TALKING POINTS ON REDUCING THE DEFICIT NOW

- In its midyear budget review, the Reagan Administration estimated that the Federal budget deficit would be roughly \$200 billion for each of the next 6 years.

- Over that 6-year period, unless something is changed these deficits will cumulate to \$1.2 trillion--just about doubling the national debt.

- Without action on the deficit, deficits for each of the next 6 years will exceed 4 percent of our Gross National Product--that is a postwar record previously matched only in 1976.

- Assuming a \$200 billion deficit has to be financed at a 10 percent interest rate--a reasonable assumption given prevailing conditions--the interest alone on a deficit of this size amounts to \$20 billion. That is enough to finance all of the Medicaid program at current funding--it is 2-1/2 times the cost of the AFDC program, or of the SSI program--it is over four times the cost of General Revenue Sharing.

- Over the next 5 years financing costs for the interest on this additional debt would amount to \$100 billion.

- In addition, if nothing is done to prevent this \$1.2 trillion addition to the national debt, interest payments on this additional debt alone would amount to \$100 billion a year after 1988. That is nearly double the present cost of interest on the national debt, and is equal to over 20 percent of all the personal tax revenue we expect to collect in 1988.

- All of this additional debt, and the interest we pay on it, has to be paid for in some way--in higher interest premiums or inflation, in higher taxes, or more severe spending cuts. The longer we wait, the higher the cost of deficit reduction will be.

- Lowering outyear deficits now should help bring down interest rates; that can stimulate investment to keep recovery going. That means a stronger economy in the outyears when further spending reductions and tax increases we enact now would be coming in place. But absent such a boost to the economy, the economy may be too stagnant in those outyears to sustain a sudden restraint on fiscal policy--which means we would be compounding the problem and risking a downward economic spiral.

- o Interest rates that are kept high by the size of anticipated deficits matter not just for government finance and the taxpayer--they matter for the homebuyer, who has seen rates creep back up to the 13+ percent range, and for the small businessman or entrepeneur trying to get started. High interest rates can cut short a promising economic future for everyone.

- o The $1.2 trillion increase in the national debt over the next six years will add $5,217.39 in new debt for each man, woman and child now living in the U.S. This would come on top of the over $6,000 debt per capita already outstanding.

- o Escalating deficits leading to higher interest rates do not just pose the threat of mortgaging our future. Higher interest rates mean lower capital formation and less long-term growth; more pressure for raising domestic barriers to free trade; and bad news for our basic industries, because the need for upgrading heavy plant and equipment means those industries are very sensitive to interest costs.

- o In addition, the stronger dollar that tends to result from higher U.S. interest rates makes it more difficult for American companies to compete with low-cost imports and to secure a foothold in overseas markets.

- o High deficits and interest rates retard capital formation and pose a real risk of 'disinvestment' in the United States, implying a much more fragile American economy. A low-growth path could condemn many citizens to poverty who might ottherwise be able to find productive and useful employment.

TALKING POINTS ON DEFICITS

- o As Martin Feldstein, President Reagan's chief economic adviser, has said, if we don't do anything about controlling this deficit now, it will cost one-fifth of all personal income taxes collected by the Federal Government just to service the interest costs of the $1 trillion of new debt accumulated over the next five years.

- o If we wait just one year to do something about controlling the increase in the deficit, it will require deeper spending cuts and higher tax increases.

  For every dollar in spending cuts needed this year, it will require 1.10 next year.

  For every dollar we raise taxes this year to accomodate the deficit, we will have to raise them $1.10 next year.

- Since 1981, we have brought about spending cuts amounting to $1Ø9 billion for the 1983, 1984 and 1985 budget years.

  But over the same period of time, we have seen the budget deficit increase by $91 billion.

  That means that the deficit has wiped out 83 percent of all the savings we have realized through our reductions in Federal spending.

Mortgage Subsidy Bonds And Mortgage Tax Credits

1. Extension of MSB Sunset

The Mortgage Subsidy Bond program would be extended for 4 years until December 31, 1987. No changes would be made in mortgage bond loan eligibility rules.

2. Reporting Rules

A. Beginning July 1, 1984, annual housing policy statements would be required to be made by State Governors or local executives specifying the housing, development, and incomes policies to be pursued by the bond issuing authority, and reporting on compliance with prior year's policy statement. Statements would also report on issuer's compliance with Congressional intent that MSB loans should be made available, to the extent feasible, to the lowest income families who can utilize the program to afford homeownership.

B. Issuers of bonds and credits would also be required to collect statistical data on bonds, loans, and beneficiaries for reporting to Treasury.

3. Mortgage Tax Credits

Bond issuing authorities would be eligible to exchange some or all of their unused bond authority for any year, in return for mortgage credit certificates entitling homebuyers to buy-down market interest rates with Federal tax credits, as provided in S. 1958, with the following modifications:

A. Credit percentage would be increased from 14.35 percent to 20 percent. But credits would be reduced by 25 percent of the taxpayer's increase in income after 5 years (in sixth and seventh year phase out would be at 5 percent and 10 percent rather than 25 percent). Credits would not be assumable, could not be limited to particular lenders or to particular developers (absent appropriate certification by developer and issuer that price did not reflect credit).

B. Tax credits would be limited to homebuyers with family incomes below 120 percent of HUD local area median for a family of four with adjustments for family size. 20 percent of credits would be restricted to homebuyers below 80 percent of median income. Targeted area rules and purchase price limitations would be replaced with limitations on maximum down payment of 15 percent.

C. Lenders would certify eligibility on the basis of borrower's tax returns. Credits issued to borrowers certified improperly by lender would be valid, but lender could be subject to negligence and fraud penalties equal to 25 percent and 100 percent of face amount of credit certificate. Borrowers would be subject to existing tax fraud and anti-perjury rules.

November 11, 1983

ECONOMIC TALKING POINTS

- The recovery is on track despite early projections of a weak and "fragile" expansion. The best measure of this is the strong expansion of real GNP. The nation's production of goods and services rose 9.7% in the second quarter, followed by a 7.9% increase in the third quarter. By this measure, the current recovery is the strongest since 1961.

- Factory output and utilization are up. Industrial output rose 1.5% in September--the tenth consecutive monthly increase. Factory utilization rose by 1.0 percentage point in September. The current level of utilization is 78.1%, and we are nearing the normal maximum capacity of 85%. This means that firms will have to start stepping up investment in plant and equipment soon.

- The payoff to the business expansion is the rapid drop in unemployment. The nation's civilian unemployment rate for October fell to 8.8%, a half of one point drop that is the largest since the Korean War. Since the recovery began in December of 1982, the unemployment rate has fallen a full two percentage points, 2.8 million new jobs have been created, and the number of unemployed has fallen by 2.1 million. Again, this is the strongest labor market recovery since 1961.

- The index of leading economic indicators advanced a healthy 0.9% in September. This was the 13th consecutive monthly gain, and suggests that the strong recovery will continue into 1984.

- The best news about this recovery is that it is non-inflationary. The consumer price index has increased at an annual rate of just 3.7% so far this year. The GNP deflator registers a 3.4% annual rate of inflation. Producer prices rose just 0.3% for October, suggesting that inflation will continue to be moderate.

- Housing starts are running at a rate of 1.6 million per year. While the rate for September was below August's four-year high performance, housing starts still are 46% above the level of September 1982.

OUTLINE OF POSSIBLE DEFICIT REDUCTION PACKAGE

- The total deficit reduction package will amount to about $150 billion over 4 years--but will principally fall in three years-- FY 1985-86.
- The package will be evenly balanced between spending restraint and revenue increases--$75 billion of each.
- All tax increases (except pure loophole closers) will be made expressly contingent on the spending cuts being achieved.
- The Finance Committee will undertake to propose 1/2 of the total spending reductions and all of the revenue increases.
- The Finance Committee will look to the other Senate committees to make the half of the spending cuts--for example, out of restraint on farm program spending, defense and discretionary spending.
- Any savings in social security will be dedicated to the Medicare Trust Fund to shore up that failing system.
- This program, together with cuts already made, exceeds the President's recommendations for total spending restraint.
- Measured over fiscal years 1984-1986 the total tax increase figure in the Finance Committee deficit reduction package ($46 billion) is less than the $58 billion in tax increases recommended by the President in his 1984 budget.

November 16, 1983

SUMMARY OF PROPOSED DEFICIT REDUCTION PACKAGE

Total Revenue Effect (Preliminary)

(billions of dollars)

84	85	86	87	84-87
3.0	16.2	25.4	29.8	74.3

I. Contingent Revenue Increases

A. Energy Tax. A two-percent tax would be imposed on the sale of sources of energy consumed in the United States. Energy sources subject to tax would include petroleum, natural gas, natural gas liquids, coal and electricity. The amount of tax collected on coal would be deposited in an acid rain trust fund.

84	85	86	87	84-87
--	4.2	6.2	6.3	16.7

B. High Income Individual Surcharge. A surcharge of two percent would be imposed on taxes over $6,300 ($5,700 on single returns) and five percent on taxes over $22,000 ($16,000 on single returns).

84	85	86	87	84-87
--	2.0	3.9	4.5	10.4

C. Rounding Down of Indexing. Indexing of brackets, exemptions, and the zero bracket amount would be computed with reference to the CPI rounded down to the next lower full percentage point.

84	85	86	87	84-87
--	0.7	1.8	3.2	5.6

D. Zero-Bracket Amount (ZBA) Increased. The ZBA would be increased by $100/$200 in 1985. Heads of households would be given a rate halfway between single and married, with a new rate schedule.

84	85	86	87	84-87
--	-1.1	-1.5	-1.5	-4.1

E. Two Percent Tax on Corporate Economic Income. A two-percent tax would be imposed on the economic income (over $100,000) of corporations.

84	85	86	87	84-87
--	2.5	4.1	5.0	11.6

II. Proposals Supported By Treasury Testimony Limiting Tax Shelters and Accounting Abuses, and Reforming the Taxation of Corporations

Revenue Effect

The proposals described below deal with tax shelters and accounting abuses, and reform the taxation of corportions and their shareholders. In the aggregate, they would increase budget receipts in fiscal years 1984 through 1987 by $13 billion, as follows:

(billions of dollars)

84	85	86	87	84-87
1.2	3.4	3.8	4.6	13.0

A. Tax Shelters.

1. Partnership Item Allocation. Special allocations of separate items of partnership income, gain, loss, deduction, or credit, would no longer be permitted except for real estate depreciation and intangible drilling costs and depletion with respect to oil and gas.

2. Retroactive Allocation of Partnership Deductions. In the case of cash basis partnerships and tiered arrangements, partnership taxable income or loss would be allocated over the taxable year on a daily basis.

3. Property Contributed to a Partnership. Gain or loss from a sale of property contributed to a partnership would be allocated to the contributing partner. Certain deductions from contributed property would be allocated to the partners in

proportion to their basis in the partnership attributable to capital contributions. Contributed property would retain its character for five years.

4. Partnership Avoidance of Capitalization of Certain Payments. Allocations of partnership income to permit the current deduction of otherwise capital expenditures would be prohibited.

5. Like-Kind Exchanges. Tax-free like-kind exchanges would have to be completed within three months after the end of the taxable year in which the first transfer occurred, and the property to be received designated at that time. Exchanges of partnership interests would no longer be tax-free like-kind exchanges.

6. Market Discount on Bonds Treated as Ordinary Income. Gain on the disposition of a bond reflecting accrued market discount would be taxed as interest income on the disposition of the bond.

7. Charitable Contributions of Property. A deduction for charitable contributions of certain appreciated property would be limited to the basis of the property unless the property has been held by the taxpayer for at least five years. The overvaluation penalty would apply notwithstanding that the property has been held for over five years.

B. Accounting Abuses.

1. Time Value of Money-Deferred Payments. The original issue discount rules would be extended to govern sales of certain property and services subject to an appropriate de minimis rule. Individuals would be excepted from the expanded rules. Imputed interest on deferred payment sale transactions not covered by the original issue discount rates would be calculated at a compound rate and allocated among payments on an economic basis under a modified section 483.

2. Time Value of Money -- Prepayments. Subject to appropriate de minimis exceptions, deductions to a cash basis taxpayer would be allowed only to the extent the expense is properly allocable to the current year.

3. Interest-Free Loans. Special rules would be provided for appropriate taxation of the lender and the borrower in an interest-free loan transaction.

4. Related Party Transactions. The limitations on accruing deductions to cash basis related parties would be expanded to cover amounts payable by partnerships to their cash basis partners. Related taxpayers accruing deductions to cash basis related parties would no longer be permanently denied a deduction for the amount accrued, but instead, the deduction would be deductible when the amount is paid.

5. Accounting -- LIFO Conformity. A subsidiary corporation could not elect the LIFO method of inventory accounting unless its parent corporation uses the LIFO method for book purposes.

6. Time Value of Money -- Premature Accrual. Where an amount is payable more than one year after the end of a taxable year, the taxpayer could choose either to deduct currently the discounted present value of the amount or to deduct the full amount of the liability when paid. A special rule would apply in the case of property and casualty insurance companies. Also, there would be a special rule for certain coal mine reclamation expenses.

C. Corporate Reforms.

1. Dividends.

a. Interest on corporate debt and dividends paid deduction. The deduction for interest paid or incurred by a corporation directly allocable to the purchase or ownership of portfolio stock would be limited to the extent of the deduction for any dividends received on such stock.

b. Short sales. Payments in lieu of dividends would not be deductible against ordinary income if the closing of the short sale occurs less than one year after the short sale itself. Amounts paid to a lender of stock in lieu of dividends would be treated as part of the short seller's basis in the stock acquired to close the short sale.

c. Extraordinary dividends and stock basis to corporations. The fair market value of extraordinary dividends (to the extent not subject to tax) would reduce the basis in stock held one year or less by a corporation. The shareholder corporation's holding period for dividends of property could not exceed its holding period for its stock in the distributing corporation.

2. Ordinary Distributions of Appreciated Property. Any ordinary, non-liquidating distribution of appreciated property would be taxable to the distributing corporation for distributions after the date of Committee action pursuant to plans adopted after that date. Certain exceptions of present law (relating to, among other things, partial liquidations, carryover basis situations, and distributions of qualifying stock) would remain.

3. Transfers of Partnership Interests by Corporations. Corporate distributions and liquidating sales of partnership interests would be treated as transfers of the distributing corporation's allocable share of certain of the partnership properties. Gain would be recognized to the corporation to the same extent as if these properties were distributed or sold.

4. Mutual Funds.

a. Widely-held corporations and the accumulated earnings tax. It would be made clear that the mere fact that a company is widely-held will not exempt it from the accumulated earnings tax.

b. Short-term capital losses from RICs and REITs. All loss recognized on the sale or exchange by a shareholder of RIC or REIT stock would be long-term to the extent of long-term capital gain distributions to such shareholder with respect to such stock.

5. Section 367 Modifications. Gain would be recognized, without regard to purpose, upon the transfer of appreciated property to a foreign corporation which is not for use in an active trade or business outside the United States. An automatic toll charge would be imposed on transfers of certain tainted assets with the exception of transfers of stock. Also, tax-free transfers abroad of intangibles would be ended. The overlap of loss recapture provisions would be prevented.

6. Decontrol of Controlled Foreign Corporations (sec. 1248). An acquisition by a controlled foreign corporation of stock of a U.S. shareholder in exchange for stock of the controlled foreign corporation would be treated as a transfer of the controlled foreign corporation's stock by the U.S. shareholder.

Nov. 17, 1983

SPENDING RESTRAINT OPTIONS
(Outlay Savings in billions)

	Fiscal Year 1984	1985	1986	1987	4-Year Total
Reconciliation spending reductions	2.8	5.8	6.0	6.6	21.2
(Finance)	(.6)	(1.2)	(1.6)	(1.9)	(5.3)
Social Security					
1. Lower COLA to next lower whole percentage amount	0	.8	1.5	2.8	5.1
Health Programs:					
Medicare					
Beneficiary Options					
1. Modify Timing & rate of increase in Part B Premium (increase to 35% by by 1990)	0	.3	.8	1.8	2.9
2. Delay in Initial Eligibility for Medicare 5/1/84	.1	.3	.3	.3	1.0
3. 3% cost sharing on all days, no limit on days, eliminate spell illness, apply deductible for each admission, limit SNF cost sharing to 3% of hospital deductible on days 21-100, annual limit on out pocket costs of $1500, (1/1/85)	0	.3	.6	.7	1.6
4. Modify Working Aged Provision	0	.3	.4	.4	1.2
5. Fee schedule for labs (including hospital-based labs) at 62% for 4 years (4/84 to 10/87)	.1	.1	.3	.4	.9

Physician Options					
1. Participating M.D. program continue for two years freeze on prevailings for non-participating M.D.'s 1/1/84 preliminary estimates	0	.4	.8	1.2	2.2
Hospital Options					
1. Limit increase in payments to hospitals to the market basket FY85,86	0	.4	1.0	1.5	2.9
Medicaid					
1. Extend current Reduction in Federal Payments for 2 years at a level of 3%--FY 85-86	0	.6	.4		1.0
Subtotal					24.1
Debt Service	.2	1.5	4.2	8.0	13.9
Total Outlay Reductions	.9	6.7	12.3	19.4	38.0

November 16, 1983

Description of Spending Restraint Options

Social Security

1. Rounding of Social Security COLA

Under the Social Security Amendments of 1983, the cost-of-living adjustment of social security benefits is paid in January of each year. The first increase under the new law is scheduled to take place in January 1984, with the amount of the increase (3.5%) determined on the basis of the increase in the CPI for the first quarter of 1983 over the CPI for the first quarter of 1982. Beginning in 1985, the measuring period will be shifted to a third quarter to third quarter basis.

The proposal would modify the COLA paid in 1985, 1986 and 1987 by rounding the increase to the next lower whole percentage amount. For example, if the increase in the CPI were 4.6%, the actual COLA paid would be 4.0%.

Health Programs

1. Modify timing and rate of increase in Part B Premium

The proposal would modify the provision previously agreed to by the Committee to hold the Part B premium at 25% of program costs through 1986. As a result of the modification, the premium as a percent of program costs would be allowed to increase by no more than 2-1/2 percentage points per year beginning in 1985 until 1988. By calendar year 1988, the premium would equal 35 percent of the costs of the program for the aged. The following are the estimated monthly premium rates for calendar years 1985-1988:

	84	85	86	87	88
Current law	$14.60	$16.60	$17.40	$18.10	$18.90
Proposal	14.60	18.30	22.50	27.20	32.80

(1983 Administration proposal)

2. Delay in Initial Eligibility Date for Medicare Entitlements

The proposal would delay eligibility for both Parts A and B of Medicare to the first day of the month following the month of the individual's 65th birthday.

(1983 Administration Proposal)

. . .

3. <u>Restructure Medicare Cost Sharing/Apply Co-Pays to Hospital Days and Provide Unlimited Hospital Days.</u>

Under present law, Medicare beneficiaries share in the costs of inpatient hospital and skilled nursing facility services. During each benefit period, the beneficiary must pay an inpatient hospital deductible ($396 in 1985). If the beneficiary is hospitalized beyond 60 days during such period, he or she must pay an additional daily coinsurance amount equal to 25 percent of the inpatient hospital deductible ($99 in 1985) for the 61st through 90th day of care. For the 60 lifetime reserve days, beneficiaries are required to pay a daily coinsurance amount equal to 50 percent of the inpatient hospital deductible ($198 in 1985). For care in a skilled nursing facility beneficiaries are required to pay a daily coinsurance amount equal to 12.5 percent of the inpatient hospital deductible ($49.50 in 1985) for care provided from the 21st through the 100th day in a skilled nursing facility.

The proposal would restructure the current inpatient hospital and skilled nursing facility cost-sharing requirements. Specifically,

(1) Eliminate patient cost sharing for any hospital days of care after 60 days during any calendar year.

(2) Impose new cost-sharing requirements on the first 60 days of inpatient care: a daily copayment equal to 8 percent of the inpatient deductible (estimated to be $31.68 during calendar year 1985) from day 2 through day 15, and a daily copayment amount equal to 5 percent of the inpatient hospital deductible (estimated to be $19.80 during calendar year 1985) for each day of care from the 16th through the 60th day of hospitalization in any benefit period.

(3) Limit the number of times a beneficiary must pay an inpatient hospital deductible to two in each year.

(4) Reduce the present copayment amount applicable to care in skilled nursing facilities from its present level (12.5 percent of the inpatient hospital deductible amount) to 5 percent of the deductible (estimated to be $19.80 during calendar year 1985).

(1983 Administration Proposal)

4. Modification of Working Aged Provision

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) changed the Medicare benefits for the working aged. As of January 1, 1983, Medicare benefits became secondary to benefits under an employer group health plan for employed individuals between the ages of 65 and 69. This provision applies to spouses only when the employee and his/her spouse are covered by an employer group health plan and both are between the ages of 65 and 69.

TEFRA does not allow Medicare to be the secondary payer if a beneficiary age 65 through 69 has a spouse under age 65 who is working and has an employer group health plan. By eliminating the lower age limit for the working spouse, this proposal would permit Medicare to act as secondary payer for the non-working spouse.

5. Participating M.D. Program

This provision would modify the amendment previously agreed to by the Committee which would freeze physician prevailing fees for seven months, beginning December 1983.

Specifically the provision would freeze all physicians prevailing fees for at least 6 months beginning January 1, 1984. Beginning in July 1984 the freeze would be continued for an additional one year for those physicians unwilling to take assignment.

In addition to the freeze, a voluntary participating system could be established for Medicare, similar to the participating physician agreements successfully used by Blue Shield plans in their private business. Under a participating system, physicians would sign an agreement indicating their willingness to accept assignment for all services provided to all Medicare patients for the following fee screen year (July 1 to June 30). By agreeing to accept assignment in advance for all services for all Medicare patients, the physician would agree to accept the Medicare determined allowance as payment-in-full except for cost-sharing amounts. The physician would bill the carrier directly and receive payment from the carrier.

The current assignment system would remain for physicians who did not voluntarily sign a participation agreement, i.e., physicians could accept assignment on a claim-by-claim basis. As under the current system, assignment must be accepted for joint Medicaid-Medicare eligibles.

A voluntary participating physician system would allow Medicare beneficiaries to better predict out-of-pocket expenses since they would know in advance which physicians participate (i.e., always accept assignment). A voluntary system would not compel any physician to participate and the current claim-by-claim assignment system would be preserved for non-participating physicians.

Several additional incentives would also be used to encourage physician participation. These include:

(1) Directories.--Like a provision already agreed to by the Committee, one incentive would require that directories of physicians be published containing the name, address, specialty and an indication of volume of assigned vs. total Medicare claims in the previous year for each physician. Directories would be published annually with carrier discretion as to the appropriate geographic level to make them most meaningful for beneficiary use. A check stuffer would be sent to all Medicare beneficiaries notifying them about the availability of the directories. The directories would be provided to senior citizen groups and would be made available for beneficiaries to review at both carrier and Social Security District and Branch offices. The directories could be purchased from the U.S. Government Printing Office.

(2) Toll-free hot lines.--The system of toll-free hot-lines already in place at the carriers would be expanded. Carriers would hire additional staff to (a) provide names, addresses and phone numbers (if available) of participating physicians in local areas requested by beneficiaries, and (b) confirm whether specified physicians participated.

(3) Electronic Billing Transmission Lines.--Currently about 13 percent of Medicare claims are transmitted to carriers by a variety of electronic/automatic mechanisms, including tape-to-tape, floppy disks, etc. As an incentive to become a participating physician, carriers could establish direct lines for the electronic receipt of claims from participating physicians. Non-participating physicians would be permitted to continue to transmit claims electronically by other modes.

(4) For beneficiaries with Medigap coverage, two simplified billing/payment arrangements would be available. Carriers could use either or both.

(a) Piggyback Billing.--Under this arrangement, the physician submits one bill to the carrier. The carrier pays the physician the Medicare reimbursement and then sends willing Medigap insurors information on the amount paid. The Medigap insuror would automatically pay the physician for the beneficiary's cost sharing liabilities. The physician would not need to submit a separate bill to the beneficiary or the Medigap plan for the cost-sharing and the beneficiary would be removed from the paperwork payment process. The Secretary would annually set a fee to be charged to the Medigap insuror for the costs of the data exchange. The Medigap plan would provide its eligibility file to the carrier. To the extent feasible, Medicaid could also make use of piggyback billing.

(b) Payment to Organization.--Under this arrangement, the physician would submit one bill to the Medigap insuror. The Medigap insuror would pay the physician an amount which the physician accepts as payment-in-full, including cost-sharing liabilities. (The Medigap plan may pay the physician more than the Medicare reasonable charge). The Medigap plan would then collect the reasonable charge from Medicare. Only one bill would be submitted by the physician and one check would be paid to the physician. The beneficiary would not be responsible for paying the physician or collecting from the Medicare carrier or the Medigap plan.

6. <u>Limit Increase in Hospital Costs Per Case</u>.

The "Tax Equity and Fiscal Responsibility Act of 1982" (Public Law 97-248, commonly referred to as TEFRA) expanded previously existing limits on medicare costs effective October 1, 1982. Among other things, it established a 3-year target rate reimbursement system which in effect limited allowable rates of increase in medicare payments per case over the fiscal year 1983-1985 period. The target rate is equal to the previous years allowable operating costs per case (or after the first year, the previous year's target amount) increased by the percentage increase in the hospital wage and price index (market basket) plus one percentage point. Penalties and bonuses are established for hospitals, with costs above and below the target.

The "Social Security Amendments of 1983" (Public Law 98-21) provides for the establishment of a prospective payment system for hospitals to be phased-in over a 3-year period. During the transitional period a portion of a hospital's payments will be based on prospective rates and a portion on the hospitals' cost base. The cost-based portion of the payment will be calculated on the basis of reasonable costs, subject to the existing rate of increase limits, without the penalties and bonuses established under TEFRA.

In addition, under current law the rates for each DRG, like the cost-based costs per case are derived from historical medicare cost data for each hospital. For fiscal years 1984 and 1985, payment amounts from the previous fiscal years would be increased by the market basket, plus one percentage point. For each fiscal year beginning in 1986 the rate of increase is left to the discretion of the Secretary.

This provision would limit the rate of increase in FY85 and FY86 in hospital payment amounts including the DRG rates to the market basket rate.

6. Extend Reduction in Federal Payments

Public Law 97-35 provided that whatever Federal matching payments a State is otherwise entitled to are to be reduced by 3 percent in fiscal year 1982, 4 percent in fiscal year 1983, and 4.5 percent in fiscal year 1984. A State may qualify for a percentage point offset to these reductions of up to 3 percent if it has a qualified hospital cost review program, an unemployment rate which exceeds 150 percent of the national average, or fraud and abuse recoveries greater than one percent of Federal expenditures. In addition States may earn back part or all of the reductions if expenditures remain below specific target amounts.

This proposal would extend the existing reduction and offset provisions for 2 years. The reduction rate would be 3 percent for fiscal years 1985 and 1986.

The savings achieved as a result of the Social Security COLA provision and the provisions relating to Part B of Medicare will be credited to the HI Trust Fund.