.

GAO's August 6, 1979, report showed that a significant amount of emergency disaster assistance loans were made at interest rates well below the Government's cost of money. Also, GAO found that many of the loans in its sample apparently went to borrowers who could get credit from other sources. This was true for FmHA even though FmHA has a test to screen out applicants who could get credit elsewhere. GAO found that FmHA's test was widely ignored or received only cursory attention.

GAO's March 28, 1980, report states that meeting the rural housing demand beyond 1980 may be difficult because of problems such as shortages of (1) rural mortgage credit, (2) housing assistance for low- and moderate-income families, particularly in remote areas, and (3) affordable building sites. The report discusses (1) how rural families receive less Federal housing support than urban families, (2) the need to increase the supply of rural mortgage credit, (3) the growing problem that homeownership is for moderate-income rural families, and (4) some of the opportunities available for FmHA to improve its rural housing programs.

Also, the report shows that the elderly are increasingly occupying substandard housing in both rural and metropolitan areas and discusses some of the difficulties of providing housing for them. Some of these difficulties include the scarcity, expense, and inconvenience of rental apartments in rural areas. In addition, the report states that renters occupy half of the substandard rural housing, which is higher than the rate that did in 1950. Age and condition of the units and renter incomes were three factors contributing to this problem.

GAO reported on August 19, 1980, that many existing rural central water systems have deteriorated and need to be repaired or replaced. Other systems need to be expanded; in some rural places additional systems need to be developed. The most

important factor inhibiting the development, expansion, repair, and replacement of central systems is a lack of money. Although both Federal and State governments provide financial aid for rural central water systems, GAO reported that the needs of rural America are greater than the funds available. GAO also reported that no one really knows the full extent of rural water development problems or the cost of solving them, although a number of studies were underway to determine this.

GAO recognizes that some communities that received FmHA water and waste disposal loans may have had the ability to finance their systems from other credit sources. But in a September 1, 1977, report, GAO pointed out that the lack of documentation in FmHA files prevented GAO from determining whether FmHA was complying with the credit elsewhere provisions of the water and waste disposal program.

Relevant GAO reports: CED-81-56, CED-80-1, CED-80-120  
CED-79-111, CED-77-116.

Contact: Thomas J. Storm, (447-6947)

Department of Commerce  
Appalachian Regional Commission

President's

Proposal - REDUCTIONS TO ECONOMIC AND REGIONAL DEVELOPMENT PROGRAMS

GAO Supplementary Discussion

GAO Views: Economic Development Administration. The fundamental goals of the Economic Development Administration (EDA) are to save and create jobs and increase incomes in economically distressed areas, and help institutions in those areas develop the capacity to plan and carry out effective economic development programs. GAO has issued several reports to the Congress on the management of the grant and loan programs administered by EDA. The central message discussed in these reports was, while EDA programs help to improve depressed areas' economies, they could be made more effective through improved management. The latest report, issued on December 2, 1980, assessed the impact of EDA-funded industrial parks. Through fiscal year 1979, EDA had funded 1,130 park projects at a cost of \$519 million. GAO found that while industrial parks help improve the economies of depressed areas by creating and saving jobs, many parks had not attracted businesses, were not well utilized, and had not created nearly as many jobs as anticipated. The report made several recommendations for correcting these problems through improved EDA management.

The Administration cited studies indicating that the total cost for each job directly created by an EDA development grant was between \$60,000 and \$70,000. In the above cited report, GAO computed the direct cost of a job created or saved through EDA-funded industrial parks at \$1,528. Moreover, in a report on measuring accomplishments under the business development assistance program, issued September 6, 1979, GAO computed the direct cost of a job created or saved through direct or guaranteed loans to businesses at \$6,688. While there is a wide discrepancy in the estimates, the computation of the cost of jobs saved and created is highly subjective because of the difficulty in documenting what would have happened without EDA assistance. Basically, GAO gave EDA credit for creating jobs when a business was established or expanded after EDA assistance and for saving jobs when a business claimed it would not have stayed in the area or would not have remained in business without EDA's assistance.

GAO recognizes that the cost of jobs saved and created could have been substantially higher had credit not been given for merely encouraging a business to stay in the distressed area where it was located, had total Federal assistance to the businesses been identified, and had cost been adjusted for inflation. GAO cannot; therefore, comment on the reasonableness of the \$60,000 to \$70,000 cost per job figure cited. It does, however, seem rather high.

GAO Views: Appalachian and Title V Regional Commissions. The Appalachian Regional Commission (ARC) was created as a national experiment in comprehensive Federal-State-local development planning aimed at correcting economic and social imbalances between

Appalachia and the rest of the Nation. On April 27, 1979, GAO issued a report to the Congress on the non-highway programs of the commission. The report concluded that despite the commission's contributions to the development of the Appalachian region, major problems have limited its success in meeting national objectives. For example, we found the commission's planning process to be incomplete at the multistate level because ARC's policy does not require States to address economic and social problems consistently when preparing their plans. Rather, ARC allows individual States to select which problems to address and which to omit. This discretion leaves a gap in the Federal-State-local approach which the commission was intended to demonstrate. In addition, we found that inadequate written guidelines for State and district planners have permitted planning deficiencies to continue.

Aside from these problems, we also reported that (1) program goals and objectives at all planning levels are inadequate to measure progress, (2) allocation procedures appear inequitable and inefficient resulting in the likely underfunding of some States while overfunding others, (3) administrative controls are inadequate for documenting and reporting on the disposition of Federal funds, (4) commission policy does not adequately address declining State financial support of the commission's non-highway programs, and (5) program evaluation is inadequate to ensure that ARC funds are having the greatest impact on solving regional problems. Although we did not recommend the elimination of ARC, we did conclude that it would be premature to consider expanding the commission concept nationwide, at a projected cost of \$1.5 to \$2 billion annually, until the issues discussed in our report were thoroughly considered and resolved. We pointed out in our report, that ARC did not have a system for determining which geographic areas no longer needed ARC assistance. In this connection, ARC's Deputy Executive Director commented that as many as 140 of Appalachia's 397 counties may no longer require ARC assistance.

Like ARC, the Title V Regional Commissions were created as Federal-State partnerships in an experiment for solving multi-State problems. On March 26, 1974, we issued a report on selected activities of 3 Title V regional commissions and ARC. Although more narrow in scope than our review of ARC, this report documented similar problems with the administration of these commissions. In addition to our work, the Office of Inspector General, Department of Commerce, issued a report on February 28, 1979, on the performance of all Title V commissions. This report discussed administrative deficiencies similar to those cited in our reports.

Relevant GAO reports: EDA: CED-79-104, CED-79-117, CED-81-7,  
FGMSD-78-34, and FGMSD-78-62.  
ARC: CED-79-50 and GGD-74-44

Contact: Robert E. Allen, Jr. (377-5483)

ADMINISTRATION BUDGET PROPOSALS FOR ENERGY PROGRAMS  
OVERALL ISSUES

The administration's proposals on energy imply a fundamental reorientation of the Federal Government's role in energy policy and programs. While it is important to analyze each separate proposal, it is perhaps even more important for the Congress to understand the broader implications and to consider carefully the basic issues raised by this reorientation.

This paper briefly discusses the more important assumptions which guide the administration's approach to energy policy and programs and the issues GAO has identified based on its past and ongoing work which should be considered by the Congress. Individual proposals on energy have been separately analyzed by GAO in terms of its completed and ongoing work and specific comments provided.

Administration assumptions

Although the administration's proposals lack sufficient detail to permit complete analysis, several underlying assumptions seem apparent about national energy policy and program direction.

1. Principal reliance should be placed on private market forces in achieving energy goals. Specific reference is made to oil and gas deregulation as providing sufficient incentive for private sector actions in fossil fuel research and development, synthetic fuels, and greater use of conservation and solar alternatives.
2. Consistent with the assumption about private market forces is the view that, when additional incentives are needed, particularly for conservation and renewable programs, the best way to provide them is through tax incentives.
3. Also consistent with the assumption about private market forces is the belief that regulations should be deemphasized or eliminated as a method to bring about changes in patterns of energy production and use. This view extends not only to oil and gas price regulation, but also to regulations dealing with efficiency of energy use in buildings and appliances.
4. Government's appropriate role with respect to technology development is in the area of long-term research and development. As efforts move closer to commercialization, the Government role should be curtailed and private market forces used to make any decisions on commercialization. The implication is that direct Government involvement in energy research and development in costly near-term activities, such as construction and operation of pilot and demonstration plants would be eliminated or reduced.

Using these assumptions, the administration's proposals can be broadly categorized as follows:

--Most synthetic fuels efforts will be centered in the Synthetic Fuels Corporation. Present Department of Energy efforts to demonstrate synthetic and other fossil fuel technologies will be curtailed and the Corporation will have to decide whether or not to support any of these efforts. Corporation efforts are expected to center on the use of loan and price guarantees for projects, to provide a "safety net" and thereby induce private investment in projects where questions exist about the price competitiveness of the end product or the technology.

--Although specifics are lacking, Department of Energy efforts in areas like solar and fossil are expected to concentrate on long-term research and development, while near-term demonstration programs for some proven technologies are eliminated. Programs to provide loans or loan guarantees to help commercialize alcohol fuels, low-head hydropower, and solar are to be reduced or eliminated.

--Higher energy prices in a deregulated environment and tax incentives to further influence market decisions are seen as the key to effective conservation efforts. Low-income weatherization, the Solar Energy and Conservation Bank, building performance and appliance efficiency standards, and programs to help utilities to do better planning and adopt regional rate structures are reduced or eliminated.

--Staffing for phasing out DOE's enforcement programs and resolving violations and litigation involving oil price regulations is reduced substantially.

#### Issues for congressional consideration

While our analyses of the administration's proposals indicate a general agreement in many areas, there are also areas of concerns with respect to specific proposals. Also important are the fundamental energy-related issues raised by the Administration's assumptions, which the Congress should also consider. In some cases, the issues are raised by the thrust of the administration's proposals; in other cases, they are raised by the implications of the proposals for related areas not addressed directly in the proposals.

1. Collectively, the administration's assumptions imply that deregulation of oil and gas prices and accelerated Federal

leasing may lead to increased domestic oil and gas production. While higher prices should lead to greater production than may be otherwise available, the United States is not likely to reverse the long-term decline taking place in domestic oil and gas production since the early 1970's. Absent effective conservation efforts and developments in other areas of energy production, the Nation could end up substantially more reliant on imports in the years ahead. (Recent GAO work, based on fundamental resource considerations, described likely trends in domestic oil and gas production through the year 2000--EMD-80-24, December 7, 1979.)

2. Many of the administration's proposals refer to natural gas deregulation. While deregulation could result in some increase in production from existing fields and further encourage conservation, it would also substantially increase consumer costs in the short term, and could cause some industrial users to switch to alternative fuels, including oil. Residential customers would have to absorb a greater share of the system costs. The Congress would have to weigh carefully the advantages and disadvantages of accelerating the existing schedule of deregulation, whereby almost all categories of natural gas would be deregulated by 1985. The anticipated cost increases would be much larger than those resulting from oil price decontrol, because a relatively small amount of oil remained under controls and because controls would have expired in any case by October 1981.

3. The administration's proposals repeatedly refer to the Government's responsibility for long-term research and development, without defining specifically what is meant by long term. It will be difficult to draw this distinction, particularly as research and development moves towards the high-cost projects needed to demonstrate technical feasibility on a reasonable scale. In any case, industry may not be willing to underwrite the risks where technology is uncertain and cost-effectiveness in an equally uncertain energy world is not clear. In essence, the issue of how far the Government may want to go in demonstrating commercial feasibility of a particular technology can be influenced by a variety of factors, including not only cost-effectiveness but also national security concerns and institutional constraints, which private market forces may not be willing or able to respond to in the short term. In summary, what is defined as long-term research and development will be important with respect to synthetic fuels, other fossil research, nuclear, solar, and many other program areas.

4. Related to the third issue are possible national security arguments for Government efforts to further breakthroughs in technologies which are not yet cost-effective, but which offer substantial possibility for reducing U.S. reliance on imported energy sources. This was the principal justification for the synthetic fuels program, as well as for other programs to spur

energy activity where private market forces and tax incentives may not yet be adequate.

5. A considerable amount of GAO work on various conservation, solar, geothermal, and fossil programs has identified institutional constraints which may impede the effectiveness of private market forces and tax incentives to influence otherwise desirable actions to bring on line energy technologies which are proven and cost-effective. For example, some solar technologies are cost-effective but have a high initial cost and result in a pay-back only over several years. The relative effectiveness of tax incentives at different levels versus low-interest loans has yet to be measured adequately.

6. The substantial cut in that part of the regulatory budget devoted to enforcement of oil pricing regulations could imply a phasing out of efforts before decisions are reached to resolve over \$9 billion of potential price violations still outstanding. The question of the need to resolve all potential violations in an acceptable, yet timely, manner involves considerations of equity--between companies that complied with the regulations and those that did not and between companies that have settled complaints about overcharges and those that have not--which should be carefully considered.

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The variety of charges and other public discussion also gives rise to questions about the future role of the Department of Energy. Before the Department was created in 1977, GAO supported the need for a Department of Energy and Natural Resources, and subsequently a Department of Energy, for the purposes of bringing about a central focus on long-term resource problems of national importance that its work indicated would require attention for years to come (EMD-77-31, March 24, 1977). GAO's work predating DOE indicated that the Government's energy work, then scattered throughout several agencies, resulted in uncoordinated, and less than effective, programs.

Although the Department has experienced many problems in its first few years, GAO still believes that over the long term a coordinated focus on energy is necessary. Whatever the disposition of the administration's energy proposals, substantial programs are likely to remain intact--including the Strategic Petroleum Reserve, nuclear programs, and to some extent fossil, conservation, and renewables programs. Moreover, a vital area which still needs substantial attention where GAO is currently completing work, is energy emergency planning.

In summary, it is still GAO's view that a central focus on energy is needed, either within a Department of Energy or as part of a new Department of Energy and Natural Resources designed to focus not only on energy but also on developing long-term policies for all fuel and non-fuel resources.

## SYNTHETIC FUELS

### GAO Supplementary Discussion

GAO Views. GAO has preformed numerous reviews pertaining to synthetic fuels. This work indicates that a synthetic fuels industry will be capital-intensive, complex, and technologically novel, and should not be expected to significantly contribute to reducing oil imports before the late 1980s. Nonetheless, since oil supply problems will almost certainly recur and may become even more serious in the 1980s, 1990s, and beyond, a national commitment to reducing the Nation's dependence on imported oil appears warranted. Synthetic fuels should contribute to reducing this dependence. Accordingly, the Government should establish an atmosphere that will encourage private industry to invest in and operate synthetic fuels plants.

To encourage the building of plants, the Congress created the Synthetic Fuels Corporation (SFC). GAO has supported the concept of the Corporation. Goals were estimated for the Corporation--to promote synthetic fuels production equivalent to 500,000 barrels of oil per day by 1987 and 2 million barrels per day by 1992. However, these goals may prove to be overly optimistic. For example, in commenting on the previous administration's illustrative goals of 1.0 to 1.5 million barrels per day of synfuels from coal by 1990, GAO stated that a more likely level was about 1 million barrels per day. Building the 15 to 25 plants required to produce this quantity of synthetic fuel, as well as in mining the coal needed to feed the plants, would require gathering and deploying massive amounts of capital, manpower, and equipment.

GAO has also expressed concern about the technical mix used to reach these goals. Although only a limited number of reasonably proven (first-generation) processes are currently available, a number of new (second-generation) technologies are now under development; the latter are widely believed to be more efficient and less expensive. Such new processes must, however, be demonstrated using commercial-sized equipment before commercial operation can be expected. Since these new technologies will not be commercially available for some time, GAO believes that reasonable production targets should be established to allow the Corporation some flexibility to adapt to new more efficient technologies as they become available and to avoid an overcommitment to the less efficient first-generation technologies. In this regard, a recent report stated that if any portion of the national goals for synthetic fuels is to be met with coal liquefaction, the bulk of the production is likely to come from existing indirect processes.

One way to avoid overcommitment to existing technology would be to establish more modest goals for the Corporation and to encourage the construction of plants that would employ a variety of technologies. Doing so would reduce the risks and costs,

while still maximizing the value of the program. This effort could find definitive answers to economic, environmental, socio-economic, technical, and other questions which persist concerning synthetic fuels production. The experience and information gained from such a varied program would facilitate the selection of technologies for further commercialization and the development of updated goals for synthetic fuels' contribution to solving the Nation's energy problems.

In addition to building plants utilizing a variety of processes, GAO has stated, it may be prudent to allow the Corporation to perform some R&D, since bringing currently unused technologies on stream will surely entail the demonstration and improvement of those technologies.

Corporation efforts are expected to center on the use of loan and price guarantees for projects providing a "safety net" to induce private investment in high risk projects where the price competitiveness of the end product is uncertain. This approach is somewhat consistent with GAO's position. However, GAO has stated that loans and loan guarantees may not in themselves induce private firms to produce synfuels. A more certain way to assure synfuel production is to provide a price guarantee coupled with a purchase guarantee. Details of specific projects would have to be considered before final judgments could be made regarding the most appropriate financing mechanism.

GAO's positions on the surface may appear somewhat consistent with the administration's proposal to transfer responsibility for construction of pilot and demonstration plants from DOE to the Corporation. However, GAO would caution that the Corporation is primarily production-oriented, with very ambitious goals to meet. Considering these goals, sponsors of demonstration plants may not be able to compete for Corporation funding with sponsors of projects using commercially available, first-generation technologies. Also, it has not been shown that private industry would be willing to fund construction of the high-cost, capital-intensive plants to demonstrate the more advanced, yet riskier technologies. If neither private industry nor the current production-oriented Corporation supports the necessary facilities, the Nation may be committed to less efficient and more costly technologies. If the responsibility for construction on these plants is transferred to the Corporation, GAO believes that it would be prudent to establish more modest and reasonable production goals, and to clarify the Corporation's policy regarding assistance in the construction of demonstration and other facilities.

Relevant GAO Reports. EMD-79-99, EMD-79-107, EMD-80-18,  
EMD-80-84, and EMD-81-36

GAO Contact. Flora Milans, 353-3408

President's  
Proposal - FOSSIL ENERGY

GAO Supplementary Discussion

GAO Views. The administration plans to revamp DOE fossil energy research and development to eliminate or reduce involvement in costly near-term activities, such as construction and operation of pilot and demonstration plants using company-specific processes. By relying on private market sources and assistance of the newly created Synthetic Fuels Corporation, the administration believes near-term technology demonstration and commercialization activities can proceed without direct Federal funding. DOE activities would consist only of supporting long-range research and development.

The administration needs to define near-term and long-term research by referring to the specific technologies and the timeframe in which they can be expected to make a contribution to energy supply. Referring to near-term activities as including construction and operation of pilot and demonstration plants using company-specific processes, beclouds the key issue of the status of the technology and the timeframe in which commercial production may be expected to occur. The broad array of synthetic fuel technologies require varying lead times and investment levels to resolve technical and environmental uncertainties prior to commercialization.

For example, GAO's work on coal liquefaction technologies concluded that since the "direct" liquefaction processes have operated only in small test facilities, successful operations in larger-scale plants are needed to reduce technology, health, and environmental uncertainties before commercialization is viable. Further, it is unlikely that any commercial "direct" liquefaction plants will be operating in the 1980s. By contrast, three "indirect" liquefaction processes are commercially available and may contribute to U.S. energy supply in the near term.

Current work in the high-Btu coal gasification area suggests that 10 years of Government support of the R&D pilot plants has brought few answers about actual commercialization and that the pilot and demonstration plant activities planned for the next several years will likely offer few more.

It is too early to tell whether private industry, on its own, will invest in synthetic fuels R&D and eventually introduce new technologies as a result of decontrol of energy prices and tax and regulatory relief. If much of DOE's synthetic fuels R&D programs is eliminated, it will be critical that the new Synthetic Fuels Corporation demonstrate production of synthetic fuels using several technologies.

GAO has issued several reports concerning DOE's management of fossil energy research and development programs and the status and problems in advancing the technologies being

developed by DOE. GAO has recently made recommendations for improvement in the management of coal liquefaction projects and the fluidized-bed combustion and magnetohydrodynamics program. In addition, GAO has discussed the status, potential, and problems to be overcome in commercializing unconventional sources of natural gas, magnetohydrodynamics, fluidized bed combustion, and coal liquefaction processes which may assist the administration and the Congress in their deliberations over specific fossil energy research and development budget reductions.

Relevant GAO Reports. EMD-79-99, EMD-79-107, EMD-80-8  
EMD-80-12, EMD-80-18, PSAD-81-19

GAO Contact. Flora H. Milans, 353-3408

## SOLAR ENERGY

### GAO Supplementary Discussion

GAO Views. In recent years, GAO has issued a number of reports that have dealt, in part, with the Federal role in developing various solar energy technologies. Other reports concerned the roles of Federal laboratories and the roles of the Solar Energy Research Institute (SERI) and the regional solar centers. In addition, a current review focuses on the planned construction of SERI's permanent facility.

The administration has proposed to shift the Department of Energy's (DOE's) solar activities away from near-term development, demonstration, and commercialization efforts, to long-range research and development projects that are too risky for private firms to undertake. This budget proposal would reduce DOE's solar spending by more than 60 percent in fiscal year 1982. GAO agrees, in principle, that emphasis should be on long-term, high-risk research and development and that, as solar technologies proceed toward commercial viability, the Federal role should be phased out and eventually eliminated.

Although information is not yet available on the specific solar projects or programs to be eliminated or reduced, GAO is concerned that the administration may be seeking to terminate the Federal role too abruptly. With respect to the roles of Federal laboratories, for example, the degree of Federal participation in the various phases of development--basic and applied research--should diminish, and industry's role increase, as work progresses toward commercialization. However, no clear cut division between the various research, development, and demonstration phases is evident. Instead, the categorization of a given activity into a particular phase is based on the judgments and perceptions of those making such a categorization. Thus, deciding what efforts are long-term or near-term research and development cannot be easily done.

While the Federal role should decline relative to industry's increased role, some degree of Federal effort should be maintained during the engineering development and demonstration phases to remove any existing barriers and help transfer to industry the knowledge gained during the research and development phases. Even if oil price decontrol and tax incentives make solar more economically attractive, other problems still need to be resolved before widespread use of a solar technology can be obtained.

A July 1979 report stated that, in addition to economic constraints, other constraints need to be resolved to successfully commercialize solar heating systems. There is a lack of warranties to protect consumers from poorly designed and improperly installed systems and from systems that are falsely advertised. Institutional constraints such as the reluctance of lending institutions to finance solar systems, utility rate structures and insurance rates also need to be resolved. Finally,

regulatory and legal constraints--such as sun rights, building codes and property tax losses--could impede widespread use of solar heating. The nature of these constraints makes it difficult for the solar industry, which currently includes many small companies, to resolve such problems without Federal assistance.

Four GAO reports on various solar demonstrations recognized that the Federal Government appropriately has a role in solar demonstrations. Although management deficiencies hindered the effectiveness of the demonstrations, with management improvements the demonstrations can be an effective mechanism for advancing solar technologies from research and development to the market place.

GAO agrees with the administration's proposal to defer the construction of the SERI permanent facility. Although over 6 years have passed since the Congress authorized the creation of SERI, much confusion remains over the role it is to play in DOE's solar programs. A current assignment has found that over 2 years and \$3 million have been spent on the design of the permanent facility without the benefit of a clearly defined role or long-term plan for its use. Accordingly, funding of the facility should be deferred until the mission of SERI is better defined and an appropriate staffing level is agreed upon.

With a proposed reduction of over 60 percent, it appears to us that Federal efforts to advance certain solar technologies may be terminated without complete consideration of desirable actions to reduce institutional and other constraints and to improve opportunities for broader commercial application.

Relevant GAO Reports. EMD-78-62, EMD-80-106, EMD-79-19, EMD-78-40, EMD-79-55, EMD-79-84, and EMD-80-41

GAO Contact. Thomas E. Melloy, 353-5711

GAO Supplementary Discussion

The administration proposes to reduce subsidies for a variety of energy supply programs. Discussed below are: geothermal loan guarantees, geothermal commercialization, energy impact assistance, energy storage systems, uranium resource assessment activities, and small hydropower demonstrations.

Geothermal loan guarantees

GAO Views. The administration proposes to terminate geothermal loan guarantees that serve merely to reallocate capital from more productive investments. It is not clear what the administration means by "more productive investments." It could mean any investment which would need a loan guarantee, and therefore, would encompass all geothermal loan guarantees. If this is the case, GAO disagrees.

Although GAO has generally held the position of being against loan guarantees because of their off-budget nature, the geothermal loan guarantee program has helped industry pursue geothermal projects and helped accelerate geothermal development and use.

GAO reported in January 1980 that the program had achieved only a limited effect on accelerating geothermal development and use; however, since that time industry's interest in participating in the program has increased. Five projects are now underway which otherwise might not have been started or might have been started only at some later date. In addition, three applications for loan guarantees are currently being considered by the Department of Energy and another 15 applications are expected to be submitted to the Department during the next 12 months.

GAO reported that the uncertainties and risks involved in high cost geothermal energy projects, along with the financial community's unfamiliarity with such projects, made it impossible for medium- and small-sized companies to obtain loans for such projects without Government loan guarantees. These companies lack the collateral to secure such loans and financiers are unwilling to make unsecured loans due to the uncertainties and risks. Thus, the program has been successful in getting industry involved in a new energy source and is serving a useful and productive purpose.

GAO believes that the geothermal loan guarantee program should be continued under carefully monitored conditions and brought to an orderly conclusion as soon as its primary objective of establishing normal borrower-lender relationships (between developers and the financial community) is achieved.

This program, it should be noted, is scheduled to be terminated by law in 1984.

Relevant GAO Report. EMD-80-26

GAO Contact. Thomas E. Melloy, 353-5711

### Geothermal commercialization

GAO Views. The administration appears to propose eliminating funding for certain geothermal commercialization activities and to phase out hydrothermal demonstration and commercialization efforts and to reduce component development. However, from available documentation, it is not clear which specific projects or activities are to be eliminated. GAO would point out, however, that careful consideration needs to be given to those geothermal demonstration and commercialization activities which are promising but would not be undertaken by the private sector.

GAO reported that geothermal development has proceeded slowly and private industry's development efforts have been limited to a few projects concerning high quality hydrothermal resources. Industry has made only limited efforts to develop other resource areas due to the high costs and financial and technical risks associated with such development.

GAO believes that Government-supported demonstration and commercialization activities are still needed because economic and technical uncertainties still exist with respect to lesser quality geothermal reservoirs. While Government support should be phased out as industry becomes involved and more becomes known, federally supported demonstration and commercialization activities will be needed for a while. Even with deregulation raising the prices of petroleum products to the point where hydrothermal/geothermal energy is more economically competitive, industry and the financial community will still have to be convinced of the economics through demonstration and commercialization activities.

A Government-supported demonstration project which may be needed to accelerate the use of geothermal energy, but which may be included in the administration's proposed cut is the binary geothermal demonstration project. This project is aimed at ultimately demonstrating a technology that has not been used anywhere in the world and is expected to be suitable for a major portion of the geothermal resources in the United States. Industry has indicated that a demonstration of this technology is needed to prove the technical viability of the binary technology, plus the economic, environmental, and social acceptability of the related geothermal plants. Without a demonstration, the use of geothermal energy as a replacement of fossil fuels will be slowed, since developers, utilities,

and the financial community will not make large-scale commitments to unfamiliar technologies until evidence is gained from commercial demonstrations.

Relevant GAO Reports. EMD-80-36 and EMD-80-26

GAO Contact. Thomas E. Melloy, 353-5711

### Energy impact assistance

GAO Views. The administration proposes to reduce funding in FY 1981 from \$62 million to \$10 million, with no funds for FY 1982, for the Department of Energy's program under section 601 of the 1978 Powerplant and Industrial Fuel Use Act. The administration proposal states that this reduction would eliminate energy impact assistance grants to States that duplicate other Federal programs and unnecessarily assume responsibility for activities that are more appropriately undertaken by State and local Governments.

The question of whether there are unanswered socioeconomic needs at the local community level as a result of energy development has yet to be satisfactorily answered. In previous work dealing with the Rocky Mountain area, GAO was unable to support the need for additional Federal assistance. Although there appeared to be an initial mismatch between the expenditure needs of affected State and local governments and the receipts generated by the energy related development, in the long-term revenues to the affected areas may be adequate.

The decision about whether to reduce Federal energy impact assistance should be viewed in the context of the total resources available to and the overall economic condition of the areas impacted by energy development. Items which should be considered include the current size and condition of public facilities, the local tax base, funds available from other Federal programs, the extent of in-migration of workers needed for development, and other economic development impacting the area.

Concerning the form of assistance, GAO has taken the position that, in most instances, loans would be more appropriate than grants. However, grants may be necessary in some instances to fund the planning efforts necessary to anticipate the impact of energy development. GAO has also taken the position that State and local governments should be primarily responsible for assuring the availability of the facilities and services needed for energy development.

The section 601 program provides funds for planning for energy development and site acquisition and development for housing and public facilities needed because of energy development. This program is just one of many sources of Federal funds being used by States and local communities to finance projects related to energy impact. For example, a

community might also look to EPA for funds for water and sewer lines and to EPA, HUD, and other agencies for funds for planning. Also, the amount of funds available from the section 601 program alone to meet energy impact assistance needs has not been significant. In FY 1980 about \$32 million was divided among 21 States.

Relevant GAO Report. EMD-77-23

GAO Contact. Flora H. Milans, 353-3408

Energy storage.

GAO Views. The administration proposes to eliminate the Department of Energy's development and demonstration efforts with respect to energy storage that can and should be supported by the private sector. While it is not clear whether the proposal is to eliminate all of DOE's energy storage development efforts, GAO agrees that some of the Department's energy storage development work is more appropriate for support by the private sector and should be terminated.

In a report on electric vehicles, GAO noted that the Department planned to spend about \$28 million during fiscal years 1978-1981 for improving commercially available batteries, about one-fourth of which was for improving lead-acid batteries. Industry was not seeking to improve the lead-acid batteries for use in electric passenger or commuter vehicles because it believed such batteries have limited potential for such use. However, lead-acid batteries have long been the focus of battery manufacturers' research for use in industrial applications such as forklifts, and other limited performance vehicles such as golf carts. Accordingly, GAO recommended that the program be redirected away from research in lead-acid batteries and be focused instead on longer term research having a higher potential payoff.

Relevant GAO Report. EMD-79-6

GAO Contact. Thomas E. Melloy, 353-5711

Uranium Resources Assessment Program

GAO Views. GAO believes that the administration's proposal to phase out DOE's uranium resource assessment program is premature. Until the new administration enunciates its future plans for nuclear energy development in this country, it is difficult to determine the effect of this proposal on the overall nuclear energy supply picture.

Specifically, while the administration supports a phase-out of this program as being no longer necessary to meet U.S. nuclear non-proliferation objectives, it is unclear at this

point in time just what degree of emphasis the proliferation issue is going to receive in the administration's nuclear energy supply strategy. Consequently, to the extent that the administration's nuclear non-proliferation goals remain undefined, it is not clear what role the Federal Government should play in assessing the adequacy of the domestic uranium resource base.

Moreover, the administration has not yet detailed intentions on the long-term future for nuclear power supply in this country. As a result, additional considerations must be factored into any decision to phase-out the uranium assessment program. What will be the role for and timing of the breeder reactor for extending existing uranium supplies? Will reprocessing and recycling of spent fuel from light water reactors be permitted? What are the plans for significantly reducing licensing times for light water reactors? Answers to such questions could have a significant impact on the need for continuing the uranium resources assessment program.

GAO Contact. Cliff Fowler, 353-5759

#### Small hydropower demonstration

GAO Views. The administration proposes to end subsidies for all additional small hydropower demonstrations on the assumption that a 21-percent investment tax credit and credit programs in the Department of Agriculture provide sufficient incentives for development.

GAO would not oppose the administration's proposal to end subsidies for small hydropower demonstration projects on the assumption that the 21-percent tax credit and other assistance will provide adequate incentives.

GAO had previously taken the position that the Department of Energy should continue its funding of small hydropower demonstration projects, and recommended that the Department of Energy expedite its grant program for demonstration projects and increase efforts to provide assistance, information, and guidance to hydro developers through an outreach program.

GAO reported in January 1980 that potential hydro developers were not in the business of hydro development and were inexperienced in the development process, and that further assistance through an outreach program would be a key element in providing an impetus for hydro development. At that time, however, the energy investment tax credit for small hydro power was not available. This development in April 1980 may stimulate development, and should be given a chance to operate.

Relevant GAO Report. EMD-80-30

GAO Contact. John Brown, 275-3572

President's  
Proposal - ENERGY CONSERVATION

GAO Supplementary Discussion

The administration proposes to make widespread and substantial cuts in energy conservation programs. After an overall comment, the following elements are discussed below: energy conservation tax credits, building and appliance standards, the Residential Conservation Service and public information programs, grants for State energy offices, incorporation of low-income weatherization assistance with HUD's block grant program, internal Federal Government conservation efforts, the Schools and Hospitals Grants Program, and electric and hybrid vehicles.

Overall Perspective

GAO Views. GAO agrees with the administration's position that progress has been made in reducing total energy demand over the past few years and that energy price increases have been a primary factor. However, three significant factors also need to be recognized when deciding on the type and level of Federal commitment to conservation programs. First, energy conservation is in the best interests of the Nation--often in excess of the value indicated by market prices. Second, energy conservation can make a direct contribution to reducing the Nation's dependence on imported oil. Third, significant potential to increase the efficiency of energy use continues to exist.

In the years following the Arab embargo, the Nation further increased its dependence on imported oil--despite substantial price increases--thus failing to alleviate the Nation's vulnerability to supply disruptions. GAO believes this situation, coupled with significant potential for increasing the efficiency of energy use of up to 50 percent in buildings alone, indicates a continued Federal need to facilitate and supplement market forces by alleviating the high level of dependence on imports and assuring that increased energy conservation is achieved in a timely manner.

While GAO's past work has identified a number of problems in DOE's implementation of energy conservation programs, GAO does not believe the solution is to eliminate or substantially reduce resources committed to these efforts. Rather, there is a need for (1) corrective action to assure that certain ongoing programs are effectively and efficiently implemented and (2) more selectivity in identifying further Federal involvement to assure that Federal resources are directed where they can most effectively contribute to the achievement of greater energy conservation, particularly with respect to reducing the level of imports.

Relevant GAO Reports. EMD-78-38, EMD-79-76, EMD-80-7,  
and EMD-81-8

GAO Contact. William C. Oelkers, 252-1400

### Energy Conservation Tax Credits

GAO Views. GAO has supported tax credits in the past to provide an incentive for consumers to achieve energy conservation opportunities. GAO has had some concern, however, over the administration's proposal to rely, for the most part, on market forces and tax credits to achieve energy conservation. Such a proposal is not likely to result in substantial near-term energy savings, and the Federal Government will need to play an important role in fostering greater energy conservation.

The Federal Government should continue to supplement market forces to assure substantial energy savings. The last 2 years' experience with the existing residential tax credit indicates that selective use has been made of the credit, even though energy prices continued to rise during that period and significant opportunities exist to cost-effectively save energy. For example, the tax credit was used more often for relatively inexpensive conservation measures. In addition, higher income households were more likely to take advantage of the credit.

Given the apparent selected impact of the credit, significant potential to save energy (estimated at up to 50 percent for homes), and the need to promptly achieve these savings in view of the continued high level of imports, GAO believes that the Federal Government should reassess the contribution being made by its ongoing energy conservation programs and continue, in a more selective manner, to facilitate and supplement market forces in the area of energy conservation.

Relevant GAO Report. EMD-77-48

GAO Contact. William C. Oelkers, 252-1400

### Building and Appliance Standards

GAO Views. In a recent report on the Building Energy Performance Standards program, GAO pointed out that such standards would close the gap between achieving cost effective energy conservation practices and the level of energy conservation which would be achieved by market forces. Such a gap exists because of imperfections in the market. For example, consumers do not have precise knowledge of how future energy prices should effect current energy conservation decisions or what energy conservation actions are needed to maximize cost effectiveness.

The report also addressed the question of establishing mandatory standards by establishing a sanction for non-compliance. It stated that, since energy prices had risen

substantially, homeowners and builders had a strong incentive to implement energy conservation measures, although a lack of awareness concerning maximum cost effective energy conservation practices would remain. Thus, while a mandatory standard may not be justified, establishing a voluntary standard could facilitate market forces by identifying the optimal level of energy conservation that could be cost effectively achieved.

With respect to appliance efficiency standards, GAO previously supported establishing major appliance standards. Since that time, some States have established appliance standards. If that trend continues, failure to establish Federal standards could result in appliance manufacturers being forced to comply with a number of different standards for their products. Thus, Federal standards would help to assure a level of uniformity in the appliance standard area as well to as assure that energy-efficient appliances are produced.

While the administration proposal does not indicate what action, if any, will be taken with respect to the appliance labeling area, that effort should continue to assure that consumers have appropriate information when making appliance purchase decisions.

Related GAO Report. EMD-81-2

GAO Contact. William C. Oelkers, 252-1400

The Residential Conservation Service  
and Public Information Programs

GAO Views. GAO recently reported on residential energy conservation outreach activities, including the energy conservation opportunities in the residential sector, its needs in order to voluntarily achieve such potential, the most effective manner of meeting those needs, and the appropriate DOE role.

The administration's proposes to abandon the Residential Conservation Service (RCS) on the basis that utilities themselves will respond to consumer needs when conservation represents an economic alternative. This proposal fails to recognize the timely and important contribution energy conservation can make in the Nation's energy program and the potential role RCS can play in achieving voluntary residential conservation. Because individual utilities face vastly different demand, supply, and cost situations, it is likely that the administration's strategy would result in a fragmented assortment of residential conservation programs--unequal in application, quality, or comprehensiveness. Ultimately, this strategy could lead to many years of delay in closing the gap between energy conservation achieved and energy conservation opportunities still available.

The report indicated that if consumers are not effectively made aware of their conservation opportunities, the extent to which they can or will voluntarily realize available energy savings will be limited. Comprehensive, on-site energy audits--a central feature of the RCS program currently underway nationwide--have been shown to be the most effective way to encourage voluntary conservation actions. While GAO has not yet examined the regulatory burden RCS has imposed on utilities, States, or the private sector, the program's on-site audit features, scope, and timing raise serious concerns about eliminating this program prematurely.

The report supports the administration's general position that many DOE information programs efforts are contributing little to meet the needs of consumers--especially in light of non-Federal activities. However, DOE can make a timely and significant contribution to achieving greater levels of voluntary conservation, specifically by playing an important role in enhancing the success of the RCS program through selectively reducing and refocusing current outreach programs. In particular, the Energy Extension Service program, if implemented consistent with congressional intent, could be the vehicle to assure that DOE outreach funds are expended efficiently and effectively toward this restructured effort.

Relevant GAO Report. EMD-81-8

GAO Contact. William C. Oelkers, 252-1400

#### Grants For State Energy Offices

GAO Views. Pursuant to specific legislative mandate, GAO has issued two reports on DOE's State Energy Conservation Program and is currently involved in a third review. GAO concluded that the 1980 energy savings goal will not be attained and that implementation of many State conservation measures were delayed or reduced in scope because of problems in establishing and administering the measures and overly ambitious and optimistic goals.

Although the specific amount of energy conserved as a result of the program is unknown and questionable at this moment, the program has been effective in terms of developing--for the first time--a capability to manage energy programs in many States. Loss of Federal funds may cause some States, because of budget constraints, to eliminate State energy offices, resulting in a loss of this management and coordination capability at the State level.

This loss would affect not only the conservation area, but would also affect the States' growing responsibilities in emergency response planning activities, such as gasoline supply distribution.

Relevant GAO Reports. EMD-78-81 and EMD-80-97

GAO Contact. William C. Oelkers, 252-1400

Incorporation of Low-Income Weatherization Assistance into HUD's Block Grant Program

GAO Views. Pursuant to specific legislative mandate, GAO has issued two reports on DOE's low-income weatherization program and is currently involved in a review of the program. Among the principal problems noted has been slow progress because of problems in obtaining sufficient labor through the Comprehensive Employment and Training Act (CETA) program. DOE revised its regulations and funding to allow the hiring of labor or contractors.

GAO concluded that the low-income weatherization program could go a long way toward reducing the utility bills of people least able to afford them. In view of the recent deregulation of oil prices, GAO believes that the need for such a program is even more acute in order to lessen the impact of rising fuel prices on low-income persons. Also, the more successful is the low income weatherization program in reducing energy costs, the less Federal funds should be necessary for the Community Service Administration's crisis intervention program to pay the fuel bills of low-income persons.

GAO has no strong views as to whether the program should be in DOE or HUD. There are advantages and disadvantages to location in either department, which are discussed below. Some concerns about the administration's justification for transferring the program to HUD are also discussed below.

An advantage to the administration's proposal is that many units need rehabilitation in addition to weatherization, and merger with the HUD program could provide this. However, there are the following disadvantages to the proposal:

- Under merger, weatherization would lose its identity and priority. In past reports, GAO has taken the position that it was desirable to place energy functions in one agency with overall responsibility to insure that such functions receive proper priority within a single department.
- Possible negative effect on rural areas and small towns, as the block grant program is primarily for big cities.
- Possible negative effect on ability of low-income persons to weatherize if local community elects loans rather than grants.

As discussed below, GAO questions the statements given by the administration to justify the transfer of the program to HUD.

--The program will be more in accord with local needs and priorities. DOE's program is carried out by granting funds to the States which subgrant funds to local community action agencies. Each State is responsible for developing and monitoring its program. Since, under the DOE program, both the State and its local communities are involved, it is unclear how the program would be more in accord with local needs under HUD.

--The DOE program has been plagued by increasing costs and quality control problems. GAO has found that part of the increase in cost is a result of the shift from free CETA labor to hired or contractor labor. It seems that cost increases and quality control problems will not disappear by changing agencies. The proposed reduction in the CETA program will likely result in higher costs for labor in the low-income weatherization program.

--The DOE program would take 50 to 100 years to reach all the potentially eligible low-income households in the Nation. The speed with which weatherization can be accomplished will primarily be influenced by the availability of labor, materials, and funds. Based on the current DOE limit of \$1,600 per unit and the estimated 10 million low-income units needing weatherization, about \$16 billion would be required to accomplish the task. Unless funding of weatherization under the block grant program is significantly increased, it is not reasonable to assume that HUD could accomplish the task in a period of time significantly less than DOE.

Relevant GAO Reports. EMD-78-81, EMD-80-59, and EMD-80-134

GAO Contact. William C. Oelkers, 252-1400

#### Internal Federal Government Conservation Efforts

GAO Views. The Federal Government is the Nation's largest single energy user, directly accounting for over 2 percent of U.S. energy consumption. Thus, the Government has a unique opportunity to save large amounts of energy and lead the Nation by demonstrating, within its own domain, an aggressive energy management program.

GAO has supported the need for a comprehensive aggressive energy conservation program in the Federal Government. Although past work has disclosed that the Government's in-house energy conservation program is in disarray, the problems appear to stem from DOE's failure to take charge and provide the necessary support.

In view of the significant future energy and cost savings that a viable and effective Federal Energy Management Program could bring to the Federal Government, GAO applauds the administration's stated intention that the Government's internal conservation effort "would be retained."

Relevant GAO Reports. EMD-80-11, EMD-79-11, and EMD-79-68

GAO Contact. William C. Oelkers, 252-1400

### Schools and Hospitals Grants Program

GAO Views. The administration proposes to retain the Schools and Hospitals Program but at a reduced rate of \$100 million.

GAO recently reported on the Energy Conservation Program for Schools and Hospitals. The program has been authorized nearly \$1 billion to provide grants to institutions to reduce energy use. Schools and hospitals are major consumers of energy and through effective conservation efforts, they can reduce their energy consumption by as much as 30 percent. GAO found that there is an opportunity to reduce overall program costs while at the same time increase energy savings.

The Schools and Hospitals Program is not an effective use of Federal funds when compared to other DOE energy conservation programs. It is among the highest in cost, yet among the lowest in yielding energy savings. GAO recommended that the focus of the program needs to be redirected toward placing more emphasis on energy audits, providing energy audits to more schools and hospitals, and more closely matching the assistance provided to the needs of schools and hospitals.

The administration's proposed reduction in program funding and GAO's recommendation would complement each other and serve to increase the program's cost-effectiveness.

Relevant GAO Report. EMD-81-47

GAO Contact. William C. Oelkers, 252-1400

### Electric and Hybrid Vehicles

GAO Views. The administration proposes to terminate a number of technology development projects based on the rationale that such projects are commercially viable without Federal assistance. Among these projects is the electric and hybrid vehicle (EHV) project. From the available information, it is unclear whether all EHV efforts are to be terminated or simply the vehicle demonstration portion. EHV efforts also include loan guarantees and research and development. Depending on the extent of the planned cuts, GAO could support some of the cuts, but on a basis different from the rationale used by the administration.

In April 1979, GAO reported on the need to redirect DOE's electric vehicle efforts. Specifically, it was recommended that DOE (1) postpone private-sector and State and local government-sector demonstrations, substituting instead a smaller Federal demonstration and (2) delay issuance of loan guarantees for vehicle and component production. These recommendations were

based on an assessment that vehicles available at that time cost too much and delivered such inferior performance that commercialization could not reasonably be expected. Available information suggests that the same deficiencies still exist with respect to the vehicles being demonstrated in the Federal efforts. Even General Motors, which previously announced entry into the electric vehicle market by 1984, seems to be backtracking; recent announcements indicate a later date for entry with "significant" quantities possibly by 1990. Accordingly, it still seems prudent at least to defer Federal support of private-sector and State and local Government-sector demonstrations. This support represents about \$10 million in the fiscal year 1981 budget. It also seems prudent to terminate the loan guarantee efforts, which represent an additional \$1.4 million in the fiscal year 1981 budget.

However, it does not seem prudent to terminate the research and development efforts. For EHV's to be commercialized, significant technical advances are required. To the extent that the Government research and development program is helping to resolve technological barriers, terminating these efforts could delay implementation of this oil-saving technology.

Relevant GAO Report. EMD-79-6

GAO Contact. Thomas E. Melloy, 353-5711

President's  
Proposal - ALCOHOL FUELS SUBSIDIES

GAO Supplementary Discussion

GAO Views. The administration proposes to terminate funding for feasibility studies, cooperative agreements, and loan guarantees for biomass-derived alcohol fuels (that is, ethanol) and biomass energy development administered by the Department of Energy. The justification essentially boils down to the following: (1) the technology for producing alcohol fuels is well-proven, (2) existing Federal and State subsidies amount to at least \$18 a barrel, and (3) removal of oil price controls makes alcohol fuels competitive with other energy forms.

Although GAO has not reviewed the effectiveness of these specific subsidies for ethanol and biomass fuels, based on prior work the proposal appears justified. A report on ethanol as a motor vehicle fuel noted that technological problems are not a major impediment to the current ethanol industry. The technology to be employed on projects supported by the Federal funding in question is well-proven and commercially available. In addition, existing tax policies provide a major subsidy for alcohol fuels. The waiver of the Federal excise tax on gasoline (when blended to produce gasohol) provides a subsidy of \$16.80 a barrel. This subsidy is supplemented in 25 States by further State gasoline tax waivers, which provide additional subsidies of up to \$42 a barrel--in one State the subsidy is \$58.80 a barrel in total.

Further, alcohol fuels should be more competitive with petroleum-based fuels in the future, even without the subsidies that are being proposed for termination. The existing price differential between ethanol and gasoline could be expected to decline as a result of the increase in gasoline prices and an expected decline in the real price of ethanol. The decontrol of oil prices should accelerate gasoline price increases and further enhance the competitive position of alcohol fuels.

Finally, another form of alcohol fuels (methanol)--which is derived primarily from coal and hence not affected by the proposed subsidy reduction--has greater potential than ethanol to replace gasoline. Methanol can be produced in much vaster quantities and potentially at considerably less cost. Therefore, there is a concern that excessive subsidies for ethanol production and use could result in an economically unjustified commitment of resources to ethanol, which has less potential than methanol. Reducing ethanol subsidies, accordingly, could serve to head off this potential problem.

Relevant GAO Reports. EMD-80-73 and EMD-80-88

GAO Contact. Thomas E. Melloy, 353-5711

President's  
Proposal - SOLAR ENERGY AND CONSERVATION BANK

GAO Supplementary Discussion

GAO Views. The Solar Energy and Conservation Bank was created by the Energy Security Act (P.L. 96-294, June 30, 1980). Although GAO has not yet specifically reviewed the Bank's activities, based on previous work on solar energy, GAO has some thoughts on the proposal to eliminate the Bank.

The Administration's rationale for this proposal is that rising energy prices and existing tax credits for solar energy systems will provide sufficient incentive for using solar energy systems, and that additional Federal incentives are, therefore, not needed to promote the use of solar energy. The Bank, as established, can subsidize the interest individuals pay in connection with purchasing solar energy systems; however, the act precludes an individual taxpayer from receiving the benefits of both this interest subsidy and the tax credits.

The solar energy tax credits were recently increased to 40 percent by the Windfall Profits Tax Act of 1980 (P.L. 96-223, April 2, 1980). On the surface, it appears that tax credits will be the preferred incentive since the interest subsidy will result in a much smaller dollar benefit to a taxpayer. GAO's past work on Federal efforts to commercialize solar heating indicated that interest subsidies may not be as effective an incentive as tax credits.

However, GAO cautions that, as noted in a report on solar heating, the success of the tax credits or other incentives should be periodically examined. The full impact of the new 40-percent solar tax credit and the decontrol of oil will not be known for some time. It may turn out that an additional incentive, such as that offered by the Bank, may still be needed if the Federal Government wishes to accelerate the widespread use of solar energy to reduce the Nation's dependence on imported energy supplies. When more is known on the impact of the decontrol and tax credit measures the Congress will have better information on which to decide whether to abolish or initiate operations of the Bank. Until more is known, a more prudent action may be to defer--as opposed to eliminate--funding the Bank.

Relevant GAO Report. EMD-79-19

GAO Contact. Thomas E. Melloy, 353-5711

RESTRUCTURING HUD'S COMMUNITY DEVELOPMENT SUPPORT ASSISTANCE

GAO Supplementary Discussion

GAO Views: The proposal to integrate the Community Development Block Grant (CDBG) and the Urban Development Action Grant (UDAG) programs into a more efficient and flexible grant mechanism has merit, particularly if proposed budget cuts are accompanied by better targeting of funds and better Federal guidance on the overall parameters within which cities can operate their block grant programs. Targeting and additional Federal guidance on eligible items could reduce the impact of budget cuts on achieving program objectives without excessive Federal intervention in the day-to-day mechanics of the program.

Our work on UDAG has identified problems with selected grants in terms of whether the grants were actually needed to stimulate private investment and whether they included a substantial commitment of private resources. On the CDBG program we found that HUD had a backlog of about \$3.4 billion in unspent funds for formula entitlement grantees as of April 30, 1980. While HUD has taken several actions to get grantees to spend block grant funds faster, this may stimulate ineffective and inappropriate use of block grant funds. For example, our current review of the CDBG program has identified several problem areas which hamper achievement of the program's objectives:

- Cities have spent funds in too many areas, in areas too large to accomplish meaningful results in a reasonable period of time, and on activities not directly related to community development. In addition, benefits to low- and moderate-income persons are not thoroughly verified, and as a result it is unclear whether or to what degree this major objective of the program is being met.
- The lack of HUD guidance on block grant supported housing rehabilitation work has resulted in non-essential work being completed, relatively high income persons being assisted, and wide disparities in the types of work that can be done.
- Audits of grantee operations by HUD's Inspector General, independent public accountants, and city comptrollers, as well as our own review, have identified many examples where inadequate information and controls exist to determine whether program expenditures are for eligible items and are adequately supported or justified.

To improve the CDBG program's efficiency and effectiveness, the Administration and the Congress may want to address such issues as:

- The need for all grantees to concentrate their block grant funds in distressed geographic areas small enough so that visible improvements are achievable in a reasonable time period.

- The need to verify information provided by grantees on benefits to low- and moderate-income persons to ensure that activities claimed to benefit low- and moderate-income persons, in actuality principally benefit these income groups.
- The need to reduce the broad list of activities currently eligible under the program to focus on those activities which meet the cities' most urgent revitalization needs. For example, many city officials told us that one activity—public services, amounting to \$240 million annually—could be eliminated from eligibility with minimal effect on achieving the objectives of the block grant program.
- The need to develop overall income eligibility requirements for recipients of block grant supported rehabilitation. Such limits would result in increasing the number of low- and moderate-income people benefiting from the program.
- The need to limit eligible housing rehabilitation work to that which is essential to restore the unit to a safe, decent, and sanitary condition, specifically prohibiting non-essential and luxury items, so that more homes needing basic repairs can be rehabilitated.

Relevant GAO Reports: CED-78-30, CED-78-157, CED-79-64, PAD-79-85, CED-80-19, and CED-80-137.

Contact: Steven J. Wozny, 426-1780.

President's  
Proposal - Phase Out of Comprehensive Employment  
and Training Act (CETA) Public Service Jobs

GAO Supplementary Discussion

GAO Views. We have not reported on the effect that a reduction in Public Service Employment (PSE) funding would have on State and local governments operating the PSE programs or on the Federal budget. GAO reports have addressed such issues as participant eligibility, enrolling the most qualified applicants and the transition of participants into jobs not supported by CETA. For example, on October 12, 1979, (HRD-79-101) we reported that as of November 1978 CETA programs had had limited success in moving participants from public service employment jobs into unsubsidized employment, and that many participants had remained in their public service jobs for a long time. We also found that unsubsidized jobs obtained by participants were largely in the public sector and with the participants' former public service employers.

The CETA amendments of 1978 reemphasized the temporary nature of PSE jobs and the importance of moving PSE participants into unsubsidized employment. The amendments provided a better framework for implementing successful transition programs. However, preliminary data on current GAO work indicate that many prime sponsors have not significantly improved transition performance.

CETA requires that the majority of funds allocated under titles IID and VI be expended for wages and employment benefits to people employed in public service jobs. It follows, therefore, that elimination of Federal funds for individuals holding CETA-funded jobs after September 30, 1981, would result in reduced outlays. The net reduction in Federal outlays would depend on the extent of fiscal substitution and the probable increase in Federal expenditures in other areas, such as public assistance payments.

Relevant GAO Reports. HRD-79-101, HRD-78-57, HRD-77-53.

GAO Contact: Maurice S. Moody, 523-8701

PHASE OUT OF FEDERAL MASS TRANSIT OPERATING SUBSIDIES

GAO Views:

GAO will be reporting shortly on the results of its review of the Federal transit subsidy program and the transit industry's cost and revenue problems that led to the need for Government subsidies. GAO concluded that demand for transit operating subsidies is approaching crisis proportions. GAO's findings are similar to the Administration's. For instance, GAO found

--one reason for soaring subsidy demands is that operating costs, which increased from \$2.5 billion in 1973 to an estimated \$5.5 billion in 1979, are not being offset by productivity improvements. GAO identified three major problem areas preventing transit from operating efficiently and effectively. One of these concerned transit's problems in expanding cost effectively into suburban areas, which are more costly to serve than dense urban areas.

--another reason for growing subsidy demands, is that transit systems have adopted and maintained unrealistically low fares even though operating costs are increasing.

Rather than recommending a phase-out of Federal operating subsidies, GAO recommended that UMTA undertake specific actions to improve mass transit efficiency and that Congress and UMTA develop policies to influence local areas to recover more of their costs from passenger fares. GAO also recommends that Congress amend the Urban Mass Transit Assistance Act of 1964 to change the method by which Federal funds are allocated to local areas, and a number of actions the Secretaries of Labor and Transportation could take to improve administration of the operating assistance program. GAO's positions are consistent with the administration's proposal in the sense that Federal operating subsidies should be reduced to encourage greater productivity and local control over mass transit. Such reductions should be accomplished over a period of several years, as proposed by the Administration, to allow transit systems and local governments sufficient time to seek alternative financing and/or adjust their level of service.

Relevant GAO Report: CED-81-28, "Soaring Transit Subsidies Must Be Controlled," (to be released shortly).

GAO Contact: John Vialet, 426-1777

President's  
Proposal - REDUCTION IN AMTRAK SUBSIDIESGAO Views:

The Administration proposes to reduce Amtrak's subsidy needs by increasing fares and eliminating routes that cannot attract sufficient riders at the higher fares. Such a policy could eventually result in eliminating most of Amtrak's routes, depending on how much the fares are increased. Most of GAO's work has centered on reducing Amtrak's costs and subsidy needs rather than increasing fares. GAO has concluded that, although Amtrak could improve its operating efficiency, it cannot substantially reduce its operating costs without reducing the size of its system. This report said that Amtrak needed to give continued attention to achieving lower direct labor costs, maintenance costs, and losses on food and beverage service. Improved efficiencies in these areas, however, will not substantially reduce Amtrak's subsidy need.

In another report analyzing 11 of Amtrak's most unprofitable routes, GAO found that, not only did the routes require substantial subsidies, but the trains wasted energy and efforts to improve service had not generally been successful. Some of these routes were subsequently discontinued, but most of them remain. Ridership generally increased on Amtrak trains because of the 1979 gasoline shortage, but some routes continue to be highly unprofitable and to carry relatively few passengers.

Regarding proposals to institute high speed rail passenger service in corridors outside the Northeast, GAO concluded that anticipated benefits may not be available or worth the cost and that substantial increases in ridership cannot be expected unless one of the other transportation modes is disrupted. Additional studies and reports by other organizations, primarily the Department of Transportation, have been completed since the GAO report was issued, but they have not focussed on the overall costs and benefits of each of the corridors proposed for development. GAO believes that such information is essential in deciding if additional passenger corridors should be developed.

Relevant GAO Reports: CED-78-67, CED-78-86, CED-79-3, PAD-79-32.

GAO Contact: J. R. Bolon, 426-1735

REDUCED FUNDING FOR THE NORTHEAST CORRIDOR IMPROVEMENT PROJECT

GAO Views:

Current legislation authorized \$2.5 billion for the Northeast Corridor Improvement Project (NECIP) to improve high-speed rail passenger service between Boston and Washington. The legislation sets forth several goals, including trip times, and specifies a completion date of September 30, 1985. Our recent report (CED-81-23, October 31, 1980), discussed the impacts of work cutbacks that had been made to stay within the \$2.5 billion authorization.

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The Administration proposes to reduce the project by about \$300 million and change its objectives to emphasize reliability and safety rather than high speeds. The effects of these changes would depend on the specific changes in work to be done under the project. Two changes specifically mentioned are (1) deleting planned electrification of unelectrified track between New Haven and Boston and (2) repairing rather than replacing the existing signaling system.

Electrification work between New Haven and Boston could probably be deleted with little or no adverse impact because most of the Corridor's riders do not use that section and those who do wouldn't seem to be affected by the small increase in trip times that would result from the deletion. Deleting the new signaling system might decrease train speeds and increase trip times, but we do not know how this would affect ridership or operating losses.

In redirecting the project's emphasis toward reliability and safety, it is not clear whether, or to what extent, funds would be shifted among the project's various work elements. Our October 1980 report discussed several cutbacks that were made to stay within the \$2.5 billion authorization that could adversely affect safety and/or reliability. For example, all fencing between tracks in stations was deleted which could reduce safety to pedestrians and could result in additional delays to trains. Shifting funds to restore work affecting reliability and/or safety could be difficult at this point because much of the project's work is completed or so far along that major changes are impracticable.

Relevant GAO Reports: CED-81-23, CED-70-23.

GAO Contact: J. R. Bolon, 424-1735.

President's  
Proposal - ACCELERATION OF MINERALS LEASING

GAO Supplementary Discussion

GAO Views. The administration proposes to accelerate the leasing of minerals--particularly energy minerals--on Federal lands to help meet the Nation's future needs for energy and also to streamline the leasing process. These actions, it is asserted, will increase future domestic production, thus contributing to economic growth and also increase receipts to the Government, thus helping to reduce the budget deficit. These actions, it is further stated, will be consistent with balanced development and environmental protection.

GAO basically shares the administration's views in this area and much recent work has called for a more balanced, orderly, and efficient approach to developing Federal lands. One report included various recommendations to open more Federal lands to leasing and improve the overall Federal oil and gas leasing and drilling permit programs. Another report advocated the leasing of the National Petroleum Reserve in Alaska (NPRA) for further exploration and development, rather than continuing the costly and largely ineffective Federal exploration program. Still another report stated that available geologic data supported a decision for more exploration of oil and gas potential on the William O. Douglas Arctic Wildlife Range rather than to close it to such exploration.

Other recent GAO work has identified problems and proposed various solutions to improve the new Federal coal leasing program. In a broader vein, GAO has identified various inconsistencies in Federal leasing rules and suggested possible ways to streamline them.

Relevant GAO Reports. EMD-80-87, EMD-80-111, EMD-81-30,  
EMD-81-40, and EMD-81-44

GAO Contact. Lowell Mininger - 254-6937

President's  
Proposal - ELIMINATION OF AIRLINE SUBSIDY PROGRAM

The elimination of the airline subsidy program authorized by Sec. 406 of the Federal Aviation Act is consistent with GAO's past recommendation that Congress needs to restructure the airline subsidy program. The restructuring should consider: when a community's air service needs subsidy; establishment of a standard to determine adequate service; basing the subsidy on actual cost of service provided; subsidizing airlines that can provide necessary service at lower cost, and; when evaluating the need for service to small communities, determine the scheduled service being provided by unsubsidized airlines.

Relevant GAO Reports: CED-77-114

For Further Information

Contact: Thomas D. Reese, 426-8462

President's  
Proposal -

TERMINATION OF FUNDING FOR CONRAIL

94011-1051

The Administration proposes an end to aid in Conrail after 1982 through (1) substantial track abandonments, (2) reductions in labor costs by reducing Conrail's workforce and changing its work rules, and (3) State and/or local subsidies if necessary to retain marginal lines.

GAO has reported several times that Conrail must act to lower its costs and increase revenue in order to reduce its need for subsidy, and have suggested some changes in emphasis for Conrail management. The overall thrust of our work supports the idea that Conrail may be somewhat hampered in taking effective action to become profitable by continued Federal subsidy. For example, labor unions may be more willing to accept working rule changes, and State and local governments more willing to accept reduced service, if the Federal umbrella is eliminated.

GAO has reported that Conrail must gain better control of its labor costs if it is to attain financial self-sufficiency. Conrail's labor costs are considerably higher than those of other railroads and Conrail's costs are affected by labor work rules that continue to be an industry-wide problem. Reducing Conrail's workforce, however, increases labor protection payments Conrail is obliged to pay under Federal law. GAO has taken the position that such special protection for workers in particular industries should be restrained, and avoided in the future.

As indicated in the Administration's proposal, several study reports regarding Conrail's future are due in April 1981 which may contain recommendations that would reduce the need for Federal funds and still result in adequate rail service.

Relevant GAO Reports: CED-78-23, CED-78-174, CED-80-61, CED-80-51, CED-80-56.

GAO Contact: J. R. Bolon, 426-1735

President's  
Proposal - Reduction of Export-Import Bank Direct Lending

GAO Supplementary Discussion

GAO Views. The United States continues to suffer serious balance of trade deficits despite a substantial increase in exports for fiscal year 1980. For 1980, the U.S. merchandise trade deficit totaled \$26.7 billion, down from a deficit of \$29.4 billion in 1979. Imports of increasingly expensive petroleum and petroleum products continue to be the major factor in our trade deficits. Therefore, the administration characterization of the U.S. export performance as being excellent is misleading.

Exports are of critical importance to the U.S. economy. Over the past decade, the share of U.S. economic output devoted to exports almost doubled from 6.4 percent in 1970 to over 12 percent in the first half of 1980. Today, one out of seven U.S. manufacturing jobs and one of every three acres of U.S. farmland produce for export. According to the conventional estimate, \$1 billion of exports supports 40,000 jobs.

The Reagan Administration would reduce the level of the Export-Import Bank's (Eximbank) direct lending authority in fiscal year 1981 by \$752 million below the current authorization, and the proposed fiscal year 1982 level would be \$600 million below the Carter Administration budget proposals. The Reagan proposal projects a reduction in Federal outlays and the Federal deficit of more than \$6 billion over the next 5 fiscal years (1982 through 1986). Since Eximbank finances only a part of each export sale, the impact on exports is substantially greater than \$6 billion.

The Eximbank has a dual mandate to be self-sustaining while at the same time to meet the export financing of foreign competitors. The Bank finances its activities through receipts from prior loans, fees and charges for insurance and guarantees, interest earned on its retained earnings and borrowings which are predominantly through the Federal Financing Bank. To date, the Bank has remained self-sustaining even though to meet foreign competition it has been lending at rates of interest below its cost of borrowing. During its existence, the Eximbank has paid over \$1 billion in dividends to Treasury. The net budgetary impact of the Bank's activities, therefore, depends on a number of factors, not solely its direct lending levels. The \$6 billion savings claimed over the next 5 years in the Reagan Administration proposal is based only on projected loan authorizations and thus would require significant downward adjustments for the Eximbank's receipts. Furthermore, the loan authorization levels are projected at unprecedented high levels, including a fiscal year 1982 level of \$6,410 million, as contrasted with the Carter Administration's actual request of \$5,000 million.

For a number of years, GAO has expressed concern over the Eximbank's subsidized lending practices which have resulted in an increasing risk of losses as the Bank's exposure has grown faster than its reserves. Accordingly, GAO's annual reports on the Eximbank's financial statements have traditionally included the qualification that GAO was unable to express an opinion on the adequacy of the Bank's reserves. GAO has also recommended that the Bank raise its interest rate on direct loans for sales where there is little or no foreign competition. The Reagan proposal would put the Bank on a more sound financial footing to the extent that its export loan subsidies are reduced by the lower loan levels and hardening of loan terms to more clearly reflect the costs of the Bank's borrowings. The key issue raised, however, is whether the Eximbank will have sufficient funding to meet export financing competition.

Faced with rapidly rising imported energy bills, the major exporting nations have been competing more aggressively for export sales. Government-supported export financing, often at heavily subsidized rates, has become a significant factor in this competition. The United States in recent years has pursued an explicit goal of reducing and eliminating subsidies in export financing. To this end, the United States has pursued multilateral negotiations in the OECD's Export Credit Group to limit subsidies. At the same time, the previous administration strengthened its negotiating position by significantly raising the Bank's direct loan authority and by approving more heavily subsidized export loans to meet foreign competition. The OECD negotiations failed in December 1980, raising the prospects of intensified credit competition among major exporting nations.

The proposed cut in direct lending authority would appear to reduce our ability to meet foreign credit competition. It clearly signals a withdrawal from aggressive credit competition, and as a result, weakens our bargaining leverage in future negotiations to eliminate credit subsidies. On the other hand, the proposal does not specify levels for Eximbank's guarantee and insurance programs, which can be substituted for direct loans but at higher costs to borrowers.

Relevant GAO Reports. ID-80-43, ID-80-16, ID-79-19 and 19a, ID-78-34, ID-78-9, ID-77-23, ID-76-17.

Contact: Frank M. Zappacosta, 275-5337

President's

Proposal - REDUCTION OF PUBLIC SERVICE AND REVENUE  
FOREGONE SUBSIDIES TO THE POSTAL SERVICE

GAO SUPPLEMENTARY DISCUSSION

For fiscal year 1980, the Postal Service had an operating loss of \$306 million. In January 1981, the Postal Service projected an operating loss of \$3 million for 1981 and a gain of \$287 million for 1982. These projections were based on the implementation of new rates in March 1981. The increased rates, as proposed by the Postal Service, were expected to increase annual revenues by \$3.7 billion. However, the rates as approved by the Postal Rate Commission will increase revenues by \$2.7 billion--\$1 billion less than the amount expected by the Postal Service.

The proposed reduction in outlays (\$250 million in 1981; \$632 million in 1982) for Postal Service subsidies combined with the \$1 billion shortfall will reduce substantially the revenues expected by the Postal Service for 1981 and 1982. If revenues projected by the Postal Service prove to be more correct than those projected by the Postal Rate Commission, the Postal Service will experience large operating losses in 1981 and 1982. Such losses probably cannot be completely offset by increased operating efficiencies and, without a reduction in services, postal rates will have to be increased. The Postal Service will probably seek increased rates before reducing the level of service.

The proposed reduction in outlays will impact on funds made available to (1) subsidize postal costs (i.e., public service) for services nationwide and in communities where post offices are not self-sustaining, and (2) cover reduction of rates (i.e., revenue foregone) for certain categories of mailings identified by statute.

To offset the reduction in the revenue foregone appropriation the Postal Service can increase rates for mail which is now handled at a reduced rate--nonprofit publications; third class mail of nonprofit organizations; library materials; and mail by the blind and handicapped. However, the public service appropriation is provided to subsidize postal costs for services nationwide and in communities where post offices are not self-sustaining. Any reduction in this appropriation must be absorbed by other postal revenues.

The 1970 Postal Reorganization Act instructed the Service to provide a maximum degree of effective postal service to rural areas, communities, and small towns where post offices are not self-sustaining. The Act stated that no small post office shall be closed solely for operating at a deficit. In 1976 legislation, the Congress spelled out procedures governing the closing of small post offices. Among other things, the Postal Service was required to consider the effect of a closing on the community and the community was allowed to appeal a decision to close a post office to the Postal Rate Commission.

We believe that, if the proposed reduction in public service appropriation is approved by the Congress, the Postal Service should be permitted to close small post offices which are operating at a deficit if alternative mail service could be at least as good. Our 1975 report suggested that the Postal Reorganization Act be changed as follows:

Sec. 101. "(b) The Postal Service shall maintain effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining. No small post office shall be closed for operating at a deficit unless the quality of mail service is maintained, it being the specific intent of the Congress that effective postal services be insured to residents of both urban and rural communities."

In addition, we believe that the community's right to appeal a decision to close a post office to the Postal Rate Commission should be eliminated.

Relevant GAO Reports. GGD-75-87

Contact. Willis Elmore, 245-5397

**SECTION E.**  
**STRETCH OUT AND RETARGET PUBLIC SECTOR CAPITAL**  
**IMPROVEMENT PROGRAMS**

GAO Views:

Early in March we will issue a report entitled "Deteriorating Highways And Lagging Revenues: A Need to Reassess the Federal Highway Program" CED 81-42.

This report points out that the condition of our Nation's highways is declining. The Interstate System has seen the most serious decline--its percentage of miles in poor condition more than doubled between 1975 and 1978. Billions of dollars will be needed to preserve these roads, and if timely action is not taken, deterioration will accelerate and even more money will be needed for reconstruction. The increasing costs to complete the Interstate System and to continue other highway programs will cost additional billions.

Mounting costs of highway construction and maintenance and lagging State and Federal highway revenues are compounding these problems. Although the States have taken a number of actions to increase highway revenues--primarily by raising motor fuel taxes--there has been no Federal action.

The report supports the administration's view that decisions will have to be made as to the Federal-aid highway categorical programs that are to be retained, modified, deleted, or added; the respective funding levels; the method used to acquire the necessary funds; and the States' responsibilities including matching ratios.

We believe the reassessment of the program should specifically consider:

- Giving priority to preserving existing highways with emphasis on the Interstate System.
- Determining whether current preservation policy needs to be modified to ensure that necessary resurfacing, restoration, and rehabilitation work on Federal-aid highways is carried out.
- Eliminating restoration funds from sanctions.
- Assessing the goal of Interstate completion as currently defined, possibly giving priority to funding essential gaps.
- Analyzing State efforts and capabilities to increase highway revenues and to preserve highways.
- Revising the Federal motor fuel tax and other highway revenue sources to be more responsive to highway needs and the inflationary trends in highway costs.

Relevant GAO Report: CED-81-42

GAO Contact: J. Kevin Donahue, 426-1777

## President's Proposal - Reduction in Federal Mass Transit Capital Grants

GAO Views: GAO has not done any work directly related to the merits of Federal funding for new subway systems beyond the Atlanta, Baltimore, Buffalo, and Miami systems that are already being funded. However, we have issued several reports which address some of these issues.

In a report on the People Mover Demonstration Projects GAO concluded that the relative benefits of downtown people-movers to other alternatives for downtown circulation need to be demonstrated and the need for multiple demonstration projects needs to be justified by UMTA. A number of reasons were cited by UMTA officials as to why multiple projects are necessary. In GAO's view, UMTA's arguments do not justify the potential \$675 million Federal investment in nine people mover demonstration projects. An UMTA official acknowledged that perhaps three to five projects would be enough to show fundamental differences. If only the three most expensive projects were built, the Federal share would be reduced by about \$322 million.

GAO issued a report recently which discussed efforts to increase commuter use of transit and ridesharing and presented matters for consideration by the Congress regarding mass transit expansion and Federal funding for ridesharing. GAO expressed concern that the decision to support transit expansion is being unduly influenced by the energy situation and the availability of windfall profits tax revenues and that not enough consideration has been given to potential adverse impacts of transit expansion on transit operating costs, deficits, and subsidies.

GAO concluded that although increasing transit capacity might produce significant percentage increases in the number of people who commute by transit, the impact of these ridership increases on energy, congestion, and pollution will be small because the existing base of transit commuters is small. Furthermore, increasing transit capacity involves considerable capital expenditures and under current industry labor practices could appreciably add to transit operating deficits.

GAO felt that Congress should support Federal funding of rider-sharing activities because, among other matters, doubling ridesharing would save at least three times as much energy as a 50-percent increase in transit commuting and would have a greater impact on congestion and pollution.

If, as the Administration has proposed, the Federal emphasis is concentrated on maintaining existing transit systems, then the Congress should recognize that the funds appropriate for this purpose should be available for operating as well as capital assistance. The

Administration correctly points out that many buses could be bought for the same cost as building a small section of a fixed rail transit system. However, if local governments can obtain Federal financing for bus replacement but must pay the full cost of repairing buses they already own, then there will be strong incentives to replace buses prematurely. GAO has discussed the merits of providing operating assistance when capital assistance is also provided in its report "Analysis of the Allocation Formula for Federal Mass Transit Subsidies"

Relevant GAO Reports: CED-81-13  
CED-80-98  
PAD-79-47

Contact: Ralph Domenick - 426-2125  
Craig Simmons - 275-3588

President's  
Proposal - REDUCTION OF AIRPORT CONSTRUCTION GRANT PROGRAM

GAO VIEWS

Larger air carrier airports, although better able to pay their own way, have received considerably more in airport construction grants than smaller ones. Priorities are needed to distribute airport development grant funds, so that grant funds are effectively utilized to meet airport problems consistent with Federal goals, such as making airports safer, maintaining the existing airport system, bring airports up to FAA standards, developing reliever airports to relieve congestion at air carrier airports, expanding the air carrier/commuter system, or making airports more compatible with their environment. If funding is decreased as proposed, priorities would be very useful. The use of priorities could also assure that airport development grants are used at airports having the greatest financial need. GAO has recommended that Congress establish priorities and use them to distribute airport grants.

Relevant GAO Reports: CED-79-17

GAO Contact: Thomas D. Reese, 426-8462

GAO Supplementary Discussion

GAO Views. The probable impacts from delaying completion of project construction are construction cost growth (inflation effects) and delays in realizing project benefits.

Concerning the cost growth impact, it is likely that the 2-year delay will result in increased construction costs, depending on the rate of price escalation. However, this impact would be offset because the U.S. Treasury would require less borrowed funds and therefore save the current high interest costs.

With respect to delays in project benefits, President Reagan's proposal apparently considered this impact. The proposal states that the budget reductions will not delay the realization of the benefits from the more significant project purposes but will defer some less critical project features. Also, those features to be deferred are not like the other projects purposes which produce significant revenues. The deferred items, as shown, will generate little, if any, revenues.

Relevant GAO Report: None

GAO Contact: Harold Pichney, 275-6076

President's  
Proposal - REFORM OF MUNICIPAL WASTE TREATMENT  
GRANTS TO REDUCE THE COST OF ACHIEVING  
ENVIRONMENTAL PROTECTION

GAO Supplementary Discussion

GAO Views. GAO's reports over the past 3 years on EPA's construction grants program have a common theme--wastewater treatment projects which do not significantly improve water quality or which are too costly should not be built. GAO agrees with the Administration's proposals on the Municipal Waste Treatment Grant Program, which has the same general approach. It must be recognized, however, that the Clean Water Act must be amended to eliminate certain inflexible requirements for providing certain treatment levels.

The GAO reports deal with the subjects of mandatory secondary treatment requirements, the basis for advanced waste treatment, the effect of nonpoint pollution on water quality goals, the high cost of projects to correct combined sewer overflow problems, and the ability of treatment plants to meet their performance standards. In addition, GAO is currently processing a draft report showing how billions in construction grants costs can be saved by communities discharging into marine waters, through changes to waiver provisions of the Clean Water Act.

GAO reports have demonstrated that the current legislation can result in constructing projects which have only a marginal impact on water quality. GAO's May 1978 report on secondary treatment in the St. Louis area showed that constructing \$163 million in facilities to obtain a secondary level of treatment would not significantly improve the Mississippi River's water quality or uses. The law nevertheless requires that secondary treatment facilities be built. Similarly, GAO's July 1980 report showed that advanced waste treatment--which removes some pollutants left after secondary treatment--with few exceptions, may not be justified because the treatment might not make a substantial difference in water quality. In both reports, GAO recommended that the Congress amend the Clean Water Act to allow EPA more flexibility to consider the impact of the secondary or advanced treatment on water quality.

The December 1977 report demonstrated the lack of adequate data on diffused or "nonpoint" pollution sources of water pollution which produce more than half the pollutants entering the Nation's waterways. Such data is crucial because funds are insufficient to treat all pollution sources. Priorities must be established to assure the selection of control projects that will most benefit water quality. Constructing waste treatment facilities, for example, may not be as beneficial as implementing practices to control nonpoint pollution.

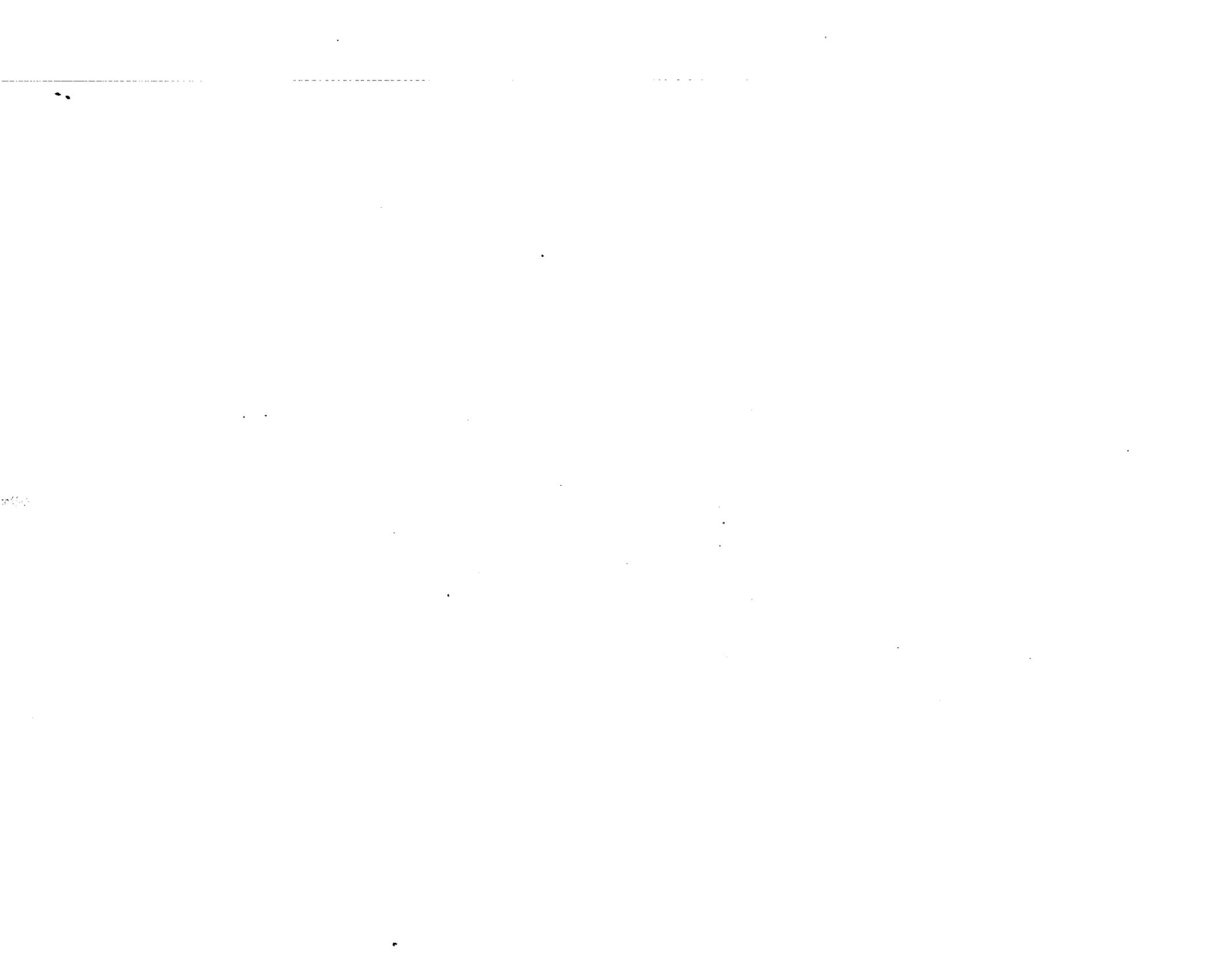
The enormous funds required for the large construction projects to curb pollution caused by sewer overflows and flooding was the subject of GAO's reports in May 1979 on Chicago's Tunnel and Reservoir Plan, and in December 1979 on the Combined Sewer Program in 15 U. S. cities. Because neither the Federal Government nor local communities can supply the \$88 billion needed to stem the pollution and flooding, GAO recommended that new techniques using inexpensive measures be attempted before considering costly solutions.

Wastewater treatment projects designed and constructed to have a significant impact on water quality have seldom or never met the performance standards they were designed to achieve. GAO's November 1980 report delineated 5 major problem areas that caused long-term noncompliance with waste treatment permits; including design and equipment deficiencies, infiltration/inflow overloads, industrial waste overloads, and operation and maintenance problems. GAO called for the Congress to require EPA to test various alternatives to the present construction grants funding program concept, to provide for better accountability so that plants not working properly can be fixed by the responsible party.

Relevant GAO Reports: CED-78-76, CED-80-86, CED-78-6,  
CED-79-77, CED-80-40, CED-81-9

GAO Contact: David L. Jones, 755-9100

**SECTION F.**  
**IMPOSE FISCAL RESTRAINT ON OTHER PROGRAMS**  
**OF NATIONAL INTEREST**



GAO Supplementary Discussion

GAO Views. The Administration proposes to terminate the funding for NOAA's Coastal Zone Management (CZM) State grant program which provides Federal grants and guidance to States to help them develop and implement coastal zone management programs. GAO's December 1976 and June 1980 reports discussed States' problems and progress in developing their programs. Both reports clearly indicated a lack of progress in carrying out the goals and objectives of the Coastal Zone Management Act, thus lending support to the proposal to terminate the grant program. GAO found that States were experiencing delays in implementing their programs because of problems in obtaining State financial and political support. The public had not supported the States' programs and coordination between States and Federal agencies was poor. GAO recommended actions to improve NOAA's management of the program.

The Administration proposes to reduce Federal funding to Sea Grant Colleges by 50 percent.

GAO reviewed the Sea Grant program in 1979 and reported that:

- Sea Grant projects appear to have limited application and are of little benefit to the identified user community.
- A follow-up evaluation of Sea Grant projects is needed to determine if the federally supported projects meet the expected goals and objectives.

GAO questioned projects at several universities because project results had not been communicated or disseminated to parties outside the Sea Grant institutions and also questioned whether the identified user of project results benefited from the research activity. GAO said improvements were needed in the administration of the program so that the day-to-day problems and needs of the marine community are addressed.

GAO has not worked on the National Ocean Satellite System or the Coastal Energy Impact Program and does not have information on the merits of the Administration's proposals.

Relevant GAO Reports: GGD-76-107, CED-80-103 and letter report dated October 25, 1979

Contact: Frank V. Subalusky, 443-8691

President's  
Proposal - Reduction of School Assistance  
In Federally Affected Areas  
(Impact Aid)

GAO Supplementary Discussion

GAO Views. In an October 1976 report to the Congress we presented an economic analysis of fiscal year 1973 impact aid data from 1,671 local education agencies. This analysis showed that without impact aid 48 percent of the agencies would need property tax increases of less than 5 percent and 18 percent would need increases of 5 to 10 percent. At the upper extreme, 15 percent of the local agencies without impact aid would need property tax increases of 25 percent or more. A 1977 updated analysis of fiscal year 1976 data showed similar results.

Relevant GAO Reports. Assessment of Impact Aid Program (HRD-76-116, Oct. 15, 1976). Letter report to Chairman and Ranking Minority Member, Subcommittee on Elementary, Secondary, and Vocational Education, House Committee on Education and Labor (HRD-78-132, July 13, 1978).

GAO Contact: Al Jojokian, 245-9623

President's  
Proposal - ECONOMIC REGULATION

GAO Supplementary Discussion

The administration proposes to eliminate or streamline a number of energy regulatory activities. Discussed below are: utility programs, coupon gasoline rationing, enforcement of oil pricing regulations, and coal switching.

Utility Programs

GAO Views. The administration's proposal appears to eliminate interventions in State public utility proceedings by DOE's Economic Regulatory Administration (ERA). In addition, the proposal would apparently eliminate ERA's ability to work with and encourage voluntary actions by utilities and States to ensure adequate and cost effective electric power.

GAO recently pointed out that States need improvement in electricity demand/supply planning and that electricity planning in many instances goes beyond State boundaries. For these reasons, GAO recommended that DOE (through ERA) take a more active role in working with States to improve electricity planning in order to protect consumers and to advocate national energy policy. GAO also recommended that, if State action is inadequate, DOE should intervene at State and regional levels to promote national energy policy. (The Utility Program within ERA is responsible for these functions.)

GAO still believes that the Federal Government has a responsibility to ensure that States and utilities consider the national energy interest in developing plans for balancing electricity supply and demand. Further, electric utilities, States, and Federal Government agencies should work together to improve electric power planning and decisionmaking. This would improve the quality of overall electric planning and help provide better information upon which electricity demand/supply decisions are made.

Relevant GAO Report. EMD-80-112

GAO Contact. John Brown, 275-3572

Coupon Gasoline Rationing

GAO Views. While coupon gasoline rationing would be cumbersome and expensive, the debate over the need for a standby rationing plan has been ongoing since 1974, with no consensus emerging around any options preferable to rationing as a last-resort measure. In fact, the Emergency Energy Conservation Act, enacted in November 1979, reaffirmed the President's and the Congress' desire to have in readiness a standby gasoline rationing plan.

GAO believes that, before abandoning development of the rationing plan, the administration should present, and get congressional agreement on, what "streamlined measures" the administration plans to substitute for a standby rationing plan.

Relevant GAO Reports. EMD-78-59 and March 26, 1979, testimony

GAO Contact. William C. Oelkers, 252-1400

Enforcement of Oil Pricing  
Regulations

GAO Views. The administration proposes only \$12 million for Economic Regulatory Administration compliance activities in 1982, a reduction of \$59 million from the 1981 budget of \$71 million. Although the 1981 budget can be reduced, such a drastic budget cut would effectively eliminate DOE's compliance program. At the beginning of fiscal year 1981, DOE had a compliance staff of 1,218. Under the proposed 1982 budget plan, DOE would have to reduce its compliance staff to about 100 by the end of fiscal year 1982. Oil companies would perceive such a staffing reduction as a lack of commitment on the part of ERA to bring all unresolved violations to a fair and logical conclusion, and probably cease their attempts to settle with ERA.

One of the principal problems facing DOE now that oil decontrol has been effected is the large number of unresolved cases involving billions in alleged violations. As of January 30, 1981, DOE had identified \$13.1 billion in alleged violations, of which about \$9 billion was still unresolved.

GAO believes that DOE should develop a plan calling for the orderly resolution of all violations and litigation outstanding on January 28, 1981, the effective date of decontrol. GAO believes that the pursuit of fair resolutions is important in the interest of fairness to the companies that did not violate pricing regulations and to those companies that agreed to settle their violations and that a failure to follow through on these charges could set a dangerous precedent for any future enforcement regulations established to implement Federal laws.

Relevant GAO Reports. EMD-80-34

GAO Contact. Gerald Elskan, 275-3551

Coal Switching

GAO Views. The administration proposes no funding for coal switching starting in fiscal year 1982, a \$24 million budget reduction. This would eliminate the following regulatory activities: (1) completion of regulatory orders which are intended to cause utilities to switch existing boilers from oil to gas to coal, (2) processing of petitions for exemptions from

the Powerplant and Industrial Fuel Use Act prohibitions on additional oil and gas use in new or existing boilers, and (3) administration of the prohibitions on natural gas use by electric utilities starting in 1990.

GAO believes that this program is an attractive target for budget cuts. Increased coal use is not strongly dependent on these programs, since economic incentives to use coal as an alternative fuel exist already. In addition, exemptions from the Fuel Use Act oil and gas use prohibitions are available if companies cannot afford to use coal, cannot comply with environmental rules, or are limited to oil and gas use by practical considerations. Preliminary information shows that utilities are reducing oil use and are attempting to convert 15 of the 32 existing powerplants under proposed orders. Many of these are likely to be completed without the program, although the Economic Regulatory Administration's environmental analyses and final conversion orders may be needed in some cases to cause final action at the State and local levels. About 40 percent of the program's projected 400,000 barrels a day savings may be achieved if all the voluntary conversions occur. Those opposed to conversion intend to apply for exemptions.

Most new boiler capacity which will be built in the U.S. will be coal-fired, according to various reports. The electric utility industry, for example, projected that 52 percent of the generating capacity to be added between 1980 and 1989 will be coal-fired, 35 percent nuclear, and only 3 percent oil- or gas-fired. However, there presently remains some economic incentive to use oil and natural gas in some industrial boilers because coal-fired boilers require a larger capital investment. The program will cause companies to carefully evaluate fuel mixtures or other alternatives to oil and gas.

Relevant GAO Report. EMD-81-31

GAO Contact. Charles Adams, 275-3551

GAO Supplementary Discussion

GAO Views. GAO recently reported on the increasing costs and competition which may hinder the U.S. position of leadership in high energy physics.

The proposed fiscal year 1982 budget reduction of \$40 million for the Department of Energy's (DOE's) general science programs still reflects a budget authority increase of about \$63 million over the fiscal year 1981 level of \$504 million. Amounts for high energy physics represents about two-thirds of DOE's general science funding.

GAO generally agrees that Federal support of long-term, high-risk basic research is appropriate. With respect to high energy physics, the Federal Government provides nearly all of the funding support. Such a role seems appropriate because the benefits of the research are primarily of a long-term, unpredictable nature, and private sponsors are unlikely to be able to realize the full benefits. In establishing funding levels for DOE's support of the program, however, inadequate consideration appears to have been given to the amounts needed to carry out program goals and the priority of high energy physics relative to other basic sciences.

Even with the limited funding increases, the program is expected to continue to stretch out construction and decrease already low levels of operations and accelerator use. Such constraints will hinder the U.S. program's ability to maintain a position of leadership, GAO believes. Accordingly, the report recommended that a study is needed to determine the appropriate funding level for the U.S. high energy physics program, considering factors impacting on its needs and importance to other basic sciences. Such a study may disclose that, all factors considered, the proposed funding level is appropriate. On the other hand, if less funding is recommended, then consideration should be given to pursuing an alternative policy or approach which would require funds equal or nearly equal to the amount deemed appropriate.

Relevant GAO Report. EMD-80-58

GAO Contact. Thomas E. Melloy, 353-3711

President's  
Proposal - Eliminate Medical Services Entitlement  
For Merchant Seamen

GAO Supplementary Discussion

GAO Views. We have not made a study of the merits of continuing entitlement of seamen as Public Health Service (PHS) beneficiaries. We noted, however, that:

- Since 1798 the Federal Government has had an extensive involvement in funding programs to control and eliminate communicable diseases.
- In a draft report on opportunities for PHS to reduce the costs, we point out that many seamen have health insurance or are covered under insurance-type programs.
- PHS has no feasible means to verify that individuals claiming to be seamen meet existing eligibility criteria.

The proposal to close the PHS hospitals and clinics is premised on low occupancy of PHS hospitals, excess supply of hospital beds in each of the eight cities where PHS has a medical hospital, and the availability of at least one other Federal hospital in each of the eight cities which is operating at less than 80% capacity. These Federal facilities would be envisioned as sources of care for the uniformed service beneficiaries of the PHS being treated in the PHS hospitals and entitled to Federal care.

In April 1975, we reported to the Chairman, Subcommittee on Labor-Health, Education, and Welfare, Senate Committee on Appropriations, that during fiscal years 1972 through 1975 the eight PHS hospitals experienced a decline in the number of hospital admissions, the average daily patient load, and outpatient visits provided to all of its beneficiaries.

In May 1977, we repeated this message and pointed out that because of the hospitals' attempts at maintaining a level and range of direct patient care services comparable to 1973 levels and ranges, the PHS hospital system was unable to

- prevent a reduction in the level and range of other health-related activities, including training and research;
- maintain authorized staff ceilings;
- maintain adequate inventories of drugs and other supplies;
- maintain an adequate program for replacing obsolete equipment or purchasing new equipment required by advancements in modern medical practice and technology; and

- Statistical sampling techniques can be used to a greater extent to reduce the amount of information collected, analyzed, validated, and processed.
- Many types of analyses EIA performs are discretionary; that is, they have not been mandated by law or requested by legislators, regulations, program managers and analysts, decisionmakers, or the general public. EIA has not demonstrated that these analyses are cost-beneficial.
- When EIA was created, it continued collecting the types of data that were collected by its predecessor agencies. Also, other types of data were collected in response to energy-crisis situations. EIA has not demonstrated that these types of data are still relevant.

While it may be possible for EIA to absorb major budget reductions and still generally meet its data requirements, GAO does not believe that the proposed funding level for data validation activities will allow the agency to meet its basic mission of providing credible information. Under EIA's initial budget of \$237 million for fiscal year 1982 activities, \$14 million, or about 11 percent of the budget, was designated for validation activities. The proposed budget request would reduce funding for validation activities to \$3 million, or only about 4 percent of the \$80 million being requested. Under the proposed level of funding, EIA would not have proper control over the quality of its information and the accuracy of most information provided would be undetermined.

This situation is exacerbated by the fact that EIA historically has not placed adequate emphasis on data validation activities. For example, the most recent PART report showed that, as of June 1980, EIA has issued validation reports on only 4 of its 55 information systems. Further, in reviewing three of these reports, PART concluded that they did not adequately address all of the issues which should be addressed in a thorough validation study and recommended that EIA assign a higher priority to validation activities.

Relevant GAO Reports. EMD-78-112 and EMD-78-86

Other Relevant Reports. PART reports, November 13, 1980 and  
May 7, 1979

CONTACT: Edward Kratzer, 376-4468

GAO Supplementary Discussion

GAO Views. GAO has issued several reports on the activities of the Energy Information Administration. These reports were critical of the methods used by the agency to define its energy data needs and to determine the usefulness of information it was providing. In addition, GAO has had considerable involvement in the work of the Professional Audit Review Team 1/ (PART), which conducts an annual evaluation of EIA's activities and operations. The administration's proposed reductions in EIA's EIA's budget would eliminate or severely cut back on the agency's discretionary, detailed data collection efforts. As shown in the following table, these reductions will encompass each of the agency's four budget categories.

<u>Budget activity</u>	<u>Previous Administration</u>		<u>Current Administration</u>	
	<u>FY 81</u>	<u>FY 82</u>	<u>FY 81</u>	<u>FY 82</u>
	(budget authority, in millions)			
Data collection	\$ 47	\$ 60	\$41	\$40
Applied analysis	11	16	10	8
Validation	14	14	11	3
Data services	<u>32</u>	<u>37</u>	<u>28</u>	<u>29</u>
	\$104	\$127	\$90	\$80

Although the administration's proposed budget will require EIA to make significant reductions in the amount and kind of data collected, analyzed, and published, there are a number of factors which will or could offset the impact of the reductions on EIA's capabilities to meet its goal of providing objective energy information. For example, EIA has been collecting data for both regulatory and statistical reporting purposes. For regulatory purposes, EIA must collect detailed information on each actor in a given regulatory situation--each refinery, each petroleum company, and so forth. Deregulation of oil prices, therefore, should enable EIA to cut back substantially on its data collection, analysis, and validation activities.

EIA can also mitigate the effects of budget reductions by improving the efficiency of its operations. For example:

1/ PART was formed to review and evaluate EIA's work and to determine whether data collection and analysis activities are being performed in an adequate and professional manner consistent with the intent of the Congress. PART members are drawn from several Federal offices and agencies. The Comptroller General appoints the PART Chairman.

--spend funds needed to maintain and repair existing equipment and facilities, resulting in the continued deterioration of the hospitals.

In a draft report on opportunities to reduce PHS costs, we state that PHS hospitals (1) are not complying with provisions of the Federal Medical Care Recovery Act and as a result have not been reimbursed for costs incurred in providing care to PHS beneficiaries treated under tort conditions; (2) are not adequately assuring that individuals seeking care as seamen beneficiaries are eligible for free care; and (3) lack adequate control over the volume, cost, and quality of services provided to PHS primary beneficiaries under contract with PHS. This report is expected to be issued to the Congress in May 1981.

We note the following issues not addressed in the President's proposal or in our reports:

1. What impact will closing the hospitals have on the PHS Commissioned Corps which provides staff to the PHS hospital system as well as the Indian Health Service Hospital System and other programs administered by the Department of Health and Human Services?
2. The PHS also operates a hospital in Carvelle, Louisiana, as a leprosarium. No mention is made about the future of this facility in the President's proposal.

Relevant GAO Reports. Letter Report to Chairman, Subcommittee on Health-Education, and Welfare, Senate Committee on Appropriations on PHS efforts to provide level and range of services at least equal to those of January 1, 1973. (MWD-76-3, Apr. 22, 1975)

Letter Report to Chairman, Senate Committee on Appropriations on PHS efforts to provide level and range of services at least equal to those of January 1, 1973. (HRD-77-111, May 26, 1977)

GAO Contact: Robert Farabaugh, 275-6207

Better Targeting of Federal Subsidies  
For Health Professions Education

GAO Supplementary Discussion

GAO Views. We believe that the broad objective of this budget reduction proposal is reasonable and warranted in view of the September 1980 report of the Graduate Medical Education National Advisory Committee which projected that by 1990 the U.S. would have an excess of about 70,000 physicians. About one-half of this excess was attributed to the influx of foreign medical school graduates.

In issued reports we have supported constraining assistance to medical students. An August 1978 GAO report concluded that it was doubtful that a separate Health Professions Loan Repayment Program was still needed to attract physicians to shortage areas. We recommended that Congress reconsider whether the loan repayment program for physicians should be continued since it had not induced substantial numbers of physicians to enter shortage areas, and it seems that many physicians participating in the programs received windfall repayment of their education loans by the Federal Government since they would have established their practice in those shortage areas anyway.

A November 1980 GAO report pointed out that the Department of Education (ED) and the Veterans Administration (VA) were providing financial assistance in the form of guaranteed student loans and educational benefits for several thousand U.S. citizens studying medicine abroad. Before authorizing guaranteed student loans for studying abroad, ED is required by law to determine that the education and training is comparable to that provided by a U.S. school. The VA Administrator can deny or discontinue educational benefits if he finds that such enrollment is not in the best interest of the individual or the Government.

Our report showed that (1) the education and training received by students at the six foreign medical schools we visited was not comparable to that offered in U.S. schools, and (2) ED and VA were not making adequate comparability determinations. We recommended that procedures be established that ensure medical schools are comparable before student loans are made.

Relevant GAO Reports. "Progress and Problems in Improving the Availability of Primary Care Providers in Underserved Areas" (HRD-77-135, August 22, 1978.)

"Policies on U.S. Citizens Studying Medicine Abroad Need Review and Reappraisal" (HRD-81-22, November 21, 1980.)

GAO Contact: J. William Gadsby, 443-3596

Eliminate Unnecessary Federal Subsidies for the  
Development of Health Maintenance Organizations

GAO Supplementary Discussion

GAO Views. Since enactment of the Health Maintenance Organization (HMO) Act of 1973, we have made numerous reviews of the HMO program. Until recently, most of our efforts were legislatively mandated or done at the specific request of a congressional committee. Our initial effort concentrated on HHS' (formerly HEW) management weaknesses and/or restrictions in the legislation which hampered program implementation. Our second major effort addresses the extent to which 14 federally qualified HMOs complied with the various provisions in the act and the Department's progress in improving program management. In this report we pointed out that HMOs' ability to become self-sustaining business entities was dependent upon such factors as

- the ability to control costs when they must rely on non-H providers to service enrollees;
- the ability to generate sufficient revenues through their pricing strategies and marketing capabilities; and
- the ability to accurately forecast future costs.

One of the recommendations in this report addressed the need for program to train individuals responsible for managing HMOs.

In May 1979 we reported to the Congress our conclusion that the existing \$4 million Federal loan limitation to help HMOs cover operating losses was sufficient to enable HMOs to achieve financial independence within 5 years after becoming qualified and we recommended that HHS develop a strategy to assess the fiscal soundness of individual HMOs.

To date nine HMOs have defaulted on their Federal loans and, according to HHS, an additional 28 HMOs are currently in noncompliance and may eventually default. Although the President's proposal states that artificially high minimum benefit requirements and organizational standards have been a leading source of defaults, we note that a leading HMO expert studied the first seven HMOs that defaulted and lost their Federal qualification. The expert concluded that poor management was the primary cause of three HMOs' default; inability to obtain projected enrollment was the cause of two defaults; one HMO had a rapid growth in enrollment while experiencing a \$5 monthly loss for each enrollee; and, one was located in an area which could not attract sufficient enrollment.

An ongoing review addresses various means that HMOs are employing to better control costs of operation. Our preliminary observations include that HMOs are either

--being more selective in whom they accept as enrollees, and/or

--adopting cost containment procedures, such as encouraging use of hospital emergency rooms only for emergencies, encouraging outpatient surgeries, requiring management approval prior to referring patients to non-HMO specialists, and monitoring length of stays in hospitals.

Relevant GAO Reports. "Factors That Impede Progress in Implementing the Health Maintenance Organization Act of 1973" (HRD-76-128, September 3, 1976)

"Can Health Maintenance Organizations be Successful?--An Analysis of 14 Federally Qualified HMOs" (HRD-78-125, June 30, 1978)

"Health Maintenance Organizations: Federal Financing Is Adequate But HEW Must Continue Improving Program Management" (HRD-79-72, May 1, 1979)

GAO Contact: Robert Farabaugh, 275-6207

President's

Proposal -

Restrain Excess Growth in the  
National Health Service Corps (NHSC)

GAO Supplementary Discussion

GAO Views. We believe that the budget reduction proposal to eliminate all new NHSC scholarship awards in 1981 and 1982 is a reasonable course of action that would temporarily curtail further growth of the NHSC and provide opportunity for a comprehensive evaluation of its long-range goals and objectives.

Over the past 9 years the NHSC has grown in size, cost, and numbers of communities served. In 1973, the NHSC had a budget of \$7 million and a field strength of 330. In 1978 the budget was about \$40 million; the field strength, 1,350. In 1979 the budget was \$63 million; the field staff, 1,850. By the end of fiscal year 1980, the budget was about \$75 million; the field staff, 2,060.

In 1980 about 2,000 health professionals served 968 communities located throughout the United States. About 50 percent of this corps are physicians; 15 percent dentists; 20 percent physician extenders; and 15 percent dietitians, social workers, and other health professionals. Of the sites, 424 were freestanding (only NHSC personnel) and 544 were integrated (NHSC providers incorporated with one or more Federal grant programs). By 1990, the NHSC plans to have about 9,000 providers and incur a total annual cost of over \$450 million.

Temporarily curtailing the growth of the NHSC scholarship program would provide an opportunity to evaluate

- whether the NHSC scholarship program is giving adequate priority to supporting students who intend to practice in the medical disciplines most needed,
- the long term financial implication of sending substantial numbers of NHSC physicians to integrated (grant-supported) health centers,
- whether NHSC providers have been placed where they are truly needed and what impact they have had on access to care and other service delivery problems at the health center level, and
- what the appropriate size of the NHSC should be given the physician supply projections and the other reductions in health professions assistance programs that are being recommended.

Relevant GAO Reports. "Progress and Problems in Improving the Availability of Primary Care Providers in Underserved Areas" (HRD-77-135, August 22, 1978).

GAO Contact: J. William Gadsby, 443-3596

Proposal - Phasing Out Federal Regulation of the  
Health Care Industry

GAO Supplementary Discussion

GAO Views. Health Planning - We have done considerable work in the health planning program over the last several years. Our initial effort, which resulted in a report to the Congress in November 1978 (HRD-77-157), identified several problems the program was experiencing during the early stages of its implementation. More recently we analyzed the adequacy of health systems plans developed by Health Systems Agencies (HSA). This effort determined that the plans, which are fundamental for accomplishing HSA objectives, were inadequately developed and did not represent a well-developed framework for making needed changes in the health care system. This report is presently with the Department of Health and Human Services (HHS) for comment and should be finalized and issued to the Congress by April 15.

Presently we are looking at the degree to which local government agencies--health departments, etc.--engage in health planning activities and the degree to which they make use of health systems plans and other inputs from HSAs. Our limited work to date indicates that local governments do perform health planning functions; that is, they identify health needs, develop plans and to the degree possible, devote resources to address the needs. Little reference is made to the HSA or its health systems plan during this process. This leads us to question whether any benefits exist due to the health planning functions performed by HSAs.

HSAs have little authority to bring about change in the health care system. They provide only advice to States in the certificate-of-need process and appropriateness review process. Their only real authority is to approve or disapprove proposed uses of Federal grant funds in their health service areas. However, according to HHS' Bureau of Health Planning, of about 6,800 reviews done by HSAs, only 86 proposals were disapproved. HHS, which has ultimate approval authority, overruled the HSA in 68 of the 86 disapprovals. Summarizing, of about 6,800 reviews of proposed uses of Federal grant funds performed by HSAs, only 18 (0.3 percent) were disapproved.

Relevant GAO Reports. Status of the Implementation of the National Health Planning and Resources Development Act of 1974 (HRD-77-157, November 28, 1978)

Letter report to the Secretary of HHS on Health Planning Savings Claimed by the American Health Planning Association (HRD-80-49, March 13, 1980)

Contact: William A. Gerken, 275-5132

Professional Standards Review Organization - The Medicaid and Medicare laws require that services paid for under the programs must be reviewed to ensure that only claims for medically necessary and appropriate services are paid. In areas where PSROs have been designated, they are responsible for such reviews of inpatient hospital services. In some areas, PSROs also review nursing home services. If PSROs are phased out as proposed by the Administration, some other mechanism for performing these reviews would have to be established (thus reducing or eliminating the administrative cost saving from abolishing PSROs) unless the utilization review provisions of the laws were also repealed. We cannot support, at this time, repeal of the utilization review provisions because we do not know what the impact would be on utilization rates.

Questions have been raised about the cost effectiveness of PSROs. The Congressional Budget Office (CBO) estimated that for every \$1 spent on the PSRO program to review Medicare inpatient hospital services only \$.40 was saved by the health care system during 1978. This results because, if fewer inpatient days occur the fixed costs of hospitals increase for each day of care provided, so society only saves a portion of the cost of a day of care. However, CBO also estimated that, on an incremental cost basis, PSROs saved the Medicare program \$1.20 for every dollar spent. Thus, viewed on this basis from the Federal perspective, Federal expenditures would increase if the PSRO program were eliminated.

It is important to keep in mind that the CBO estimates are national averages and that individual PSROs vary greatly in their effectiveness. It could be preferable to continue funding effective PSROs and to eliminate PSROs which are not cost effective by substituting something more effective for them.

One potential long-term benefit of effective PSROs (or any form of effective utilization review) could be the reduction of excess hospital capacity through closure or conversion of unneeded low occupancy hospitals and preventing the construction of unneeded additional facilities.

In 1978, we reported that the operating costs of the PSROs could be reduced by consolidating small PSRO areas.

Relevant GAO Report. Opportunities to Reduce Administrative Costs of Professional Standards Review Organizations, HRD-78-168, October 12, 1978

Contact: Robert Iffert, 245-1572

President's

Proposal - TERMINATION OF THE HUD PLANNING ASSISTANCE PROGRAM

GAO Supplementary Discussion

GAO Views: In proposing to end HUD's planning assistance program authorized by Section 701 of the Housing Act of 1954, the Administration states that the 701 program has accomplished its primary objective of developing sub-national planning capabilities and that general planning assistance, unlinked to program implementation, as in the case of the 701 program, is ineffective. Also, the Administration believes that to the extent States and localities benefiting from the program find it worthwhile and of high priority, they can provide funding, or use block grant or general revenue sharing funds for this purpose, at their own discretion.

We do not totally agree with these arguments. The 701 program does fund planning activities of States and localities. However, organizations receiving the largest portion of 701 funds (about \$22 million of \$34 million authorized for fiscal year 1981) are the approximately 640 metropolitan and non-metropolitan areawide planning organizations. These organizations do not qualify for funding under the Community Development Block Grant (CDBG) program or general revenue sharing. Therefore, unless States, cities, or localities fund areawide planning organizations, they would likely be forced to curtail much of their planning efforts. An alternative to ending the 701 program would be to limit 701 funding to entities, such as areawide planning organizations, who do not receive funding from CDBG or revenue sharing.

Relevant GAO Report: February 20, 1974, letter report to HUD on the 701 program.

Contact: Steven J. Wozny, 426-1780.

GAO Supplementary Discussion

GAO Views: The Administration proposes to eliminate the rehabilitation loan program principally on the basis that this fund provides assistance for housing rehabilitation similar to that currently being provided through the Community Development Block Grant (CDBG) program. GAO concurs in this assessment but believes it is important to note that the termination of this fund coupled with the Administration's proposed restructuring of the CDBG program may result in reduced levels of housing rehabilitation being accomplished nationwide. GAO believes that the impact resulting from a reduction in Federal expenditures for housing rehabilitation can be offset, or minimized, through the adoption of certain new housing rehabilitation policies and the implementation of improved management practices.

In December 1979, GAO reported that annually \$240 million in Federal funds for housing rehabilitation assistance under HUD's rehabilitation loan fund and CDBG programs were not being used effectively by communities. For example, over \$76 million in rehabilitation loan funds and a large amount of CDBG rehabilitation funds were being used to refinance home mortgages rather than for housing rehabilitation. GAO further estimated that over \$150 million in CDBG rehabilitation funds could be used more effectively by communities if they would combine direct grants with other funds or use loans instead of grants to finance housing rehabilitation—thereby stretching the use of available funds. Also, GAO stated that additional funds could be better spent if HUD (1) ensured that low- and moderate-income persons received funding priority and (2) implemented higher interest rates and more realistic repayment periods to reflect a borrower's loan repayment ability as provided for by legislation.

GAO also reported in March 1980 that better methods were available for improving HUD's cash management procedures for the rehabilitation loan fund program and procedures for letter-of-credit withdrawals for CDBG rehabilitation direct grants. The Federal savings from planned corrective actions by HUD could result in about \$1 million annually.

GAO work currently underway also shows that the lack of HUD guidance on CDBG supported housing rehabilitation work has resulted in non-essential work being completed, relatively high income persons being assisted, and wide disparities in the types of work that can be done. GAO believes that if better Federal guidance is provided to communities (1) limiting eligible housing rehabilitation work to that which is essential to restore the unit to a safe, decent, and sanitary condition, specifically prohibiting non-essential items and (2) developing overall income eligibility requirements for recipients, then more rehabilitation could be accomplished with available funds.

Relevant GAO Reports: CED-80-19 and CED-80-74.

Contact: Steven J. Wozny, 426-1780

GAO Supplementary Discussion

GAO Views We agree with the President's proposed (1) moratorium on Federal land purchases, (2) elimination of the State recreation grant program, and (3) use of the Land and Water Conservation Fund (LWCF) for restoration and improvement of the existing national park system. We do not agree with his proposal to cut the historic preservation fund from \$32 million to \$5 million in fiscal year 1982.

State recreation grants—States obtain funds for outdoor recreation projects from the LWCF on 50/50 matching basis. States can use other Federal funds to finance all or part of the matching requirement. Therefore, eliminating the State portion of the LWCF could also reduce the need for other Federal funds. On November 1, 1979, we issued a report which identified 500 recreation projects that received financial assistance through the LWCF and other Federal programs. The total cost of these projects amounted to about \$144 million with the LWCF contributing about \$66 million and other Federal programs contributing about \$47 million for a total of \$113 million in Federal funding. The Federal share therefore was 78 percent. Should the 78 percent total Federal funding hold up for all projects, potential Federal savings could be greater (an additional 28% of project costs) if the States did not go forward with the projects or use the funds for other purposes.

During a current evaluation, we found that some States, because of shrinking recreation budgets, were having problems adequately maintaining and operating LWCF projects. Some were using Comprehensive Employment Training Act funds and other Federal programs to operate and maintain local recreation areas or were allowing them to deteriorate. Elimination of the State share of the LWCF could encourage States to use funds earmarked for land acquisition and development for the operation and maintenance of existing recreation facilities.

Federal land acquisition and administration and National park restoration and improvement—We issued a report on December 14, 1979, which pointed out that at the present time, the Federal Government has no overall policy on how much land it should protect, own, and acquire. Federal agencies have followed the general practice of acquiring as much land as possible regardless of need, alternative land control methods, and impacts on private land owners. Consequently, lands have been purchased that were not essential to achieving project objectives, and before planning how the land was to be used and managed. We, therefore, agree that there should be a moratorium on Federal acquisition until an overall policy is developed.

Reducing the Federal share of the LWCF except for contingencies would also reduce the future need for developmental and operational funds. The Park Service needs over \$5 billion to rehabilitate, upgrade, and replace facilities in National Parks, including \$1.6 billion to protect visitor health and safety and \$2 billion to upgrade its road system. The Congress would

have to appropriate about \$342 million a year to fund just health and safety projects over a 5-year period. The \$105 million of LWCF monies proposed by the President would help, but would not be enough to correct just health and safety deficiencies. Two alternatives would be to (1) raise user charges (entrance and camping fees) or collect them at additional locations and use the funds to correct health and safety deficiencies, and (2) require concessionaires to make health and safety improvements on facilities they own or manage.

Another alternative source of funding was pointed out in our January 22, 1981, report which said that the National Park Service spent \$2.4 million to purchase land at the Lake Chelan National Recreation Area contrary to Congress' intent that acquisition costs be minimal. We recommended that the Service stop purchasing additional land and sell back to previous owners or other private individuals lands compatible with the purposes of the recreation area. There may be other areas where the Service should sell land back to private land owners. These funds could be used for restoration and improvement of the park system.

The urban national recreation area program provides Federal funds from LWCF to help develop urban recreation areas for inner-city residents. The Park Service estimates expenditures of over \$313 million to develop and acquire land for the first three national recreation areas—Golden Gate, Gateway, and Cuyahoga Valley. Two additional recreation areas established in late 1978—Santa Monica and Chattahoochee—have authorized expenditures of about \$200 million for land acquisition.

Our June 1979 report pointed out that the urban national recreation areas were not being used very often by transit-dependent, low-income, inner-city residents who need recreational opportunities the most. The report also noted that about 45 percent of the lands within the recreation areas were owned by State and local governments. Since less than half of these lands had been donated to the Secretary, we recommended that the Secretary examine ways to accomplish the recreation areas' objectives without Federal land ownership.

Historic preservation fund—Reducing the historic preservation fund from \$32 to \$5 million in fiscal year 1982 would cut off Federal funding of State historic preservation offices and, therefore, greatly reduce their role in the National Archeology Program, which costs about \$100 million annually and is not working well. Because of a lack of Federal direction and criteria on determining whether an archeological site is of national significance, Federal agencies could spend billions of dollars over the next 10 to 30 years on archeological studies, many of which may not be necessary. State historic preservation offices could play a greater role in helping Federal agencies determine whether archeological properties are significant and eligible for listing on the National Register of Historic Places.

Relevant GAO Reports: CED-81-10, CED-80-115, CED-80-14,  
CED-80-23, CED-79-98

GAO Contact: Roy J. Kirk, 376-8212

GAO Views:

On October 15, 1980, we issued a report entitled "Highway Safety Grant Program Achieves Limited Success," (CED-83-16.) We found that, since 1966, the Department of Transportation (DOT) had provided States and local governments nearly \$1.3 billion in Federal highway safety grants to help reduce motor vehicle accidents and deaths. Our assessment of the grant program indicated that

- changing and sometimes conflicting direction from the legislation, DOT, and the States had caused the program to address a multitude of safety activities that may not have been the most effective,
- evaluations generally had not determined whether funded projects effectively reduced accidents, and
- many measures that are believed to improve highway safety are not implemented by the States.

We made several recommendations to the Secretary of Transportation to improve the Federal administration of the program. However, because of the large amount of funds that had already been spent on the program, and the lack of documented evidence to measure its effectiveness, we also felt that the Congress should consider some rather drastic administrative alternatives. Namely,

- if the Federal role is to continue administering the safety grant program, the program's effectiveness could be improved by strengthening DOT's leadership role and administrative authority. This alternative would limit the States' ability to address any and all safety-related activities by establishing a single program direction that all States should follow.
- if the Federal role is to assist in financing safety activities in State-identified problem areas, DOT could limit its involvement in the program to include only technical assistance to the States regarding safety research. Therefore, the States could be funded directly, eliminating many of the burdensome administrative requirements that are now part of the program. Under this approach, the Congress could determine a more narrow scope for funding eligible safety-related activities.
- if the responsibility for financing and administering future highway safety activities is ever to be turned over completely to the State and local government, the Federal role in highway safety grant program could be eliminated, and future funding could be discontinued. Because the Federal grants represent only 2 to 3 percent of what the State and local governments are already spending in this area, the Federal funding for the program may not, in itself, be large enough to have any significant impact on overall accident reductions. Moreover, the program may have

already served its purpose by establishing uniform safety standards, data collection/analysis systems, and State highway safety agencies. Thus, the States would be solely responsible for funding those safety activities that they believe in and are already supporting with their own funds.

In its budget reduction justification, the Administration referred to GAO's report and our conclusion that there is no evidence that highway safety grants have reduced highway fatalities as part of its justification for discontinuing the program.

Relevant GAO Reports: CED-78-18; CED-79-33; CED-81-16.

GAO Contact: J. Kevin Donohue, 426-1777.

President's Proposal

REDUCTIONS IN NASA PROGRAMS - CHAPTER 6, p. 6-35

GAO Supplementary Discussion

In August 1978, GAO reported on its analysis of, among other things, the need for more than three orbiters. At the time of GAO's study, the administration was requesting four orbiters but both NASA and DOD had taken the position that five orbiters would be required. The report discussed GAO's analysis of the need for a three, four, or five orbiter fleet. GAO concluded that three orbiters may be more than enough to provide a balanced and viable space program, but it also recognized that a fourth orbiter would provide for fleet attrition.

GAO Report: PSAD-78-57

Contact. Walton H. Sheley, Jr., 275-3456

GAO Supplementary Discussion

In July 1980, GAO reported on NASA Aircraft Energy Efficiency Program. GAO found that NASA's role in aeronautics had centered around basic research and technology work but had also been encouraged to increase emphasis on efforts that have nearer term payoff. Without a significant increase in resources, NASA could not satisfy both of these demands. Therefore, GAO concluded that there was a need to develop policy guidance and direction to maintain a balanced aeronautical research and technology program that would be responsive to national needs.

GAO Report: PSAD-80-50

Contact. Walton H. Sheley, 275-3456



**SECTION G.**  
**CONSOLIDATE CATEGORICAL GRANT PROGRAMS INTO BLOCK GRANTS**

President's Proposal: Consolidating Elementary and Secondary  
Education Programs

GAO Supplementary Discussion

GAO Views. Federal education programs have been intended to supplement or stimulate State and local efforts. Over 80 Federal education programs support elementary and secondary education. Our April 1980 report to the Congress discusses the potential for a number of Federal education programs to provide duplicative services to students and increase the administrative costs.

We found that despite providing similar services under two or more Federal and/or State programs, duplication of services to students in the 36 local education agencies in the six States covered by our review was minimal. However, Federal, State, and local education agencies were spending significant amounts on administration. Although we did not identify significant instances of duplicate services to students, the administration of several separate programs, each with its own set of regulations requiring separate applications, evaluations, parent advisory groups, and other elements, undoubtedly adds to administrative costs.

Our report concluded that ways to improve administration of Federal education programs, including consideration of proposal to consolidate programs, should be explored.

Relevant GAO Reports: HRD-80-18, April 30, 1980

GAO Contact: William Hightower (245-9623)

GAO Supplementary Discussion

GAO Views. Health Programs: Currently, there are about 25 categorical health programs with annual appropriations approximating \$3 billion. Each program is intended to increase the accessibility of the general population or particular groups within the population to health services. Some programs are directed toward providing specific types of health services (i.e., family planning services, alcohol or drug abuse treatment, venereal disease treatment, etc.) while others are directed toward the development of centers where comprehensive health services are to be available (i.e., community health centers, mental health centers, etc.). Regardless of whether the health services offered are disease-specific or comprehensive in nature, similarity exists in that each program uses Federal grants to fund State or local governments or private organizations for providing these services. Some of the grant programs distribute funds to State and local entities based on formulae while others distribute funds directly to grantees based on estimated costs that will be incurred in providing the service or services.

In both testimonies and reports to the Congress, we have called for fundamental changes in the Federal assistance system and recommended consolidation of categorical programs. In regard to all types of grant programs, we have stated that:

- The categorical grant system has fostered an unwieldy and fragmented system for delivering public services. Categorical grants are too restrictive to meet actual service needs and cause administrative management problems at the State and local level.
- National priorities defined through the categorical grants with State and local government matching requirements induce these governments into ventures they otherwise may not have pursued with their own funds. As a result of the matching requirements to obtain the Federal funds, some needed State and local program efforts not consistent with national priorities are unsuccessful when competing with the federally supported programs for limited State and local funds.
- Legislative consolidation of like or similar programs is the most effective solution to (1) State and local governments' problems caused by the proliferation of categorical grant programs and (2) Federal agencies' inability to portray unified approaches to deal with social issues and population needs.

Opponents of legislative consolidation of categorical grant programs into a smaller number of block grants generally argue that with block grants, the Federal government loses fiscal accountability over the Federal funds. We believe that accountability for proper expenditure of funds is an important Federal interest but does not believe it is lost through the block grant approach. State and local governments can still be held accountable for the expenditures of Federal funds and it can be argued that with block grants it is easier to determine who is accountable.

In the health area, our recently issued report on infant mortality points out the problems associated with categorical grants. This report cited inconsistencies and lack of cohesiveness between such categorical grant programs as Maternal and Child Health, Sudden Infant Death Syndrome, Family Planning and Adolescent Pregnancy, and Genetic Screening; between the categorical programs and other federally funded efforts, such as Medicaid; and between all the federally assisted efforts and those of private industry. We recommended consolidation of the categorical health programs mentioned above. Also, we suggested that the Department of Agriculture's Women and Infant Care Program also be considered for consolidation.

In another recent report which focused on the Sudden Infant Death Syndrome program, we cited problems in administering the program and again recommended that the program be consolidated into the Maternal and Child Health program.

The myriad of categorical grant programs which have the same or similar objectives also provides opportunities for abuse and mismanagement at the grantee level. A 1976 report pointed out how a single grantee had obtained Federal funds directly as the grant recipient and indirectly as a "second-tier" grantee to provide family planning services in a community. The multiplicity of funding sources provided the grantee opportunity for duplicative payments. Such abuse would have been precluded if the programs were consolidated, and we recommended that the Congress consolidate the various family planning programs.

In an ongoing review of the family planning program (in essence there are three major sources of Federal funds--Title X of the Public Health Service Act and Titles V and XX of the Social Security Act and thus can be viewed as three programs) we are determining whether there are opportunities to consolidate these Federal efforts into a single program.

Relevant GAO Reports. "Administration of Federal Assistance Programs--A Case Study Showing Need for Additional Improvements" (HRD-76-91, July 28, 1976)

"Better Management and More Resources Needed to Strengthen Federal Efforts to Improve Pregnancy Outcome" (HRD-80-24, Jan. 21, 1980)

"The Sudden Infant Death Syndrome Program Helps Families But  
Needs Improvement" (HRD-81-25, Feb. 6, 1980)

GAO Contact: Robert Farabaugh, 275-6207



**SECTION H.**

**REDUCE OVERHEAD AND PERSONNEL COSTS OF THE FEDERAL GOVERNMENT**

Reductions of Federal Civilian Employment

GAO Supplementary Discussion

GAO Views. Reductions in the number of civilian employees are anticipated through reduced program levels in the revised budget and "by reducing overhead and by greater efficiencies in carrying out Federal programs." By far the most substantial employment reductions, however, are to be effected by the imposition of lower personnel ceilings and continuation of the hiring freeze until the lower ceilings are met.

We have maintained in reports over the past 10 years that personnel ceilings and freezes are not effective manpower controls because they limit management flexibility to plan and achieve work goals. We have recommended replacing personnel ceilings with funding controls and suggested that the Congress should carefully assess the impact of personnel ceilings and cutbacks if it is to avoid reducing staff at the expense of effectively administering important programs.

Our work has shown that personnel ceilings are inefficient because they

- are arbitrarily applied,
- are inflexible to program changes,
- are uneconomical because they increase overtime usage and contracting,
- cause skill imbalances,
- cause work and services to be deferred or cancelled, and
- cause managers to emphasize meeting the ceiling instead of the work.

If personnel ceilings yield inefficiencies, then hiring freezes are likely to yield even greater inefficiencies because of the necessarily arbitrary and capricious manner in which they affect an agency. With personnel ceilings, an agency at least retains the flexibility to shift resources through the process of attrition and replacement. This flexibility is lost during a hiring freeze. The inability to replace people with essential skills may bring substantial parts of an organization to a virtual standstill. Similarly, different attrition rates between localities will produce imbalances between parts of the organization whose workload is interdependent. This can rapidly lead to

overload in one location and underemployment of staff at another. Declining staff handling a steady or rising volume of work is likely to produce an escalating error rate as a result of pressure to handle an increased volume of work per person. Finally, the hiring freeze will impact most severely on those programs which are already understaffed.

Substantial employment cutbacks suggest the possibility of formal reductions-in-force. We have found that widespread use of reductions-in-force leads to the same problems--workload and skill imbalances, curtailed services and overtime or contracting out--that result from freezes and ceilings. In addition, reductions-in-force are usually associated with opportunities for earlier than normal retirement which increases the loss of the Government's most experienced and skilled employees and adds to the retirement system's already serious financial condition.

In summary, reductions--whether by hiring freeze, ceilings or reductions-in-force--would be credible if they were based on sound analysis that matched staffing levels directly to workload. However, this has rarely been the practice in the past, and it does not seem likely that renewed emphasis on ceilings and freezes without such analysis will reduce inefficiency or lead to increased productivity.

Relevant GAO Reports. B-165959, April 30, 1971; FPCD-74-46, July 21, 1974; FPCD-74-50, June 21, 1974; FPCD-75-129, January 7, 1975; FPCD-76-88, June 2, 1977; FPCD-77-85, February 9, 1978; GGD-77-85, September 13, 1977, FGMSD-79-43, July 27, 1979; PSAD-80-76, September 29, 1980.

GAO Contact. John Anderson, 275-5907

President's

Proposal - Revision of Federal Pay Comparability Standard

GAO Supplementary Discussion

GAO Views. In recent years GAO has issued several reports on the compensation policies and the pay-setting processes of the various Federal pay systems. One of our first and most important observations was that the Government's compensation policies, structures, and practices require continual evaluation and research to keep up with the constantly changing nature and composition of the labor markets as well as the Government's needs. Improvements are needed to achieve more reasonable comparability with the non-Federal sector in line with the basic purposes of comparability.

GAO has recommended that a policy which allows for adjusting not only pay but also benefits to achieve total compensation comparability between the Federal and non-Federal sectors be adopted. Benefits, however, are numerous, complex and difficult to quantify, and many assumptions and predictions must be made when estimating benefit levels and costs. While different assumptions may be equally reasonable and acceptable, they can yield different results. With the Federal nonpostal civilian payroll at nearly \$55 billion, changes brought about by instituting total compensation comparability could have a substantial effect.

We have reviewed the plan being developed by the Office of Personnel Management (OPM)--apparently the same plan as discussed in the revised budget--and we believe that certain features of OPM's approach need to be modified or substantiated before an accurate total compensation comparability system can be achieved. Specifically, we believe that OPM should be required to (1) insure that all significant benefits are appropriately accounted for in the analysis, (2) justify the assumptions used, (3) provide assurances that benefits data can be accurately gathered and classified and (4) consider major differences in benefits by major employee group and by locality. Given these complexities, we believe that an evolutionary approach which can be modified and refined over time may be appropriate. One possible approach would be to initially implement a total compensation comparability system in which pay and benefits are measured and adjusted separately.

A further refinement of the principle of comparability would be to include State and local governments in Federal white- and blue-collar pay surveys. We believe that the present legislated pay principle of comparability with the private sector is too restrictive. While the exclusion of State and local governments was originally justified on the grounds that their

salaries were "administered rates" which lacked the economic characteristics of private enterprise pay and that pay data gathered from State and local governments would be negligible compared to data from private firms, conditions have changed. State and local government employees now represent about 15 percent of the civilian work force and their pay--especially through collective bargaining--has become more competitive in the marketplace. We support their inclusion.

We do not support establishing the Federal compensation standard at 94 percent of the average non-Federal compensation (including benefits). We strongly believe that it is both inequitable and inappropriate to adjust Federal compensation upward or downward without first substantiating that differences do in fact exist, attaching a value to each of the differences, and assessing the implications of making such adjustments. A similar view was expressed by the President's Pay Agent when commenting on the time lag between the pay survey reference date (March) and the adjustment date (October). It stated that Federal pay adjustments must be based on factual data and not estimates or projections.

The revised budget proposed the 94 percent standard to recognize "those aspects of Federal employment which make it more attractive than many comparably-paid jobs in the private sector." As an example, the budget said that Federal employees may change jobs and career paths many times during a career with no loss in fringe benefits while comparable treatment is seldom available to private sector employees.

The "portability" feature is not unique to Federal employment. In the non-Federal sector social security retirement and disability coverage follows workers throughout their careers, even though they may change employers. Retirement entitlements under the Employee Retirement Income Security Act of 1974 are another example. Non-Federal workers may also obtain the same or a similar benefits package when transferring within units of a large corporation or, because of union-negotiated benefits packages, even to other companies within the same industry. We question whether valid assessments can be made of these factors which could serve as a basis for adjusting Federal compensation. Moreover, the budget proposal, in effect, assumes that each Government agency is a separate, independent employing entity rather than viewing the Government, overall, to be one employer. We believe this premise can be seriously questioned, particularly when it is used to reduce Federal employees' compensation.

Salaries for comparable jobs often vary substantially from one geographic area to another. Setting Federal white-collar pay on a locality basis similar to the Federal blue-collar system

would lessen situations where the Federal Government overpays in some areas and is unable to effectively recruit and retain employees in others. It would also obviate the need for separate cost-of-living allowances in nonforeign areas.

We support the movement to a locality pay system. We have some concerns, though, over how a total compensation policy might be implemented on a locality basis. Under OPM's approach, only a nationwide measurement of benefits will be obtained. Since indications are that private sector benefits can vary significantly from area to area, the use of local pay but national (instead of local) benefit measures in a total comparability analysis and adjustment could introduce some additional inequities into Federal compensation. We have recommended that OPM analyze local benefits and, if they are found to differ materially by locality, OPM should be required to take not only local pay but also local benefits into account when assessing and adjusting Federal compensation on the local level.

GAO has recommended several other changes to certain features in the blue-collar pay system that cause Federal wages to depart from prevailing private-sector rates. The features that should be modified are

- a five-step grade system with the average private-sector rate equated to the Federal step 2 even though 80 percent of the employees are above step 2;
- Federal rates which are sometimes set on rates paid in other than the local wage area;
- night-shift differentials that are not set according to local prevailing practice; and
- exclusion of State and local government jobs from the pay surveys.

By causing Federal blue-collar pay to exceed private-sector rates, these features reduce confidence in the Government's pay-setting policies, and increase outlays for pay and benefits. To the detriment of Federal blue-collar employees, these features also increase the likelihood of contracting out inasmuch as private-sector employees will tend to be less costly.

We support attempts to make Federal premium pay more consistent with non-Federal practices. For example, as mentioned earlier, cost-of-living allowances--a form of premium pay--for Federal employees in non-foreign areas should be unnecessary under a locality-determined pay system supplemented by special staffing differentials. We also believe that a

comprehensive approach is needed to reconcile inherent conflicts not only between the Fair Labor Standards Act and certain title 5 provisions (such as overtime entitlement) but also among all of the statutes, regulations, and instructions affecting premium pay.

We are generally in favor of the executive branch having additional pay flexibilities for recruiting and effectively managing a quality work force. For example, we have in the past recommended that more rational pay systems are needed to be designed around more logical groups of occupations. The authority to establish special occupational schedules for Federal white-collar employees could greatly assist in this area.

There are currently no principles or standards for setting Federal military pay. Under the proposed reforms the military would receive a pay adjustment based on salary increases in the private sector. The military would not be included in the total compensation comparability provision as would most Federal civilian employees, and military benefits would continue to be set separately.

We believe that it would be inequitable to set the compensation of Federal civilian employees by considering both pay and benefits but to allow the military--who enjoy even more liberal benefits--to receive their pay increases based on private sector salary movements alone. While the severe recruitment/retention problems in the military may require fundamental changes in pay policies, these changes have not yet been justified. In the interim, it appears reasonable that linking military and civilian pay be continued. The Federal white-collar pay adjustment percentage is used for adjusting pay of such groups as Members of Congress, Federal judges, and others. Further, the Federal white-collar pay survey would probably not provide an accurate estimate of overall salary movements in the private sector since this survey was designed to measure salary movements only for the selected occupations covered in the Federal General Schedule.

We cannot comment on the correctness of the 4.8 percent Federal white collar pay increase expected in October 1981 if certain reforms are enacted since that figure would depend on the many assumptions and predictions made in the analysis. As an example as to how variable such a figure might be, the Congressional Budget Office estimated that the 1980 adjustment for General Schedule employees under a total compensation mode could have ranged anywhere from 3.4 percent to 14.8 percent. This is because Federal benefits could be valued as being from 2.8 percent of pay behind the private sector to as much as 7.4 percent ahead, depending on what benefits are considered representative of the private sector and how they are measured:



CHAPTER 3

COST-SAVING PROPOSALS NOT INCLUDED

IN ADMINISTRATION PACKAGE



STATEMENT ON

IRS RESOURCES

In the emphasis to balance the budget by reducing Federal spending, we must not overlook the need for resources with which to collect Federal revenues generated through the tax system. Taxes are the primary source of Federal revenues, accounting for 96 percent of the \$465.9 billion collected in fiscal year 1979. Considerable evidence exists, however, to indicate that non-compliance with the tax laws is a serious problem. For example, the Internal Revenue Service estimated that up to \$135 billion in income earned by individuals went unreported in tax year 1976. Had the taxes due on this income been paid, the fiscal year 1977 budget deficit would have been reduced by 58 percent, from \$45 billion to \$19 billion. It is imperative that sufficient resources be available to shore-up the voluntary compliance upon which the tax system is based and provide better assurance that taxes owed the Government are in fact collected. Revenue collection and spending reduction go hand in hand with a balanced budget.

To illustrate, IRS estimates that its document matching program, in which information returns submitted by payers are compared with taxpayers tax returns, will recover about \$5.70 to the Treasury for each dollar spent in fiscal year 1981. As we pointed out in testimony last October before the House Subcommittee on Commerce, Consumer, and Monetary Affairs, Committee on Government Operations and in our October 20, 1980 report on the same subject (IRS Can Expand and Improve Computer Processing of Information Returns, FGMSD-81-4), IRS has made good progress toward a 100 percent match of all documents received, but additional improvements depend on an adequate funding level. For example, IRS currently matches about 76 percent of the information returns received. To increase that coverage beyond 90 percent would cost an additional \$40 million. That increase in funding, however, would return about \$107 million to the Treasury--a benefit-to-cost ratio of \$2.67 to \$1.

Contact. William J. Anderson, 275-6059

## THE DEPARTMENT OF ENERGY'S BREEDER REACTOR PROGRAM

Although the administration has not yet announced the details of its nuclear energy budget, one of the largest elements in recent years, a program which has generated considerable controversy, and a program which merits close congressional attention is the Department of Energy's breeder reactor program. Based on a considerable amount of recent work, GAO offers the following thoughts.

The development of a new generation of nuclear powerplants--breeder reactors--has been justified on the basis that they will make nuclear power a long-term energy source, not subject to the limitations of the Nation's uranium resource base. However, for the past several years there has been a great deal of controversy about whether a long-term future for nuclear power is desirable. Consequently, while the question of if and when breeder reactors should become commercially available remains unanswered, the Department is continuing a breeder reactor technology development program for ultimate commercial application.

At the center of the controversy about the future of breeder reactors has been the issue of if and when a commitment should be made to the construction and operation of the first commercial-scale breeder reactor facility--the Clinch River Breeder Reactor (CRBR). For about the past 4 years the administration and the Congress have been unable to agree on this issue and, as GAO reported recently, the stalemate has had a profound effect on both the timely development of the technology and the Department's ability to efficiently manage it.

Specifically, GAO found that if the United States wants to rely on nuclear power as a long-term energy source or even if it chooses only to preserve a future energy supply option for possible use if other energy technologies cannot carry the load, it is time to move the technology forward by constructing and operating a demonstration plant. In GAO's opinion, a decision to go ahead with the construction and operation of a demonstration plant would help foster a more appropriate breeder reactor research, development, and demonstration program. Without the construction and operation of a demonstration plant, the existing program lacks the direction and focus necessary for efficiently managing the research and development efforts now under way. As such, the entire breeder reactor development program is left in a state of disarray that could result in a considerable waste of money and time. Accordingly, to continue to fund the program at several hundred million dollars a year to keep the scientific and engineering team together is hard to justify.

GAO recommended that if the Congress wishes to commit the Nation to nuclear power as a long-term energy source, the Department should demonstrate the viability of breeder technology by constructing and operating a breeder reactor facility. On the other hand, if the Congress cannot reach a resolution on whether

to preserve the breeder option, it should consider terminating the breeder program. The latter course of action could result in cost savings of several hundred million dollars a year.

Relevant GAO Reports. EMD-80-81, EMD-79-89, and EMD-79-62

GAO Contact. Cliff Fowler, 353-5759

Potential Savings by Modifying Provisions  
of Other Special Employee Assistance Programs

GAO Views. GAO recognizes that providing special assistance to certain groups designated by Congress as impacted by Federal policies is a complex and controversial question. However, we believe that the approach for determining compensation amounts for recipients of special cash benefits as outlined in our statement on the trade adjustment assistance program should be considered for other special employee assistance programs. Briefly, this approach would require employees to exhaust unemployment insurance benefits before receiving any special payments which would be at an amount comparable to unemployment insurance benefits. Besides the Trade Act of 1974, some of the major laws with provisions for special cash benefits include (1) the Regional Rail Reorganization Act of 1973, (2) the Redwood National Park Act (1978), and (3) the Airline Deregulation Act 1978.

While we have not projected the cost savings, we have no reason to doubt that modification of all acts with provisions for special benefits along the lines of our suggestion would probably save millions of dollars annually. Most importantly, implementation of a uniform approach for determining benefits would insure that all recipients designated by Congress for special assistance would be treated equally.

Relevant GAO Reports. HRD-80-11, HRD-80-63, CED-80-16, HRD Statement before the Subcommittee on Oversight, House Committee on Ways and Means (February 21, 1980).

Contact: C. I. (Bud) Patton, 523-8701

Interagency Sharing of Federal Medical Resources  
Would Reduce Costs and Improve Effectiveness

GAO Views. In a June 1978 report to the Congress, we proposed legislation to establish a Federal policy that (1) directs interagency sharing of Federal medical resources, when appropriate, and (2) removes many of the legislative and administrative obstacles to such sharing.

Over the years, Federal agencies have become increasingly concerned with their abilities to provide quality health care directly to their primary beneficiaries. However, little attention has been given to taking advantage of the opportunities to improve patient care and reduce Federal care costs through interagency sharing of medical resources. In fact, because of the emphasis on individuals agencies' capabilities, several obstacles have evolved which now make sharing--even when it is tried--much more difficult.

Legislation is needed to require interagency (primarily between the Department of Defense and the Veterans Administration) sharing when appropriate and to encourage the establishment of Government-wide implementing procedures. Such legislation should encourage individual initiative without affecting any Federal agency's organizational or command structures. It should also give increased management options to local Federal medical officials to make the best use of our Nation's medical resources. The enactment of legislation would provide the impetus for an effective Federal medical resources sharing program and a concerted effort by the involved agencies to make sharing a routine occurrence.

In view of the increasing concern in the Nation regarding the spiralling costs of health care, enacting legislation which (1) establishes a firm Federal policy to promote Federal interagency sharing and (2) removes restrictions on the types of services which can be shared, would be both beneficial and timely and would provide the impetus and direction needed to make such sharing more a rule than an exception.

The total potential savings which would result from the implementation of coordinated planning and sharing of medical resources among Federal agencies are difficult to quantify. However, we included in our report several case studies to illustrate that even a minimal amount of interagency sharing would result in substantial savings in several areas of the country. Also, recurring annual savings of nearly \$100 million would result from each one percent reduction in the direct health care budgets of the Departments of Defense and Health and Human Services and the Veterans Administration (including those for operations and construction) which accrues from increased sharing of Federal medical resources. We believe savings of this magnitude can reasonably be expected if a legislatively mandated and fully operational interagency sharing program is achieved.

Near the end of the 96th Congress, the Senate passed the legislation as we recommended, but the House did not act on the measure. In January 1981, the legislation was reintroduced in the Senate.

We continue to believe that the enactment of legislation such as we proposed would result not only in significant savings to the Government but also in beneficiaries' improved access to health care directly provided by the Federal Government.

Relevant GAO Reports - "Legislation Needed to Encourage Better Use of Federal Medical Resources and Remove Obstacles to Interagency Sharing," HRD-78-54, June 14, 1978.

GAO Contact: David P. Baine - 426-5246

## Reducing Funding For Emergency School Aid

GAO Views. We issued a report on the Emergency School Aid Act (ESAA) on January 20, 1978. Our primary concern was that program funds had been used for general education rather than desegregation assistance because the administration allowed funding for (1) past desegregation efforts, (2) schools not affected by desegregation plans, and (3) activities not directly related to implementing plans.

The report contained recommendations to the Congress and the Secretary of HEW. (After issuance of the report a separate Department of Education was established. The Secretary of Education is non-responsible for the matters discussed in the report.) Almost all of them have been or are being implemented. Specifically, the Congress, in the Education Amendments of 1978, amended the act in accordance with our recommendations to (1) include recentness of desegregation efforts as a basis for awarding grant funds, (2) clarify a basis for eligibility for funds under the "integrated schools" provision, and (3) limit the amount of funds under the state-wide competition. The Department of Education has provided guidance to Office for Civil Rights officials and ESAA program officers about eligibility of desegregation plans and funding only those schools affected by, and only those activities that are related to implementing, the plans.

In final year 1980, the Congress reduced the President's initial budget request by \$18.8 million and rescinded an additional \$11 million from the general grants program.

Relevant GAO Report - Better Criteria Needed for Awarding Grants for School Desegregation (HRD-78-36, January 20, 1978).

GAO Contact: William Hightower (245-9623)

Service Contract Act Should Not Apply To Service Employees of  
ADP and High-Technology Companies

GAO Views. The Service Contract Act of 1965 protects workers' wages on Federal contracts when the contract's principal purpose is to provide services in the United States using service employees. For contracts over \$2,500, the minimum wages and fringe benefits must be based on rates the Secretary of Labor determines as prevailing for service employees in the locality.

On June 5, 1979, the Department of Labor ruled that all Federal contracts for the maintenance and repair of ADP, telecommunications and other high-technology equipment are subject to the wage determination and other requirements of the act. Previously, Federal contracting agencies had not considered these contracts to be subject to the act.

We believe that the act was not intended to cover maintenance services related to commercial products acquired by the Government. Also, Labor made no feasibility, cost/benefit, or impact studies to support its ruling.

We said that Labor's decision to enforce the act's coverage would adversely affect operations in the ADP, office equipment, and other scientific and high-technology industries. The ruling will impose an undue financial and administrative burden on the affected companies and industry compliance would be counterproductive and costly. Furthermore, wage protection for these service workers is not needed.

The most serious concern presented by the 13 corporations we contacted were that Labor's decision would eventually

- increase the administrative burdens and operating costs of each corporation and
- hinder employee productivity and morale by disrupting merit pay systems and staff practices.

In addition, several corporations stressed the inflationary impact Labor's wage determinations could have on the industries' wage rates.

Our corporation said a new system estimated to cost almost \$1 million would be needed to track data on employees servicing approximately 700,000 machines within the Government. Another corporation estimated that the cost to develop and implement new data processing systems and modify existing systems would be \$1.5 to \$2 million. A third corporation estimated the cost to design, develop, and install its system at over \$1 million, with annual maintenance costs of \$250,000.

The first corporation also stated that, to maintain its merit pay system and still comply with the act, a separate work force would have to be created for the Federal contracts. To do this, the corporation estimated it would incur developmental and implementation costs of \$9.35 million--including the almost \$1 million for a new system--and annual recurring costs of \$3.3 million.

One corporation said the first-year inflationary impact on its field service technician wages would be \$648,000. Another corporation estimated the impact at \$12 million. A third and much larger corporation said the inflationary impact on technician wages would be \$100 million the first year.

We obtained information on the act's application at 114 Federal agency installations. At 42 of the installations, contracting difficulties developed because contractors refused to accept contracts subject to the act.

At 21 of the installations, agencies also attempted or considered attempting to acquire maintenance services through third-party contractors--firms other than the original equipment manufacturers. Some third-party arrangements proved successful; others did not.

One Army installation had to permanently shut down its \$12 million computer system because the sole-source contractor would not accept a follow-on maintenance contract containing Service Contract Act provisions. The system is expected to be scrapped, and replacement computer services are being obtained from sources at much higher cost and considerable inconvenience.

Various Federal officials cited other impacts they believe would occur if maintenance and repair services under existing contracts expiring during fiscal year 1980 were discontinued and could be renewed. These included (1) complete stoppage of the space shuttle program, (2) inability to monitor and record

vital signs of critically ill or postsurgical patients at a veterans' medical center, (3) loss of support to U.S. Army Health Service Command activities throughout the world, (4) delay or shutdown of test and research programs on the F-15 and F-16 fighters and B-1 bomber, and (5) serious programmatic impact on the design, development, test, production, and retirement of nuclear weapons.

We recommended that the Congress amend the Service Contract Act to make it clear that the act excludes coverage for ADP and other high-technology commercial product--support services--i.e., service the Government procures based on established market prices of commercial services sold in substantial quantities to the public.

Pending such action by the Congress and to avoid further serious impairment to the conduct of Government business, the Secretary of Labor should temporarily exempt from the act's coverage certain contracts and contract specifications for ADP and other high-technology commercial product support services.

Relevant GAO Report

Service Contract Act Should Not Apply to Service Employees of ADP and High-Technology Companies (HRD-80-102, 9/16/80).

GAO Contact: Charles Gareis (523-8706)

## Incentives to States for Hospital Cost Containment

GAO Views. We issued a report on September 19, 1980, entitled "Rising Hospital Costs Can Be Restrained By Regulating Payments and Improving Management" that assessed the impact of State prospective ratesetting programs on rising hospital costs. We determined that during the 3-year period 1975-77 the annual increase in expenditures per care for all community hospitals in the country averaged 14.9 percent. In States without a prospective ratesetting program the growth rate averaged 17.9 percent while States with prospective ratesetting programs averaged 13.9 percent--4 percent less than the States without programs and 1 percent less than the national average.

All the reasons that some prospective ratesetting programs have successfully controlled hospital cost increases are not readily apparent. There appears, however, to be a relationship between the effectiveness of some programs and elements essential to an effective ratesetting program identified in 1977 by the Health Care Financing Administration (HCFA):

- (1) All hospitals within a given system should submit accounting and reporting data based on uniform systems.
- (2) Health planning and ratesetting should be closely coordinated.
- (3) Prospective ratesetting systems should focus on total hospital expenditures including utilization factors.
- (4) Prospective ratesetting systems should cover all payers.
- (5) Hospital participating in prospective ratesetting systems should be mandatory.
- (6) Statistical screens should be established to determine what hospital costs are reasonable.
- (7) An appeals or exceptions process should be created to allow hospitals the opportunity to rectify what they believe to have been an inappropriate decision.

HFCA's participation of Medicare in prospective ratesetting programs is limited to experimental and demonstration projects as provided by section 222 of the Social Security Amendments of 1972 (P.L. 92-603). This inability of Medicare to participate has probably reduced the effectiveness of State prospective ratesetting programs. As a result we recommended the Congress amend the Social Security Act to permit full participation of HFCA's Medical program in existing prospective ratesetting programs.

Since issuance of our report an HHS contractor assessing prospective ratesetting programs also concluded that these programs have been successful in restraining hospital cost increases. The final report, however, will not be available until early 1982.

Relevant GAO report - HRD-80-72  
PAD-80-17

GAO Contact: William A. Gerkins, 275-5132

Changes in the Calculation of Social Security  
Benefits Would Result in Large Savings

GAO views.

• Congress should amend section 215(g) of the Social Security Act to require calculation of Social Security Retirement and Survivors Insurance benefits to the nearest penny.

Presently, the Social Security Act requires that benefit payments be rounded to the next highest dime. We estimated that a savings of \$386 million would accrue to the Retirement and Survivors Insurance program from calendar years 1980 through 1986 if benefits were calculated to the nearest penny. A savings, although somewhat smaller, would also be achieved for the Disability Insurance program.

Relevant GAO Reports.

Savings To The Social Security System If Benefits Were Calculated To The Nearest Penny  
(HRD-78-160, September 8, 1978)

Implementing GAO's Recommendations On The Social Security Administration's Programs Could Save Billions  
(HRD-81-37, December 31, 1980)

GAO Contact: Peter McGough, FTS 987-3138

Reduction of Federal Financing of  
Certain Railroad Retirement Benefits  
Reevaluating to What Extent the Federal Government  
Should Fund Certain Windfall Benefits for Dual Beneficiaries

GAO Views.

Railroad workers who also worked for nonrailroad employers covered by social security can receive benefits from both the social security and railroad retirement programs if such benefits were earned before 1975. Because such benefits are computed under each system, beneficiaries receive benefits weighted twice. This advantage received by such dual beneficiaries has been labeled a "windfall" and from fiscal year 1976 to 1980, the Congress has appropriated about \$1.4 billion to pay these windfall benefits.

Since the Congress agreed to pay windfall benefits in 1974, the estimated annual cost has doubled from \$250 million to an estimated \$529 million needed annually from fiscal years 1980 to 2000. In view of congressional concern about increasing windfall costs, the Congress may wish to reconsider tapping the alternative funding sources it considered and rejected in 1974--railroad employees and employers and social security--as well as the option to eliminate such benefits. However, most of the reasons the Congress gave for not selecting those alternatives are still valid today. One reason--the railroad industry's questionable ability to share the responsibility--could be reevaluated in light of events since 1974.

If the Congress decides that continued appropriations for windfall benefits are appropriate, the issue then becomes how much of the windfall costs does the Government want to finance. The Railroad Retirement Act contains certain offset provisions which reduce retirees' private pensions when they receive dual benefits. These offsets were imposed beginning in 1966, in part, to reduce the railroad retirement program's loss stemming from windfall benefits being paid. If the intent of the Congress is to cover only net windfall benefits, that is, after offsets to the private pension are considered, then the latest Railroad Retirement Board's estimate of \$529 million needed annually from fiscal years 1981 to 2000 may be overstated by about \$107 million per year.

In view of events since 1974, we recommend that the Congress reevaluate the issue of how to finance windfall benefits, and that as part of such evaluation it decide to what extent the Federal Government should fund windfall costs.

Relevant GAO Reports.

Report expected to be issued March 1981.

GAO Contact: Peter McGough, FTS 987-3138

Termination of Certain Social Security Benefits  
Phasing Out the Death Benefit

GAO Views.

• Social Security has paid more than \$6 billion in lump sum death benefits since 1940, the first year payments were made. In fiscal 1978, about 1.3 million lump sum death payments were made totaling about \$332 million.

The lump sum death benefit was part of the original Social Security Act of 1935. At that time, this was an important benefit because there was no provision for survivors benefits. It provided funds for the deceased wage earners survivors, dependents, or estate toward the costs that arose at the time of death.

Subsequent amendments provided for benefits to survivors and dependents of deceased wage earners. In 1950, the intent of the lump sum payment was changed from the original concept of a return on an individual's contribution to the Social Security program to one of providing a modest payment for expenses of the last illness and burial of the deceased worker. The maximum benefit is \$255.

While GAO has not developed estimates of cost savings which could be realized if the benefit was eliminated, the savings would be considerable. HHS estimates that eliminating the current lump sum death benefits would save the Social Security trust fund \$227 million in fiscal 1980 and \$378 million in fiscal 1984. The net savings would be \$221 million in fiscal 1980 and \$370 million in fiscal 1984 after establishing a modified death benefit under the SSI program.

It is HHS' view that the lump sum death benefit is not earnings related and does not seem particularly appropriate under the earnings-related social security programs. The proposal for a death benefit under the SSI program provides for payment to people who are most in need of the payment.

Relevant GAO Reports.

The Lump Sum Death Benefit--Should It Be Changed?  
(HRD-80-7, August 2, 1980)

GAO Contact: Peter McGough, FTS 987-3138

Reduction of Certain Social Security Benefits  
Revising the Social Security Benefit Formula  
to Stop Advantage to Short-Term Workers

GAO Views.

The social security benefit formula ensures that low wage workers receive a proportionately higher return on their payroll tax contribution than workers with higher wages. This favorable rate of return is based on a social adequacy or welfare objective. The formula also provides this advantage to average or high wage earners who work for only short periods in employment covered by social security, (short-term worker advantage) although such an advantage may not be warranted for them.

Short-term workers have contributed a relatively small amount of social security tax because they have had little work in covered employment. They receive, however, a higher return on their contribution than the average wage earner because of the benefit formula used to attain the program's social adequacy objective. In many instances, short-term workers have substantial income in addition to their social security.

According to the Social Security Administration, stopping the short-term worker advantage could save from \$11 billion to \$15 billion over the next decade depending on the method used. Stopping the short-term worker advantage would also end "windfall" social security benefits to retired government workers.

Because a social adequacy benefit seems inappropriate for the average or high wage earner, and in view of the concern about the financial stability of the social security program, the Congress should consider removing the advantage that the current social security benefit computation method provides to the short-term worker.

Relevant GAO Reports.

Report expected to be issued May 1981.

GAO Contact: Peter McGough, FTS 987-3138.

Eliminate GI Bill Benefits for Correspondence Courses  
and General Flight Training

GAO Views. The Chairman, Senate Committee on Veterans' Affairs, asked GAO to survey a representative sample of veterans who had completed flight or correspondence courses to determine whether their full-time occupations were related to the training they had received under the GI bill.

Over 1 billion dollars in educational assistance has been paid by the Veterans Administration to veterans enrolled in flight or correspondence training since the current GI bill was enacted in 1966. However, our review of a random sample of veterans who completed such training during a recent 5-year period showed that only about 16 percent of flight-trained veterans and 34 percent of correspondence-trained veterans had full-time jobs related directly to their training.

Employment survey reports submitted to VA by vocational/technical schools indicate that in general over 50 percent of flight and correspondence course graduates have found training-related employment. However, these reports provide no assurance that most veterans obtained full-time employment in training related occupations. Our findings support proposed legislation submitted by VA to terminate GI bill benefits for flight and correspondence training.

Relevant GAO Report. GI Bill Benefits for Flight and Correspondence Training Should Be Discontinued (HRD-79-115, Aug. 24, 1979)

GAO Contact: Dave Zylks (245-9623)

## Repeal of Davis-Bacon Wage Requirements

GAO Views. In April 1979, we issued a report in which we recommended that the Congress repeal the Davis-Bacon Act. We concluded that repeal of the act and removal of its wage determination requirements would result in substantial savings on Federal or federally financed construction costs.

As stated in our report to the Congress in April 1979, we believe that the Congress should repeal the Davis-Bacon Act because (1) significant changes in economic conditions, and the economic character of the construction industry since 1931, plus the passage of other wage laws, make the act unnecessary, (2) after nearly 50 years, the Department of Labor has not developed an effective program to issue and maintain current and accurate wage determinations; it may be impractical to ever do so, and (3) the act results in unnecessary construction costs of several hundred million dollars annually and has an inflationary effect on the areas covered by inaccurate wage rates and the economy as a whole.

In addition, the Davis-Bacon Act, along with the weekly payroll reporting requirement of the Copeland Anti-Kickback Act also result in substantial unnecessary administrative costs for contractors--which are ultimately passed on to the Government--and for agencies to administer and enforce the act's requirements.

More recently, we made a review of one of the largest Federal construction projects which would benefit from repeal of the Davis-Bacon Act--the Washington Regional Rapid Transit System (METRO). The latest estimate for a completed rail system by the late 1980's is \$8.2 billion. In a report issued in October 1980, we found that setting prevailing wages for METRO construction--as required by the Davis-Bacon Act--may increase the construction costs by about 6.8 percent. We estimate, that as a result of Labor establishing wages at higher rates than those actually prevailing in the area of METRO projects, future METRO construction costs could be increased by about \$149 million.

Critics of our report and recommendation, such as OMB and the Secretary of Labor, contend that the Davis-Bacon Act is still needed to protect the construction workers and that the problems in implementing the act could be resolved through administrative action including, where appropriate, modification of Labor's regulations.

We disagree. The Davis-Bacon Act covers less than one-fourth of the estimated 4 million construction workers. The fact that the remaining 3 million workers who work on projects not covered by the act are among the best paid workers in the country indicates to us that construction workers do not need the "special protection" the critics deem essential.

Also, in our opinion, the problems and inadequacies we have identified--over almost 20 years of reviews--cannot be corrected or improved significantly by any administrative action, modifying regulations or applying additional resources to the program. Obstacles, inadequacies and problems continue to hamper Labor's attempts to develop and issue accurate wage rates based on prevailing rates in localities. In our view, the act is impractical to administer--it cannot be effectively and efficiently administered. Further, improving the administration of the Davis-Bacon Act prevailing wage determinations may slightly lessen or dampen, but not eliminate, the act's inflationary effect. Only the repeal of the act would return the determination of labor costs on federally funded or assisted construction projects to the forces of the competitive marketplace and eliminate the act's inherent inflationary effect.

Defenders of the act also argue that it increases worker productivity and prevents awards to incompetent contractors. On the basis of studies we have reviewed conclusive evidence does not exist that the act results in greater productivity. Contract awards to incompetent contractors is a procurement and contracting issue, and has little to do with Labor's administration of the act. The Federal Government and its contracting agencies must follow well-established and longstanding procurement rules and regulations to assure that contracts are awarded to responsive and responsible bidders.

In conclusion, we believe that the concept of issuing prevailing wages as stated in the Davis-Bacon Act is fundamentally unsound. We do not believe the act can be effectively, efficiently, and equitably administered. The act should be repealed.

Finally, an increasing number of congressional members are advocating repeal of the act. This is evidenced by a House bill introduced in the 96th Congress for repeal which had about 75 cosponsors. Moreover, bills have also been introduced in the 97th Congress recommending repeal. Others seeking repeal, in addition to GAO, include, the Association of General Contractors, Associated Builders and Contractors, Inc., the American Farm Bureau Federation; many leading economists, such as Arthur Burns; many contractors, and a number of State legislators. They believe, as GAO does that the law has outlived its usefulness, is inflationary, is impossible to administer and should be repealed.

Relevant GAO Reports. HRD-79-18, April 27, 1979  
HRD-81-10, October 2, 1980

Contact: Raymond J. Kowalski, 523-2706

Additional Proposal

Opportunities for Greater Use of User Charges to

Fund Special Benefit Services Provided by USDA

GAO Supplementary Discussion

GAO Views. We recently completed a review of the Department of Agriculture's use of user charges to fund special benefit services. Based on fiscal year 1980 findings and cost data, we concluded that Federal appropriations could be reduced as much as \$48 million annually if recipients of special benefit services were charged for all costs except those which can be readily identified with public benefits. A draft of the proposed report was sent to the Department for comment on January 16, 1981. The final report will be issued in the near future.

The Department provides a wide range of marketing and regulatory services which primarily benefit identifiable recipients. Marked differences now exist in the degree to which costs associated with providing these services are borne by the recipients. As a result, certain sectors of the agricultural marketing industry are receiving preferential treatment at the expense of the general taxpayer.

The special benefit services discussed in the report and the amount of additional user fees include grain inspection and weighing, \$22.8 million; food commodities grading, \$1.2 million; cotton classing, \$9.1 million; tobacco and naval stores commodities grading, \$6.3 million; phytosanitary inspections, \$1.4 million; mailed market news reports, \$0.7 million; warehouse examinations, \$2.8 million; imported animal inspections, \$3.2 million; imported seed inspections, \$0.5 million; and plant variety certifications, \$0.3 million.

Relevant GAO Report CED-81-49, now in process

GAO Contact Leigh Cowing (447-2234)

Additional Proposal

Food Stamps For the Military

GAO Supplementary Discussion

GAO Views. According to Department of Agriculture income criteria, all cash income received by a household must be included in determining food stamp eligibility. For military members, income consists of basic pay, allowances for subsistence and quarters, and special and incentive pays.

Under current and proposed revisions to the food stamps program, in-kind benefits such as housing assistance are excluded from the income determination process. In the military, some members are given cash allowances for housing which would be included in determining food stamps eligibility. Other military members receive in-kind housing (Government Quarters) which is excluded from the income eligibility criteria. As a result, military members living in Government quarters stand a better chance of being eligible for food stamps than those members receiving cash allowances for quarters.

We estimated that 19,700 military members were potentially eligible for food stamps in 1980 according to Department of Agriculture criteria. Placing a dollar value on in-kind quarters would reduce the number eligible for food stamps and also eliminate the inequitable treatment between military members.

Relevant GAO reports. FPCD-81-27, December 9, 1980.

GAO Contact. Ken Coffey, 275-5140

## Additional Proposal

### Reduction of Funds for Cost-Sharing of Measures Under the Resource Conservation and Development Program

#### GAO Supplementary Discussion

GAO Views. The Resource Conservation and Development Program is administered by the Soil Conservation Service, Department of Agriculture, to promote the development, improvement, conservation, and utilization of natural resources of a project area to meet local needs. The program was funded at about \$32 million for fiscal year 1980. About \$15 million of these funds were distributed to authorized project areas nationwide for use in cost-sharing local project measures. Usually such cost-sharing was used for measures designed to reduce soil erosion and sedimentation, increase recreation, and minimize flooding. The remaining RC&D funds are used to pay for full-time project coordinators and related technical assistance--which are considered essential program ingredients. Usually, most RC&D project measures are financed by sources other than RC&D and included a mix of Federal, State, or private sources. These measures require no RC&D cost-sharing--just the energy and talents of the project coordinator and local people.

GAO observations from an on-going review of the program indicate that there are other Federal programs, such as Agriculture's soil conservation programs, Rural Clean Water Program, and Watershed Protection and Flood Prevention Program, that have been established with their own sources of Federal funding to pursue the same general objectives as RC&D does with its cost-sharing measures. Accordingly, in view of current heavy budget constraints and proposed budget reductions, GAO suggests that the Congress consider dropping the cost-sharing part of RC&D for those measures that can be funded under other Federal programs.

GAO Contact John Murphy (447-9267)

Other

Reducing Land Acquisition Costs By

Expediting Condemnation Cases

GAO Views: In a May 14, 1980, report, GAO concluded that the Department of Justice could reduce land acquisition costs by expediting the settlement of condemnation cases with private land owners. At the end of fiscal year 1979, Justice had 21,230 condemnation cases pending, some as long as 4 years. Considering the volume and appraisal value of tracts in condemnation--16,832 contracts in 1978 valued at \$332 million, with land owners claiming \$1.2 billion--Justice estimated that each year's delay in processing these cases through the courts would cost the Government an additional \$31 million because of escalating land values.

In March 1978, Justice developed a caseload reduction plan to help reduce increasing workload of condemnation cases referred to Justice and pending in court, awaiting closing action.

A year later, progress had been made by Justice in closing cases faster, but major problem areas remained, including limited staff resources. In fiscal year 1980 the Congress increased Justice's staff by 20 positions to handle condemnation cases. This should help expedite closings and result in lower land acquisition costs. Further, the President proposed a moratorium on Federal land purchases which should help reduce the condemnation workload.

Relevant GAO Reports: CED-80-54

GAO Contact: Roy J. Kirk, 376-8212

ADDITIONAL ITEM:

ALTERNATIVES AVAILABLE TO ASSIST THE  
COAST GUARD IN MEETING ITS RESPONSIBILITIES

GAO Views. In an April 1980 report, GAO stated that the Coast Guard could not meet its legislated responsibilities with its limited resources. GAO identified serious problems with the number and condition of the Coast Guard's vessels, the number and experience of its personnel, and the condition of its shore facilities. Estimates of future needs show the need for substantial increases in funds to provide additional vessels and personnel to meet the Coast Guard's increased duties. GAO provided 5 alternatives for the Senate oversight committee to consider, assuming that funds might not be available:

- Transferring certain Coast Guard missions to industry.
- Establishing performance levels based on funding, rather than on program goals.
- Purchasing less costly cutters with limited capabilities.
- Using contractors when the Coast Guard does not have the resources needed to meet unusual circumstances or needs.
- Charging users for Coast Guard Services.

GAO's report also identified the disadvantages with each alternative.

As discussed in the report, the Coast Guard needs substantial resources increases to meet its established responsibilities. Coast Guard resources apparently will be reduced for fiscal year 1982. Therefore, GAO believes that Coast Guard responsibilities should also be reduced and the alternatives outlined above adopted.

Relevant GAO Reports: CED-80-76

GAO Contact: David L. Jones, 755-9100

ADDITIONAL ITEM:

FEE SYSTEMS: A MEANS FOR UNDERWRITING  
HAZARDOUS WASTE PROGRAM COSTS

GAO Views. In a January 1979 report, GAO stated that many States may not accept responsibility for implementing the hazardous waste provisions of the Resource Conservation and Recovery Act (RCRA). Under such circumstances, the Environmental Protection Agency (EPA) will need funding to provide program oversight and to operate hazardous waste programs in States that do not seek or receive EPA authorization to operate their own program. GAO recommended that EPA request that RCRA be amended to allow EPA to include a fee system to cover hazardous waste program costs where (1) a State cannot or will not assume responsibility for its program and (2) EPA is required by RCRA to assume responsibility for the State's program.

The fee system approach recommended is similar to the funding source for the recently passed "Superfund" legislation, which allows EPA to clean up spilled toxic wastes and hazardous waste sites and later to attempt to recover the costs of such cleanup from responsible parties.

Amendment of RCRA and the adoption of a fee system would eliminate the need for Federal general revenue support for EPA to provide oversight and operate hazardous waste programs in States that do not seek or receive EPA authorization to operate their own programs.

Relevant GAO Reports: CED-79-14

GAO Contact: David L. Jones, 755-9100

ADDITIONAL ITEM:

INCREASED REVENUES FROM FEDERAL WATER RESOURCES PROJECTS

GAO Views. The Army's Corps of Engineers and the Department of the Interior's Water and Power Resources Service are two principal Federal agencies which build and operate multipurpose water projects. The 1981 appropriation act for the two agencies includes \$2.3 billion for construction and \$1.1 billion for operation and maintenance costs.

The Resources Service and Corps repayment policies are designed to recover reimbursable construction and operation and maintenance costs from water project beneficiaries when projects are fully developed. However, the policies do not assure full cost recovery when water supply or reservoir storage space is underutilized; that is, water uses have not developed as originally intended. GAO's audit work shows that intended water users, such as cities, industries, and irrigators, have not purchased more than 15 million acre-feet of water or storage space in Federal reservoirs. As a result, the Government (general taxpayer) absorbs the substantial amounts of costs associated with the underutilized reservoirs (estimates of amounts involved not available).

In many cases, the water agencies have not required the existing water users of the underutilized reservoirs to share more equitably in project cost recovery. To achieve this objective, changes in agency policies and practices are necessary, and the agencies must make project repayment a priority. Adoption of such policies would be fair to the water users and lessen the taxpayers' increasing burden for repaying the costs of constructing and operating water resources projects.

Relevant GAO Report: None, audit work complete and report is being prepared (Code 085550)

Contact: Harold Pichney, 275-6076

## Additional Items for Consideration

### Small Business Administration

GAO Views: Since 1975, GAO has issued numerous reports to the Congress on management and financial assistance programs administered by the Small Business Administration (SBA). These reports have documented many management and program deficiencies which have seriously hindered SBA's ability to carry out its mission in an effective and efficient manner. Unfortunately, all too often, these deficiencies have gone uncorrected. For example, on August 21, 1979, we issued a report which followed up on actions taken by SBA to correct problems cited in six GAO reports issued between 1975 and 1976. We found that effective corrective action had not been taken on 27 of the 33 recommendations we reviewed.

Although our reports have not recommended the elimination of any SBA programs, we have raised numerous issues having budgetary implications. For instance, on February 23, 1976, we reported that (1) numerous 7(a) loans were approved which merely transferred the risk of loan payment from banks and other creditors to SBA, and (2) some 7(a) loans were made to wealthy businesses not intended to receive assistance. Moreover, a problem permeating the entire loan process was the shortage or improper alignment of personnel. We recommended that SBA consider realigning its current staff or requesting additional personnel from the Congress. Our August 1979 report disclosed that, SBA had not filled all the positions authorized by the Congress for the 7(a) program. As a result, SBA field office personnel were continuing to process loans without adequate analysis resulting in the same problems cited in 1976.

Other GAO reports with budgetary implications were issued on March 3, 1978, and December 8, 1980. In our March report, we evaluated the Small Business Investment Company Program (SBICs) and concluded that continued Federal participation was questionable. We reached this conclusion after finding that the program was benefiting only a select group of small businesses and that loan-oriented SBICs were providing small businesses with the same type of financing provided by the 7(a) loan program. In the report we recommended to the Congress that continued Federal funding of the program be contingent on SBA fully justifying the program's role in financing the equity needs of small businesses.

The December 1980 report, discusses our evaluation of the Economic Opportunity Loan Program. Our review disclosed that Economic Opportunity Loans have not been an effective means of helping disadvantaged people start or improve their own business. More borrowers have defaulted on the loans than have repaid them. Many who paid off their loans have not remained in business. Furthermore, we found the outlook for borrowers with active loans is not good since many are in financial difficulty. We stated that if program results do not improve, congressional oversight committees should determine whether the program's objectives could be better achieved by transferring its funds to other Federal programs for disadvantaged businesses.

Relevant GAO reports: GGD-76-24, CED-78-45,  
CED-79-103, and CED-81-3

Contact: Robert E. Allen, Jr. (377-5483)

GAO RECOMMENDATIONS RELATING TO FEDERAL CIVILIAN

RETIREMENT NOT INCLUDED IN ADMINISTRATION'S PROPOSAL

GAO Supplementary Discussion

Limiting Cost-of-Living Adjustments to Something Less Than  
the Full Percentage Increase in the Consumer Price Index

GAO Views. Considerable attention has been given in the Congress and elsewhere to the cost-of-living adjustment provisions of Federal retirement systems. GAO has long been concerned about the equity and costs of the Government's policy of full, automatic cost-of-living increases for Federal retirees and has reported on this subject several times. Our reports have urged the Congress to enact legislation making the Federal cost-of-living adjustment process more rational, more consistent with prevailing non-Federal practices, and less costly. As discussed earlier, we have recommended to the Congress and strongly endorse the Administration's proposal to provide cost-of-living adjustments annually instead of biannually.

But to fully satisfy the objectives of making the Federal adjustment process more rational, more equitable, and less costly, the Congress should consider adopting a modified policy of less than full inflation indexing.

The erosion of the purchasing power of retirement benefits is certainly a serious issue. Inflation shrinks the purchasing power of all Americans. While the established policy of full, automatic indexation of Federal retirement benefits is a laudable, humanistic objective, it is highly inequitable to others not similarly treated and costly. Historically, it has resulted in Federal retirees receiving far greater increases than active Federal employees. This has encouraged and continues to encourage valuable, experienced employees, particularly top officials whose pay rates have been depressed, to retire early rather than continuing to work.

Generally, the purchasing power of non-Federal retirees' income, if protected at all, is only partially protected from inflation. They are no less deserving of full purchasing power protection; it is simply a matter of affordability. From an equity standpoint, we believe it is unreasonable to force taxpayers whose incomes (pay or retirement) are not fully protected from inflation to pay for full, automatic indexation of Federal retirees'

benefits. Because of the costs involved, this places a financial burden on current as well as future taxpayers.

Accordingly, we urged the Congress to consider adopting a modified policy of less than full indexation of Federal retirement benefits. We suggested that annual adjustments for Federal civilian and military retirees be limited either to 75 percent of the full percentage increase in the Consumer Price Index or to the average percentage pay increase granted to active Federal employees.

Limiting annuity cost-of-living adjustments to less than the full percentage rise in the Consumer Price Index would reduce retirement outlays by hundreds of millions of dollars annually. For example, if the 1979 adjustments had been limited to the average percentage pay increase granted to active Federal white-collar employees, retirement outlays for that year alone would have been over \$800 million lower. With outlays for Federal civilian and military retirement programs approaching \$30 billion annually, each 1-percent reduction in cost-of-living adjustments would reduce annual outlays by about \$300 million.

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Virtually all Federal entitlement and income security programs are adjusted for inflation. The issue of whether or not to continue fully indexing benefit payments based on the Consumer Price Index goes far beyond Federal civilian staff retirement systems.

Relevant GAO Reports. FPCD-76-80, July 27, 1976; FPCD-78-2, November 17, 1977; PAD-79-22, August 15, 1979; B-130150, January 30, 1980; B-130150, July 1, 1980; B-199649, December 15, 1980.

GAO Contact. Robert Shelton, 275-5743

Savings Possible From Standardizing Annuity

Reductions for Survivor Benefits

GAO Views. Significant unnecessary costs and inequities can be avoided by changing the methodology that is used to determine the amount of civil service annuity reductions for retirees who have elected survivor benefits. Under the method used by the Office of Personnel Management, newly retired personnel pay more than previous retirees for the same survivor benefit coverage. Computing the survivor benefit reduction the same way for new and previous retirees would eliminate this inequity and reduce expenditures from the retirement fund by at least \$77 million annually.

Relevant GAO Reports. FPCD-81-35.

GAO Contact. Robert Shelton, 275-5743.

## Unnecessary Voluntary Early Retirement

GAO Views. We recently completed a review of another special early retirement provision in the civil service retirement system whereby employees can volunteer to retire early (age 50 with 20 years of service or any age with 25 years) if their agency is undergoing a major reduction-in-force, major reorganization, or major transfer of function.

Before 1973, the law allowed only involuntary early retirements for employees who had lost their jobs through reductions-in-force. Beginning in 1973, the law allowed the Civil Service Commission (now the Office of Personnel Management) to authorize agencies undergoing major reductions-in-force to permit employees not directly affected by the reduction to retire early. The basic purpose of the law was to reduce involuntary separations, thereby saving the jobs of younger workers not eligible for immediate retirement benefits who might otherwise be separated.

The Civil Service Reform Act, effective January 1979, liberalized the voluntary early retirement program. It allows employees to retire early during major reorganizations and transfers of function. OPM's implementing regulations allow early voluntary retirements in organizations where no employee is being involuntarily separated.

Our review of the voluntary early retirement program at eight agencies revealed that the early retirements helped very little with the staffing problems the program was intended to correct. In many cases, all the early retirees were replaced by new hires.

The voluntary early retirement program is expensive. Our actuaries estimate that it will cost \$109 million in 1980. We believe the program, with proper controls, can be workable. However, as presently designed and administered, it is resulting in too many unnecessary retirements. We are concerned that (1) early retirement authorizations are not restrictive enough to insure a high probability of job savings, (2) agencies do not exhaust other management techniques for solving staffing problems before turning to the early retirement program, and (3) as the program was revised under civil service reform, employees can retire early even though none of the agency's employees are being adversely affected. Our report contained recommendations to the Congress for major changes to the program.

Relevant GAO Reports. FPCD-81-8, December 31, 1980.

GAO Contact. Robert Shelton, 275-5743.

Increased Revenues Possible If

Full Retirement Costs Were Recognized

GAO Views. Civil service retirement costs are understated because they are calculated on a "static" basis, whereby no consideration is given to the effect of future general pay increases and annuity cost-of-living adjustments on ultimate benefit payments. The static cost of benefits accruing annually under the civil service system is currently estimated to be 13.73 percent of pay, which is about equal to the combined rate of contributions being made to the retirement fund by agencies and their employees--generally, 7 percent of pay each. However, the estimated "dynamic" cost of the system, including factors for pay and annuity cost-of-living increases, is 36.81 percent of pay. Based on this estimate, the cost to the Government for benefits which accrued during the fiscal year 1980 was \$15.1 billion--\$11.6 billion more than the \$3.5 billion agencies contributed to the retirement fund.

Funding retirement costs on a dynamic basis would not increase Federal outlays, however, it would require increased contributions from off-budget entities whose employees participate in the civil service retirement system and thereby increase Federal revenues.

Relevant GAO Reports. B-199649, December 15, 1980.

GAO Contact. Robert Shelton, 275-5743.

## Curtailing Special, Early Retirement Programs

**GAO Views.** With the tremendous costs associated with Federal retirement programs and the large unfunded liabilities that have accumulated, the continuation of generous early retirement benefits may just no longer be possible. Rather than encouraging people to retire early, we believe the Government's retirement policies should more appropriately be designed to encourage the retention of experienced personnel wherever possible.

The term "early retirement" can have different meanings depending upon the context in which it is used. To some, it may mean retiring before age 65, while to others, it may mean retiring before meeting a plan's requirements for normal retirement. For example, in context of the Nation's retirement programs in general, the civil service system's normal retirement age of 55 is quite early. However, it is not generally recognized that many Federal personnel can retire with immediate benefits even earlier than age 55. Almost all military members and around 40 percent of civilian employees retire before 55.

Early retirements in the Federal sector can be grouped into two general categories--(1) those persons who are working in jobs where the basic retirement provisions allow for retirement earlier than that usually available to other employees and (2) those persons who are allowed to retire earlier than they otherwise could have because of disability or some other event that precluded their continued employment to the normal retirement age.

Certain types of Federal personnel are allowed to retire early under the general presumption that their duties need to be performed by a young and vigorous work force. These include the military, foreign service, law enforcement and firefighter personnel, air traffic controllers, and others. We reviewed the historical development of these special benefit programs and found it difficult, in most cases, to clearly identify any current management or compensation policies that are being served by the programs as they are designed.

Federal law enforcement officers and firefighters are a good illustration. They may retire at age 50 after completing 20 years of service and receive an immediate annuity equal to 50 percent of their high-3 years average salary. In contrast, most other personnel covered by the civil service system must be at least age 60 to retire after 20 years of service and would receive an annuity equal only to 36.25 percent of their high-3 salary.

This early retirement policy was enacted more than 30 years ago to improve the quality of Federal law enforcement service by helping to maintain a young, vigorous work force. The special annuity formula is not intended to reward the employees for performing demanding or hazardous services. Rather, the more generous annuities are designed to make earlier retirement economically feasible.

We evaluated the reasonableness, effectiveness, and costs of this special early retirement program and concluded that the need for continuing it was questionable. There were several reasons for our conclusion. Perhaps the primary ones were the fact that employees covered by the special policy were not retiring much earlier than those who were not covered by it, and the costs of covered employees' benefits was considerably greater.

We found that over the policy's 30-year history, the average retirement age of covered employees ranged from only 1 to 3 years less than that of employees retiring under regular civil service optional retirement provisions. To achieve this 1-to-3 year reduction, the Government pays heavily. Based on actuarial estimates, the annual cost for the early retirement benefits is 61 percent more than what the cost would be to provide the same employees with regular benefits.

Relevant GAO Reports. FPCD-78-49, December 29, 1978.

GAO Contact. Robert Shelton, 275-5743.

## Savings by Replacing Old, Inefficient Computers

GAO Views. On December 15, 1980, we reported that much of the Government's inventory of medium- and large-scale ADP equipment was obsolete, and that it was costing more to operate and maintain than it would to lease, operate, and maintain more modern equipment of similar capacity. Newer equipment costs less to operate and maintain because fewer people are required, lower energy consumption, and less floor space is required. In just the four installations analyzed in detail, we found that \$1.4 million could be saved annually with newer equipment. When you consider that there are over 1,000 computers of similar vintage in the Federal inventory, the potential savings to the cost of Federal operations become extremely significant.

In view of the potential savings, Government-wide, we made specific recommendations to the Office of Management and Budget and the General Services Administration so they could act without delay to realize these savings as well as many side benefits the newer equipment offers. Although OMB has expressed similar concern for the seriousness of this problem, recently it placed a temporary freeze on all procurements, including ADP equipment. Because of its negative impact on savings in this particular instance, GAO has urged OMB to grant an exception for replacing old computers.

We believe this is one of our most significant reports in the ADP area. Not only is there a potential for substantial savings Government-wide but there is an opportunity to improve ADP resource management which will have continuing benefits. Considering the importance of this subject and its potential for reducing Federal operating costs, the Committee may wish to inform both OMB and GSA of its desires for expeditious actions on this matter.

Relevant GAO Report. AFMD-81-9.

Contact. Walter Anderson, 275-5044.

## Savings Potential in Foreign Military Sales

GAO Views. The Department of Defense continues to make large subsidies to foreign countries under the foreign military sales program. By not charging foreign governments enough for equipment and spare parts--items which make up a large portion of the over \$15 billion in sales during fiscal year 1980--the Department is, in effect, subsidizing the sales with Defense appropriations.

During the past several years, GAO has issued numerous reports on the need to improve pricing and cost recoupment under the foreign military sales program. These reports, coupled with congressional action on the recommendation have resulted in savings of over a billion dollars.

Although the Department of Defense has taken considerable corrective actions based on previous GAO work and congressional followup, cost recovery practices are still inadequate. As a result, we are continuing work in this area and have received requests for additional work from several congressional members. This work is primarily concentrated in the following three areas.

1. The Department of Defense has not developed a good basis for determining if all administrative costs of supporting the foreign military sales program are being recovered. As a result, Defense does not operate the foreign military sales program at no cost to the taxpayer as required by law.
2. Weaknesses persist in Defense pricing policies and practices. The military services still are charging less than full replacement costs for items sold from inventories.
3. The Department of Defense does not have adequate control over foreign military sales accounting and cannot provide foreign countries with an accurate accounting for their funds which are deposited in trust fund accounts.

The new administration could realize substantial budgetary savings by improving the financial management of foreign military sales. Furthermore, in view of the program's size, the Committee also may wish to recommend to the Department of Defense that it focus the necessary resources to ensure that the foreign military sales program is not subsidized.

Relevant GAO Reports. FGMSD-80-47, FGMSD-80-26, FGMSD-79-33, FGMSD-79-31, and FGMSD-79-16.

Contact. John Simonette, 275-1581.

President's

Proposal -

INTEGRATING THE GOALS OF REGULATORY  
RELIEF WITH PAPERWORK REDUCTION  
GAO SUPPLEMENTARY DISCUSSION

The Administration needs to apply enough OMB resources to effectively implement the Paperwork Reduction Act of 1980 (P.L. 96-511). Tremendous potential exists for improving the management of the Government's activities and programs through more effective use of information resources. This could result in reduced costs for both the Government and private sectors and in improved performance and productivity.

The Administration has linked the goals of regulatory relief with paperwork reduction, with both functions to be carried out by the Office of Information and Regulatory Affairs in OMB. While there is a close relationship between regulations and paperwork, the legislation is not limited to paperwork issues. In addition, it covers ADP, telecommunications, and privacy functions previously assigned to OMB. The functions in these areas were reemphasized to get OMB to take a stronger role in carrying out its assigned responsibilities. The legislation also returns the statistical policy function to OMB and establishes a new records management policysetting and oversight function. These information-related functions are of equal importance to the function of reviewing Federal regulations and should be given strong attention. In this regard, the House Report on the legislation states that each of the functions should be effectively and efficiently carried out and that the OMB Director and Office Administrator should insure that one function does not dominate the others.

Successful implementation of the Paperwork Reduction Act by OMB and the agencies should provide a good management boost to the Administration's program.

Relevant GAO Reports: Testimony of Elmer B. Staats, Comptroller General of the United States, on H.R. 6410, The Paperwork Reduction Act of 1980, before the Subcommittee on Legislation and National Security, House Committee on Government Operations; February 7, 1980.  
Letter of March 3, 1980, from the Comptroller General to the Chairman, Subcommittee on Legislation and National Security, House Committee on Government Operations, providing responses to questions and examples of potential benefits through implementation of H.R. 6410  
Letter of July 25, 1980, from the Comptroller General to the Chairman, Subcommittee on Federal Spending Practices and Open Government, Senate Committee on Governmental Affairs, providing comments on S. 1411.

GAO Contact: Danny R. Latta - 275-5710





