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COST ESTIMATES OF THE CARTER WELFARE REFORM PROPOSAL

INTRODUCTION

Prior to President Carter's announcement on August 6, 1977, of the Administration's plan for comprehensive welfare reform, the President had stated his desire to reduce the costs of the welfare system. However, the plan revealed that day, and later embodied in H.R. 9030, did not reduce the costs of welfare, but instead increased them. The President made no effort to disguise this fact, but freely admitted in his press conference that his plan would increase the cost of welfare by $2.8 billion. His proposal estimated current expenditures on welfare at $27.9 billion and the costs of the reformed system at $30.7 billion. These estimates, however, did not include the costs of the reformed Earned Income Tax Credit, which HEW estimates to be an additional $3.4 billion. Adding this calculation to the others, there would be a total federal expenditure of $34.1 billion, or an increase of $6.2 billion.

However, even this estimate cannot be accepted as final, for the simple reason that the Administration has seriously overestimated the cost offsets of the present system and underestimated the costs of its proposed reforms.

UNDERESTIMATION OF THE COSTS OF THE PRESENT SYSTEM

On page 19 of the release of the Department of Health, Education, and Welfare of August 6, in which the reform plan was

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presented, there is given a list of "Current Federal Expenditures and Offsets" that explains how the estimate of $27.9 billion cost of the current welfare systems was reached. This table is reproduced below.

AFDC	$ 6.4 billion
SSI	5.7 "
Food Stamps	5.0 "
Earned Income Tax Credit	1.3 "
Stimulus Portion of CETA and WIN	5.9 "
Extended UI	.7 "
Decreases in Regular UI Outlays*	.4 "
Increases in Social Security Contributions*	.3 "
Savings Within HEW Budget From Prevention of Fraud and Abuse	.4 "
Wellhead Tax Revenues	1.3 "
TOTAL	$27.9 billion

*Due to estimated increases in employment from jobs program.

In other words, the President's estimate of a $2.8 billion increase in federal spending was based on his calculation that the government now spends $27.9 billion and the new program would cost $30.1 billion. However, various problems arise with this calculation. As several critics have pointed out, the calculation of the costs of the present system includes offsets that cannot fairly be counted as annual federal expenditures. Specifically, these fallacious costs include (1) $5.9 billion for CETA and WIN. These programs were intended to be temporary expenditures and cannot be counted as permanent governmental responsibilities; (2) the extended Unemployment Insurance program ($.7 billion) which also was intended to be temporary; (3) the increases in social security contributions that will accrue due to increased employment and contributions to the Trust Funds. However, under current law, social security funds are entirely separate from general revenue sources, and contributions to them cannot be counted as federal expenditures from them. While the Carter social security reforms included the idea of financing these funds from general revenues, this measure was rejected by the Senate and the House. Therefore, the estimated $.3 billion increase in contributions from this source cannot apply to federal expenditures for welfare. (4) Similarly, the projected saving of $.4 billion from efforts to prevent fraud and abuse cannot be included since any savings from this source should be returned to the Treasury and not used for unauthorized spending. (5) Finally, the $1.3 billion projected from wellhead tax revenues and the rebate to be based on this revenue is meaningless, since the tax has not been and probably will not be adopted by Congress. The President's cost estimate of $27.9 billion for the current welfare system, therefore, includes $8.6 billion which cannot fairly be included. The estimate of $27.9 billion should be reduced by $8.6 billion to a total of $19.3 billion.

The Administration's cost estimate of current welfare expenditures thus overstates welfare costs; if the cost estimates of the proposed reform are accepted at $34.1 billion, this represents an increase in federal expenditures for welfare of $14.8 billion.

OTHER COST ESCALATORS IN THE REFORM PACKAGE

Even these calculations assume that the Administration's estimates of the cost of its reform plan are accurate. This, too, is highly questionable. The specific areas in which the Administration appears to have underestimated the costs of its reforms, some of which are "built-in" cost escalators, are those of Medicaid, the Earned Income Tax Credit, the federal responsibility for some state expenditures, the expanded terms for eligibility, the provisions for control of fraud and evasion, and the questionable use of variable indices. While it is impossible at the present time to give precise estimates of the increased costs, it will be made clear that such increases will occur.

1. Medicaid: The Administration did not include Medicaid services in the welfare reform plan because it intends to deal with this aspect of welfare in its projected health care plan. Whatever health care legislation it proposes, however, the welfare plan itself will lead to increased spending due to the automatic linkage of cash assistance with Medicaid. At the present time recipients of AFDC are also eligible for Medicaid benefits. As the welfare plan admits that 2 million more recipients of federal cash assistance will enter the program, these also would be eligible for Medicaid and would further increase the costs of this program (which in 1976 cost $15 billion for its 24.4 million recipients).

2. Earned Income Tax Credit (EITC): The Administration estimates that its reformed and expanded EITC will cost an additional $3.4 billion, as previously noted. However, as the tax credit will apply to incomes up to the level of $15,600 per year, several critics of the plan have estimated a more expensive cost for this part of the plan. Mr. Laurence Woodworth, Assistant Secretary of the Treasury for Tax Policy, has testified before the Welfare Reform Subcommittee on September 20, 1977, that this expanded EITC will add $3 billion more to the plan.

3. Hold Harmless Provision: Under the Administration's plan, the states will be required to pay for 90% of their current expenditures on AFDC, SSI, and Emergency and General Assistance for the first year of a 3-year transition period. The purpose of this "maintenance of effort" requirement is to guarantee that current recipients of welfare do not lose benefits during the transition. To balance this provision and to assure fiscal relief to the states, the plan also contains a "hold harmless" provision, under which the federal government is to assume some state expenditures above the 90% level of current costs, when states must spend beyond that level to avoid reducing current benefits.

As Mr. Robert Carleson, former U.S. Commissioner of Welfare, has testified before the Welfare Subcommittee, this provision gives an incentive to the states to increase considerably their welfare expenditures shortly before full adoption of the new system and then to pass the new and higher costs on to the federal government. It would be to the political interests of state legislators to expand welfare benefits and to the financial interests of the welfare recipients. It would, however, present an added burden for the taxpayer of federal revenues.

4. Eligibility for Cash Assistance: The Administration plan for the first time would provide eligibility for cash assistance to unemployed single adults, childless couples, and working families who are not blind, disabled, or aged. This will vastly increase both the number of recipients and the cost of the program as well as change the basic concepts of the role of welfare in American society. The Assets Test contained in the plan will also increase the number of recipients and the cost of their benefits. Excluded from "countable assets" of an applicant are (1) the total value of household goods and personal effects, (2) the total value of owner-occupied housing, (3) the first $3,000 of the retail value of a non-business vehicle, and (4) the total value of prepaid burial contracts. Under this Test, it would be possible for a single, able-bodied adult to own a house, expensive furniture, clothing, jewelry, electrical and electronic equipment, and a car. The Income Test also excludes from countable income 50% of wages, 80% of non-employment income, and 100% of other federal means-tested income (e.g., veterans' pensions). While it is difficult to arrive at a precise estimate of how many more recipients will be added to welfare or how much their benefits would cost, it is rather clear that (a) eligibility for cash benefits will be accessible to a broad cross-section of Americans and (b) welfare will become more attractive to those who are eligible. It is, therefore, proper to greet with skepticism the Administration's estimate of an increase of only 2 million more cash recipients.

5. <u>Control of Fraud and Evasion</u>: The only provision for the control of fraud and evasion in the plan is that recipients of cash benefits must regularly report on their income. However, there is no specification of the frequency of reporting or of the method. The Secretary of the Department of Health, Education, and Welfare is allowed (but apparently not required by law) to suspend payments until such reports have been received. Nor is there provision for checking on the accuracy and honesty of such reports. Given these apparent laxities of administration, it is not clear that the stipulated penalties for fraud (a fine of $5,000 or imprisonment for one year or less) will be effective deterrents.

6. <u>Variable Indices</u>: The Administration, in some aspects of its plan, used certain variable indices to calculate benefits and other costs. Such indices were based on 1977-78 values, though the plan is not to go into effect until 1981. By that year, some of these indices will have increased, thereby increasing the costs to the federal government. Two of these indices are the minimum wage level and the poverty index. An instance in which the former will affect the cost of the program is that the federal government is to pay 30% of each worker's wage base in the Jobs Component of the plan in order to defray the overhead costs to the states. As the minimum wage increases--as it has by 54% from 1965 to 1976--the costs of this federal portion will also rise. Secondly, the Administration's plan proposes a federal national benefit floor of $4,200 for a family of four. This figure is calculated as 65% of the poverty line ($6,440) in 1978, and will increase as the cost of living increases. The Administration states that it will seek adjustments in this floor to meet the costs of inflation, and this will further escalate costs.

CONCLUSION

The factors discussed above will have a dramatic impact on the cost of the President's welfare plan. If the estimate of the Treasury Department of an increased $3 billion for the EITC is added and if the inappropriate cost offsets are discounted, the Administration's plan will cost the federal government <u>at least</u> $37.1 billion, an increase of $17.8 billion above present welfare costs. When the built-in escalators are considered, however, this figure must be increased even more, though the precise amounts cannot at this time be calculated. The estimates given here do not consider other cost problems such as possible increased expenses to the states or the costs of administration and the transition to the new program. However, there appears to be every reason to believe that the President's welfare reform proposal will be considerably more expensive than the Administration originally estimated or than the current welfare system.

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NOTE: The Heritage Foundation is in the process of preparing an exhaustive calculation of the precise costs of the Carter welfare reform plan. This estimate will be completed and published early next year.