FY 2000 Budget ~~[illegible]~~ File

Date: 12/31/98

# FAX

## Health Division

Office of Management and Budget
Executive Office of the President
Washington, D.C. 20503

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## FY 2000 Mandatory Health Sources & Uses of Funds

($ in billions, by fiscal year, numbers may not add due to rounding)

| | 2000 | 2000-2004 |
|---|---|---|
| **SOURCES OF FUNDS** | | |
| **Reduce Medicare Epotein (EPO) Payments by 10%.** FY 1999 Budget proposal. | -0.07 | -0.41 |
| **Require Contractors to Provide MSP Data.** FY 1999 Budget proposal. | -0.01 | -0.76 |
| **Clarify Medicare's Partial Hospitalization Benefit.** FY 1999 Budget proposal. | -0.02 | -0.15 |
| **Base Medicare Payment for Drugs on Provider Acquisition Cost.** FY 1999 Budget proposal. | -0.11 | -0.71 |
| **Centers of Excellence.** FY 1999 Budget proposal delayed by one year. | 0.00 | -0.59 |
| **Reduce Hospitals' Market Basket.** Provides zero update of hospital market basket for FY 2000. | -0.65 | -3.88 |
| **Reduce Medicare Bad Debt Payments.** Increases BBA bad debt cut to 55% beginning in FY 2000 and reduces bad debt payments to all non-hospital providers that recieve reimbursement by 55% beginning in FY 2000. | -0.30 | -2.11 |
| **Reduce PPS Hospital Payments for Capital.** Increases BBA capital reduction by an additional 3% in FY 2000 (i.e., net 5.1% percent reduction in FY 2000). | -0.20 | -0.20 |
| **Establish a National Limit for All Prosthetics and Orthotics.** Establishes national limits based on the median of all state fee schedules. | -0.05 | -0.43 |
| **Require 10% Coinsurance for Certain Medicare Lab Services.** Institutes 10% coinsurance rate on hospital OPD lab services. Coinsurance does not apply to lab services that are also preventive services (e.g., pap smears). Effective date: January 1, 2001. | 0.00 | -0.70 |
| **Accelerate Inherent Reasonableness Savings.** Reduces reimbursement for six selected DME (e.g., 2 types of electric nerve stimulators). | -0.02 | -0.10 |
| **Medicaid Cost Allocation.** Reduces Medicaid similar to approach for Food Stamp reduction in Agriculture Research bill but without TANF prohibition. | -0.05 | -1.39 |
| **Medicaid Rebates from Generic Drug Manufacturers.** HCFA A-19 proposal. | -0.01 | -0.13 |
| **Other Non-Medicare/Medicaid Offset Sources.** | 0.00 | -3.60 |
| ***Subtotal, Sources of Funds*** | **-1.47** | **-15.15** |
| **USES OF FUNDS** | | |
| **Discretionary Spending for Public Health Infrastructure Initiative.** | 0.00 | 1.00 |
| **Other HHS Discretionary.** | 1.30 | 7.90 |
| **Medicare Buy-In for 55-65.** Effective date: 1/1/01. | 0.00 | 1.44 |
| **Cancer Clinical Trials.** Funds allocated to separate account outside of Medicare trust funds. Capped demonstration. Structure of trials covered to follow. | 0.00 | 0.75 |
| **Disease Management: Asthma Initiative.** Provides $50 million in grants in FY 2000 to states that submit Medicaid disease management programs to identify and treat asthmatic children with the most appropriate care. | 0.05 | 0.05 |
| **Waive Cost-sharing for Medicare Preventive Benefits.** Waive deductible and/or coinsurance for preventive benefits requested in HCFA A-19. Effective date: January 1, 2001. | 0.00 | 0.77 |
| **Jeffords/Kennedy.** | 0.02 | 0.79 |

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## FY 2000 Mandatory Health Sources & Uses of Funds

($ in billions, by fiscal year, numbers may not add due to rounding)

| | 2000 | 2000-2004 |
|---|---|---|
| **Medicaid Costs of SSI Restoration.** Restores SSI and related Medicaid for disabled legal qualified immigrants who entered after 8/22/96 and lived in U.S. for 5 or more years. | 0.00 | 0.50 |
| **Prenatal Care for Immigrants.** Allow states to provide Medicaid prenatal care to qualified legal immigrants who entered the US after 8/22/96. | 0.00 | 0.10 |
| **Legal Immigrant Children.** FY 1999 Budget proposal. | 0.03 | 0.21 |
| **CHIP Funding for the Territories.** FY 1999 Budget proposal. | 0.03 | 0.14 |
| **Increase BBA DSH Allotment for DC Medicaid.** Provides $9 million federal DSH allotment increase in FY 2000 for D.C. | 0.01 | 0.01 |
| **Foster Care Extension.** Allows states to extend Medicaid eligibility to children up to age 21 who were eligible for Foster Care assistance at age 18. | 0.01 | 0.05 |
| **300% Eligibility Expansion.** HCFA A-19 proposal. | 0.01 | 0.11 |
| **Extension of Medicaid TANF Transition Fund.** Expands use of $500 million TANF fund to fund outreach to all children. Lifts sunset. | 0.04 | 0.35 |
| **Assisted Living Initiative.** Provides $80 million in HUD grants to senior housing facilities converting to assisted living. Grants contingent on States offering Medicaid services (personal care, HCBW) in facilities. | 0.00 | 0.00 |
| **Transitional Medicaid Simplification.** Eliminates reporting requirements for certain families and states; drops state mandate to provide transitional Medicaid if expand coverage to low-income families. | 0.00 | 0.00 |
| **Other LTC.** Includes several non-Medicaid/Medicare long-term care proposals funded by other sources. | N/A | N/A |
| **Medicare+Choice Policies.** Per earlier discussions with HCFA. | 0.00 | 0.00 |
| **Expand Medigap Open Enrollment to Disabled/ESRD.** Expands initial 6 month open enrollment period to new disabled and ESRD beneficiaries and provides a guaranteed issue option in the event their HMO withdraws from Medicare. | 0.00 | 0.00 |
| **Guarantee Medigap Enrollment in Plans with Drug Coverage for Beneficiaries Dropped By HMOs.** Allows guaranteed enrollment for benes. dropped by HMOs in any Medigap plan that offers drug coverage, provided the beneficiary's HMO offered such coverage. | 0.00 | 0.00 |
| **Patients' Bill of Rights.** | 0.00 | 0.00 |
| **CHIP Outreach.** Removes outreach from 10% cap; establishes separate outreach cap of 3% of benefits; requires states to use portion of remaining 10% cap to improve data systems, collection and reporting activities. | 0.00 | 0.88 |
| **Subtotal, Uses of Funds** | **1.50** | **15.03** |
| *Effect of Medicare proposals on Medicaid spending* | -0.01 | -0.07 |
| **TOTAL** | **0.01** | **-0.18** |



December 31, 1998

TOTAL P.04

# Mandatory Decisions for FY 2000 HHS Health Budget

December 31, 1998

The attached table provides detail on the decisions for mandatory health initiatives and offsets for the FY 2000 HHS mandatory health budget.

The table provides FY 2000 outlay numbers and total FYs 2000-2004 outlay numbers for each initiative and offset to be included in HHS' budget.

Additional administrative items will be sent on Monday, January 4.

We removed virtually all proposals HCFA noted as having a Y2K problem. We believe that the partial hospitalization proposal from the FY 1999 President's Budget can be implemented in FY 2000. We also removed several proposals to which HHS/HCFA raised policy objections. Please provide your response to this table by close of business, Monday, January 4.

We also request official OACT scoring for the items in this table.

For the assisted living proposal, we will be organizing a meeting with HHS to discuss appropriate minimum criteria for grant recipients.

# HHS Health Funding Alternatives

$ in millions; non-adds are in italics; indented lines are non-adds to the line above

| | FY 1999 Enacted | FY 2000 Passback | HHS FY 2000 Appeal | $600 M Over Passback |
|---|---|---|---|---|
| **FDA Program Level** | **1,135** | **1,263** | **1,527** | **+64** |
| **FDA BA** | **982** | **1,080** | **1,328** | **+64** |
| *Injury Reporting* | *N/A* | *15* | 15 | |
| *Product Safety (includes $ 20.4M for LA lab)* | *N/A* | *43* | 56 | +9 |
| *PMA Approvals* | *N/A* | *20* | 36 | -9 |
| *Food Safety* | *49* | *49* | 98 | +30 |
| *Tobacco* | *34* | *34* | 84 | +34 |
| *Rent* | *83* | *95* | 95 | |
| *Buildings & Facilities* | *11* | *16* | 23 | |
| *Integrating NOAA Seafood PBO* | *0* | 3 | 3 | |
| **HRSA** | **4,118** | **4,023** | **4,409** | **+62** |
| *MCH Block Grant* | *700* | *700* | *755* | |
| *Health Professions* | *302* | *197* | *340* | |
| *Consolidated Health Centers* | *925* | *925* | *1,015* | *+20* |
| *Ryan White* | *1,411* | *1,484* | *1,505* | *+27* |
| *Health Facilities Construction* | *65* | *0* | *0* | |
| *Program Management* | *119* | *117* | *133* | |
| *Hansen's Disease Activities* | *22* | *12* | *17* | *+5* |
| *Family Planning* | *215* | *230* | *230* | *+10* |
| **IHS Program Level** | **2,600** | **2,775** | **2,980** | **+0** |
| **IHS BA** | **2,242** | **2,417** | **2,622** | **+0** |
| *Clinical Services* | *1,542* | *1,667* | *1,693* | |
|   *Dental Health* | *71* | *81* | *88* | |
| *Preventive Services* | *87* | *92* | *104* | |
|   *Community Health Rep./Nursing* | *76* | *81* | *93* | |
| *Other Services* | *321* | *348* | *441* | |
|   *Urban Health* | *26* | *28* | *40* | |
|   *Contract Support Costs* | *204* | *229* | *305* | |
| *Facilities* | *292* | *310* | *384* | |
|   *Health Facilities Construction* | *41* | *37* | *83* | |
|   *All Other* | *251* | *273* | *301* | |
| **CDC Program Level** | **2,705** | **2,731** | **3,929** | **+119** |
| **CDC BA 1/** | **2,610** | **2,627** | **3,481** | **+114** |
| *Chronic and Envir. Disease* | *294* | *259* | *552* | *+47* |
|   *Tobacco* | *74* | *74* | *228* | *+27* |
| *Preventive Health Block Grant* | *150* | *120* | *160* | |
| *NIOSH* | *200* | *212* | *217* | |
| *NCHS Program Level* | *95* | *105* | *135* | *+5* |
| *NCHS BA* | *27* | *0* | *39* | |
| *Injury Control (incl. violence against women)* | *58* | *61* | *125* | |
| *Savings of 0.43% from S&E from increased efficiencies* | *N/A* | *-3* | *0* | |
| *Immunizations* | *421* | *476* | *573* | *+30* |
|   *Global Polio/Measles* | *28* | *25* | *33* | *+10* |
| *STDs* | *124* | *129* | *139* | *+2* |
| *Infectious Disease Program Level (CDC +PHSSEF)* | *138* | *173* | *226* | |
| *Infectious Disease CDC BA* | *138* | *153* | *226* | *+10* |
|   *Public Health Surveillance Initiative (BA) 2/* | *N/A* | *30* | *30* | |
|   *Food Safety* | *14* | *14* | *32* | *+10* |
|   *Hepatitis C* | *N/A* | *5* | *15* | |

| | FY 1999 Enacted | FY 2000 Passback | HHS Appeal | $600M Over Passback |
|---|---|---|---|---|
| **CDC continued** | | | | |
| *Buildings & Facilities -- Labs* | *18* | *40* | *115* | |
| *Construction* | *11* | *32* | *62* | |
| *HIV Prevention* | *657* | *657* | *669* | *[+10.000]* |
| *Violent Crime Trust Fund* | *51* | *51* | *51* | |
| *Race and Health* | *10* | *10* | *32* | *+25* |
| | | | | |
| **NIH** | **15,612** | **15,661** | **17,198** | **+0** |
| | | | | |
| **SAMHSA Program Level** | **2,488** | **2,542** | **2,798** | **+167** |
| **SAMHSA** | **2,488** | **2,405** | **2,796** | **+167** |
| *Mental Health Block Grant* | *289* | *289* | *375* | *+70* |
| *Mental Health KDA* | *98* | *78* | *102* | *+20* |
| *PATH* | *26* | *30* | *30* | *+1* |
| *Substance Abuse Block Grant* | *1,585* | *1,585* | *1,685* | *+50* |
| *SABG Advance Funding* | *N/A* | *100* | *0* | |
| *Substance Abuse Treatment KDA* | *151* | *131* | *155* | |
| *Substance Abuse Prevention KDA* | *90* | *65* | *94* | |
| *Targeted Capacity Expansion* | *21* | *26* | *73* | |
| *Youth Substance Abuse Prevention Initiative* | *66* | *40* | *66* | *+26* |
| *Substitute BA for 1% Eval. Funds in Nat'l Household Survey* | | | | |
| *PL* | *38* | *38* | *42* | |
| *BA* | *38* | *0* | *42* | |
| | | | | |
| **AHCPR Program Level** | **171** | **201** | **216** | **+5** |
| **AHCPR BA** | **100** | **0** | **142** | **+5** |
| *Research on Health Costs, Quality, and Outcomes* | *141* | *50* | *173* | |
| *MEPS* | *28* | *36* | *40* | |
| *Program Support* | *2* | *2* | *2* | |
| *Research on Race And Health* | | | | *+5* |
| | | | | |
| **Office of the Secretary Program Level** | **241** | **234** | **450** | **+3** |
| **Office of the Secretary BA** | **221** | **196** | **253** | **+3** |
| *Increase Nursing Home Init. by $9.5M; Reduce AFL by $8.5M* | *N/A* | *1* | *9* | |
| *Discontinue Office of Minority Health Earmarks* | *28* | *25* | *34* | *+3* |
| *Substitute BA for 1% Eval. Funds in Pol. Research and ASPE* | | | | |
| *PL* | *17* | *17* | *17* | |
| *BA* | *17* | *0* | *17* | |
| *GDM savings from discontinuing $1.59M in one-time activities and $4M for one-time Congressional increase* | *N/A* | *-6* | *0* | |
| *Trust Fund Transfer* | *6* | *7* | *7* | |
| *Office for Civil Rights* | *21* | *22* | *23* | |
| *Bioterrorism* | *2* | *0* | | |
| | | | | |
| **PHS 1% Eval. $ Buy Back** | | | | **?** |
| | | | | |
| **PHSSEF** | **406** | **294** | **928** | **+87** |
| *Bioterrorism* | *134* | *128* | *305* | *+37* |
| *CBC AIDS* | *50* | *0* | *50* | *+50* |
| *Measles/Polio/Environmental Health Lab 1/* | *33* | *[30.000]* | *[38.000]* | |
| *Y2K* | *189* | *166* | *573* | |

| | | | | |
|---|---|---|---|---|
| **Program Mgt. for HRSA, CDC, SAMHSA, FDA, and Physicians' Compensation** | | | | **+20** |
| **Program Management for GDM** | | | | **+5** |
| **Managing Physicians' Compensation** | **0** | **-27** | **0** | **+8** |
| **HCFA Program Level** | **2,086** | **2,336** | **2,747** | **+25** |
| **HCFA BA** | **1,947** | **1,780** | **1,994** | **+25** |
| *Long Term Care* | | | | +25 |
| **IG** | **29** | **30** | **33** | |
| **Other Committed EXOP** | | | | **+40** |
| **Total Discretionary BA** | **30,755** | **30,487** | **35,183** | **+600** |

1/ HHS appealed for CDC's polio/measles/environmental health lab activities ($38M) within the PHSSEF. We have placed this funding within CDC's totals to make it consistent with our passback. Therefore the HHS appeals document shows PHSSEF $38M higher and CDC $38M lower than the numbers shown in this chart.

2/ Includes $20M from the PHSSEF in FY 2000.

# Tax Meeting Agenda

**December 16, 1998**

I. **Discuss starting point package -- modify on pay-as-you-go basis.**

II. **Prioritize how package would be shaved if insufficient offsets.**

III. **Prioritize how package would be modified/added to if additional offsets are found.**

## Existing Tax Cut Package

| PROPOSAL | | | 5 YEAR COST (IN BILLIONS OF $) |
|---|---|---|---|
| I. | Child Care | | |
| | a. | Dependent Care Tax Credit (DCTC) | 5.1 |
| | b. | Tax Credit for Employers | 0.5 |
| II. | School Construction | | 5.0 |
| III. | Employer Provided Education (Sec. 127) | | 1.0 |
| IV. | Low Income Housing Tax Credit | | 1.6 |
| V. | Climate Change | | 3.6 |
| VI. | Pensions | | 0.9 |
| VII. | Extenders (R&E,WOTC,WTW,etc.) | | 3.3 |
| VIII. | International and Puerto Rico | | 1.4 |
| IX. | $2,000 Severance Pay Exemption | | 0.8 |
| **TOTAL** | | | **$24.2 billion** |
| I. | Savings: ½ year extenders | | -1.6 |
| II. | Drop Severance Pay | | -0.8 |
| **TOTAL** | | | **$21.8 billion** |

## New Tax Cut Proposals

750 / 750 / 1000 cont.

| PROPOSAL | | 5 YEAR COST (IN BILLIONS OF $ ) |
|---|---|---|
| I. | Long-term Tax Credit | 5.2 |
| II. | Tax Credit for the Disabled | 0.7 |
| III. | Small Business Health Purchasing Cooperatives | 0.2 |
| IV. | Stay at Home Moms (add to child care) | 0.6 .8 |
| V. | ~~Tax Credit for Work-site Schools~~ | ~~0.2~~ |
| VI. | Tax Credit for Workplace Literacy | 0.2 ✓ |
| VII. | Eliminate 60-month limit on interest deduction | 0.3 ✓ |
| VIII. | Green Bonds - Ron Klain | 0.7 downsize |
| IX. | Fund of Fund Tax Cut | 0.9 |
| X. | Personal Credits and AMT | 0.8 |
| XI. | Employee Telecommunter Expense | 0.3 |
| **TOTAL** | | **$10.1 Billion** |
| **TOTAL OF 2 TAX PACKAGES** | | **$31.9 Billion** |

| Items Not Discussed at the Last Meeting | |
|---|---|
| **Option** | **5 Year Cost (billions)** |
| Steel | na |

| Proposals Left On the Table/Below the Line from Last Meeting | |
|---|---|
| **Option** | **5 Year Cost (billions)** |
| Tax Credit for Work-Site Schools | na -- likely small |
| Tax Credit for Workplace Literacy | less than 0.2 |
| Liberalize Lifetime Learning Tax Credit | Option Range: 2.8; 7.1 |
| Exclusion for Americorp Education Awards | na -- may raise very small amount |
| Home Ownership Tax Credit | Roughly 0.5 |
| CDFI Tax Credit | About 0.1 |
| Financial Security (one new small tax item) | na -- likely small |
| Cap Gains Exclusion -- Land for Conservation | na -- likely small |
| Pensions -- WTW (DOL proposal) | na |

| Proposals Taken Off the Table at the Last Meeting | |
|---|---|
| **Option** | **5 Year Cost (billions)** |
| Lifetime Learning Savings Accounts | About $10 bilion over ten years |
| WTW-WOTC Longer Extensions | Permanent -- roughly 2.5 |
| Modify R & E Credit (Small business, consortia) | na -- likely small |
| Farm and Ranch Risk Management Accounts | na |
| Pensions (DOL proposals EZs, EITC) | na |
| Oil and Gas Marginal Wells (DOE) | na |
| HUD (multi-family exit, LIHTC carveout, elderly tax credit) | na |

Brief Description

# Possible New Tax Cut Initiatives

## Health:

### *Long-term Care Tax Credit*

Lack of insurance against the costs of long-term care expenses is a major problem for the elderly and their families. This proposal would give people who are limited in three or more activities of daily living (ADLs- eating, toileting, transferring, bathing, dressing, and continence) or their caregivers a tax credit of $1,000 to help pay for formal or informal long-term care. The credit would also cover people with severe cognitive impairments.

**Cost:** $6.5 billion over 5 years.

**Process Status:**
The process is far along and in good shape. The next step is decision on whether to include in the budget.

### *Tax credit for disabled workers*

Almost 75 percent of people with severe disabilities are unemployed. For many, the high cost of support services and devices, as well as the potential to lose Medicaid or Medicare coverage, prevent them from seeking and keeping jobs. This proposal would give a tax credit of $1,000 to people with disabilities who work in recognition of their formal and informal costs associated with employment. The credit would be available for people who are limited in two or more ADLs (excluding continence management) or three or more instrumental ADLs (IADLs -- meal preparation, shopping, money management, telephoning, and housework). About 240,000 taxpayers will benefit in CY 2000.

**Cost:** $700 million over five years.

**Process Update:**
The process is far along and in good shape. The next step is decision on whether to include in the budget.

### *Small business health purchasing cooperatives*

Over a quarter of private-sector workers in firms with 50 or fewer employees lack health insurance -- significantly higher than the national average of 17 percent uninsured. This results in part because administrative costs are higher and small businesses pay more for benefits than larger employers. This initiative encourages the development of small business health purchasing cooperatives, in some ways modeled on FEHBP. There are two tax proposals regarding these cooperatives. The first proposal would make them tax-exempt. (We are examining more limited alternatives to tax-exempt status that would also promote the making of grants by private foundations to a qualified cooperative.) The second part of the proposal would create a new tax credit for employers with fifty or fewer employees, who purchase health insurance through the cooperative, and who had not previously provided health insurance. The credit would be available for the first two years of coverage and would equal ten percent of employer contributions up to a cap.

**Cost:**

**Process Update:**
There have been extensive discussions among DPC/NEC/Treasury/HHS staff. The main issue of contention is over the tax treatment of the cooperatives. Treasury has serious tax policy concerns about granting permanent tax exemption to entities that are functionally identical to for-profit businesses to help cover start-up expenses. DPC/NEC/HHS are extremely concerned that without such tax treatment foundations will not provide funds to cooperatives and the proposal will not be viable.

## Children and Families

### *Tax Relief for Stay-at-Home Parents*
Our proposed increase in the DCTC did not receive strong bipartisan support, in part because conservatives objected to the exclusion of benefits for stay-at-home-parents. To increase support for our existing child care tax proposal, it could be expanded to include tax assistance to stay-at-home parents. This would be accomplished by assuming these families incur a certain amount of child-care expenses and therefore could be eligible for the DCTC. To control the cost, the stay-at-home-parent options would focus on families with very young children.

A series of options have been developed that assume a certain amount of child-care expenses for all families with very young children.

**Cost:** Cost from options range from no additional cost (carved out of existing child-care tax cut) to $6.1 billion over five years (on top of existing proposal). Two in-between options cost $1.6 billion and $2.9 billion over five years.

**Process Update:**
The options have been developed and costs estimated. In addition to the question of the availability of funds, the main issue is over broadening the appeal of our proposal by adding stay-at-home parents versus Treasury tax policy concerns over exacerbating the code's tilt in favor of stay-at-home parents.

## Education and Training

### *Tax Credits for Work-Site Schools*

A 25 percent tax credit would be provided to employers who enter into a cooperative agreement with local public schools to provide space, utilities and maintenance for satellite elementary schools located on their work site. The base for the annual credit would include the cost of tangible personal property or real property donated to the school plus the fair market rental value of real property dedicated for school use. Teacher salaries are ineligible for the credit. The credit would be limited to $150,000 per year, per facility. Credits could be claimed for up to 10 years. To be eligible for the credit, the taxpayer must enter into an agreement with a local public school agency that is approved by the Department of Education. The Department would be limited in the number of agreements that could be approved per year.

**Cost:**

**Process Update:**
There have been ongoing staff discussions. A decision needs to be made on whether to pursue this option further. Treasury is concerned that this provision subsidizes quasi-private education by providing a tax credit to private employers who contract with public schools for their employees.

### *Tax Credit for Workplace Literacy Programs*

Employers who provide certain workplace literacy, ESL, and basic education programs for their employees would be allowed a 10 percent income tax credit against expenses, with a maximum credit of $525 per participating employee. Eligible education would generally be limited to instruction at or below the level of a high school degree given to employees with less than a high school diploma or its equivalent, and to ESL for employees with limited English proficiency. Eligible expenses would include payments to third parties and payments made directly to cover instructional costs, including salaries of instructors, curriculum development, textbooks, etc.

**Cost:**

**Process Update:**
The process is reasonably far along. A decision needs to be made on whether this option should be pursued on the tax or spending side.

### *Liberalize the Lifetime Learning Credit*

The proposal presents two options to enhance the Lifetime Learning Credit. First, accelerate from 2003 to 2000 the increase in the base of the lifetime learning credit from $5,000 to $10,000. Second, Increase the lifetime learning credit rate from 20 percent to 30 percent of the first $5,000 and reduce it to 10 percent on the second $5,000 of qualified expenses. The maximum credit per taxpayer would remain equal to $2,000.

**Cost:** The approximate cost of the first options is $2.8 billion over five years. The rough cost is of the second option is $7.1 billion over 5 years.

**Process Update:**
The options have been developed.

### *Lifetime learning savings accounts*

Two proposals are being considered. The first would make Education Individual Retirement Accounts available to everyone (adults as well as children) by removing the current-law age 30 distribution requirement and the age 18 contribution limit. The second would add education expenses to the list of distributions from a Roth IRA that can be taken tax free. Unlike other distributions on the list, however, tax-free withdrawals for education expenses could be taken at any time, without being subject to a five-year holding period.

**Cost:**

**Process Update:**
The options have been developed. Treasury, however, has serious concerns regarding these proposals because they are unlikely to stimulate education among those most in need, but provide windfalls to the rich for saving they would have done anyway.

### *Exclude Americorp Education Awards from Taxable Income*

Americorp members are eligible for post-service educational awards of up to $9,450. The awards can be used either to pay higher education expenses or to repay student loans. Americorp also pays the interest on existing student loans while the borrower is a member of Americorp. The educational awards and interest payments are treated as taxable income. The proposal would exclude from taxable income Americorp educational awards.

**Cost:**

**Process Update:**
There have been several discussions on this issue. The main sticking point is that many Americorps participants would actually be made worse off because they would lose access to HOPE and Lifetime Learning tax credits.

### *Eliminate 60-month limit on deductibility of student loan interest*

Under current law, student loan interest is deductible only during the first 60 months in which interest payments are required. The proposal would eliminate the 60-month limit.

**Cost:**

**Process Update:**
The options has been developed.

## Urban - Empowerment

### *Green bonds*

Under current law, state and local governments may issue tax-exempt bonds without limit to pay for the costs of public environmental remediation projects. In addition, tax-exempt bond money may be lent to private entities to finance facilities for sewage, solid waste, hazardous materials, environmental enhancement of hydro-power facilities, and urban redevelopment, but those bonds are limited by the private activity bond cap. The proposal would create a new financing mechanism–green bonds–to raise funds to finance environment-related public projects. Like qualified zone academy bonds (QZABs), this program would allow state and local governments to issue zero-interest bonds to lenders who could claim a tax credit for the life of the bond in lieu of interest. Green bond authority for each state is capped. The issuer makes no principal or interest payments on the bond until maturity (13 years under the QZAB program).

**Cost:**

**Process Update:**
The process is reasonably far along but is not complete. In addition to the school construction model, a staff group has been considering including a credit similar to the low-income housing tax credit model; a new category of private activity tax-exempt bond; and a state-managed revolving fund financed by federal grants used to subsidize interest payments on tax-exempt bonds issued by localities. A decision needs to be made on whether to pursue this option further.

### *Home ownership tax credit*

This proposal aims to encourage home ownership among low-income people. State housing finance agencies would induce investors to purchase low-interest second mortgages by auctioning tax credit authority (paid over ten years) to subsidize the mortgage payments. The unsecured second mortgages of up to 20 percent of purchase price would allow purchasers to qualify for first mortgages with lower incomes and down payments and avoid PMI payments. This program would be targeted at families in underserved areas. Credit authority is capped; the program is designed to cost about $500 million over five years. (Treasury does not have enough information to do a revenue estimate.) It would save a family buying a $75,000 home $750 in up front costs and $140 per month, primarily in lower mortgage insurance costs.

**Cost:** Roughly $500 million over five years.

**Process Update:**
The process is reasonably far along. There have been ongoing discussions among NEC/DPC/Treasury/HUD/NRC. A decision needs to be made on whether to continue to pursue this option. Treasury is concerned that this proposal is extremely complex and encourages home ownership among those least likely to be able to afford it on a sustainable basis.

### *Tax Credit For Equity Investments in CDFIs*

The Community Development Banking and Financial Institutions Act of 1994 created the Community Development Financial Institutions (CDFI) Fund, now housed within the Department of Treasury, to provide equity investments, grants, loans, and technical assistance to qualifying organizations for community development. The CDFI Fund was appropriated $95 million in FY 1999. The proposal would provide $100 million in nonrefundable tax credits to the CDFI Fund to allocate among equity investors in qualified CDFIs between 2000 and 2009. The allocation of credits would be determined by the CDFI Fund using a competitive process similar to the one used for grants, loans, and equity investments. The maximum amount of credit allocable to a particular investment would be 25 percent of the amount invested, though the CDFI Fund could negotiate a lower percentage. Certain special basis and recapture rules would apply and certain design issues remain.

**Cost:**

**Process Update:**
The option is nearly complete.

### *Increase the private activity bond cap*

Under current law the volume cap for each state is the greater of $50 per capita or $150 million. The current cap allows about $15 billion of private activity bonds to be issued annually, about $5 billion which are new mortgage revenue bonds. The cap will increased by 50 percent between 2003 and 2007, when it will be the greater of $75 per capita or $225 million. The proposal would make the increase in the cap effective in 2000.

**Cost:** About $0.5 billion over 5 years.

**Process Update:**
Option has been developed.

### *WTW/WOTC longer extensions*

The work opportunity tax credit (WOTC) and the welfare to work (WTW) tax credit encourage employers to hire members of certain economically disadvantaged targeted groups. Both credits will expire on June 30, 1999. The proposal would make the WOTC and WTW credit permanent. Alternatively, the length of extension would be tailored to available revenue offsets. (Last year's budget contained short-term extensions of both credits.)

**Cost:**

**Process Update:**
Options have been developed.

## R & D

### *Modify Research and Experimentation Tax Credit*

The current research credit is 20 percent of qualified research expenses above a base amount. The base amount generally is the product of the taxpayer's "fixed-base percentage" and the average of the taxpayer's gross receipts for the four preceding years. Taxpayers can also elect into an alternative credit that has lower credit rates and lower statutory fixed-base percentages.

Several options are being explored including adding a small business feature and additional tax incentives for research consortia.

**Cost:**

**Process Update:**
There have discussions among NEC/OVP/Treasury staff. Options need to be fleshed out further. A decision needs to be made on whether to pursue these options.

## Other

### *Allow Personal Credits to be Deducted Against the Alternative Minimum Tax*

The proposal would extend the deductibility of personal tax credits against Alternative Minimum Tax (AMT) liability for one year, for tax year 1999. The recent omnibus spending bill provided that personal tax credits could offset AMT liability tax year 1998.

**Cost:** A one-year extension would cost about $0.8 billion.

**Process Update:**
Option has been developed.

### *Employee telecommuter expense*

Qualified telecommuting expenses paid for, or reimbursed by, an employer would be excludable from the income of an employee. Qualified expenses would include charges for an additional telephone line or advanced telecommunications service up to $60 per month (indexed after the initial year).

**Cost:**

**Process Update:**
The option has been developed. While this would encourage telecommuting and more flexible work arrangements, Treasury has serious concerns that this proposal would be extremely difficult to administer and would largely produce windfalls for those who are currently telecommuting.

### *Financial security*
A number of proposals were part of a Financial Security package sent to the NEC from Treasury. Most of these proposals involve increased spending, and most of the tax proposals have already in proposed in last year's budget. The only proposal that represents a new tax incentive calls for eliminating user fees for initial determination letters for small businesses adopting a qualified retirement plan for the first time.

**Cost:**

**Process Update:**
Tax option has been developed.

### *Capital Gains Exclusion For Sales of Land for Conservation*
Under current law sales of land to non-profit organizations or governments for conservation purposes are subject to tax on any capital gain. Such land donated to non-profit organizations generally qualifies for a charitable deduction and avoids tax on the gain. The proposal would provide a 50 percent exclusion for capital gains for land sold to government agencies or qualified non-profit conservation organizations thereby reducing the maximum capital gains rate from 20 percent to 10 percent. The proposal requires that the land be used to protect fish, wildlife or plant habitat or open space for agriculture, outdoor recreation or scenic beauty.

**Cost:**

**Process Update:**
Option has been developed. CEQ is proposing this option, while Treasury is concerned that this proposal would add to the complexity and inequity of the tax code without advancing land conservation.

### *Farm and Ranch Risk Management (FARRM) Accounts*
Up to 20% of farming income could be contributed to a FARRM savings account and deducted from income. The income earned on the account is taxable as earned. The contribution plus any accrued capital gain is taxable upon withdrawal from the account. Contributions and earnings must be withdrawn within 5 years; otherwise the balance in the account would be deemed to have been distributed and subject to income tax and a 10 percent penalty. Balances would be deemed to have been distributed and taxable two years after an account holder stops farming.

**Cost:**

**Process Update:**
This has come up in the context of the farm safety net policy process. It is important to note that the Administration <u>strongly</u> opposed adoption of FARRM accounts and prevented the provision from being enacted in the omnibus appropriations bill. Treasury has serious concerns that it would provide a windfall to a few rich farmers and do nothing to reduce risk or encourage saving. A decision needs to be made on whether to pursue this option further.

## Pensions

### *Enterprise zone wage credit extension*

Current law provides a 20 percent credit for the first $15,000 of wages for employees who live and work in empowerment zones (EZs) or who live in DC and work in the DC zone (an EZ-like designation covering parts of the District of Columbia). The credit will expire at the end of 2004 for EZs and 2002 in the DC zone. The proposal, put forward by the Department of Labor (DOL), is aimed at encouraging zone employers to provide pension and health benefits to EZ wage credit-eligible employees. The credits, which are 20 percent of the employer's qualifying pension and health insurance contributions, would not be included under the current wage cap, but the qualifying contributions would be subject to separate limits of $2,500 (for pensions) and the Federal FEHBP contribution (for health insurance). The Departments of Housing and Urban Development and Agriculture would certify that the pension and health benefits offered qualify for the credit.

**Cost:**

**Process Update:**
This proposal has been considered by the pension working group. This is a DOL proposal. Treasury is concerned that this proposal has a very high cost-benefit ratio and would make the EZ wage credit more complex. A decision needs to be made on whether to pursue this option further.

### *Employee benefits tax credit for EITC recipients*

EITC recipients could claim additional refundable credits if they purchase health insurance or contribute to pension plans. The maximum pension credit would be equal to the lesser of 50 percent of the employee's contribution or $1,000 (indexed). The maximum health credit would be equal to the lesser of 50 percent of the employee's contribution or 50 percent of the employee cost for standard Blue Cross insurance under FEHBP. The credits would not be phased in with earnings; rather, a taxpayer would be eligible for the maximum credit as soon as the taxpayer contributes to a pension plan or purchases health insurance. The credits would be phased out with the EITC. In addition, the definition of non-taxable earned income would be modified to exclude non-taxable contributions to pension plans and health insurance purchases.

**Cost:**

**Process Update:**
This proposal has been considered by the pension working group. This is a DOL proposal. Treasury is concerned that this proposal would raise compliance problems with the EITC and do little to enhance health insurance and pension coverage among low-income families. A decision needs to be made on whether to pursue the option further.

***Additional Proposals/Areas Have Been Raised:***

- Steel
- Oil and Gas (Energy Department Proposal on marginal wells)
- UI
- Additional Housing Proposals (HUD)

FY 2000 Budget: Tax Proposals

December 1, 1998

**MEMORANDUM FOR GENE SPERLING**
**DIRECTOR, NATIONAL ECONOMIC COUNCIL**

**FROM:** ROBERT E. RUBIN

**SUBJECT:** Meeting on Tax Cut Options

An NEC process in coordination with Treasury staff has developed possible new tax cut options for the President's budget. NEC-DPC sub-groups (Treasury, OMB, CEQ, OVP, and various agencies) have been working on priority areas, including health, education and training, children and families, empowerment, R & D, and pensions.

This meeting will focus on these new possible proposals and the context for their consideration. Treasury has a number of concerns about many of these proposals, including questions about administrability, marginal effect and social policy judgments. Moreover, as a more general matter, we face serious budgetary and analytic resource constraints. Given what the Administration is almost certainly committed to, there is little room for new proposals, especially if we decide to support a fix to the marriage penalty.

In that context, we need to decide which, if any, of the new proposals to work on, bearing in mind that such effort comes at the cost of work on other high priority issues, development of possible raisers, revision of the tax baseline and issuance of regulatory guidance (which is always heavily weighted toward year-end).

More generally, there is as always the broader question regarding the extent to which we should focus on simplifying the tax code versus the extent to which we should pursue other social and economic objectives at the expense of making the tax code more complex.

In light of the above considerations, we believe that the NEC Principals need to focus on the following questions:

- Should the budget include marriage penalty relief?

- Should a share of tobacco receipts, if any, go to offset tax cuts?

- Will all revenue raisers continue to be dedicated solely to tax cuts?
- Should all of our tax cuts from last year's budget be re-proposed?
- Which of the new tax cut options should be given priority consideration, if any?
- Which tax cut options should not be considered further, because they are bad policy, conflict with other objectives, or have no realistic prospect of being enacted?

Below is a discussion and background relevant to the above questions as well as brief descriptions, pros and cons, and rough cost estimates of the possible new tax cut proposals.

## Marriage Penalty Relief

Treasury estimates that, in 1999, 48 percent of all couples will have a marriage penalty and 41 percent will have a marriage bonus. Aggregate penalties will be $28 billion in 1999, and aggregate bonuses will be $27 billion. Despite this rough parity, marriage penalty relief has broad support in Congress. Various legislative proposals have been introduced to address the marriage penalty, some of which the Administration has supported. The question now is whether marriage penalty relief should be included in the budget. Marriage penalty relief would cost more than $10 billion over five years.

**Pros**

- It would increase the appeal of our package to Democrats (as well as Republicans) and increase the likelihood that they would embrace our proposal overall and help ensure that it would serve as the Democratic proposal in any tax debate. Recall that this past year the Senate Democrats dropped some of our key tax cuts to make room for marriage penalty relief.
- It would put the President on the record more clearly on an issue that we have voiced support for in the past, that is likely to pass one day in some form and that we would never openly oppose. Including a specific proposal might increase our chances of influencing the ultimate design of any marriage penalty relief.

**Cons**

- Proposed solutions are very costly. Even limited relief would absorb $10 billion or more in raisers that could be used for other priorities.
- There is little evidence that marriage penalties and bonuses in the income tax affect decisions to marry, divorce or work.

- Most marriage penalty relief proposals benefit higher income couples disproportionately. Steps can be taken to minimize this. For example, relief can be designed to help people who face marriage penalties due to the phase-out of the EITC.

If the group decides to move ahead on serious consideration of marriage penalty relief, two very general design options should be considered:

1) Increase the Standard Deduction for Married Couples -- Both Archer ($27 billion over five years) and Gramm-Domenici (about $15 billion) used this design, although their specific proposals were flawed and are not expressly suggested.

2) A Second Earner Deduction -- Daschle (about $10 billion) took this approach, although his specific proposal was overly complicated and is not expressly suggested. Couples would be allowed to deduct a portion of the earnings of the spouse with lower earnings.

There is a tradeoff between the two approaches . Raising the standard deduction is simpler, but the second earner deduction is better targeted to couples that actually face marriage penalties.

## Tobacco

The details about how to approach tobacco need to be resolved. The first decision, of course, is whether tobacco should be on the list of revenue raisers. If so, one possibility would be to impose a $0.50 per pack excise tax on cigarettes (and a proportionate increase in the excise tax on other tobacco products). (Alternatively, the excise tax could be set equal to the difference between the $1.10 per pack increase projected to have arisen from last year's aborted tobacco settlement and the price increase due to the just-enacted settlement with state attorney generals.) A $0.50 excise tax would raise roughly $30 billion over five years.

**Pros**

- It would reduce smoking by roughly 2.5 billion packs per-year (a 10% reduction), thereby promoting the health of the U.S. population. Youth smoking would fall by roughly 16%.

- Many people want to quit, but can't. Preventing people from starting to smoke can make them much better off over the long run, even if they are hurt by the tax in the short run.

- The excise tax is much simpler than some alternative proposals and will have a more certain effect on cigarette prices.

**Cons**

- The tax increase may not be warranted on economic grounds. Some evidence suggests that current state and local cigarette taxes already may exceed the costs to society from premature death and illness, even before the $0.45 per-pack state settlement costs are considered.

- Smokers may react to higher taxes by switching to brands with higher tar and nicotine, or to less heavily taxed forms of tobacco, therefore reducing the health gains.

- Cigarette excise taxes are regressive.

- A high tax burden on cigarettes encourages smuggling. Smuggling can be addressed by stepped-up enforcement, but that is costly.

## Revenue Raisers

About $22 billion over five years of our revenue raisers remain from last year's budget. This is several billion less than the cost of our existing tax cut package. Treasury staff is currently conducting an intensive effort to develop additional revenue raising provisions. It is too early to know the magnitude of these additional raisers. Many of our existing raisers remain controversial.

Under the existing tax package, the revenue raising provisions are dedicated solely to tax cuts. The group needs to discuss whether the new budget should be similarly constructed or whether any of the revenue raisers should go to offset spending priorities. The obvious downside of using the revenue raisers for spending priorities is that it will invite the criticism that the President's budget does not include a tax cut but a tax increase. The upside would be that the resources would provide some flexibility in an extremely tight budget year.

## Existing Tax Cut Package

In addition to focusing on possible new proposals, the group needs to focus on whether to include each of the proposals from last year and whether any should be modified. The table below provides an overview of our existing tax cut package:

| Existing Proposals | Five Year Cost -- Billions (Scoring from last year's budget) |
|---|---|
| Child Care: | |
| Dependent Care Tax Credit (DCTC) | 5.1 |
| Tax Credit for Employers | 0.5 |
| Subtotal | 5.6 |
| School Construction | 5.0 |
| Employer Provided Education (Sec. 127) | 1.0 |
| Low Income Housing Tax Credit | 1.6 |
| Climate Change | 3.6 |
| Pensions | 0.9 |
| Extenders (R&E, WOTC, WTW, etc.) | 3.3 |
| International and Puerto Rico | 1.4 |
| $2,000 Severance Pay Exemption | 0.8 |
| **TOTAL** | **$24 billion** |

We have discussed possible modifications to some of our existing proposals, including:

**School Construction** -- a staff group has been discussing technical modifications to improve the targeting and efficiency of the school construction proposals.

**Child Care** -- in addition to considering additions to the current DCTC proposal, the child and family sub-group has been exploring how to include a stay-at-home-mom component within the existing proposal, in the event that no additional offsets are available (see below).

**Climate Change** -- Todd Stern's working group has been exploring possible modifications to the existing package within the same revenue constraint.

# Possible New Tax Cut Proposals

## Health

*Long-term Care Tax Credit*

Lack of insurance against the costs of long-term care expenses is a major problem for the elderly and their families. This proposal would give people who are limited in three or more activities of daily living (ADLs- eating, toileting, transferring, bathing, dressing, and continence) or their caregivers a tax credit of $1,000 to help pay for formal or informal long-term care. The credit would also cover people with severe cognitive impairments. The cost is **$6.5 billion** over 5 years.

**Pros**

- Long-term care costs account for nearly half of all out-of-pocket health expenditures for Medicare beneficiaries.

- The credit provides immediate relief for people needing long-term care and their families.

- Preliminary conversations with aging advocates suggest that this tax credit would be well received.

**Cons**

- Many people who need the most help will not benefit because they are not taxable and the credit is not refundable for most recipients. (Making the credit refundable would double its cost.)

- The IRS would find it difficult to enforce compliance without actually engaging in expensive and possibly intrusive audits of taxpayers. The Social Security Administration or other government agency may be better able than the IRS to verify the existence of a disability before any payment is made to the taxpayer.

- It is exceedingly difficult to define a qualifying standard for children under 6 years of age. Obviously, all small children are limited in their ADLs. Treasury is working with DPC and HHS to try to work out an enforceable and equitable standard.

***Tax credit for disabled workers***

Almost 75 percent of people with severe disabilities are unemployed. For many, the high cost of support services and devices, as well as the potential to lose Medicaid or Medicare coverage, prevent them from seeking and keeping jobs. This proposal would give a tax credit of $1,000 to people with disabilities who work in recognition of their formal and informal costs associated with employment.

The credit would be available for people who are limited in two or more ADLs (excluding continence management) or three or more instrumental ADLs (IADLs -- meal preparation, shopping, money management, telephoning, and housework). The proposal will cost about **$700 million** over five years. About 240,000 taxpayers will benefit in CY 2000.

**Pros**

- Many disabled individuals incur additional costs in order to work and earn taxable income, and thus do not have the same ability to pay as taxpayers who do not incur such expenses. A tax credit would provide some adjustment for these differences in ability to pay.

- This credit is more attractive than a credit against employment related expenses because it compensates disabled people for formal and informal expenses both at home and at work.

**Cons**

- The proposed $1,000 credit would not induce many disabled people to enter the workforce.

- Many people who need the most help will not benefit because they are not taxable.

- Allowing taxpayers with difficulties with three of more IADLs may open the credit to abuse. A taxpayer, who had difficulty with cleaning the house, cooking meals, and shopping, could qualify for the credit even though he or she experienced no difficulty at work. Monitoring IADLs would be extremely difficult for the IRS to administer. (Treasury is exploring alternative options to provide coverage to disabled workers without using an IADL test.)

***Small business health purchasing cooperatives***

Over a quarter of private-sector workers in firms with 50 or fewer employees lack health insurance -- significantly higher than the national average of 17 percent uninsured. This results in part because administrative costs are higher and small businesses pay more for benefits than larger employers. This initiative encourages the development of small business health purchasing cooperatives, in some ways modeled on FEHBP. There are two tax proposals regarding these cooperatives. The first proposal would make them tax-exempt. (We are examining more limited alternatives to tax-exempt status that would also promote the making of grants by private foundations to a qualified cooperative.) The second part of the proposal would create a new tax credit for employers with fifty or fewer employees, who purchase health insurance through the cooperative, and who had not previously provided health insurance. The credit would be available for the first two years of coverage and would equal ten percent of employer contributions up to a cap.

<u>Provide Tax Exemption to Cooperatives</u>

Treasury has serious tax policy concerns about granting permanent tax exemption to entities that are functionally identical to for-profit businesses to help cover start-up expenses.

**Pros**

- Private foundations would be more likely to make start-up grants to the cooperatives.

**Cons**

- The cooperatives would be indistinguishable from (and would compete on a tax-advantaged basis with) taxable, for-profit insurance brokers.

- Without special rules, granting tax-exempt status to these cooperatives creates the opportunity for small employers to shelter investment income from tax.

- It is unclear that the purported economies of scale to be gleaned by the cooperatives would ever materialize, especially since those employers that can purchase health insurance at favorable rates are less likely to join. Also, there is no guarantee that the benefits of tax exemption would flow through from the cooperative to small employers.

- The purpose of the tax exemption would be to enable private foundations to make grants for start-up expenses -- a short term problem -- but tax exemptions would be permanent.

<u>Employer Tax Credit</u>

**Pros**

- An employer tax credit may help to jump-start the cooperative.

- The proposed tax credit has been designed to minimize both inequities and undesirable behavioral responses to a credit. Tax credits are targeted to new health insurance coverage, reducing the chance that credits merely provide windfalls to employers for continuing to do what they already do.

**Cons**

- Many may view this credit as unfair. Employers who currently provide health insurance will view the credit as an unfair benefit to their competitors. Employers who insure outside the cooperative and large employers would not be eligible for the credit. Employees who purchase insurance outside of work typically pay higher premiums than do employers and receive no tax benefit at all–neither exclusion from income nor a tax credit–and may feel especially disadvantaged.

- The proposed credit is unlikely to substantially increase health insurance coverage.

## Children and Families

*Tax Relief for Stay-at-Home Parents*

Our existing package includes an expansion of the child and dependent care tax credit (DCTC) to make it easier for families to afford child-care. The DCTC is equal to a percentage of the taxpayer's employment-related expenditures for child or dependent care, with the amount of the credit depending on the taxpayer's income. Our existing proposal, which costs about $4.5 billion over five years (not including the cost of proposed simplification to the household maintenance test), would increase the maximum credit from its current rate of 30% to 50% for those with incomes under $30,000, and gradually phase it down to 20% at $59,000 of income.

Our proposed increase in the DCTC did not receive strong bipartisan support, in part because conservatives objected to the exclusion of benefits for stay-at-home-parents. To increase support for our existing child care tax proposal, it could be expanded to include tax assistance to stay-at-home parents. This would be accomplished by assuming these families incur a certain amount of child-care expenses and therefore could be eligible for the DCTC. To control the cost, the stay-at-home-parent options would focus on families with very young children.

Treasury has serious tax policy concerns about compounding the tax code's heavy bias in favor of stay-at-home parents and exacerbing disincentives to work.

Options include:

A. Include stay-at-home family feature within existing revenue cost. This option would reduce our original proposal so that families with income of $30,000 or less could take a credit for 40% of their expenses (rather than our proposed 50%), and the rate would more gradually phase down to 20% at $58,500. The proposal would add an allowance for $600 worth of child care expenses per year for those families with children under age one regardless of actual child care costs or earnings. The maximum credit for a family with an infant and a stay-at-home parent is $240. Under this option, the maximum allowable child care expenses would remain $2,400 for one child and $4,800 for two or more children.

B. Add stay-at-home parent feature on top of existing proposal. Add one of the following to the existing proposal:

i) Allow all families with a child under the age of one to have assumed expenses of $600 per year per child. Under this proposal, the maximum allowable expenses would increase from $2,400 to $3,000 for one child under age one and from $4,800 to $6,000 for two or more children under age one. This proposal adds **$1.6 billion** to the cost of the existing $4.5 billion proposal over five years.

ii) Same as i), but assume $1,200 per year in expenses and raise cost maximum to $3,600 for one child under age one and $7,200 for two or more children under age one. This would add about **$2.9 billion** to the cost of the existing $4.5 billion proposal over five years.

iii) Same as i), but increase the age limit so that families with children under 4 benefit. This would add **$6.1 billion** to the cost of the existing $4.5 billion proposal over five years.

**Pros**

- A variation of this proposal has been adopted by a number of Republicans in the Senate, led by Senator Chafee, and a few in the House, including Bob Franks (R-NJ).
- By having one tax proposal that supports child care as well as stay-at-home parents, it builds support for the initiative from two different constituencies.
- Some research suggests that infants benefit from having a stay-at home parent; thus, the disincentive to work may be desirable in this case.

**Cons**

- The income tax code and Social Security heavily favor families with stay-at-home parents.
- It is a paradox to be arguing for tax relief for stay-at-home parents and marriage penalty relief. Most stay-at-home parents receive marriage bonuses; proposals to aid one-earner couples will increase those bonuses.
- The CDCTC is one of the few major work incentives in the tax code for second earners with children. Providing the credit for one-earner couples partially negates that incentive.

## Education and Training

### *Tax Credits for Work-Site Schools*

A 25 percent tax credit would be provided to employers who enter into a cooperative agreement with local public schools to provide space, utilities and maintenance for satellite elementary schools located on their work site. The base for the annual credit would include the cost of tangible personal property or real property donated to the school plus the fair market rental value of real property dedicated for school use. Teacher salaries are ineligible for the credit. The credit would be limited to $150,000 per year, per facility. Credits could be claimed for up to 10 years. To be eligible for the credit, the taxpayer must enter into an agreement with a local public school agency that is approved by the Department of Education. The Department may approve no more than X agreements per year.

Treasury is concerned that this provision subsidizes quasi-private education by providing a tax credit to private employers who contract with public schools for their employees. This is inconsistent with the Administration's strong opposition to the Coverdell bill, which would have directly subsidized private education.

**Pros**

- Work-site schools can benefit employers by reducing turnover and absenteeism, and school districts, because work-site schools are an inexpensive way to relieve overcrowding.

- About 30 work-site schools have been established over the past 10 years.

**Cons**

- Tax credits will not provide an incentive for government and non-profit employers, nor for small firms or those without tax liabilities. Several of the existing work-site schools were established by tax-exempt employers.

- It is not clear that a credit would stimulate the creation of many additional work-site schools, since other factors appear to dominate the decision to establish such schools for both employers and school districts.

- If work-site schools convey extra benefits to employers, they, not the federal government, should share the costs with the local school district.

***Tax Credit for Workplace Literacy Programs***

An alarming number of adults in the U.S. -- 44 million according to the National Adult Literacy Survey -- struggle with a job application or cannot read to their children. Many have a learning disability and never knew it. Others are immigrants who face long waiting lists in many cities where they seek English-as-a-Second Language (ESL) courses.

Under the proposal, employers who provide certain workplace literacy, ESL, and basic education programs for their employees would be allowed a 10 percent income tax credit against expenses, with a maximum credit of $525 per participating employee. Eligible education would generally be limited to instruction at or below the level of a high school degree given to employees with less than a high school diploma or its equivalent, and to ESL for employees with limited English proficiency. Eligible expenses would include payments to third parties and payments made directly to cover instructional costs, including salaries of instructors, curriculum development, textbooks, etc. Unless the employer works with an eligible provider under the Adult Education Act, the curriculum must be approved by a state or local adult education authority. The education must be provided under a section 127 educational assistance plan. The employer could claim a credit for employees with high school degrees but with low functional education if the employer works with a provider under the Adult Education Act to test the employees and provide the instructional program.

Treasury believes that the substantive goals of this proposal could be much more effectively met through a grant program.

**Pros**

- Two common problems with adult basic education programs are attrition and lack of relevancy. The three primary reasons for attrition are: 1) lack of child care, 2) lack of transportation to classes, and 3) difficulty making classes fit with job responsibilities. This proposal avoids these problems because employees would not need to find additional child care, transportation, and time outside of that required for work. In addition, because these courses are tailored to each employer, adults are better able to understand the relevancy of the basic skills concepts as they apply them to their current work situation.

- A tax credit available to all non-profit private-sector employers, because of its potentially wide availability, would mesh well with the President's commitment to reduce illiteracy. A grant program would reach far fewer employers.

**Cons**

- Approximately two-thirds of employers (30-40% employees) do not pay taxes and therefore could not benefit from a tax credit. Nearly 60% of C corporations that employ workers either pay no taxes or are limited in their use of tax credits. Governments and nonprofit entities such as universities, nonprofit hospitals, etc. would not benefit from a tax credit.

- Much of the benefits of the credit would simply be windfalls for employers who are already providing literacy education.

- It is unclear whether this credit would significantly affect employers' willingness to establish literacy programs.

- The credit will impose significant administrative burdens on both the IRS and on participating employers in order to limit their ability to recharacterize job-specific training that would not qualify for the credit as basic education that would qualify. Also, to prevent abuse, employers who want to serve workers with a high school degree but poor education would be forced to use outside providers and testers, which might not be the most efficient arrangements.

- The cost of subsidizing employers is less controllable with tax credits, which are essentially entitlements, than with grants.

*Liberalize the Lifetime Learning Credit*

The proposal presents two options to enhance the Lifetime Learning Credit. The primary advantage is that this builds upon an existing provision without creating significantly more complexity. The primary drawback is the cost.

Option 1

Accelerate from 2003 to 2000 the increase in the base of the lifetime learning credit from $5,000 to $10,000. The approximate cost is **$2.8 billion** over five years.

**Pros**

- Consistent with the President's original proposal.
- The incentive effect of the higher limit would come into play sooner.

Option 2

Increase the lifetime learning credit rate from 20 percent to 30 percent of the first $5,000 and reduce it to 10 percent on the second $5,000 of qualified expenses. The maximum credit per taxpayer would remain equal to $2,000. The rough cost is **$7.1 billion** over 5 years.

**Pros**

- This option provides a proportionately larger incentive for lifetime learning for those taking a single course or attending a less expensive institution.
- This targeting diminishes the incentive for students to attend more expensive educational institutions, and makes it less likely that the credit will simply be captured as higher tuition.

**Con**

- Benefits only those with sufficient tax liabilities to use additional credits.

***Lifetime learning savings accounts***

Two proposals are being considered. The first would make Education Individual Retirement Accounts available to everyone (adults as well as children) by removing the current-law age 30 distribution requirement and the age 18 contribution limit. The second would add education expenses to the list of distributions from a Roth IRA that can be taken tax free. Unlike other distributions on the list, however, tax-free withdrawals for education expenses could be taken at any time, without being subject to a five-year holding period.

Treasury has serious concerns regarding these proposals because they are unlikely to stimulate education among those most in need, but provide windfalls to the rich for saving they would have done anyway.

**Pros**

- Well-educated workers are essential to an economy experiencing technological change and facing global competition. The proposals are intended to encourage the retraining of the workforce to reflect changing needs and new technologies.

- Either proposal may make it easier for adults to finance their own education.

**Cons**

- The proposal will be very ineffective at increasing educational opportunities for families whose adult members have little or no post-secondary education. These families are much more likely to have low incomes. Low-income families do not have the financial resources to make significant contributions to an account for adult education and often do not have tax liability. Other tax-favored savings vehicles already compete for their limited savings, including deductible IRAs, Roth IRAs, 401(k) plans and Medical Savings Accounts.

- The proposal would primarily benefit people with high incomes, providing a windfall for saving they are already likely doing. It is unlikely to increase their saving.

- Current law already contains many subsidies for adult education which are better targeted to aid low- and middle-income families. These provisions include: the Lifetime Learning tax credit, the exclusion for employer-provided educational assistance, guaranteed student loans, subsidized loans, and student loan interest deductions.

***Exclude Americorp Education Awards from Taxable Income***

Americorp members are eligible for post-service educational awards of up to $9,450. The awards can be used either to pay higher education expenses or to repay student loans. Americorp also pays the interest on existing student loans while the borrower is a member of Americorp. The educational awards and interest payments are treated as taxable income. The proposal would exclude from taxable income Americorp educational awards.

Treasury believes that this proposal will benefit few recipients of Americorp education assistance and could make many worse off.

**Pros**

- Americorp officials strongly support the proposal because recent Americorp alumni have complained that they have been subject to unexpected tax liabilities at a time when they have no cash to pay.
- Similar tax subsidies exist under the GI Bill (with respect to educational expenses) and Peace Corp (with respect to loan repayments and interest forbearance).

**Cons**

- Many recipients will pay more in taxes if education grants are tax-free, since the grants can reduce educational expenses eligible for the Hope or Lifetime Learning credits. For taxpayers in the 15-percent tax bracket, the tax credits are more generous.
- Excluding amounts used for living expenses would run counter to the tax treatment of scholarships generally.
- Excluding only amounts used for loan repayments would give better tax treatment than GIs who cannot exclude recruitment bonuses in the form of loan repayments nor can they use GI Bill benefits (which are excluded from income) to repay student loans.

***Eliminate 60-month limit on deductibility of student loan interest***

Under current law, student loan interest is deductible only during the first 60 months in which interest payments are required. The proposal would eliminate the 60-month limit.

**Pros**

- Simplifies calculation of deductible interest payments for students with more than one student loan, as loans may have entered repayment status on different dates.
- 60-month limit is difficult to administer and requires special rules to deal with common situations, such as periods of deferment or hardship forbearance, loan refinancings, and loan consolidations.
- If 60-month limitation is eliminated, interest paid on qualified student loans would be deductible, without regard to whether a student makes voluntary early payments or makes delinquent payments, or whether the lender structures the loan so that interest payments are

required every other month (which arguably could extend the present-law 60-month period for 10 years).

- Provides longer-term relief to students with large educational debt. Present-law AGI limitations (which apply at the time the interest payments are made) ensure that relief is targeted to low and middle-income taxpayers.

**Con**

- Student loan interest constitutes personal interest, which generally is non-deductible. Therefore, it may be appropriate to limit the period of time for each loan that interest payments can be claimed as an above-the-line deduction.

## Urban - Empowerment

***Green bonds***

Under current law, state and local governments may issue tax-exempt bonds without limit to pay for the costs of public environmental remediation projects. In addition, tax-exempt bond money may be lent to private entities to finance facilities for sewage, solid waste, hazardous materials, environmental enhancement of hydro-power facilities, and urban redevelopment, but those bonds are limited by the private activity bond cap. The proposal would create a new financing mechanism–green bonds–to raise funds to finance environment-related public projects. Like qualified zone academy bonds (QZABs), this program would allow state and local governments to issue zero-interest bonds to lenders who could claim a tax credit for the life of the bond in lieu of interest. Green bond authority for each state is capped. The issuer makes no principal or interest payments on the bond until maturity (13 years under the QZAB program). Other options are also being considered: including a credit similar to the low-income housing tax credit model; a new category of private activity tax-exempt bond; and a state-managed revolving fund financed by federal grants used to subsidize interest payments on tax-exempt bonds issued by localities.

**Pros**

- A tax credit bond provides a much larger subsidy to State or Local government issuers than tax-exempt bonds.

- Tax credit bonds may be more efficient than tax-exempt bonds because they do not provide windfall gains to high-bracket taxpayers.

- Limiting the amount that can be issued limits the Federal revenue loss.

**Cons**

- The tax credit bond is extremely complex and untested. It may meet market resistance. Complex rules will be necessary to deter abuse. Many are similar to those that apply to tax-exempt bonds, but each element needs to be reexamined to see how it applies to the new bonds. Bond purchasers may thus heavily discount the new bonds, especially in the short run.

- It is unclear that state and local governments are making inadequate investment in environmental remediation.

***Home ownership tax credit***

This proposal aims to encourage home ownership among low-income people. State housing finance agencies would induce investors to purchase low-interest second mortgages by auctioning tax credit authority (paid over ten years) to subsidize the mortgage payments. The unsecured second mortgages of up to 20 percent of purchase price would allow purchasers to qualify for first mortgages with lower incomes and down payments and avoid PMI payments. This program would be targeted at families in underserved areas. Credit authority is capped; the program is designed to cost about $500 million over five years. (Treasury does not have enough information to do a revenue estimate.) It would save a family buying a $75,000 home $750 in up front costs and $140 per month, primarily in lower mortgage insurance costs.

Treasury is concerned that this proposal is extremely complex and encourages home ownership among those least likely to be able to afford it on a sustainable basis. By competing for resources with the low-income housing credit, it might divert tax subsidies from a more effective mechanism to assist them.

**Pros**

- This proposal would increase home ownership rates among lower-income families, who have a lower home ownership rate than higher-income families (50 percent vs. 80 percent). Some evidence suggests that home ownership has positive externalities: for example, compared to renters, home owners are more likely to vote in elections, more likely to invest in their communities (e.g., maintain and improve the appearance of their residence); and more likely to get involved in organizations (e.g., PTA).

- This proposal could make the tax system more equitable because lower-income home owners receive smaller benefits from the mortgage interest deduction: first, they are less likely to itemize; second, if they do itemize, they will receive the deduction at a 15-percent rate compared to rates up to 39.6 for the highest income families.

- Whereas evidence from a recent Federal Reserve working paper suggests that current provisions in the tax code help exacerbate urban sprawl, this proposal -- by being targeted at underserved areas -- would help to revitalize distressed inner-city communities.

- Unlike the mortgage deduction which helps lower the cost of monthly payments, this proposal helps lower up-front costs, which the evidence suggests is the greatest impediment to home ownership.

- It will help lower-income families build assets.

**Cons**

- This program is targeted at people who the private mortgage market has deemed to be un-credit-worthy (probably for good reason). Early information suggests that delinquency rates for these low down payment mortgages are twice those of conventional mortgages.

- By lowering the down payment requirement, it will reduce saving among low-income people who would like to be home owners. Moreover, it is unclear why we want to encourage poor people, especially those who cannot save, to purchase their homes. For example, in an economic downturn, these home owners may be more vulnerable and more likely to lose their homes.

- This credit is likely to compete for funding with the low-income housing credit, arguably a more efficient mechanism for advancing the housing needs of low-income families.

- The tax credit mechanism itself is likely to be inefficient; the credits are likely to trade at a discount because of the high default risk of the loans, the risk to investors that they may not be able to use the credits, and possible syndication and marketing costs.

- A better approach is to guarantee access to credit and reduce the cost of PMI, as is done currently through the FHA loan program.

- It is far from clear that home ownership *causes* the salutary effects attributed to home owners.

- This proposal is a less efficient mechanism to provide assistance with down payments and closing costs to lower-income families than a grant program.

***Tax Credit For Equity Investments in Community Development Financial Institutions***

The Community Development Banking and Financial Institutions Act of 1994 created the Community Development Financial Institutions (CDFI) Fund, now housed within the Department of Treasury, to provide equity investments, grants, loans, and technical assistance to qualifying organizations for community development. The CDFI Fund was appropriated $95 million in FY 1999. The proposal would provide $100 million in nonrefundable tax credits to the CDFI Fund to allocate among equity investors in qualified CDFIs between 2000 and 2009. The allocation of credits would be determined by the CDFI Fund using a competitive process similar to the one used for grants, loans, and equity investments. The maximum amount of credit allocable to a particular investment would be 25 percent of the amount invested, though the CDFI Fund could negotiate a lower percentage. Certain special basis and recapture rules would apply and certain design issues remain.

**Pros**

- The effectively capped credit ensures that limited resources are targeted to assist those areas most in need.
- Since grants by taxable entities to some tax-exempt CDFIs are already deductible, the tax credit essentially gives similar tax treatment to equity investments in for-profit CDFIs.

**Cons**

- This proposal does not assist non-profit CDFIs or those that do not issue stock, such as mutual organizations. This could result in the CDFI Fund shifting Federal grants and loans to the non-profit CDFIs. Also, the proposed credit might raises concerns that the CDFIs will receive lower appropriations.
- The CDFI Fund was under attack last year by some in Congress (although the Fund did receive an increased appropriation this fiscal year and its reauthorization was reported favorably out of Subcommittee).
- Since CDFIs are already directly subsidized by grants, it would be straightforward and much more efficient to simply increase the appropriation.

***Increase the private activity bond cap***

Under current law the volume cap for each state is the greater of $50 per capita or $150 million. The current cap allows about $15 billion of private activity bonds to be issued annually, about $5 billion which are new mortgage revenue bonds. The cap will increased by 50 percent between 2003 and 2007, when it will be the greater of $75 per capita or $225 million. The proposal would make the increase in the cap effective in 2000. The proposal would cost about $.5 billion over 5 years.

**Pros**

- There is widespread Congressional support for further increasing the volume cap.
- State and local housing agencies strongly support this proposal, hoping to secure larger allocations of issuance authority.

- Increasing the cap might make more bond-financed low-income housing credit projects possible.

**Cons**

- Tax-exempt bonds are inherently inefficient because the federal revenue loss exceeds the interest savings to the issuer.

- Increasing the volume of private activity bonds puts upward pressure on interest rates, exacerbating the inefficiency, and raising the cost of school bonds and other more worthy public activities.

- Increasing the volume cap reduces the incentive for State and local governments to choose the best projects among competing applicants and to allocate no more volume cap to any one project than necessary.

- Additional mortgage revenue bonds are not needed because market rates are quite low by historical standards, and most bond-generated mortgage funds aid those who would be eligible for mortgages without the subsidy.

***WTW/WOTC longer extensions***

The work opportunity tax credit (WOTC) and the welfare to work (WTW) tax credit encourage employers to hire members of certain economically disadvantaged targeted groups. The WOTC is limited to wages paid during the first year of employment. Targeted groups include family assistance recipients for any 9 months during an 18 month period, certain economically disadvantaged groups, and vocational rehabilitation referrals. The maximum credit is $2,400. The WTW credit is limited to wages paid during the first two years of employment, and targets long-term welfare recipients and individuals who are no longer eligible for welfare because of federal or state time limits. The maximum credit for the first year is $3,500 and for the second year is $5,000. Both credits will expire on June 30, 1999. The proposal would make the WOTC and WTW credit permanent. Alternatively, the length of extension would be tailored to available revenue offsets. (Last year's budget contained short-term extensions of both credits.) The revenue loss estimates for one-year extensions of the WOTC and WTW credit are $439 million and $91 million, respectively.

**Pros**

- A permanent WOTC and WTW would encourage employers to hire certain economically disadvantaged targeted groups without the uncertainty created by temporary credits.

**Con**

- Permanent extensions of the WOTC and WTW are premature. The WOTC replaced the prior targeted jobs tax credit which was the subject of some criticism regarding its effectiveness as an employment incentive. The Congress specifically intended the credit to be short-term to provide an opportunity to assess the operation and effectiveness of the new credit. For similar reasons, the WTW credit was enacted as a temporary credit.

## Modify Research and Experimentation Tax Credit

**Background**

The current research credit is 20 percent of qualified research expenses above a base amount. The base amount generally is the product of the taxpayer's "fixed-base percentage" and the average of the taxpayer's gross receipts for the four preceding years. Taxpayers can also elect into an alternative credit that has lower credit rates and lower statutory fixed-base percentages.

Qualified research expenses generally include expenses for wages and supplies used to conduct technological research activities within the United States. Contract research payments also are eligible for the credit, but the amount of payment eligible for the credit is limited to 65 percent of the amount paid by the taxpayer (75 percent in the case of research consortia). In addition, a 20 percent credit is provided for increases in amounts paid by the taxpayer to educational institutions and certain other organizations for basic research over a minimum basic research amount (the "basic research credit"). The research credit expires on June 30, 1999.

There are two options.

<u>Provide a refundable tax credit for small businesses</u>.
*(We are also exploring other proposals to provide relief to small businesses that conduct research.)*

**Pro**

- Many small businesses do not have tax liability against which to claim the research credit and receive no tax benefit in the current year for undertaking research. A refundable credit would provide a current tax benefit for small firms whether they have a tax liability or not.

**Cons**

- Firms with no tax liability (or sales) could claim that they undertook research to obtain a refundable credit, and it would be extremely difficult for the IRS to police whether qualified research had actually been undertaken.

- Canada enforces its refundable credit by examining the validity of every claim for a refund. The Canadian government established a separate administrative unit for this purpose.

- Small businesses that are start-ups already receive favorable treatment, which was expanded in 1996.

- Proposals that would expand the availability of the credit would raise the revenue cost of extending the current credit. For that reason, the NEC considered and rejected proposals to expand the research credit in 1994.

<u>Increase the percentage of qualified research expenses paid to certain research consortia that is eligible for the credit.</u>
*(Under a special rule enacted in 1996, 75 percent of those research expenses are eligible for the credit.)*

**Pro**

- The proposal would encourage research on problems of industry-wide concern and would avoid duplication of research by competing firms.

**Cons**

- Research undertaken through consortia already receives favorable tax treatment. Firms that contract out research generally are allowed to claim a credit for 65 percent of those expenditures, whereas for consortia established by non-profit educational organizations or trade associations the percentage is 75 percent.

- Increasing the percentage of eligible research for consortia to 100 percent would provide a larger tax benefit to research conducted through consortia than research performed in house. A portion of the research expenditures paid to consortia (and contractors) is disallowed to provide a level playing field with research conducted in house. Certain expenditures that are not directly related to research conducted in house are ineligible for the credit, such as certain overhead and profit margins. These expenses should also be disallowed when research is conducted through a consortia.

- There is no evidence that research performed through consortia is more beneficial to society than other research, including research conducted in house. Although the spillover benefits to a specific industry may be large, other research may have greater spillover benefits to society (i.e., medical research). Absent information on the societal benefits from different forms of research, the Federal government attempts to "pick the winners" may distort the allocation of research spending in ways that reduce the benefits to society.

- The proposal would largely be a windfall to firms that would undertake certain types of research using consortia anyway. Even absent the credit firms have a financial incentive to undertake research through consortia to solve industry-wide problems -- they avoid the cost of duplication of effort in cases where it would be extremely difficult for an individual firm to capture the profits attributable to the research.

- The proposal benefits a small number of research consortia (and their industry supporters). Many of those organizations have also benefitted from significant direct support from the Federal government.

## Other

***Allow Personal Credits to be Deducted Against the Alternative Minimum Tax***

The proposal would extend the deductibility of personal tax credits against Alternative Minimum Tax (AMT) liability for one year, for tax year 1999. The recent omnibus spending bill provided that personal tax credits could offset AMT liability tax year 1998. A one-year extension would cost about $0.8 billion.

**Pros**

- The proposal preserves the ability of people to take advantage of the new child and education credits.

- Permitting personal tax credits to offset AMT liability better targets the AMT to those making excessive use of tax preferences.

- Permitting personal tax credits to offset AMT liability eliminates complex tax computations for many taxpayers, both those who are actually affected and for millions who must do the computations only to find that their tax liability is not affected.

**Con**

- Permitting tax credits to offset AMT liability may divert attention from needed long term reform, such as indexing the parameters for inflation.

***Employee telecommuter expense***

Qualified telecommuting expenses paid for, or reimbursed by, an employer would be excludable from the income of an employee. Qualified expenses would include charges for an additional telephone line or advanced telcommunications service up to $60 per month (indexed after the initial year).

Treasury has serious concerns that this proposal would be extremely difficult to administer and would largely produce windfalls for those who are currently telecommuting.

**Pros**

- This would encourage telecommuting and thus reduce the environmental impact of other types of commuting.
- It encourages employers to make more flexible work schedules available to employees.
- The proposal would give telecommuters an income exclusion equivalent to that provided for many actual commuters.

**Cons**

- Abuse will be very difficult to monitor. Because the benefit can be provided by salary reduction (that is, at no cost to the employer), the employer has little or no stake in limiting the benefit to employees' actual business use.
- The proposal favors telecommuting expenses over home office expenses and the expenses of self-employed persons working out of home with respect to the costs of second phone lines.
- It is unclear that the tax subsidy would be an effective means to encourage telecommuting.

***Financial security***

A number of proposals were part of a Financial Security package sent to the NEC from Treasury. Most of these proposals involve increased spending, and most of the tax proposals have already in proposed in last year's budget. The only proposal that represents a new tax incentive calls for eliminating user fees for initial determination letters for small businesses adopting a qualified retirement plan for the first time.

***Capital Gains Exclusion For Sales of Land for Conservation***

Under current law sales of land to non-profit organizations or governments for conservation purposes are subject to tax on any capital gain. Such land donated to non-profit organizations generally qualifies for a charitable deduction and avoids tax on the gain. The proposal would provide a 50 percent exclusion for capital gains for land sold to government agencies or qualified non-profit conservation organizations thereby reducing the maximum capital gains rate from 20 percent to 10 percent. The proposal requires that the land be used to protect fish, wildlife or plant habitat or open space for agriculture, outdoor recreation or scenic beauty.

Treasury is concerned that this proposal would add to the complexity and inequity of the tax code without advancing land conservation.

**Pros**

- The proposal might advance land conservation goals through voluntary sales by property owners rather than by regulation.

- The proposal might reduce the price of land sold to governments and qualified non-profits.

**Cons**

- Generous tax provisions already exist to benefit land conservation. Landowners can deduct the value of conservation easements and the discount in bargain sales to charitiese as charitable deductions. Taxpayers can deduct the full market value of appreciated land thereby saving both the value of the charitable deduction and the capital gains tax.

- The proposal might actually hurt conservation programs by favoring sales over donations of land for conservation, thereby forcing the non-profit groups to raise larger amounts of funds for land purchases and reducing the funds available for direct conservation efforts.

- The proposal may allow taxpayers to double dip. The capital gains exclusion would allow a seller to reduce the price of land by the capital gains tax saving. The taxpayer may then be able to claim a charitable deduction for the bargain sale to the charity.

- The proposal has the potential for significant abuses. For example, land could be sold to a non-profit and then leased back to the seller for continued use in ranching or farming.

- The cost of the proposal may be significantly higher than anticipated if some very large properties are transferred or such sales techniques are marketed more broadly to agricultural landholders. In addition to the initial revenue cost, future income would be removed from the income tax base.

- The proposal would add to the onerous complexity of the capital gains tax.

***Farm and Ranch Risk Management (FARRM) Accounts***

Up to 20% of farming income could be contributed to a FARRM savings account and deducted from income. The income earned on the account is taxable as earned. The contribution plus any accrued capital gain is taxable upon withdrawal from the account. Contributions and earnings must be withdrawn within 5 years; otherwise the balance in the account would be deemed to have been distributed and subject to income tax and a 10 percent penalty. Balances would be deemed to have been distributed and taxable two years after an account holder stops farming.

The Administration strongly opposed adoption of FARRM accounts and prevented the provision from being enacted in the omnibus appropriations bill. It would provide a windfall to a few rich farmers and do nothing to reduce risk or encourage saving.

**Cons**

- FARRM accounts are of no value to farmers suffering losses, because a tax deduction is worthless to them. More than 75 percent of farmers have no tax liability. Most of those who are taxable have substantial non-farm income.

- FARRM Accounts are not IRAs, but tax-preferred short-term savings vehicles intended to ameliorate income volatility among farmers.

  - The tax preference for FARRM Accounts differs from that for IRAs because FARRM accounts do not allow tax-free buildup and amounts must be distributed within five years.

- The proposal is apparently meant to respond to a perception of excessive volatility in farmers' incomes. However, other much more effective and equitable tax provisions are in place to address volatility.

  - Farmers can elect to average their farming income over a three-year period. **(Made permanent in 1998.)**

  - Farmers are allowed to carry back net operating losses over the five previous years. (Most taxpayer are allowed to carry back NOLs for only two years.) **(Enacted in 1998.)**

  - Taxes on certain payments, including disaster payments, crop insurance and proceeds from emergency livestock sales can be deferred.

- The provision is most valuable to wealthy farmers who are in high income tax brackets and have available substantial wealth to deposit in an account.

  - By perpetually contributing 20 percent of income into a FARRM account, a farmer could eventually shelter about a year's income from tax indefinitely (5 years' contributions each equal to 20 percent of annual income).

- **The provision is unlikely to stimulate saving.**

- Because basis and earnings must be tracked separately, the taxation of FARRM accounts would be complex.

# Pensions

*Enterprise zone wage credit extension*

Current law provides a 20 percent credit for the first $15,000 of wages for employees who live and work in empowerment zones (EZs) or who live in DC and work in the DC zone (an EZ-like designation covering parts of the District of Columbia). The credit will expire at the end of 2004 for EZs and 2002 in the DC zone. The proposal, put forward by the Department of Labor (DOL), is aimed at encouraging zone employers to provide pension and health benefits to EZ wage credit-eligible employees. The credits, which are 20 percent of the employer's qualifying pension and health insurance contributions, would not be included under the current wage cap, but the qualifying contributions would be subject to separate limits of $2,500 (for pensions) and the Federal FEHBP contribution (for health insurance). The Departments of Housing and Urban Development and Agriculture would certify that the pension and health benefits offered qualify for the credit (although only DOL has expertise in that area).

Treasury is concerned that this proposal has a very high cost-benefit ratio and would make the EZ wage credit more complex.

**Pro**

- Some workers might get pension coverage.

**Cons**

- This proposal will do little for pension security relative to its cost.
  - Low-income workers are much more likely to leave their jobs within one or two years, resulting in little capacity for accumulating vested pension savings.
  - The credits are likely to subsidize behavior that would have occurred in any event, or to accrue to third parties rather than the intended recipients.
  - It would be difficult to prevent workers from making a contribution, claiming a credit, and then withdrawing the contribution.
- Adding an additional credit will make the EZ wage credit more complex and difficult to administer. In particular, it would be difficult for DOL to determine who was covered by a pension prior to enactment and thus disqualified. Given that few employers are likely to use this credit, the administrative costs could be large relative to the number of additional employees covered.

### *Employee benefits tax credit for EITC recipients*

EITC recipients could claim additional refundable credits if they purchase health insurance or contribute to pension plans. The maximum pension credit would be equal to the lesser of 50 percent of the employee's contribution or $1,000 (indexed). The maximum health credit would be equal to the lesser of 50 percent of the employee's contribution or 50 percent of the employee cost for standard Blue Cross insurance under FEHBP. The credits would not be phased in with earnings; rather, a taxpayer would be eligible for the maximum credit as soon as the taxpayer contributes to a pension plan or purchases health insurance. The credits would be phased out with the EITC. In addition, the definition of non-taxable earned income would be modified to exclude non-taxable contributions to pension plans and health insurance purchases.

Treasury is concerned that this proposal would raise compliance problems with the EITC and do little to enhance health insurance and pension coverage among low-income families.

**Cons**

- The proposal is inefficient, because it will subsidize saving that is already occurring and is unlikely to increase saving for retirement.
  - Low income workers are unlikely to have the resources to make significant contributions to pension savings plans. Many will prefer to save for more immediate needs, if they are able to save at all.
  - The proposed credit rate (50 percent) is substantially higher than penalties for early withdrawals of tax preferred retirement savings (10 percent). As a result, taxpayers would be able to receive a subsidy for contributing to a savings plan, even if they immediately withdrew the contribution.
- Most EITC recipients wait until the end of the year to claim the credit on their tax return, even when they have the option of claiming advance payments during the year. Workers may be reluctant to claim the credit in advance for fear of overestimating the amount to which they are entitled. If low income workers are unwilling to claim a credit in advance, they will not receive it when they actually need assistance purchasing health insurance.
- The proposal could increase EITC noncompliance. The IRS cannot currently verify health insurance expenditures. The IRS receives information about 401(k) and IRA contributions, but this information is not matched to tax returns before EITC claims are paid.
- From 1991 to 1993, EITC recipients could receive a supplemental credit if they purchased health insurance for their children. Some taxpayers claimed the credit even though they purchased no health insurance. Others were taken advantage of by sellers who claimed that taxpayers had to buy a health plan to receive the EITC. OBRA 1993 repealed this provision.

# The HHS Appeal

- **Following Through on Presidential Initiatives**
  - **Tobacco, Health Research, Head Start, Food Safety, Drug Abuse Treatment**
- **Strengthening Public Health**
  - **FDA Modernization, Chronic Disease, Bioterrorism**
- **Enhancing the Health of All Americans**
  - **Safety Net, Racial Health Disparities, Native American Health, Violence Against Women, Elderly**
- **Providing Sufficient Program Support**
  - **All HHS Agencies and a modernized HCFA**

FY 2000 Budget FY

# Medicaid Recoupment

- The Tobacco Agreement reimburses States for Medicaid costs that are partly Federal costs.

- HHS has an obligation to the taxpayers to recoup the Federal share of these costs. In 2000 alone no less than $4 billion is Federal taxpayer money.

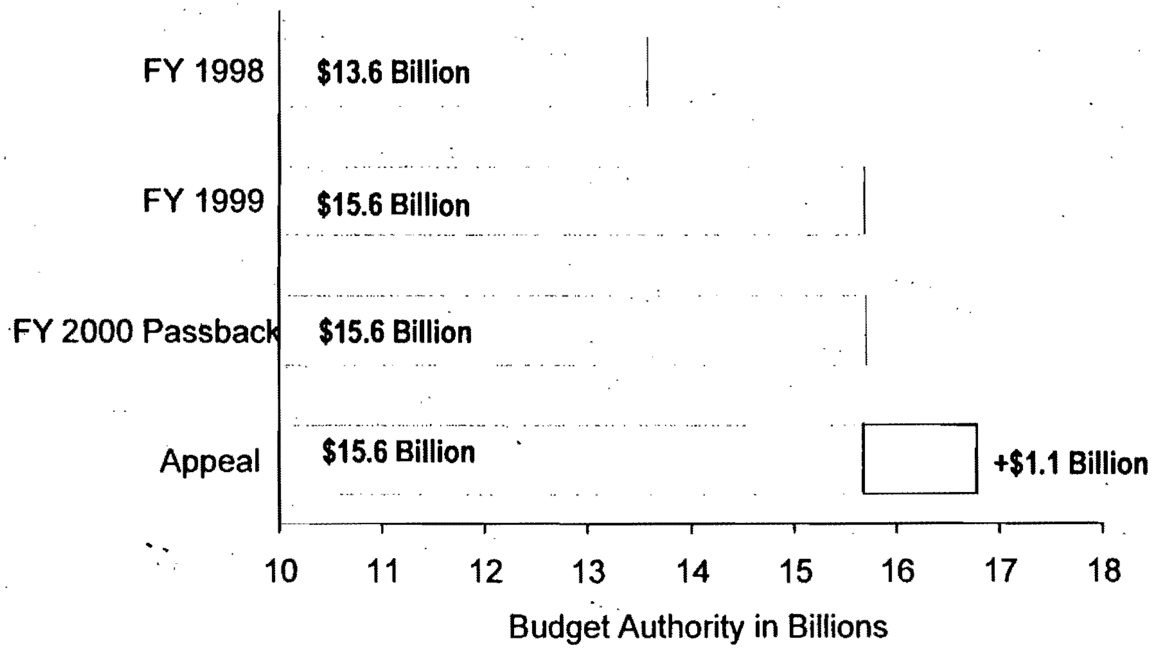
- Medicaid Recoupment can finance both the HHS appeal and other appropriate investments.

# Following Through on Presidential Initiatives

| | |
|---|---|
| Health Research | Continue the long-range expansion plan for NIH, AHCPR health services, CDC prevention research. (+$1.2 billion) |
| Head Start | Continue on the path towards serving one million children in 2002. (+$100 million) |
| Food Safety | Improve the safety of fruits, vegetables, seafood; reduce disease with faster response to outbreaks. (+$67 million) |
| Tobacco | Enhance enforcement of FDA rule and reduce children's access to tobacco. (+$50 million)<br>"Deglamorize tobacco" - and provide the science base for tobacco control activities. (+$154 million) |

# Following Through on Presidential Initiatives
## Health Research - NIH, AHCPR, CDC

- This Administration committed to and should follow through on long-term expansion
- Appeal continues 5-year, 50% NIH growth plan with even annual growth



# Strengthening Public Health
## Countering Bioterrorism

We must improve the nation's readiness for the medical needs resulting from a bioterrorist attack, in the following areas: (+$193 million) -- Emergency Funding

- **Public Health and Medical Infrastructure** (+$156 million)
  - Employ more epidemiological intelligence and laboratory specialists
  - Purchase rapid communication systems and lab equipment
  - Train medical and lab staff to detect lethal agents
- Research and Development (+$33 million)
  - Ensure an effective defense against the health consequences of bioterrorism and develop better treatment
- Medical Response Capability (+$3 million)
  - Better equip and train our National Medical Response Teams and local Metropolitan Medical Strike Teams

# Enhancing the Health of All Americans:
## Improving Native American Health

- Indian people have the Nation's worst health status.
  - 5 year mortality rate increases in alcoholism (+15%), diabetes (+35%), HIV (+200%), and cancer (+11%).
- We need an additional $205 million to:
  - Increase medical services - e.g., reduce current 30 to 90 day waiting period for alcoholism services; respond to the 2% annual growth rate in the Indian service population.
  - Bring sanitation and clean water to 1,800 more homes
  - Continue construction of hospitals (Navajo), and support Tribal Joint Ventures to build own facilities.
  - Support Tribal Self-Determination by funding 95% of tribal contract support costs.

Native American

Jill Anel
Dr Lorenzo
Jim
July 4th

→ ADA - states & groups → Letter

→ ADA → ADAPP

Self - evaluation — most integrated setting - overriding the states

→ Outreach
Compliance & enforcement

→ LTC trg

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## FY 2000 President's Budget Health Sources and Uses of Funds -- REVISED

($ in billions, all estimates preliminary; numbers may not add due to rounding)

| | FY 2000 | FY 00-04 |
|---|---|---|
| **SOURCES** | | |
| *Tobacco Revenue* | 0.00 | -3.60 |
| | | |
| *Reduce Medicare Epotein (EPO) Payments by 10 Percent (FY 99 PB)* | -0.05 | -0.32 |
| *Require Contractors to Provide MSP Data (FY 99 PB)* | -0.01 | -0.69 |
| *Clarify Medicare's Partial Hospitalization Benefit (FY 99 PB)* | -0.02* | -0.12 |
| *Base Medicare Payment for Drugs on Provider Acquisition Cost (FY 99 PB).* | -0.07 | -0.69 |
| *Centers of Excellence (FY 99 PB)* | 0.00 | -0.52 |
| *Reduce Hospitals' Market Basket 1/* | -0.57 | -3.00 |
| *Reduce Medicare Bad Debt Payments to all Providers* | -0.29 | -1.69 |
| *Pay Single Fee for Surgery* | -0.08* | -0.51 |
| *Reduce the Medicare Lab Test Fee Ceiling Reimbursement 2/3/4/* | -0.06 | -0.38 |
| *Establish a National Limit for All Prosthetics and Orthotics* | -0.07 | -0.35 |
| *Decrease Prosthetics and Orthotics Update* | -0.01 | -0.10 |
| *Require 10% Coinsurance for Certain Medicare Lab Services 3/* | 0.00 | -0.81 |
| X *1.5% Conversion Factor for Physicians* | $\boxed{-0.25}$ | -1.40 |
| *Accelerate Inherent Reasonables Savings* | -0.02 | -0.14 |
| | | |
| *Medicaid Cost Allocation* | -0.05 | -1.39 |
| *Medicaid Rebates from Generic Drug Manufacturers* | -0.01 | -0.13 |
| | | |
| *Medicaid costs from Medicare coinsurance proposal* | 0.01 | 0.04 |
| | | |
| **Subtotal, Sources of Funds** | **-1.53** | **-15.80** |
| | | |
| **USES** | | |
| *HHS Discretionary* | 1.30 | 7.90 |
| *Public Health Infrastructure Initiative* | 0.03 | 1.00 |
| | | |
| *Medicare Buy-In for 55-65 (FY 99 PB) 5/* | 0.00 | 1.60 |
| *Cancer Clinical Trials (FY 99 PB)* | 0.00 | 0.75 |
| *Disease Management: Asthma Initiative* | 0.05 | 0.05 |
| *Waive Cost-sharing for Preventive Benefits* | 0.00 | 0.81 |
| *Jeffords/Kennedy* | 0.07 | 1.05 |
| *Legal Immigrant Children (FY 99 PB)* | 0.04 | 0.28 |
| *CHIP Funding for the Territories (FY 99 PB)* | 0.03 | 0.03 |
| *Increase BBA DSH Allotments for DC Medicaid* | 0.01 | 0.01 |
| *Foster Care Extension* | 0.01 | 0.05 |
| *300% Eligibility Expansion* | 0.01 | 0.11 |
| *Extension of Medicaid TANF Transition Fund* | 0.00 | 0.40 |
| | | |
| *Assisted Living Initiative* | 0.00 | 0.00 |
| *Transitional Medicaid Simplification* | 0.00 | 0.00 |
| *Medicare+Choice Policies* | 0.00 | 0.00 |
| *Expand Medigap Open Enrollment to Disabled/ESRD* | 0.00 | 0.00 |
| *Guarantee Medigap Enrollment for Benes. Losing HMO Drug Coverage* | 0.00 | 0.00 |
| *Patients' Bill of Rights* | 0.00 | 0.00 |
| | | |
| *Enable States to Increase CHIP Spending on Outreach 6/* | 0.00 | 0.30 |
| **Subtotal, Uses of Funds** | **1.55** | ~~14.34~~ |
| | | |
| **TOTAL, SOURCES + USES** | **0.02** | **-1.40** |

*HCFA believes proposal cannot be implemented in FY 2000 due to Y2K.

1/ Represents update of MB-2.6 in FY 2000 (i.e., a 0.1% update).

2/ Reduce lab fee ceiling by an additional 1% (the ceiling would be reduced from 74% to 72%).

3/ HCFA does not support proposal.

4/ DPC does not support proposal.

5/ Includes SSA costs

6/ Remove outreach from 10% cap. Cap at 3% of benefits. Policy delayed one year. Cost estimates extremely preliminary.

NOTE: Table does not include long-term care initiatives with other sources: AoA National Family Caregivers, Long-Term Care Tax Credit, Disability Tax Credit, and long-term care insurance for Federal employees.

Note: A capital cut (both inpatient and outpatient) that could score up to $200m in FY 00 and $200m over five is also available.

FY 2000 Budget

**HEALTH CARE IDEAS**

**1. Long-Term Care.** This initiative could be part of a "preparing for Medicare long-term reform" package; a women's initiative if coupled with pension policies for women or family leave policies; or with an elderly housing initiative (policies to promote maintaining home ownership, beginning to promote assisted living facilities, and ensuring quality in nursing homes).

- **Long-term care tax credit.** (new policy) Along with the lack of coverage of prescription drugs, the poor coverage of long-term care represents a major cost burden for the elderly and their families. Long-term care costs account for nearly half of all out-of-pocket health expenditures for Medicare beneficiaries. This proposal would give people with three or more limitations in activities of daily living (ADL) or their caregivers a tax credit of up to $1,000 to help pay for formal or informal long-term care. (Cost: About $6 billion over 5 years).

- **Offering private long-term care insurance to Federal employees.** (new policy) Since expanding Federal programs alone cannot address the next century's long-term care needs, the Federal government -- as the nation's largest employer -- could serve as a model employer by promoting high-quality private long-term care insurance policies to its employees. Under this proposal, OPM would offer its employees the choice of buying differing types of policies and use its market leverage to extract better prices for these policies. There would be no Federal contribution for this coverage. (Cost: Small administrative costs; OPM estimates about 300,000 participants).

- **Family Caregiver Support Program.** (new policy) About 50 million people provide some type of long-term care to family and friends. Families who have a relative who develops long-term care needs often do not know how to provide such care and where to turn for help. This proposal would give grants from the Administration on Aging to states to provide for a "one-stop-shop" access point to assist families who care for elderly relatives with 2 or more ADL limitations and/or severe cognitive impairment. This assistance would include providing information, counseling, training and arranging for respite services for caregivers. (Cost: About $500 -750 million over 5 years; discretionary).

- **Nursing home quality initiative.** (expanding on administrative initiative) On July 21, the President announced an initiative to toughen enforcement tools and strengthen Federal oversight of nursing home quality. On October 22nd, the Justice Department and HCFA held a conference to begin to develop other quality/anti-fraud and abuse initiatives with enforcement agencies from around the nation. Proposals to respond to these challenges and to implement the initiatives the President outlined in July can be included in the budget or as freestanding legislation. The initiative will no doubt include new enforcement provisions (e.g., increased penalties, etc.), as well as new funds to conduct more frequent surveys of repeat offenders and improve surveyor training. We are also working with DHHS and HUD to explore the possibility of establishing a Commission to oversee HCFA's nursing home enforcement efforts as well as to begin to look at other types of housing where health care is offered (e.g., assisted living facilities). (Costs: $500 - 750 million over 5 years).

**2. Disability.** This health initiative could be packaged with the non-health ideas such as the "Bridge" integration grant proposal and the access to information technologies initiative.

- **Jeffords-Kennedy Work Incentives Improvement Act.** (Congressional proposal; not passed in 1998) In the final budget negotiations this year, the Administrative put the Jeffords-Kennedy bill on its list of priorities for passage. This bill would enable people with disabilities to go back to work by providing an option to buy into Medicaid and Medicare, as well as other pro-work initiatives. Although it was rejected by Republicans, the Administration has been stating that we will continue to fight to give people with disabilities the opportunity to work -- including the critical health insurance that makes work possible. (Cost: About $1.2 billion over 5 years).

- **Tax credit for work-related impairment expenses for people with disabilities.** (new policy) Almost 75 percent of people with significant disabilities are unemployed; for many, the high costs of support services/devices, as well as the potential to lose Medicaid or Medicare coverage, prevent them from seeking and keeping jobs. This proposal would give a tax credit of $1,000 to $5,000 (depending on the design and costs) to people with disabilities who work, in recognition of their formal and informal costs associated with employment. This policy complements the Jeffords-Kennedy Work Incentive proposal, described above, but has the advantage of helping people in all states irrespective of whether states take up optional coverage. (Cost: Depends on the options; $1 to 2 billion over 5 years).

- **Promoting Medicaid de-institutionalization.** One of the biggest frustrations for people with severe disabilities and their families is the "institutional bias" in Medicaid -- meaning the tendency to simply put people with great health care needs in nursing homes rather than develop viable, community-based alternatives. In 1998, HHS funded a small demonstration project in 4 states to test different models for offering people with disabilities the choice of care settings. This proposal would build on these tests by developing and propagating models that give people residing in a nursing home after a "date certain" a choice of care settings. (Cost: $50 million over 5 years).

- **Medigap reform for people with disabilities.** In 1997, the President endorsed bipartisan legislation from Rockefeller, Chafee and Nancy Johnson that makes Medigap supplemental insurance more accessible to beneficiaries. The Balanced Budget Act did include some of its important protections for seniors on Medicare, but essentially excluded beneficiaries with disabilities from this reform. This proposal would make all Medigap insurers provide Medigap to people with disabilities when they sign up for Medicare. It would also ensure that they get a guaranteed issue Medigap option when in the event that their HMO withdraws from Medicare. (Cost: not clear that there will be costs).

**3. Modernizing Medicare.** These policies could "lay the groundwork" for the recommendations of the Medicare commission and re-affirm our ongoing commitment to improve and modernize Medicare.

- **Adopting private sector, competitive pricing strategies.** (FY 1998 budget) The President has consistently supported giving the Health Care Financing Administration the same tools to manage health care costs as are used by private sector plans. This includes competitive pricing for services like durable medical equipment and other supplies; expanding the competitive pricing demonstration for managed care; and adopting new payment methodologies like Centers of Excellence, among others. Although these ideas are being considered by the Medicare Commission, the President could take the lead on increased competition within Medicare since he has supported this approach in the past. (Savings: $0.1 to $0.5 billion, depending on the policies).

- **Reducing Medicare fraud and overpayment.** (Some FY 1999 policies; some new policies) Medicare fraud poses a serious threat to its financial well-being. In every budget for the last 5 years, the President has proposed new initiatives to help combat excessive payments and provider fraud in Medicare. Last year alone, Medicare saved over $1 billion through these efforts. The President announced last January a 10-point plan for reducing fraud and overpayment, including provisions like reducing overpayments for drugs and ensuring Medicare does not pay for claims that ought to be paid by private insurers. HHS and the Department of Justice continue their efforts to enforce current policies and develop new ones. (Savings: From $1 to 3 billion over 5 years, depending on the policies).

- **Protecting beneficiaries from HMO withdrawals from Medicare.** This year, a number of HMOs have pulled out of Medicare with only a few months notice, leaving 50,000 beneficiaries with no plan options in their areas. These withdrawals are causing beneficiaries unnecessary hardships as they rush to find alternative sources of coverage. The President has stated his determination to work with the Secretary of HHS and Congress to develop legislation to prevent this behavior in the future (e.g., limit the time between when a plan files to participate in Medicare and when enrollment begins, making it less necessary for plans to pull out at the last minute). (Cost: not clear that there will be costs).

- **Prescription drug coverage for Medicare beneficiaries.** (new policy) The lack of coverage for prescription drugs in Medicare is widely believed to be its most glaring shortcoming. Virtually every private health plan for the under-65 population has a drug benefit, in recognition of the medical community's reliance on prescriptions for the provision of much of the care provided to Americans. Lack of Medicare coverage of drugs results in high out-of-pocket beneficiary costs -- which will only become larger in the next century since the vast majority of advances in health care interventions will be pharmacologically-based. Responding to this fact, Republicans and Democrats on the Medicare Commission, as well as almost every health care policy expert, are consistently stating that reforming Medicare without addressing the prescription drug coverage issue would be a mistake. We are developing a wide variety of options, including a means-tested Medicaid option, a managed care benefit only approach, a traditional benefit for all beneficiaries, and an unsubsidized purchasing mechanism that uses Medicare's size as leverage for drug discounts for beneficiaries. If desirable, a proposal could be included in the budget or coordinated with the March release of the Medicare Commission's recommendations. (Cost: Varies significantly depending on proposal, ranging from $1 to 20 billion a year).

- **Redesigning and increasing enrollment in Medicare's premium assistance program** (extension of July executive action and new policy). Over 3 million low-income Medicare beneficiaries are eligible but do not receive Medicaid coverage of their Medicare premiums and cost sharing. Many more may not get enough assistance through the new, BBA provision that is supposed to help higher income beneficiaries. We are developing a range of proposals that build on the President's actions in this area to better utilize Social Security Offices to educate beneficiaries about this program, to reduce administrative complexity for states and to give them incentives to engage in more aggressive outreach efforts. (Costs vary depending on policies; up to $500 million over 5 years).

- **Cancer clinical trials demonstration** (FY 1999 budget; not passed). Less than three percent of cancer patients participate in clinical trials. Moreover, Americans over the age of 65 make up half of all cancer patients, and are 10 times more likely to get cancer than younger Americans. This proposed three-year demonstration, extremely popular with the cancer patient advocacy community, would cover the patient care costs associated with certain high-quality clinical trials. (Cost: $750 million over 3 years).

- **Providing needed education funds to children's hospitals.** (new policy) Medicare has invested billions of dollars in graduate medical education to hospitals since 1966. However, because of its current formula, free-standing children's hospitals are forced to shoulder the majority of the cost of training pediatricians, placing them at a severe financial disadvantage. This proposal would consider addition funding outside of Medicare to provide reimbursement for the training costs incurred by children's hospitals. Addressing children's hospitals' education financing has bipartisan support, and Senator Frist has made this a priority for the Medicare Commission. (Costs: depends on the proposal).

**4. Health Insurance Coverage Expansions.** The rising number of uninsured makes the need to propose insurance expansions important.

- **Small business purchasing cooperatives** (different version in previous budgets; not passed). Over a quarter of workers in firms with fewer than 10 employees lack health insurance — almost twice the nationwide average. This results in large part because administrative costs are higher and small businesses pay more for the same benefits as larger firms. This initiative encourages the development of purchasing groups modeled on FEHBP by allowing them to be considered non-profits (which will facilitate private foundation support), providing Federal grant support, and having the Office of Personnel Management provide technical assistance. We are also considering giving employees who purchase coverage through the purchasing groups with tax credits to encourage them to take up coverage. (Cost: about $50 to 100 million over 5 years).

- **Children's health insurance outreach** (FY 1999 budget; not passed and new policy). To date, 42 states have had their CHIP plans approved. These new expansions have great potential to help uninsured children, but not if families do not know or understand the need for insurance. Moreover, over 4 million uninsured children are eligible for Medicaid today. To facilitate spending on outreach, this proposal would allow states to draw down more of its CHIP allotment for outreach. An additional proposal is to pay for a nationwide toll-free number that connects families with state eligibility workers. NGA is sponsoring this line for one year only; such a line is essential for the nationwide media campaign that we are planning to launch in January with the NGA. (Cost: small but unknown at this point; could be funded through tobacco recoupment)

- **Demonstration of Medicare buy-in for people ages 55 to 65** (full proposal in FY 1999 budget; not passed). Americans ages 55 to 65 have a greater risk of becoming sick; have a weakened connection to work-based health insurance, and face high premiums in the individual insurance market. The latest report shows that the uninsured are growing at the fastest rate in this age group; by 2010, the number of uninsured people age 55 to 65 will nearly double. Building on last-year's proposal, we could allow a limited number of people ages 62 to 65 and displaced workers ages 55 to 65 to buy into Medicare. As a demonstration, this might gain the support that it lacked last year. (Cost: at least $500 million over 5 years, which would assist about 30,000 people).

**Public Health/Underserved Populations**

- **Combating Resistance to Antibiotics (Super Bug).** Recent reports have indicated that resistance to antibiotics is increasingly becoming a public health crisis, causing prolonged illnesses and even death. For example, 500,000 Americans per year are infected with Staph (*Staphylococcus aureas)*, a commonly-acquired, potentially lethal, hospital-based infection. The bacteria now only responds to vancomycin, and CDC has recently documented the first cases of resistance to this last resort drug. The hospital costs alone associated with treating antibiotic resistance total over $600 million per year. This new initiative could address this critical emerging problem through: (1) a major health-warning outreach campaign involving hospitals, health professionals, and managed care organizations; (2) new research and surveillance efforts to understand where and why antibiotic resistance occurs and develop effective responses as well as to develop new vaccines that could help limit the occurrence of diseases where there is or will soon be increased antibiotic resistance; and (3) demonstrations that bring in a team of public health experts into a community to implement and test effective strategies to combat antibiotic resistance. (Cost: $25 million per year).

- **Assuring Ability to Detect and Manage Bioterrorism.** Bioterrorism is becoming an increasing threat that has the potential to injure or kill millions of Americans through deadly diseases, such as anthrax. While law enforcement and intelligence agencies seek to thwart these kinds of attacks, when prevention fails, we need a system in place that is prepared to manage and minimize the public health consequences. Unfortunately, unlike many types of attacks, bioterrorist threats could go for days or even weeks without being detected as they could be noticed only when clusters of deaths or a series of illnesses begin to emerge. Therefore, it is critical that the nation's public health system is equipped to both detect and respond to this potential problem. This initiative would: train epidemic intelligence officers who can coordinate with state health departments and other intelligence officers to identify and respond to attacks; develop a Metropolitan Medical Response System, a mass casualty emergency response system, that includes primary care, emergency transportation, and decontamination abilities that will be critical to save lives in the event of an attack; create and maintain a stockpile of pharmaceuticals, that would be critical in the event of a bioterrorist attack that could expose hundreds of thousands of Americans to a disease (current stockpiles, that contain many inactive antibiotics, are inadequate to address a major outbreak); and improve research to develop new vaccines and antibiotics that could be used in the event of an attack. (Cost: $100 to $300 million per year).

- **Announcing a New Initiative to Prevent and Treat Asthma.** Over the past 15 years, there has yet to be a fully understood and greatly concerning increase in the number of children afflicted with asthma. In fact, cases have doubled to total about 15 million, with the increase in rates highest in children under 5 years old. This disease is one of the leading causes of school absenteeism, accounting for over 10 million missed school days. Recently, the National Heart, Lung, and Blood Institute developed new treatment guidelines designed for health care providers and patients with asthma. These guidelines demonstrate that appropriate medical care, along with measures to control allergens and other environmental triggers, can tremendously reduce the frequency and severity of attacks. The proposed initiative is designed to broadly disseminate these guidelines to State and local public health programs. These public health coalitions will then work with schools, child care organizations, businesses, and other community organizations to reduce harmful exposures to asthma patients and make it easier for asthma patients to follow their treatment plans. This initiative would complement our current efforts to identify and enroll eligible children in Medicaid and the new Children's Health Insurance Program. (Cost: $50 million).

- **Launching New Initiative to Improve Awareness and Treatment for People With Mental Illness.** Mrs. Gore's office is recommending a White House Conference on Mental Health for this spring to raise awareness about mental illness and to take the next steps to improving access to and treatment of mental health. In addition, next year, HHS will release a historic Surgeon General's report documenting the widespread incidence and impact of mental illness. To bolster these activities, the Vice President's office would like to unveil a series of public-private initiatives to further improve access to prevention and treatment and to raise awareness about mental health, including involving foundations, businesses, and states in new partnerships to highlight and build on cost effective coverage and delivery practices; and improving the delivery of mental health services in Federal health programs. We believe this initiative should also include increases in the mental health block grant which enables states to provide critical mental health services, including assuring homeless shelters identify and treat mental illnesses, improving the availability of state-of-the-art treatments, and providing new incentives to communities who have implemented effective mental health programs, including homeless programs that effectively address mental illness. (Cost: Up to $100 million per year).

- **Applying Effective Prevention Strategies to Combat Heart Disease, the Nation's Leading Killer.** While diseases, such as cancer and HIV/AIDS receive far more media attention, heart disease is the leading killer of women and men across nearly all racial and ethnic groups. More than 960,000 Americans die of heart disease each year, accounting for more than 40 percent of all deaths, and 58 million Americans live with some form of this disease. This disease can be markedly reduced by: preventing smoking which causes one-fifth of all cardiovascular deaths; improving physical activity, as Americans who are not physically active are at twice the risk of heart disease; and improving nutrition. We are taking new strides in research in this area, and NIH recently launched one of the largest clinical prevention trials, that is examining heart disease among postmenopausal women, including the role of nutrition, increased exercise and physical activity. This initiative could also emphasize: launching a new partnership with aging networks to evaluate and improve nutrition in public-private programs; measuring successful community prevention approaches and replicating them nationwide; and creating a network of, educators, churches, minority-based organizations to launch nationwide awareness campaign about prevention. (Cost: $20 million per year supplemented by NIH funding in this area).

- **Improving Emergency Medical Services in Rural Areas.** The presence of viable EMS systems is critical for residents in rural and frontier areas. Because of the high rates of occupational injury associated with employment unique to rural areas, such as farming, mining, and fishing, rural residents experience disproportionate rates of trauma and medical emergencies. Although farmers constitute only 4 percent of U.S. workers, 38 percent of all machinery related deaths occur on farms. In addition, the death rate from accidental injuries in most rural areas is over twice the rate for the largest city. Long distances between hospitals, tertiary care centers, and other providers can increase the morbidity and mortality associated with medical emergencies. Financing modern emergency care systems in small rural communities is difficult at best. Many rural and frontier communities face challenges in obtaining ambulance equipment and communication systems and recruiting, training, and retaining EMS personnel. This proposal would provide funds to States and local communities to improve access to 911 services or alternative systems where the 911 option is not economically viable. It would also develop and fund programs to help rural communities train local citizens in CPR and first responder techniques, help recruit and retain EMS personnel, and develop distance learning programs for EMS staff in order to ensure they receive appropriate training and support. (Cost: $50 million).

- **Investing in Promising Biomedical Research.** We are now poised to make revolutionary advances that could dramatically alter and improve the way we treat diseases. To help realize these new possibilities, the President's FY1999 budget included a historic multi-year investment in biomedical research and Congress funded NIH at even higher levels (a $2 billion increase this year). However, there is no evidence that the Republicans in Congress have any intention of altering their longstanding commitment to outbid us on NIH funding. It appears futile to compete with them while still maintaining our own commitment in other priority areas. Moreover, even NIH is beginning to get a level of scrutiny about their ability to wisely and appropriately spend such large increases. Having said this, the research issue has captured the imagination of virtually every community, and the President and Vice President have both spoken at great detail about the importance of this type of investment. Therefore, it seems ill-advised not to continue some level of increased commitment. We recommend somewhere between $500 million and $1 billion, although the higher amount is only conceivable assuming we use at least some tobacco dollars in this area.

- **Improving Access to Promising HIV/AIDS Drugs.** With progress in lifesaving

HIV/AIDS therapies, the AIDS community has made it a top priority to extend these state-of-the-art treatments to Americans in need. While we have supported healthy increases in these areas, in some states, such as Texas and North Carolina, there are up to year-long waiting periods to get on these drugs, and other states have chosen to limit their programs so they do not pay for the comprehensive range of drugs needed to effectively treat HIV. Therefore, we are recommending new investments in the AIDS Drugs Assistance Program (ADAP) which helps people pay for these costly therapies that can run as high as $15,000 per year. In addition, we believe we should propose new increases in prevention and treatment for HIV/AIDS. (Cost: approximately $150 million per year).

- **Continuing the President's Successful Race and Health Initiative.** Minorities suffer as much as five times the rate for certain diseases and mortality rates, such as cancer, diabetes, heart disease, immunizations, HIV/AIDS, and infant mortality. In fact, infant mortality rates are 2½ times higher for African-Americans and 1½ times higher for Native Americans, and African-American men under 65 suffer from prostate cancer at nearly twice the rate of whites. The President's race and health initiative, designed to eliminate the startling racial health disparities in these six critical health areas has been extremely well received by the minority and public health communities. When launching this program last year, we committed to investing $400 million over five years, and this budget should include no less than the $80 million promised for each year. This initiative could fund: (1) new incentives to public health programs to target disparities, including creating incentives for communities to develop effective private-public cardiovascular outreach campaigns and developing new networks with managed care, minority-based organizations through the National Diabetes Education Program to implement treatment guidelines, (2) a $30 million grant program to test innovative community approaches to addressing these disparities and replicating these programs nationwide; and (3) investments to build on this year's historic prevention and treatment efforts to address the ongoing health crisis of HIV/AIDS in the minority community. These investments could be supplemented by new efforts at NIH to better understand these disparities and develop new approaches to disseminate the most up-to-date information. (Cost: $120 million -$150 million per year).

- **Enhancing Drug Approvals, Food Safety, and other FDA priorities.** The FDA has unprecedented new challenges, including: a surge in promising technologies and drugs that need approval; increasingly challenging diseases, such as AIDS and emerging pathogens; important public health issues such as food and blood safety and dietary supplements; as well as major new statutory responsibilities from FDA reform. However, funding for this agency has not increased in several years. This has serious implications for the agency, as food inspections, organ banks, and drug companies are rarely inspected; and it is more challenging to meet drug approval needs. OMB and HHS have made it a high priority to increase funding for this agency this year, and the Vice President's office has recommended increases as well.

We are working closely with them to determine the most advisable and needed funding.

- **Improving Health for Medically Underserved Native Americans.** Native Americans have disproportionately high rates of chronic and acute diseases (as much as five times higher diabetes rates, and three to four times the rate for SIDS). It is widely recognized that the IHS, the main health care resource for Native Americans living on reservations, does not have sufficient funding to address the needs of this population, and OMB and HHS are proposing increases in this area. We believe that this initiative should also include an emphasis on health areas where there are particularly large disparities, such as diabetes and cancer. This would build on the President's efforts to elevate the Director of IHS to an Assistant Secretary position and his participation in the conference on "Building Economic Self-Determination in Indian Communities". It would compliment well his race and health initiative. (Cost: working with HHS and OMB to determine needed increases).

- **Improving Access to Emergency Room Care for Veterans.** As part of the President's request to bring Federal health programs into compliance with the patients' bill of rights, there is some question as to whether the VA provides veterans adequate access to emergency room services. The VA currently only pays costs associated with emergency services provided to veterans at VA hospitals; and some argue that even though this is a discretionary, deliberately limited program, it is not entirely consistent with the patient protection to assure emergency services when and where the need arises. We expect Senator Daschle will offer a proposal to extend veterans' access to emergency rooms at non-VA facilities, and it is advisable for us to address this widely-publicized issue to some extent so we are not perceived as reneging on our commitment to apply the patients' bill of rights where we can. (Cost: VA's current proposal costs \$550 million per year. However, OMB has been working to dramatically reduce the costs of this proposal).

- **Investing in Promising DoD Breast Cancer/Prostate Cancer Research Programs.** We have continually highlighted DoD's innovative, popular cancer research programs (most recently the President announced grants in the DoD prostate cancer research program in his Father's Day radio address). However, we have been increasingly criticized by advocates who question the Administration's commitment to this program because the President's budget has never proposed <u>any</u> funding for this critical program. Advocates believe that the lack of an Administration proposal makes it much more difficult to lobby for funding on the Hill. DoD is somewhat resistant to this concept as they believe that although they have developed a model program in response to a Congressional mandate, cancer research is not within their military mission. If you chose to fund this area, we would need to at least match FY1999 funding and potentially increase this amount.(Cost: About \$250 million per year).