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Program Targeting Options and the Elderly

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ABSTRACT

The current emphasis on federal deficit reduction has led to a renewed interest in more precisely targeting governmental programs to reach the intended recipients. The targeting of benefits is not always easy, however, even when the objectives of programs are well defined. The case of programs for the elderly is both important for current policy and a good example of applied targeting.

Income criteria are frequently advocated for targeting in transfer programs, but practical difficulties can be very significant. For example, measurement problems are particularly important in programs for the elderly because of the importance of in-kind benefit programs. Further, the lack of appropriate administrative data on individuals in various programs implies that implicit targeting through overall program choices is the only feasible approach. When the distributional effects of currently discussed options are considered, the differences among alternatives are seen to be very large. It also is apparent that expenditure-side targeting is a much cruder instrument than tax-side targeting, at least given the nature of current programs and data.

* University of Rochester and Congressional Budget Office, respectively. The analysis and conclusions in this paper are those of the authors and do not necessarily represent those of the Congressional Budget Office. Many people provided helpful comments and contributions including Nancy Gordon, Bruce Jacobs, Richard Kasten, and Ralph Smith.

Program Targeting Options and the Elderly

by Eric A. Hanushek and Roberton Williams

I. Introduction

As federal budgetary pressures increase, the idea of more precise targeting of outlays becomes increasingly attractive. The notion is that by refining the distribution of outlays to direct benefits toward the more needy, the harm of any program reduction can be minimized. Of course, this presumes that it is possible to define and measure "most needy" in some reasonable manner related to the program under consideration. This paper considers alternatives in the targeting of programs for the elderly.

Discussions of targeting have taken place at a variety of levels. One major theme has been the improvement of income measures used to determine program eligibility and benefit levels. Central to these discussions is accounting for noncash benefits that individuals might receive along with cash income. Whether and how these benefits are counted, often linked to the measurement of poverty, can significantly affect the determination of who the needy are, and consequently the distribution of benefits across population subgroups. It is particularly significant in comparing the elderly to the nonelderly because of the substantial average noncash benefits of the elderly through the Medicare system.

A second theme of these discussions relates to the distribution of benefits among the elderly themselves. Current budgetary pressures have forced consideration of a wide range of options--both programmatic changes and tax revisions--to reduce the federal deficit, many of which would affect primarily the elderly. Most frequently discussed are program

changes that would reduce benefits. While attempts have been made to design proposals with distributional effects in mind, it must be recognized that working within the constraints of current program structures can make accurate targeting difficult. Finally, as an alternative to changing programs, tax revisions can also be used to reduce the deficit, but again, the implicit targeting of any revenue changes must be kept in mind.

II. Targeting Program Benefits to Individuals

Programs that provide benefits to individuals use eligibility criteria to determine who gets aid. In principle, these criteria direct benefits to those whom the programs are intended to help, while denying assistance to others. This targeting serves a number of purposes. First, it is a means of allocating scarce federal funds "efficiently," not in the economist's sense of the word but rather in the sense of getting funds to where they will be most effective in meeting the program's aims. The asset test in the Food Stamp program, for example, focuses aid on the most needy by denying benefits to households that are otherwise eligible but whose liquid assets could be used to buy food. Second, targeting can be used to exclude people who might change their behavior in undesired ways if they were eligible for benefits. This is the case in the Supplemental Security Income (SSI) program where participation is restricted to people who are aged, blind, or disabled; because these groups are not expected to work, these categorical criteria limit reductions in work effort that the program might otherwise cause. Third, in the case of appropriated programs, targeting criteria determine the distribution of benefits, at least in the short run; in the longer run, targeting may influence the level of program

support, since funding may depend on the program's image in terms of getting aid to those for whom it is intended.

Alternative Targeting Devices

A wide range of characteristics can be used as targeting devices. Some programs base eligibility on physical status, offering aid, for example, only to those nonelderly who are blind or disabled. Others specify age: Medicare, for example, is available to essentially all Americans age 65 or older. Family composition can determine who is helped, as in the Aid to Families with Dependent Children (AFDC) program which, in half the states, assists only those families with children in which either there is only one parent or one parent is incapacitated. Veterans' benefits are distributed on the basis of prior military service. And many programs direct aid to those whose economic well-being is below some threshold, defined in terms of income or some other dimension of need. Moreover, programs often use combinations of these characteristics to assess eligibility; for example, SSI is available to people over age 65 and to younger disabled people, but only if both their incomes and their liquid assets are below fixed limits.[1]

Targeting criteria are often determined by the nature of the specific programs. Participation in programs intended to assist the elderly is naturally limited to people at least 62 or 65 years old, while programs aimed at children generally restrict benefits to families with members

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[1]Another way in which benefits can be targeted is through the federal personal income tax. If some or all benefits are made taxable--as is now the case for Social Security payments to those with high enough incomes, for example--existing progressive tax rates will skew net benefits toward those with lower incomes. This effect can be increased by making larger percentages of benefits taxable for those above the thresholds. This approach is addressed further later in the paper.

under 18 years of age. Other programs may have less obvious bounds, and their eligibility criteria may seem to reflect this. For example, some veterans' benefits are available only to people who served in the armed forces during specified periods.

Poverty and Income as Targeting Criteria

Programs for which eligibility is based on poverty or low-income criteria have two general purposes. First, they are designed to alleviate current problems such as hunger, lack of shelter, or medical needs, that are expected to be short-term in nature. In this sense, assistance treats the symptoms of poverty but not its root causes. Dealing with the latter forms the second aim: helping the poor to support themselves in the future. Some programs--such as job training--are aimed at poor adults with the goal of providing them with skills that will make them self-sufficient. Others--such as Head Start--focus on poor children, trying to help them past the barriers that being poor establish and on to adult lives out of poverty. Straddling the line between these two general aims--helping with current needs and curing long-term problems--are programs for the elderly, who are not expected to become independent but will have specific daily care needs that are likely to last for the rest of their lives.

Programs that address these problems--both short-term and long-term--use income criteria for eligibility, not so much because income is necessarily the correct measure of need, but rather because low income serves as a proxy for other conditions. Ideally, targeting ought to be done through a general specification of social priorities and choices. It is not always possible, however, to find operational indicators that assess directly

whether or not to aid a particular person or family. We might want to offer job training to people whose work skills are too limited for them to earn non-poverty wages, but we identify eligible candidates through observing their incomes and not by examining their skills.[2] We might want to help disadvantaged children to be able escape poverty when they grow up; yet we target cash, food, housing, and educational aid based on their parents' incomes, not on more direct measures of specific deprivation or on whether they are unlikely to make it on their own as individuals.[3] Of course, some programs with income eligibility criteria are intended for people with low incomes, regardless of cause. Food stamps are available, at least in part, because as a society we feel that no one should go hungry.

Whether or not a poverty measure--as opposed to some simple income limit--is needed or appropriate as an eligibility criterion depends on the nature of the program in question.[4] Programs for which only specific kinds

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[2]Income criteria for job training programs may have a quite different purpose, identifying not those with inadequate skills, but rather those least able to finance their own training.

[3]Providing for the immediate needs of children through food or shelter is, of course, an additional motivation independent of any long run goals.

[4]The official poverty measure has two basic strengths in assessing financial need. First, it provides a way to compare the well-being of families of different types and sizes or in different circumstances. Because there are separate income thresholds for families with varying numbers of adult and child members, we can aggregate poverty status across families. Second, because it is defined at the national level, the poverty measure is consistent across states. While this is also a shortcoming, it does allow program eligibility to be defined uniformly throughout the country.

The weaknesses of the official poverty measure have been frequently discussed. The omission of in-kind income is particularly important. Underreporting of income, particularly in the cases of interest, dividends, and rental income, is known to be serious. Wealth, except to the extent

of families can qualify may not need an aggregate measure of well-being across family types; for example, among the non-disabled, SSI offers benefits only to single people or couples age 65 and over, so there is no need for the more complex set of poverty thresholds that provide comparisons across family groupings with other characteristics.

Expanding the Definition of Income

It is generally recognized that ignoring in-kind benefits in measuring income understates the well-being of families. Less well understood are the effects of expanding the definition of income to include in-kind benefits. Much attention has been directed to the fact that changing the definition of income to count in-kind benefits and leaving any set of thresholds--such as those used for the official poverty measure--unaltered would lead automatically to significant reductions in the number of families with incomes below the thresholds. Data published by the Bureau of the Census, for example, show that the overall poverty rate would have been between 2.0 percentage points and 4.7 percentage points lower in 1985, depending on how in-kind income is valued.[5] This would reduce the number

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that it generates cash income, is excluded. Taxes are ignored. And, geographic differences in cost of living are not considered. See Hanushek and Williams [1986].

[5]The in-kind benefits included were food stamps, housing assistance, medical benefits, and school lunches. See Bureau of the Census, Estimates of Poverty Including the Value of Noncash Benefits: 1985, Technical Paper 56, September 1986, p. 17. Similar differences were found for other years:

Difference Between Official and Expanded Poverty Rates
(in percentage points)

Year	1979	1980	1981	1982	1983	1984	1985
Range of Estimates							
Low	2.5	2.4	2.2	2.2	2.0	2.0	2.0
High	4.7	4.9	4.7	4.7	4.7	4.6	4.7

TABLE 1. POVERTY RATES USING ALTERNATIVE DEFINITIONS OF INCOME BY FAMILY TYPE, 1984 (in percents)

Income Measure	Married Couples w/Child. under 18	Single Parents w/Child. under 18	All Families	Elderly Units	Unrel. Indivs.	All Persons
IN-KIND BENEFITS MEASURED AT MARKET VALUE						
Pre-Means Tested	9.7	45.0	12.7	19.5	23.0	16.0
All Cash	9.4	42.8	11.9	17.5	21.8	15.1
Cash + In-Kind	7.2	28.3	8.1	3.6	14.2	10.1
After Taxes	8.5	29.0	8.9	3.6	15.4	11.0
IN-KIND BENEFITS MEASURED AT POVERTY BUDGET SHARE VALUE						
Pre-Means Tested	9.7	45.0	12.7	19.5	23.0	16.0
All Cash	9.4	42.8	11.9	17.5	21.8	15.1
Cash + In-Kind	8.2	34.7	9.9	10.3	18.5	12.7
After Taxes	9.4	35.5	10.6	10.3	19.8	13.6

SOURCE: Eric A. Hanushek and Roberton Williams, "Alternative Poverty Measures and the Allocation of Federal Benefits," in Bureau of the Census, Proceedings of the Conference on the Measurement of Noncash Benefits, Volume 1, December 1985, p. 113.

NOTE: For a discussion of alternative ways to value in-kind benefits, see Bureau of the Census, Estimates of Poverty Including the Value of Noncash Benefits: 1984, Technical Paper 55, August 1985.

Figure 1

Poverty Rates by Income Measure

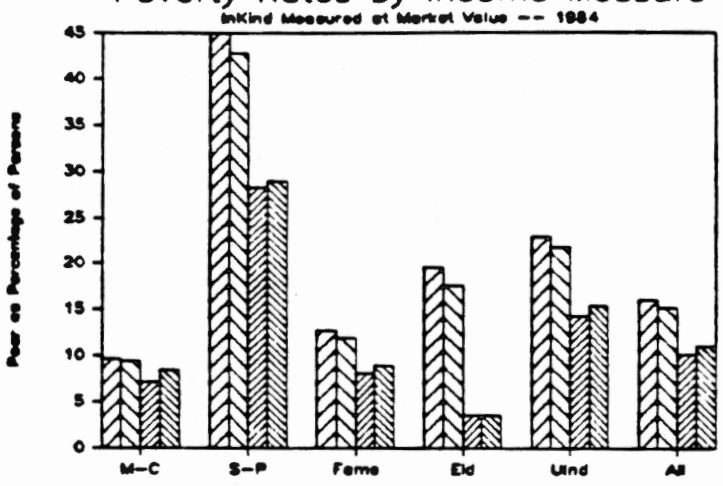
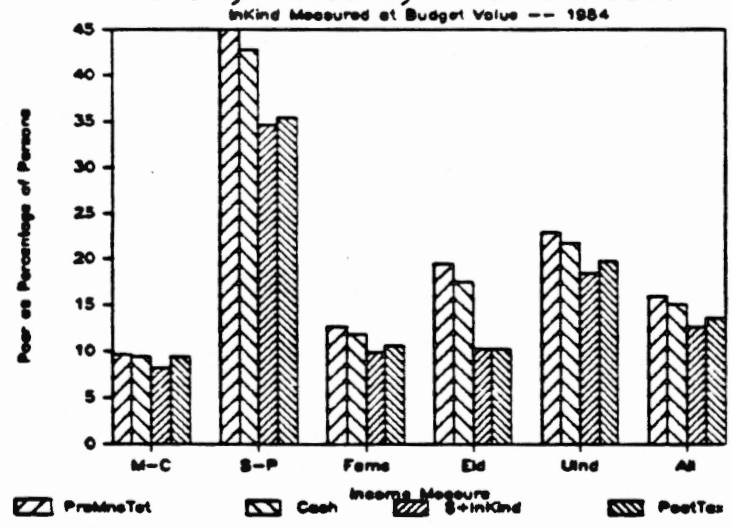


Figure 2

Poverty Rates by Income Measure



Population Subgroups

M-C : married couples with related children under 18 years of age
S-P : single parents with related children under 18 years of age
Fams : all primary families and unrelated subfamilies
Eld : all families and unrelated subfamilies with all members age 65 or over, plus all people age 65 and over not living with relatives.
UInd : all unrelated individuals
All : all people

SOURCE: Eric A. Hanushek and Roberton Williams, "Alternative Poverty Measures and the Allocation of Federal Benefits," in Bureau of the Census, Proceedings of the Conference on the Measurement of Noncash Benefits, Volume 1, December 1985, p. 114.

of people qualifying for programs that have poverty status as an eligibility criterion, as critics often complain. The complaint, however, is not directly relevant to the issue; any poverty measure comparing income against fixed thresholds is necessarily an arbitrary statistic which can be driven to any given value by the appropriate choice of thresholds. For the purposes of program targeting, the more relevant question to ask is whether a particular income measure directs benefits toward those people for whom aid is intended. As noted above, the answer depends on which program is being considered.

What is clear is that the definition of income can affect which families are considered "needy" and thus determine the distribution of benefits among families. Table 1 and Figures 1 and 2 show the effects on poverty rates of using alternative income measures. Because they are less likely to get noncash benefits, married couples with children would experience a relatively small drop in their poverty rate--between 1.2 and 2.2 percentage points (a 13 to 25 percent decline) depending on how in-kind income is valued. The effects would be greater for family types that participate in non-cash assistance programs more often: the poverty rate of single-parent families with children would fall by 19 percent or 34 percent, while that of elderly families would be reduced by 41 percent or 79 percent.[6]

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[6]Table 1 and Figures 1 and 2 reveal significant differences in poverty rates, depending on the method used to value in-kind benefits. The market value is generally greater than either the poverty budget share value or the cash equivalent value (not shown in the table or graphs), and the difference is greatest for health care benefits. This is particularly evident for the elderly, for whom counting in-kind income at market value lowers the poverty rate to 3.6 percent, while using the poverty budget share value--which limits the dollar value of in-kind benefits--causes the

Allocating program benefitson the basis of cash plus in-kind income would, therefore, provide less for the elderly and for single-parent families, while a greater share of assistance would go to married couples with children, if no other changes were made.

If income were also measured after taxes, this effect would be even greater. Using the poverty budget share valuation of in-kind income, the combined effect on poverty rates of counting noncash benefits and excluding taxes would be essentially zero for married couple families. On the other hand, because other family types pay less taxes, their poverty rates would fall more: poverty rates would decline by 17 percent among single-parent families, and by 41 percent among elderly households.

At the same time, counting in-kind benefits as income would not necessarily lead to large or inadvertent changes in the distribution of program benefits. In the first place, Congressional action would generally be required to alter eligibility criteria to include in-kind income; such action would signal revised intent in terms of who should receive assistance. Further, because most programs have multiple eligibility criteria, changing the definition of income might have little effect on who qualifies for benefits; other criteria may be more important in restricting the eligible population.

What additional information is needed to value in-kind income?

If in-kind benefits are to be counted when income is measured, two pieces of information about those benefits are needed for each family. First, we must know how much of each good or service the family receives.

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poverty rate to fall only to 10.3 percent. There is little agreement on what the appropriate valuation method is.

For area estimates such as national averages, survey data could be used; the usual problems of misreporting would occur, made worse in those situations where recipients do not know how much of a particular in-kind benefit they were given, such as in the case of public housing or energy assistance in the form of third-party payments. For eligibility determination, information could be obtained either from program records or from applicant reports. The former would be administratively complex, however, given the many types of assistance provided by different agencies, while the latter would be subject to underreporting, either intentional or from lack of knowledge.

The second and perhaps more difficult need is a means of valuing in-kind benefits. The seminal work of Timothy Smeeding and subsequent refinements by the Bureau of the Census demonstrate that valuation methods can be devised.[7] There is, however, much disagreement on what method is appropriate, best indicated by the fact that the Census Bureau publishes data based on three alternatives. Arguments can be offered for each of the three--and for other possibilities as well--and consensus is unlikely to be obtained on any one.

The previous data (and the more detailed analyses by the Bureau of the Census) provide insights into the relative importance of different issues. The large changes in the poverty rates result directly from including benefits from Medicare and Medicaid and subsidized housing. The medical programs are especially important for the elderly and differences in their

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[7]Bureau of the Census, Alternative Methods for Valuing Selected In-Kind Transfer Benefits and Measuring Their Effect on Poverty, Technical Paper 50, March 1982. See also Technical Papers 51, 52, 55, and 56 in the same series.

presumed value lead to the extraordinary swings in the evaluation of their well-being.

As a result, any move to introduce broader measures of income is likely to affect the elderly relatively more heavily than younger people. This is not to say that such options should not be considered; because of the noncash benefits they receive, the elderly are, after all, better off than one would infer from looking only at cash incomes. It does emphasize, however, that attempts to improve targeting through a more inclusive income measure could have potentially significant distributional effects. Furthermore, the alternative ways of valuing noncash benefits mean that the effects may well be arbitrary. Given the importance of medical insurance as noncash income for the elderly, the choice of valuation method could markedly affect the distribution of program benefits between the elderly and the nonelderly.

III. Distributional Impact of Specific Targeting Options for the Elderly

The second major issue is the impact of programmatic reductions on the elderly. Much of the public debate to date has involved taking the structure of programs as given and focusing on the distributional impacts of any aggregate cutbacks. Almost anything that is done, however, has immediate implications for the well-being of the elderly. Therefore, a parallel consideration has been how program parameters could be altered to protect the low-income elderly from adverse effects.

This work has been quite specific, because, unlike the general discussions of changing income distributions, it has delved into the actual operational details of programs. Specifically, it has worried about how

programs could be modified in realistic ways to achieve savings while protecting the elderly poor and limiting any increase in the level of poverty among the elderly.

Three types of basic policies could be pursued. The first, which has received the most attention, is actions on the spending side that would lead to immediate savings. These options have had the greatest appeal because they involve changes that could be quickly implemented and that would generate obvious rapid reductions in the overall deficit. The simplest example of this is eliminating the cost of living adjustment (COLA) built into Social Security. The second basic policy involves "deeper" structural adjustments that would alter expenditure patterns in the long run but have only small effects in the short run. An example of this is changing the "bend points" in the Social Security benefits formula. The final kind of change involves working on the tax side instead of the benefits side. Increased taxation of Social Security benefits would fall into this category.

The interesting aspect of each of these approaches is that while specific proposals do not represent explicit targeting choices, their evaluation has been in terms of their implicit targeting. Specifically, proposals have been assessed in terms of their distributional impacts, holding constant the amount of change in expenditures or taxes.

To put the possibilities into perspective, Table 2 shows the expenditure levels for the major programs affecting the elderly, while Table 3 provides information about the distribution of cash transfer benefits by income

TABLE 2. OUTLAYS AND TAX EXPENDITURES FOR SELECTED BENEFIT PROGRAMS, 1985-1990 (By fiscal year, in billions of dollars)

Program	Baseline 1985	Projected 1986	1987	1988	1989	1990	Total Projected 1986-1990
				OUTLAYS			
Non-Means-Tested Cash Benefits							
Social Security	192	202	215	229	244	260	1,150
Railroad Retirement	6	6	7	7	7	7	34
Civil Service Retire.	23	25	26	28	30	32	141
Military Retirement	16	18	19	20	21	23	102
Other Federal Employee Retirement	1	1	1	1	1	1	4
Veterans' Compensation	10	10	11	11	11	11	54
Subtotal	248	262	278	296	314	334	1,485
Supplemental Security Income a/	10	10	10	12	11	11	54
Medicare Hospital Insurance	48	52	57	63	70	78	321
Supplemental Medical Insurance	23	26	29	33	33	38	169
Subtotal	71	78	86	96	108	121	489
				TAX EXPENDITURES			
Partial Exclusion of SS/RR Benefits from Adjusted Gross Income	18	19	20	21	22	22	104

SOURCE: Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," March 1985.

a. Fiscal year 1988 includes 13 months of payments; fiscal year 1990 includes only 11 months of payments.

TABLE 3. FAMILIES RECEIVING BENEFITS FROM SELECTED PROGRAMS, CALENDAR YEAR 1983 a/

Family Income Relative to Poverty Line	Percentage of Recipients in Group	Percentage of Total Program Benefits Received by Group	Number of Families Receiving Benefits		Average Benefits	
			In Thousands	As Percentage of Families in Group	In Dollars	As Percentage of Average Income
Social Security and Railroad Retirement						
Total Families	100	100	23,510	25.6	6,010	34.3
Below Poverty Line	17	9	3,890	26.0	3,370	76.0
100-125 Percent	9	8	2,190	43.4	4,840	74.2
Over 125 Percent	74	83	17,440	24.2	6,750	30.9
Civil Service and Military Retirement						
Total Families	100	100	2,820	3.1	11,590	37.2
Below Poverty Line	2	1	60	0.4	2,770	63.7
100-125 Percent	3	1	90	1.7	3,900	54.4
Over 125 Percent	95	98	2,670	3.7	12,060	37.0
Supplemental Security Income						
Total Families	100	100	2,990	3.2	2,460	24.3
Below Poverty Line	54	47	1,620	10.8	2,130	46.4
100-125 Percent	16	18	470	9.4	2,820	38.6
Over 125 Percent	30	35	900	1.2	2,860	13.2
Social Security, Railroad Retirement, SSI, Civil Service or Military Retirement b/						
Total Families	100	100	26,100	28.4	6,950	38.2
Below Poverty Line	18	9	4,620	30.9	3,620	81.2
100-125 Percent	9	7	2,400	47.5	5,120	77.4
Over 125 Percent	73	84	19,080	26.5	7,990	34.8

SOURCE: Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," March 1985, p. 22.

a. Unrelated sub-families and unrelated individuals are each defined as separate families in these tabulations. All numbers have been rounded.

b. Families receiving benefits from one or more of these programs. Families receiving benefits from more than one program are counted only once.

category, where income includes cash only.[8] The major programs represent about one-third of all federal outlays. Because of their magnitude, they are programs that need to be considered in any discussions of deficit reduction.

The options discussed here are described briefly in Table 4. They are intended to be illustrative, and represent neither the only ones nor ones currently under active consideration. The nature of these programmatic changes can be seen from Table 5 which summarizes the distribution of their effects by income category.[9]

The first general conclusion arising from this analysis is that programmatic changes would have widely different impacts on the level of poverty among the elderly. Options that do not recognize differences in economic circumstances, such as increases in individual beneficiaries' premiums for Medicare or across-the-board cuts in COLAs, would fall disproportionately on the poor and near poor. At the other extreme, other changes, such as moving from percentage to fixed amount COLAs, would have little effect on the low-income elderly and could even improve the well-being of some of them.

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[8]These estimates are based upon tabulations from the March 1984 Current Population Survey.

[9]These alternate plans are described in great detail in CBO, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled", Staff Working Paper, March 1985. All of the calculations result from CBO simulations based upon distributional information from the 1984 Current Population Survey and CBO projections of macroeconomic parameters as of February 1985. The effects shown might therefore not be accurate if the options were implemented now.

TABLE 4. SUMMARY DESCRIPTIONS OF POLICY OPTIONS

Option	Description
FREEZE OPTIONS	
Freeze Social Security and Railroad Retirement program benefits.	One-year elimination of COLA for Social Security and Railroad Retirement only.
Combine Social Security and Railroad Retirement freeze with increased SSI Guarantee	One-year elimination of COLA for Social Security and Railroad Retirement only plus raise SSI guarantee levels for individuals by $20/mo. and for couples by $30/mo.
Freeze all non-means-tested program benefits	One-year elimination of COLA for Social Security, Railroad Retirement, Civil Service Retirement, military retirement, veterans' compensation, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard.
Combine freeze on all non-means-tested programs with increase in SSI guarantee.	One-year elimination of COLA for Social Security, Railroad Retirement, Civil Service Retirement, military retirement, veterans' compensation, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard plus raise SSI guarantee levels for individuals and for couples by $20 and $30 per month, respectively.
Exempt Social Security and Railroad Retirement benefits below a specified threshold (COLA Cap)	Provide COLA only for that portion of Social Security and Railroad Retirement benefits that is below poverty threshold. No COLA would be provided for any other non-means-tested programs.
Replace Social Security and Railroad Retirement COLA with flat COLA	Provide all Social Security and Railroad Retirement beneficiaries with COLA equal to that COLA that would have been given to recipients with benefits at the poverty threshold. No COLA would be provided for any other non-means-tested program.
Exempt Social Security and Railroad Retirement beneficiaries below a specified threshold (Poverty COLA)	One-year elimination of COLA for all non-means-tested programs except that Social Security and Railroad Retirement beneficiaries with benefits below the poverty threshold would receive the full COLA.

TABLE 4, continued.

Option	Description
MEDICARE OPTIONS	
Increase SMI premium to 35% of costs	Raise Supplemental Medical Insurance premiums for all beneficiaries so that total premiums cover 35% of SMI costs.
Increase SMI premium to 30% of costs and increase deductible	Raise Supplemental Medical Insurance premiums for all beneficiaries so that total premiums cover 30% of SMI costs and increase SMI deductible from $75 to $200. Index deductible to CPI in the future.
Introduce income-related SMI premium	Impose 1% surtax on taxable income of SMI enrollees; limit surtax to no more than subsidy value of SMI benefits.
TAXATION OF BENEFIT INCOME OPTIONS	
Eliminate thresholds for inclusion of benefits in AGI	Eliminate income thresholds for including Social Security and Railroad Retirement benefits in taxable income. Continue to tax half of benefits.
Include up to 85% of benefits above threshold in AGI	Use current thresholds ($25,000 for single returns and $32,000 for married couples) but tax 85% of Social Security and Railroad Retirement benefits for those above the threshold.
Lower the thresholds and increase percent of benefits included in AGI	Lower thresholds to $20,000 for single returns and to $25,000 for married couples and tax 85% of Social Security and Railroad Retirement benefits for those above the threshold.
Include 50% of value of HI and 75% of SMI in AGI	Require Medicare beneficiaries to include as taxable income 50% of the insurance value of Hospital Insurance benefits and 75% of the insurance value of Supplemental Medical Insurance benefits.

SOURCE: Derived from Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," Staff Working Paper, March 1985.

TABLE 5. AMOUNTS AND SOURCES OF BUDGETARY SAVINGS

Option b/	Fiscal Years 1986-1990 Budgetary Savings a/ (in billions of dollars)	Distribution of Effects on Recipients in 1983 (in percents)				
		Poor c/	100%-125% of Poverty Line	125%-200% of Poverty Line	200%-300% of Poverty Line	Over 300% of Poverty Line
One-Year Benefit Freeze Options						
Freeze Social Security and Railroad Retirement program benefits	33.8	8	7	23	24	39
Combine Social Security and Railroad Retirement freeze with increase in SSI Guarantee	29.9	d/	5	24	27	44
Freeze all non-means-tested program benefits	43.3	6	6	19	22	47
Combine freeze on all non-means-tested programs with increase in SSI guarantee	39.4	d/	4	20	24	52
Exempt Social Security and Railroad Retirement benefits below a specified threshold (COLA Cap) f/	16.5	1	2	12	20	66
Replace Social Security and Railroad Retirement COLA with flat COLA f/	10.2	-15e/	-2e/	8	21	86
Exempt Social Security and Railroad Retirement beneficiaries below a specified threshold (Poverty COLA) f/	33.1	1	4	19	23	53
Medicare Options						
Increase SMI premium to 35 percent of costs g/	17.1	11	8	23	23	36
Increase SMI premium to 30 percent of costs and increase deductible g/	17.7	11	8	23	23	36
Introduce an income-related SMI premium	8.7	d/	d/	1	7	92
Taxation of Benefit Income Options						
Eliminate thresholds for inclusion of benefits in adjusted gross income	36.1	d/	d/	7	28	65
Include up to 85 percent of benefits above threshold in AGI	19.3	0	0	0	d/	100
Lower the thresholds and increase percent of benefits included in AGI	28.4	0	0	d/	1	99
Include 50 percent of value of HI and 75 percent of SMI in AGI	20.1	d/	d/	4	18	77

SOURCE: Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," March 1985, p. 108.

a. Budgetary savings estimated for fiscal years 1986-1990; distributional effects are for calendar year 1983.
b. See source for complete definitions of options.
c. Poor families are those with incomes below Census poverty thresholds.
d. Less than 0.5 percent.
e. Total benefits received by the poor and near-poor in 1983 would increase by about $0.3 billion, and benefits received by the nonpoor would decrease by $1.6 billion, resulting in a net loss of $1.3 billion to be allocated across groups.
f. Benefit levels for all other non-means-tested programs would be frozen.
g. The distributions of effects of these options are identical because it is assumed that per capita deductible expenditures do not vary by income group.

The second observation is that expenditure policies with respect to the elderly are relatively clumsy instruments for targeting. This is easiest to see in terms of curtailing the COLA for Social Security. Social Security payments are correlated with the overall income level of the elderly, but only imperfectly. While it has sometimes been asserted that the elderly poor could be protected from the effects of a one-year freeze on Social Security benefits with expenditures of as little as $400 million--about 8 percent of expected budgetary savings--this is only the case if the elderly poor could be identified by the Social Security Administration. They can't. The Social Security system can only make adjustments in the current level of benefits that are calculated on the basis of past contributions. They do not have direct access to information on other income of the elderly.

A third observation is more subtle. Curtailing COLAs could be combined with policies designed to increase the benefits going to the low-income elderly, such as payment increases for Supplemental Social Insurance (SSI) beneficiaries, for example. This would indeed lessen the impact of COLA curtailments, but would do so only in the aggregate. The individuals brought above the poverty line through increases in SSI benefits would generally not be the same as the individuals pushed below the poverty line by a COLA curtailment. It is generally the case that implicit targeting is an aggregate, not an individual, concept.

The expenditure cuts considered above, curtailing COLAs or increasing SMI premiums for Medicare, take the existing structure of programs as given. The distribution of the cuts thus follows the pattern of distribution built into the programs. In addition, unless they are

continued over time, the cuts have a large immediate impact but little long-term impact on the expenditure patterns of these programs. To the extent that the major problem facing the federal government is a short run fiscal shortfall that will go away in the longer run, this is an appropriate focus. In other words, if the need to deal with budgetary deficits is simply a temporary imbalance, there is no (exogenous) incentive to change the character of the programs. On the other hand, if the problem of fiscal imbalance is one that will exist for some time, basic alterations in program design may be needed.

In terms of this longer run perspective, alternative targeting notions are more important. Within the Social Security system, for example, one inherent source of distributional outcomes lies in the basic benefit formula. Currently, Social Security provides larger relative benefits to those with lower lifetime earnings. It does this through the "bend points" in the benefit formula which determine how rapidly benefits rise with lifetime earnings.[10] By adjusting these, the amount of redistribution of the Social Security system can be altered.[11]

Making such adjustments involves a number of large policy issues. First, there is a delicate balance between the notions that Social Security is a return on individual payments into the system and that Social Security

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[10]The primary insurance amount (PIA) is based on average indexed monthly earnings (AIME). Currently the PIA is equal to 90 percent of the first $297 of AIME, plus 32 percent of the next $1,493 of AIME, plus 15 percent of any AIME in excess of $1,790. $297 and $1,790 are commonly referred to as the "bend points" in the formula.

[11]The amount of redistribution is a function of both the bend points and the replacement rates--the percentage of earnings in each bracket paid as retirement benefits. In addition, the amount of redistribution depends on payroll tax rates and maximum taxable earnings over workers' lifetimes.

is a transfer system with redistributive characteristics. Changes in the benefit formula could seriously affect that balance. Second, alterations in the bend points can have substantial long run effects, but would have very little immediate impact on the deficits. This results from the fact that changes in the benefit formula only affect those who have not yet retired.

Finally, the discussion of expenditure policies should be contrasted with the options on the tax side. The current personal income tax system has a somewhat complicated formula that includes a portion of Social Security benefits in taxable income for high income tax payers.[12] Currently, relatively few recipients pay taxes on Social Security; it is estimated that only about one-sixth of tax units with Social Security income will be liable for taxes totalling about $3 billion from this source in 1987. However, if the income thresholds for taxing benefits were lowered or the portion of Social Security that is included as taxable income were increased, benefits net of taxes could be altered to be more consistent with the overall ability to pay of the elderly.

The fundamental difference between operating on the tax side and on the benefit side is the capacity to target changes more directly to the economic circumstances of the elderly. As it stands now, individuals can receive low Social Security benefits either because they had low lifetime incomes or because they had low Social Security earnings. In the latter case, low Social Security earnings do not accurately reflect the lifetime

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[12]In most cases, if adjusted gross income plus nontaxable interest income plus one half of Social Security retirement benefits exceeds $25,000 for individual filers ($32,000 for joint filers), then one-half of benefits are included in taxable income.

incomes of individuals because they do not recognize either uncovered employment or incomes from sources other than earnings. Thus, using only Social Security earnings data and calculated benefits cannot take into account other sources of income, and benefit adjustments that direct increases to those now receiving low payments would be "inefficient" from a targeting standpoint.

Table 5 clearly demonstrates that changing the taxability of Social Security could raise as much money as straight COLA freezes while having a very different impact on the poor.[13] Since relatively few of the elderly poor pay taxes under the current system, they would generally escape benefit reductions--net of taxes--accomplished in this way.

Several arguments can be raised against changing the taxability of Social Security. First, some contend that payments by individuals into Social Security accounts come from after-tax income, and therefore they have already been taxed once. This is only partially true, however, since only a small portion of current benefits could have been funded by contributions made by individuals. Second, the taxation of benefits (under the progressive income tax system) again raises the issue of whether the underlying philosophy of the system is to provide retirement income payments in line with contributions to the system or to accomplish redistributive goals.

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[13]In fact, changing the taxation of Social Security could raise significantly more money if inflation rates remain at their current low levels. The estimates given in Table 5 were based on the assumption that the annual inflation rate would be 3.7 percent. With lower inflation, COLAs would be smaller, and eliminating them would save less money.

A final note is important. The recently enacted revisions to the tax code interact with these comments about targeting. Reduced marginal tax rates mean that less tax will be paid on the taxable portion of Social Security benefits in the future. On the other hand, changes in what income must be reported for tax purposes will mean that more returns will be subject to tax on Social Security payments. The net effect is uncertain, but the revenue changes could significantly affect the targeting of benefits based on overall well-being of the elderly.

IV. Summing Up

This paper has attempted to delineate a variety of issues related to the targeting of benefits for the elderly. These have been somewhat artificially divided into broad discussions of general income targeting issues and of specific programmatic revisions. The key point is, however, that current income measurement and benefit targeting for the elderly is especially imprecise. This arises from two fundamental factors. First, the elderly receive particularly important noncash benefits, the most significant of which is medical insurance under Medicare. It is unreasonable to neglect these payments in considering the well-being of the elderly and the distribution of programmatic funds. The valuation of these benefits is extremely difficult, however, and how it is done has important distributional implications.

Second, within the existing set of programs, explicit targeting is frequently ruled out because appropriate information is lacking. Virtually all programmatic changes can, however, be viewed as adopting implicit targeting choices. When considered in this framework, specific options

designed primarily to reduce the deficit can have enormous--and widely differing--distributional effects. Even if the explicit intent is to direct benefits more precisely on the basis of income, targeting may be quite imprecise. This is because specific program offices, such as the Social Security Administration, lack the information needed to determine total incomes of beneficiaries. By comparison, because it is based on the fundamental concept of ability to pay, the tax system provides an alternative that can better attain distributional objectives, even though it, too, neglects noncash income.

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PROGRAM TARGETING OPTIONS AND THE ELDERLY

by

Eric A. Hanushek and Roberton Williams*

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ABSTRACT

The current emphasis on federal deficit reduction has led to a renewed interest in more precisely targeting governmental programs to reach the intended recipients. The targeting of benefits is not always easy, however, even when the objectives of programs are well defined. The case of programs for the elderly is both important for current policy and a good example of applied targeting.

Income criteria are frequently advocated for targeting in transfer programs, but practical difficulties can be very significant. For example, measurement problems are particularly important in programs for the elderly because of the importance of in-kind benefit programs. Further, the lack of appropriate administrative data on individuals in various programs implies that implicit targeting through overall program choices is the only feasible approach. When the distributional effects of currently discussed options are considered, the differences among alternatives are seen to be very large. It also is apparent that expenditure-side targeting is a much cruder instrument than tax-side targeting, at least given the nature of current programs and data.

* University of Rochester and Congressional Budget Office, respectively. The analysis and conclusions in this paper are those of the authors and do not necessarily represent those of the Congressional Budget Office. Many people provided helpful comments and contributions including Nancy Gordon, Bruce Jacobs, Richard Kasten, and Ralph Smith.

Program Targeting Options and the Elderly

by Eric A. Hanushek and Roberton Williams

I. Introduction

As federal budgetary pressures increase, the idea of more precise targeting of outlays becomes increasingly attractive. The notion is that by refining the distribution of outlays to direct benefits toward the more needy, the harm of any program reduction can be minimized. Of course, this presumes that it is possible to define and measure "most needy" in some reasonable manner related to the program under consideration. This paper considers alternatives in the targeting of programs for the elderly.

Discussions of targeting have taken place at a variety of levels. One major theme has been the improvement of income measures used to determine program eligibility and benefit levels. Central to these discussions is accounting for noncash benefits that individuals might receive along with cash income. Whether and how these benefits are counted, often linked to the measurement of poverty, can significantly affect the determination of who the needy are, and consequently the distribution of benefits across population subgroups. It is particularly significant in comparing the elderly to the nonelderly because of the substantial average noncash benefits of the elderly through the Medicare system.

A second theme of these discussions relates to the distribution of benefits among the elderly themselves. Current budgetary pressures have forced consideration of a wide range of options--both programmatic changes and tax revisions--to reduce the federal deficit, many of which would affect primarily the elderly. Most frequently discussed are program

changes that would reduce benefits. While attempts have been made to design proposals with distributional effects in mind, it must be recognized that working within the constraints of current program structures can make accurate targeting difficult. Finally, as an alternative to changing programs, tax revisions can also be used to reduce the deficit, but again, the implicit targeting of any revenue changes must be kept in mind.

II. Targeting Program Benefits to Individuals

Programs that provide benefits to individuals use eligibility criteria to determine who gets aid. In principle, these criteria direct benefits to those whom the programs are intended to help, while denying assistance to others. This targeting serves a number of purposes. First, it is a means of allocating scarce federal funds "efficiently," not in the economist's sense of the word but rather in the sense of getting funds to where they will be most effective in meeting the program's aims. The asset test in the Food Stamp program, for example, focuses aid on the most needy by denying benefits to households that are otherwise eligible but whose liquid assets could be used to buy food. Second, targeting can be used to exclude people who might change their behavior in undesired ways if they were eligible for benefits. This is the case in the Supplemental Security Income (SSI) program where participation is restricted to people who are aged, blind, or disabled; because these groups are not expected to work, these categorical criteria limit reductions in work effort that the program might otherwise cause. Third, in the case of appropriated programs, targeting criteria determine the distribution of benefits, at least in the short run; in the longer run, targeting may influence the level of program

support, since funding may depend on the program's image in terms of getting aid to those for whom it is intended.

Alternative Targeting Devices

A wide range of characteristics can be used as targeting devices. Some programs base eligibility on physical status, offering aid, for example, only to those nonelderly who are blind or disabled. Others specify age: Medicare, for example, is available to essentially all Americans age 65 or older. Family composition can determine who is helped, as in the Aid to Families with Dependent Children (AFDC) program which, in half the states, assists only those families with children in which either there is only one parent or one parent is incapacitated. Veterans' benefits are distributed on the basis of prior military service. And many programs direct aid to those whose economic well-being is below some threshold, defined in terms of income or some other dimension of need. Moreover, programs often use combinations of these characteristics to assess eligibility; for example, SSI is available to people over age 65 and to younger disabled people, but only if both their incomes and their liquid assets are below fixed limits.[1]

Targeting criteria are often determined by the nature of the specific programs. Participation in programs intended to assist the elderly is naturally limited to people at least 62 or 65 years old, while programs aimed at children generally restrict benefits to families with members

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[1]Another way in which benefits can be targeted is through the federal personal income tax. If some or all benefits are made taxable--as is now the case for Social Security payments to those with high enough incomes, for example--existing progressive tax rates will skew net benefits toward those with lower incomes. This effect can be increased by making larger percentages of benefits taxable for those above the thresholds. This approach is addressed further later in the paper.

under 18 years of age. Other programs may have less obvious bounds, and their eligibility criteria may seem to reflect this. For example, some veterans' benefits are available only to people who served in the armed forces during specified periods.

Poverty and Income as Targeting Criteria

Programs for which eligibility is based on poverty or low-income criteria have two general purposes. First, they are designed to alleviate current problems such as hunger, lack of shelter, or medical needs, that are expected to be short-term in nature. In this sense, assistance treats the symptoms of poverty but not its root causes. Dealing with the latter forms the second aim: helping the poor to support themselves in the future. Some programs--such as job training--are aimed at poor adults with the goal of providing them with skills that will make them self-sufficient. Others--such as Head Start--focus on poor children, trying to help them past the barriers that being poor establish and on to adult lives out of poverty. Straddling the line between these two general aims--helping with current needs and curing long-term problems--are programs for the elderly, who are not expected to become independent but will have specific daily care needs that are likely to last for the rest of their lives.

Programs that address these problems--both short-term and long-term--use income criteria for eligibility, not so much because income is necessarily the correct measure of need, but rather because low income serves as a proxy for other conditions. Ideally, targeting ought to be done through a general specification of social priorities and choices. It is not always possible, however, to find operational indicators that assess directly

whether or not to aid a particular person or family. We might want to offer job training to people whose work skills are too limited for them to earn non-poverty wages, but we identify eligible candidates through observing their incomes and not by examining their skills.[2] We might want to help disadvantaged children to be able escape poverty when they grow up; yet we target cash, food, housing, and educational aid based on their parents' incomes, not on more direct measures of specific deprivation or on whether they are unlikely to make it on their own as individuals.[3] Of course, some programs with income eligibility criteria are intended for people with low incomes, regardless of cause. Food stamps are available, at least in part, because as a society we feel that no one should go hungry.

Whether or not a poverty measure--as opposed to some simple income limit--is needed or appropriate as an eligibility criterion depends on the nature of the program in question.[4] Programs for which only specific kinds

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[2]Income criteria for job training programs may have a quite different purpose, identifying not those with inadequate skills, but rather those least able to finance their own training.

[3]Providing for the immediate needs of children through food or shelter is, of course, an additional motivation independent of any long run goals.

[4]The official poverty measure has two basic strengths in assessing financial need. First, it provides a way to compare the well-being of families of different types and sizes or in different circumstances. Because there are separate income thresholds for families with varying numbers of adult and child members, we can aggregate poverty status across families. Second, because it is defined at the national level, the poverty measure is consistent across states. While this is also a shortcoming, it does allow program eligibility to be defined uniformly throughout the country.

The weaknesses of the official poverty measure have been frequently discussed. The omission of in-kind income is particularly important. Underreporting of income, particularly in the cases of interest, dividends, and rental income, is known to be serious. Wealth, except to the extent

of families can qualify may not need an aggregate measure of well-being across family types; for example, among the non-disabled, SSI offers benefits only to single people or couples age 65 and over, so there is no need for the more complex set of poverty thresholds that provide comparisons across family groupings with other characteristics.

Expanding the Definition of Income

It is generally recognized that ignoring in-kind benefits in measuring income understates the well-being of families. Less well understood are the effects of expanding the definition of income to include in-kind benefits. Much attention has been directed to the fact that changing the definition of income to count in-kind benefits and leaving any set of thresholds--such as those used for the official poverty measure--unaltered would lead automatically to significant reductions in the number of families with incomes below the thresholds. Data published by the Bureau of the Census, for example, show that the overall poverty rate would have been between 2.0 percentage points and 4.7 percentage points lower in 1985, depending on how in-kind income is valued.[5] This would reduce the number

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that it generates cash income, is excluded. Taxes are ignored. And, geographic differences in cost of living are not considered. See Hanushek and Williams [1986].

[5]The in-kind benefits included were food stamps, housing assistance, medical benefits, and school lunches. See Bureau of the Census, Estimates of Poverty Including the Value of Noncash Benefits: 1985, Technical Paper 56, September 1986, p. 17. Similar differences were found for other years:

Difference Between Official and Expanded Poverty Rates
(in percentage points)

Year	1979	1980	1981	1982	1983	1984	1985
Range of Estimates							
Low	2.5	2.4	2.2	2.2	2.0	2.0	2.0
High	4.7	4.9	4.7	4.7	4.7	4.6	4.7

TABLE 1. POVERTY RATES USING ALTERNATIVE DEFINITIONS OF INCOME BY FAMILY TYPE, 1984 (in percents)

Income Measure	Married Couples w/Child. under 18	Single Parents w/Child. under 18	All Families	Elderly Units	Unrel. Indivs.	All Persons
IN-KIND BENEFITS MEASURED AT MARKET VALUE						
Pre-Means Tested	9.7	45.0	12.7	19.5	23.0	16.0
All Cash	9.4	42.8	11.9	17.5	21.8	15.1
Cash + In-Kind	7.2	28.3	8.1	3.6	14.2	10.1
After Taxes	8.5	29.0	8.9	3.6	15.4	11.0
IN-KIND BENEFITS MEASURED AT POVERTY BUDGET SHARE VALUE						
Pre-Means Tested	9.7	45.0	12.7	19.5	23.0	16.0
All Cash	9.4	42.8	11.9	17.5	21.8	15.1
Cash + In-Kind	8.2	34.7	9.9	10.3	18.5	12.7
After Taxes	9.4	35.5	10.6	10.3	19.8	13.6

SOURCE: Eric A. Hanushek and Roberton Williams, "Alternative Poverty Measures and the Allocation of Federal Benefits," in Bureau of the Census, Proceedings of the Conference on the Measurement of Noncash Benefits, Volume 1, December 1985, p. 113.

NOTE: For a discussion of alternative ways to value in-kind benefits, see Bureau of the Census, Estimates of Poverty Including the Value of Noncash Benefits: 1984, Technical Paper 55, August 1985.

Figure 1

Poverty Rates by Income Measure

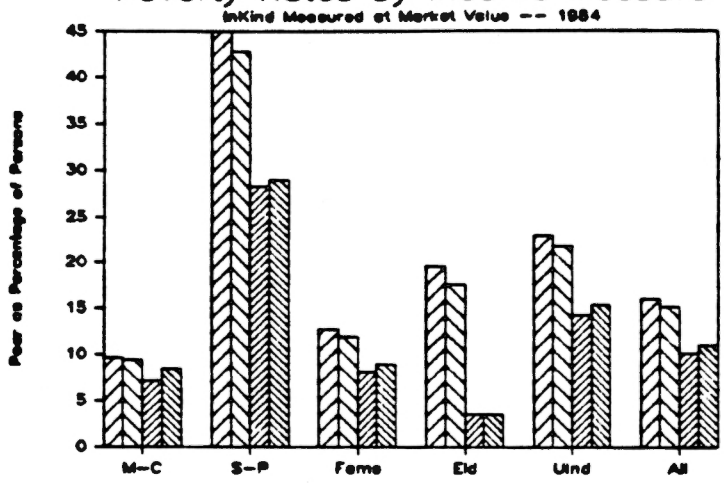
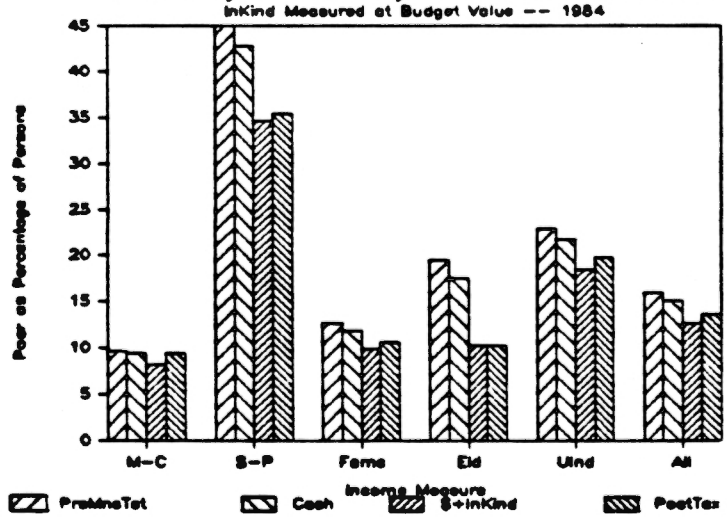


Figure 2

Poverty Rates by Income Measure



Population Subgroups

M-C : married couples with related children under 18 years of age
S-P : single parents with related children under 18 years of age
Fams : all primary families and unrelated subfamilies
Eld : all families and unrelated subfamilies with all members age 65 or over, plus all people age 65 and over not living with relatives.
UInd : all unrelated individuals
All : all people

SOURCE: Eric A. Hanushek and Roberton Williams, "Alternative Poverty Measures and the Allocation of Federal Benefits," in Bureau of the Census, Proceedings of the Conference on the Measurement of Noncash Benefits, Volume 1, December 1985, p. 114.

of people qualifying for programs that have poverty status as an eligibility criterion, as critics often complain. The complaint, however, is not directly relevant to the issue; any poverty measure comparing income against fixed thresholds is necessarily an arbitrary statistic which can be driven to any given value by the appropriate choice of thresholds. For the purposes of program targeting, the more relevant question to ask is whether a particular income measure directs benefits toward those people for whom aid is intended. As noted above, the answer depends on which program is being considered.

What is clear is that the definition of income can affect which families are considered "needy" and thus determine the distribution of benefits among families. Table 1 and Figures 1 and 2 show the effects on poverty rates of using alternative income measures. Because they are less likely to get noncash benefits, married couples with children would experience a relatively small drop in their poverty rate--between 1.2 and 2.2 percentage points (a 13 to 25 percent decline) depending on how in-kind income is valued. The effects would be greater for family types that participate in non-cash assistance programs more often: the poverty rate of single-parent families with children would fall by 19 percent or 34 percent, while that of elderly families would be reduced by 41 percent or 79 percent.[6]

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[6]Table 1 and Figures 1 and 2 reveal significant differences in poverty rates, depending on the method used to value in-kind benefits. The market value is generally greater than either the poverty budget share value or the cash equivalent value (not shown in the table or graphs), and the difference is greatest for health care benefits. This is particularly evident for the elderly, for whom counting in-kind income at market value lowers the poverty rate to 3.6 percent, while using the poverty budget share value--which limits the dollar value of in-kind benefits--causes the

Allocating program benefitson the basis of cash plus in-kind income would, therefore, provide less for the elderly and for single-parent families, while a greater share of assistance would go to married couples with children, if no other changes were made.

If income were also measured after taxes, this effect would be even greater. Using the poverty budget share valuation of in-kind income, the combined effect on poverty rates of counting noncash benefits and excluding taxes would be essentially zero for married couple families. On the other hand, because other family types pay less taxes, their poverty rates would fall more: poverty rates would decline by 17 percent among single-parent families, and by 41 percent among elderly households.

At the same time, counting in-kind benefits as income would not necessarily lead to large or inadvertent changes in the distribution of program benefits. In the first place, Congressional action would generally be required to alter eligibility criteria to include in-kind income; such action would signal revised intent in terms of who should receive assistance. Further, because most programs have multiple eligibility criteria, changing the definition of income might have little effect on who qualifies for benefits; other criteria may be more important in restricting the eligible population.

What additional information is needed to value in-kind income?

If in-kind benefits are to be counted when income is measured, two pieces of information about those benefits are needed for each family. First, we must know how much of each good or service the family receives.

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poverty rate to fall only to 10.3 percent. There is little agreement on what the appropriate valuation method is.

For area estimates such as national averages, survey data could be used; the usual problems of misreporting would occur, made worse in those situations where recipients do not know how much of a particular in-kind benefit they were given, such as in the case of public housing or energy assistance in the form of third-party payments. For eligibility determination, information could be obtained either from program records or from applicant reports. The former would be administratively complex, however, given the many types of assistance provided by different agencies, while the latter would be subject to underreporting, either intentional or from lack of knowledge.

The second and perhaps more difficult need is a means of valuing in-kind benefits. The seminal work of Timothy Smeeding and subsequent refinements by the Bureau of the Census demonstrate that valuation methods can be devised.[7] There is, however, much disagreement on what method is appropriate, best indicated by the fact that the Census Bureau publishes data based on three alternatives. Arguments can be offered for each of the three--and for other possibilities as well--and consensus is unlikely to be obtained on any one.

The previous data (and the more detailed analyses by the Bureau of the Census) provide insights into the relative importance of different issues. The large changes in the poverty rates result directly from including benefits from Medicare and Medicaid and subsidized housing. The medical programs are especially important for the elderly and differences in their

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[7]Bureau of the Census, Alternative Methods for Valuing Selected In-Kind Transfer Benefits and Measuring Their Effect on Poverty, Technical Paper 50, March 1982. See also Technical Papers 51, 52, 55, and 56 in the same series.

presumed value lead to the extraordinary swings in the evaluation of their well-being.

As a result, any move to introduce broader measures of income is likely to affect the elderly relatively more heavily than younger people. This is not to say that such options should not be considered; because of the noncash benefits they receive, the elderly are, after all, better off than one would infer from looking only at cash incomes. It does emphasize, however, that attempts to improve targeting through a more inclusive income measure could have potentially significant distributional effects. Furthermore, the alternative ways of valuing noncash benefits mean that the effects may well be arbitrary. Given the importance of medical insurance as noncash income for the elderly, the choice of valuation method could markedly affect the distribution of program benefits between the elderly and the nonelderly.

III. Distributional Impact of Specific Targeting Options for the Elderly

The second major issue is the impact of programmatic reductions on the elderly. Much of the public debate to date has involved taking the structure of programs as given and focusing on the distributional impacts of any aggregate cutbacks. Almost anything that is done, however, has immediate implications for the well-being of the elderly. Therefore, a parallel consideration has been how program parameters could be altered to protect the low-income elderly from adverse effects.

This work has been quite specific, because, unlike the general discussions of changing income distributions, it has delved into the actual operational details of programs. Specifically, it has worried about how

programs could be modified in realistic ways to achieve savings while protecting the elderly poor and limiting any increase in the level of poverty among the elderly.

Three types of basic policies could be pursued. The first, which has received the most attention, is actions on the spending side that would lead to immediate savings. These options have had the greatest appeal because they involve changes that could be quickly implemented and that would generate obvious rapid reductions in the overall deficit. The simplest example of this is eliminating the cost of living adjustment (COLA) built into Social Security. The second basic policy involves "deeper" structural adjustments that would alter expenditure patterns in the long run but have only small effects in the short run. An example of this is changing the "bend points" in the Social Security benefits formula. The final kind of change involves working on the tax side instead of the benefits side. Increased taxation of Social Security benefits would fall into this category.

The interesting aspect of each of these approaches is that while specific proposals do not represent explicit targeting choices, their evaluation has been in terms of their implicit targeting. Specifically, proposals have been assessed in terms of their distributional impacts, holding constant the amount of change in expenditures or taxes.

To put the possibilities into perspective, Table 2 shows the expenditure levels for the major programs affecting the elderly, while Table 3 provides information about the distribution of cash transfer benefits by income

TABLE 2. OUTLAYS AND TAX EXPENDITURES FOR SELECTED BENEFIT PROGRAMS, 1985-1990 (By fiscal year, in billions of dollars)

Program	Baseline 1985	Projected 1986	1987	1988	1989	1990	Total Projected 1986-1990
OUTLAYS							
Non-Means-Tested Cash Benefits							
Social Security	192	202	215	229	244	260	1,150
Railroad Retirement	6	6	7	7	7	7	34
Civil Service Retire.	23	25	26	28	30	32	141
Military Retirement	16	18	19	20	21	23	102
Other Federal Employee Retirement	1	1	1	1	1	1	4
Veterans' Compensation	10	10	11	11	11	11	54
Subtotal	248	262	278	296	314	334	1,485
Supplemental Security Income a/	10	10	10	12	11	11	54
Medicare Hospital Insurance	48	52	57	63	70	78	321
Supplemental Medical Insurance	23	26	29	33	33	38	169
Subtotal	71	78	86	96	108	121	489
TAX EXPENDITURES							
Partial Exclusion of SS/RR Benefits from Adjusted Gross Income	18	19	20	21	22	22	104

SOURCE: Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," March 1985.

a. Fiscal year 1988 includes 13 months of payments; fiscal year 1990 includes only 11 months of payments.

TABLE 3. FAMILIES RECEIVING BENEFITS FROM SELECTED PROGRAMS, CALENDAR YEAR 1983 a/

Family Income Relative to Poverty Line	Percentage of Recipients in Group	Percentage of Total Program Benefits Received by Group	Number of Families Receiving Benefits		Average Benefits	
			In Thousands	As Percentage of Families in Group	In Dollars	As Percentage of Average Income
Social Security and Railroad Retirement						
Total Families	100	100	23,510	25.6	6,010	34.3
Below Poverty Line	17	9	3,890	26.0	3,370	76.0
100-125 Percent	9	8	2,190	43.4	4,840	74.2
Over 125 Percent	74	83	17,440	24.2	6,750	30.9
Civil Service and Military Retirement						
Total Families	100	100	2,820	3.1	11,590	37.2
Below Poverty Line	2	1	60	0.4	2,770	63.7
100-125 Percent	3	1	90	1.7	3,900	54.4
Over 125 Percent	95	98	2,670	3.7	12,060	37.0
Supplemental Security Income						
Total Families	100	100	2,990	3.2	2,460	24.3
Below Poverty Line	54	47	1,620	10.8	2,130	46.4
100-125 Percent	16	18	470	9.4	2,820	38.6
Over 125 Percent	30	35	900	1.2	2,860	13.2
Social Security, Railroad Retirement, SSI, Civil Service or Military Retirement b/						
Total Families	100	100	26,100	28.4	6,950	38.2
Below Poverty Line	18	9	4,620	30.9	3,620	81.2
100-125 Percent	9	7	2,400	47.5	5,120	77.4
Over 125 Percent	73	84	19,080	26.5	7,990	34.8

SOURCE: Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," March 1985, p. 22.

a. Unrelated sub-families and unrelated individuals are each defined as separate families in these tabulations. All numbers have been rounded.

b. Families receiving benefits from one or more of these programs. Families receiving benefits from more than one program are counted only once.

category, where income includes cash only.[8] The major programs represent about one-third of all federal outlays. Because of their magnitude, they are programs that need to be considered in any discussions of deficit reduction.

The options discussed here are described briefly in Table 4. They are intended to be illustrative, and represent neither the only ones nor ones currently under active consideration. The nature of these programmatic changes can be seen from Table 5 which summarizes the distribution of their effects by income category.[9]

The first general conclusion arising from this analysis is that programmatic changes would have widely different impacts on the level of poverty among the elderly. Options that do not recognize differences in economic circumstances, such as increases in individual beneficiaries' premiums for Medicare or across-the-board cuts in COLAs, would fall disproportionately on the poor and near poor. At the other extreme, other changes, such as moving from percentage to fixed amount COLAs, would have little effect on the low-income elderly and could even improve the well-being of some of them.

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[8]These estimates are based upon tabulations from the March 1984 Current Population Survey.

[9]These alternate plans are described in great detail in CBO, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled", Staff Working Paper, March 1985. All of the calculations result from CBO simulations based upon distributional information from the 1984 Current Population Survey and CBO projections of macroeconomic parameters as of February 1985. The effects shown might therefore not be accurate if the options were implemented now.

TABLE 4. SUMMARY DESCRIPTIONS OF POLICY OPTIONS

Option	Description
FREEZE OPTIONS	
Freeze Social Security and Railroad Retirement program benefits.	One-year elimination of COLA for Social Security and Railroad Retirement only.
Combine Social Security and Railroad Retirement freeze with increased SSI Guarantee	One-year elimination of COLA for Social Security and Railroad Retirement only plus raise SSI guarantee levels for individuals by $20/mo. and for couples by $30/mo.
Freeze all non-means-tested program benefits	One-year elimination of COLA for Social Security, Railroad Retirement, Civil Service Retirement, military retirement, veterans' compensation, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard.
Combine freeze on all non-means-tested programs with increase in SSI guarantee.	One-year elimination of COLA for Social Security, Railroad Retirement, Civil Service Retirement, military retirement, veterans' compensation, and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard plus raise SSI guarantee levels for individuals and for couples by $20 and $30 per month, respectively.
Exempt Social Security and Railroad Retirement benefits below a specified threshold (COLA Cap)	Provide COLA only for that portion of Social Security and Railroad Retirement benefits that is below poverty threshold. No COLA would be provided for any other non-means-tested programs.
Replace Social Security and Railroad Retirement COLA with flat COLA	Provide all Social Security and Railroad Retirement beneficiaries with COLA equal to that COLA that would have been given to recipients with benefits at the poverty threshold. No COLA would be provided for any other non-means-tested program.
Exempt Social Security and Railroad Retirement beneficiaries below a specified threshold (Poverty COLA)	One-year elimination of COLA for all non-means-tested programs except that Social Security and Railroad Retirement beneficiaries with benefits below the poverty threshold would receive the full COLA.

TABLE 4, continued.

Option	Description
MEDICARE OPTIONS	
Increase SMI premium to 35% of costs	Raise Supplemental Medical Insurance premiums for all beneficiaries so that total premiums cover 35% of SMI costs.
Increase SMI premium to 30% of costs and increase deductible	Raise Supplemental Medical Insurance premiums for all beneficiaries so that total premiums cover 30% of SMI costs and increase SMI deductible from $75 to $200. Index deductible to CPI in the future.
Introduce income-related SMI premium	Impose 1% surtax on taxable income of SMI enrollees; limit surtax to no more than subsidy value of SMI benefits.
TAXATION OF BENEFIT INCOME OPTIONS	
Eliminate thresholds for inclusion of benefits in AGI	Eliminate income thresholds for including Social Security and Railroad Retirement benefits in taxable income. Continue to tax half of benefits.
Include up to 85% of benefits above threshold in AGI	Use current thresholds ($25,000 for single returns and $32,000 for married couples) but tax 85% of Social Security and Railroad Retirement benefits for those above the threshold.
Lower the thresholds and increase percent of benefits included in AGI	Lower thresholds to $20,000 for single returns and to $25,000 for married couples and tax 85% of Social Security and Railroad Retirement benefits for those above the threshold.
Include 50% of value of HI and 75% of SMI in AGI	Require Medicare beneficiaries to include as taxable income 50% of the insurance value of Hospital Insurance benefits and 75% of the insurance value of Supplemental Medical Insurance benefits.

SOURCE: Derived from Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," Staff Working Paper, March 1985.

TABLE 5. AMOUNTS AND SOURCES OF BUDGETARY SAVINGS

Option b/	Fiscal Years 1986-1990 Budgetary Savings a/ (in billions of dollars)	Distribution of Effects on Recipients in 1983 (in percents)				
		Poor c/	100%-125% of Poverty Line	125%-200% of Poverty Line	200%-300% of Poverty Line	Over 300% of Poverty Line
One-Year Benefit Freeze Options						
Freeze Social Security and Railroad Retirement program benefits	33.8	8	7	23	24	39
Combine Social Security and Railroad Retirement freeze with increase in SSI Guarantee	29.9	d/	5	24	27	44
Freeze all non-means-tested program benefits	43.3	6	6	19	22	47
Combine freeze on all non-means-tested programs with increase in SSI guarantee	39.4	d/	4	20	24	52
Exempt Social Security and Railroad Retirement benefits below a specified threshold (COLA Cap) f/	16.5	1	2	12	20	66
Replace Social Security and Railroad Retirement COLA with flat COLA f/	10.2	-15e/	-2e/	8	21	86
Exempt Social Security and Railroad Retirement beneficiaries below a specified threshold (Poverty COLA) f/	33.1	1	4	19	23	53
Medicare Options						
Increase SMI premium to 35 percent of costs g/	17.1	11	8	23	23	36
Increase SMI premium to 30 percent of costs and increase deductible g/	17.7	11	8	23	23	36
Introduce an income-related SMI premium	8.7	d/	d/	1	7	92
Taxation of Benefit Income Options						
Eliminate thresholds for inclusion of benefits in adjusted gross income	36.1	d/	d/	7	28	65
Include up to 85 percent of benefits above threshold in AGI	19.3	0	0	0	d/	100
Lower the thresholds and increase percent of benefits included in AGI	28.4	0	0	d/	1	99
Include 50 percent of value of HI and 75 percent of SMI in AGI	20.1	d/	d/	4	18	77

SOURCE: Congressional Budget Office, "An Analysis of Selected Deficit Reduction Options Affecting the Elderly and Disabled," March 1985, p. 108.

a. Budgetary savings estimated for fiscal years 1986-1990; distributional effects are for calendar year 1983.
b. See source for complete definitions of options.
c. Poor families are those with incomes below Census poverty thresholds.
d. Less than 0.5 percent.
e. Total benefits received by the poor and near-poor in 1983 would increase by about $0.3 billion, and benefits received by the nonpoor would decrease by $1.6 billion, resulting in a net loss of $1.3 billion to be allocated across groups.
f. Benefit levels for all other non-means-tested programs would be frozen.
g. The distributions of effects of these options are identical because it is assumed that per capita deductible expenditures do not vary by income group.

The second observation is that expenditure policies with respect to the elderly are relatively clumsy instruments for targeting. This is easiest to see in terms of curtailing the COLA for Social Security. Social Security payments are correlated with the overall income level of the elderly, but only imperfectly. While it has sometimes been asserted that the elderly poor could be protected from the effects of a one-year freeze on Social Security benefits with expenditures of as little as $400 million--about 8 percent of expected budgetary savings--this is only the case if the elderly poor could be identified by the Social Security Administration. They can't. The Social Security system can only make adjustments in the current level of benefits that are calculated on the basis of past contributions. They do not have direct access to information on other income of the elderly.

A third observation is more subtle. Curtailing COLAs could be combined with policies designed to increase the benefits going to the low-income elderly, such as payment increases for Supplemental Social Insurance (SSI) beneficiaries, for example. This would indeed lessen the impact of COLA curtailments, but would do so only in the aggregate. The individuals brought above the poverty line through increases in SSI benefits would generally not be the same as the individuals pushed below the poverty line by a COLA curtailment. It is generally the case that implicit targeting is an aggregate, not an individual, concept.

The expenditure cuts considered above, curtailing COLAs or increasing SMI premiums for Medicare, take the existing structure of programs as given. The distribution of the cuts thus follows the pattern of distribution built into the programs. In addition, unless they are

continued over time, the cuts have a large immediate impact but little long-term impact on the expenditure patterns of these programs. To the extent that the major problem facing the federal government is a short run fiscal shortfall that will go away in the longer run, this is an appropriate focus. In other words, if the need to deal with budgetary deficits is simply a temporary imbalance, there is no (exogenous) incentive to change the character of the programs. On the other hand, if the problem of fiscal imbalance is one that will exist for some time, basic alterations in program design may be needed.

In terms of this longer run perspective, alternative targeting notions are more important. Within the Social Security system, for example, one inherent source of distributional outcomes lies in the basic benefit formula. Currently, Social Security provides larger relative benefits to those with lower lifetime earnings. It does this through the "bend points" in the benefit formula which determine how rapidly benefits rise with lifetime earnings.[10] By adjusting these, the amount of redistribution of the Social Security system can be altered.[11]

Making such adjustments involves a number of large policy issues. First, there is a delicate balance between the notions that Social Security is a return on individual payments into the system and that Social Security

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[10]The primary insurance amount (PIA) is based on average indexed monthly earnings (AIME). Currently the PIA is equal to 90 percent of the first $297 of AIME, plus 32 percent of the next $1,493 of AIME, plus 15 percent of any AIME in excess of $1,790. $297 and $1,790 are commonly referred to as the "bend points" in the formula.

[11]The amount of redistribution is a function of both the bend points and the replacement rates--the percentage of earnings in each bracket paid as retirement benefits. In addition, the amount of redistribution depends on payroll tax rates and maximum taxable earnings over workers' lifetimes.

is a transfer system with redistributive characteristics. Changes in the benefit formula could seriously affect that balance. Second, alterations in the bend points can have substantial long run effects, but would have very little immediate impact on the deficits. This results from the fact that changes in the benefit formula only affect those who have not yet retired.

Finally, the discussion of expenditure policies should be contrasted with the options on the tax side. The current personal income tax system has a somewhat complicated formula that includes a portion of Social Security benefits in taxable income for high income tax payers.[12] Currently, relatively few recipients pay taxes on Social Security; it is estimated that only about one-sixth of tax units with Social Security income will be liable for taxes totalling about $3 billion from this source in 1987. However, if the income thresholds for taxing benefits were lowered or the portion of Social Security that is included as taxable income were increased, benefits net of taxes could be altered to be more consistent with the overall ability to pay of the elderly.

The fundamental difference between operating on the tax side and on the benefit side is the capacity to target changes more directly to the economic circumstances of the elderly. As it stands now, individuals can receive low Social Security benefits either because they had low lifetime incomes or because they had low Social Security earnings. In the latter case, low Social Security earnings do not accurately reflect the lifetime

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[12]In most cases, if adjusted gross income plus nontaxable interest income plus one half of Social Security retirement benefits exceeds $25,000 for individual filers ($32,000 for joint filers), then one-half of benefits are included in taxable income.

incomes of individuals because they do not recognize either uncovered employment or incomes from sources other than earnings. Thus, using only Social Security earnings data and calculated benefits cannot take into account other sources of income, and benefit adjustments that direct increases to those now receiving low payments would be "inefficient" from a targeting standpoint.

Table 5 clearly demonstrates that changing the taxability of Social Security could raise as much money as straight COLA freezes while having a very different impact on the poor.[13] Since relatively few of the elderly poor pay taxes under the current system, they would generally escape benefit reductions--net of taxes--accomplished in this way.

Several arguments can be raised against changing the taxability of Social Security. First, some contend that payments by individuals into Social Security accounts come from after-tax income, and therefore they have already been taxed once. This is only partially true, however, since only a small portion of current benefits could have been funded by contributions made by individuals. Second, the taxation of benefits (under the progressive income tax system) again raises the issue of whether the underlying philosophy of the system is to provide retirement income payments in line with contributions to the system or to accomplish redistributive goals.

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[13]In fact, changing the taxation of Social Security could raise significantly more money if inflation rates remain at their current low levels. The estimates given in Table 5 were based on the assumption that the annual inflation rate would be 3.7 percent. With lower inflation, COLAs would be smaller, and eliminating them would save less money.

A final note is important. The recently enacted revisions to the tax code interact with these comments about targeting. Reduced marginal tax rates mean that less tax will be paid on the taxable portion of Social Security benefits in the future. On the other hand, changes in what income must be reported for tax purposes will mean that more returns will be subject to tax on Social Security payments. The net effect is uncertain, but the revenue changes could significantly affect the targeting of benefits based on overall well-being of the elderly.

IV. Summing Up

This paper has attempted to delineate a variety of issues related to the targeting of benefits for the elderly. These have been somewhat artificially divided into broad discussions of general income targeting issues and of specific programmatic revisions. The key point is, however, that current income measurement and benefit targeting for the elderly is especially imprecise. This arises from two fundamental factors. First, the elderly receive particularly important noncash benefits, the most significant of which is medical insurance under Medicare. It is unreasonable to neglect these payments in considering the well-being of the elderly and the distribution of programmatic funds. The valuation of these benefits is extremely difficult, however, and how it is done has important distributional implications.

Second, within the existing set of programs, explicit targeting is frequently ruled out because appropriate information is lacking. Virtually all programmatic changes can, however, be viewed as adopting implicit targeting choices. When considered in this framework, specific options

designed primarily to reduce the deficit can have enormous--and widely differing--distributional effects. Even if the explicit intent is to direct benefits more precisely on the basis of income, targeting may be quite imprecise. This is because specific program offices, such as the Social Security Administration, lack the information needed to determine total incomes of beneficiaries. By comparison, because it is based on the fundamental concept of ability to pay, the tax system provides an alternative that can better attain distributional objectives, even though it, too, neglects noncash income.

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