

PATHOLOGY PRACTICE ASSOCIATION  
ANNUAL MEETING  
LOS ANGELES, CALIFORNIA  
DECEMBER 9, 1983

I AM PLEASED TO BE ABLE TO JOIN WITH YOU TODAY AT YOUR ANNUAL MEMBERSHIP MEETING TO SHARE WITH YOU SOME OF MY CONCERNS ABOUT THE BUDGET GENERALLY AND ABOUT HEALTH CARE COSTS SPECIFICALLY. WHILE YOU AND I HAVE HAD SOME DISAGREEMENT IN THE PAST WITH RESPECT TO THE METHOD OF REIMBURSEMENT FOR HOSPITAL BASED PATHOLOGISTS, I BELIEVE WE WOULD ALL AGREE THAT THERE IS A NEED TO SLOW DOWN THE RATE OF INCREASE IN HEALTH CARE COSTS. FAILURE TO DO SO ENCOURAGES THOSE WHO WOULD LIKE TO SEE AN END TO THE PRIVATE PRACTICE OF MEDICINE AND AN INCREASE IN GOVERNMENT REGULATORY ACTIVITIES. BUT BEFORE TALKING SPECIFICALLY ABOUT HEALTH CARE OR ABOUT PHYSICIAN REIMBURSEMENT, I'D LIKE TO SPEND A FEW MOMENTS TALKING WITH YOU ABOUT THE BUDGET DEFICIT.

PROBLEMS WITH THE DEFICIT

A LOT OF US ARE TERRIFIED, WHEN WE SEE HOW HIGH THE BUDGET DEFICITS ARE GOING TO BUILD UP BY THE YEAR 1990. WE NOW HAVE A

NATIONAL DEBT OF \$1.3 TRILLION AND WE'RE TALKING ABOUT DOUBLING THAT BETWEEN NOW AND 1990 TO \$2.6 TRILLION. THE INTEREST ON THAT DEBT WILL BE ABOUT \$220 BILLION PER YEAR. IT DOESN'T TAKE A GENIUS TO UNDERSTAND WE HAVE A PROBLEM. BETWEEN FOUR AND FIVE HUNDRED BILLION DOLLARS GOES THROUGH THE FINANCE COMMITTEE, INCLUDING SOCIAL SECURITY, MEDICARE, MEDICAID, UNEMPLOYMENT, TAX JURISDICTION AND TRADE JURISDICTION. THIS IS AN IMPORTANT RESPONSIBILITY. IF WE DO NOTHING ABOUT THE BUDGET DEFICIT, WE MAY NOT HAVE ANY PROGRAMS.

WE NEED TO HAVE A BIPARTISAN COALITION OF REPUBLICANS AND DEMOCRATS IN THE HOUSE AND THE SENATE WILLING TO DISCUSS WAYS TO SOLVE THE DEFICIT PROBLEM. PRESIDENT REAGAN WANTS TO CUT SPENDING, AND NOT INCREASE OR ADD ANY NEW TAXES. OTHERS WOULD PREFER TO SOLELY RAISE TAXES. I BELIEVE WE CAN LOWER THE DEFICITS THROUGH A MIXTURE OF TAXES AND SPENDING CUTS AND SEND A SIGNAL TO THE FINANCIAL MARKETS IN THIS COUNTRY THAT WE ARE SERIOUS, RESPONSIBLE AND WILLING TO MAKE TOUGH DECISIONS.

ON THE SPENDING SIDE, WHAT ARE WE GOING TO CUT? LET'S START WITH AGRICULTURE. THE COST OF AGRICULTURE HAS GONE FROM ABOUT \$4 BILLION WHEN JIMMY CARTER LEFT OFFICE, TO \$23 BILLION UNDER CONSERVATIVE RONALD REAGAN. ADD TO THAT A \$12 BILLION SO-CALLED PIC PROGRAM, THAT'S \$35 BILLION. IT IS A VERY, VERY

EXPENSIVE PROGRAM. THE FARMERS HAVE HAD GREAT DIFFICULTIES, BUT I AM NOT CERTAIN THAT THE ENTIRE SOLUTION IS A FEDERAL RESPONSIBILITY.

STARTING WITH THE A'S...AND AGRICULTURE, AND CONTINUING THROUGH THE ALPHABET, YOU GET INTO DEFENSE AND A LOT OF OTHER PROGRAMS WHERE I THINK WE CAN STILL MAKE SUBSTANTIAL SAVINGS. I AM VERY OPTIMISTIC ABOUT A LOT OF THINGS THAT HAVE HAPPENED. INTEREST RATES ARE CUT IN HALF BUT THEY ARE STILL TOO HIGH. THEY ARE STILL TOO HIGH BECAUSE OF THE HIGH DEFICIT, AND THE DOLLAR IS TOO STRONG. WE CAN'T EXPORT AS MUCH BECAUSE OF HIGH INTEREST RATES.

MEMBERS OF CONGRESS SAY, "OH, IT'S THE FEDERAL RESERVE'S FAULT. WE OUGHT TO PUT MORE MONEY INTO THE SYSTEM AND THEN THE INTEREST RATES WOULD DROP AND PROBABLY INFLATION WOULD GO UP." MY VIEW IS THAT IF WE DO AS WELL ON THE FISCAL SIDE IN CONGRESS AS PAUL VOLCKER, CHAIRMAN OF THE FEDERAL RESERVE BOARD, DOES ON THE MONETARY SIDE, WE MIGHT HAVE A BETTER PICTURE RIGHT NOW.

TREASURY SECRETARY DON REGAN HAS A STUDY EXPLAINING THAT DEFICITS DON'T HAVE ANY IMPACT ON INTEREST RATES. I TOLD HIM TO SEND ME A LOT OF THOSE BECAUSE PEOPLE IN MY STATE THINK THEY DO



HAVE AN IMPACT. MOST PEOPLE BELIEVE WHEN YOU'RE IN DEBT YOU'VE GOT A PROBLEM.

IN THE LAST WEEKS OF THIS PAST SESSION I PUT FORWARD A DEFICIT REDUCTION PACKAGE THAT SPREAD THE REDUCTIONS ACROSS ALL PROGRAMS AND RECIPIENTS, EVEN SOCIAL SECURITY BENEFICIARIES. I THINK SUCH A BROAD SCALE EFFORT IS CRITICAL IF WE ARE TO EXCEED. WHILE NOT AGREEING ON ALL THE SPECIFICS THE COMMITTEE AGREED IN PRINCIPLE TO THE APPROACH AND DIRECTED THE STAFF TO DRAFT A BILL FOR THEIR CONSIDERATION.

HEARINGS ON THE PACKAGE ARE SCHEDULED FOR THE WEEK OF DECEMBER 12. WITNESSES WILL HOPEFULLY PROVIDE US WITH THEIR VIEWS OF THE PROPOSAL AND, IF THEY DISAGREE, SOME ALTERNATIVES THAT WE MIGHT CONSIDER.

I AM CONFIDENT THAT WHEN WE RETURN FROM THE CHRISTMAS RECESS WE WILL MAKE SOME DECISIONS, AND WE WILL FINALLY MAKE SOME PROGRESS IN ADDRESSING THE VERY REAL THREAT THE DEFICIT POSES.

MEDICARE COSTS

RECENT ESTIMATES SHOW THE MEDICARE HOSPITAL TRUST FUND AS BEING DEPLETED AS EARLY AS 1990. THIS FINANCING PROBLEM IS MORE THAN ANYTHING ELSE, THE RESULT OF RAPIDLY GROWING HOSPITAL COSTS. SUCH COSTS ARE EXPECTED TO INCREASE AT AN AVERAGE ANNUAL RATE OF 10.5 PERCENT FROM NOW UNTIL 1995, WHILE THE TAX BASE FOR THE TRUST FUND IS EXPECTED TO GROW AT AN ANNUAL RATE OF ONLY 7.0 PERCENT.

THE HIGH COST OF HEALTH CARE IN THIS NATION, NOT JUST THE COST OF MEDICARE, IS A REAL PROBLEM. A PROBLEM FOR WHICH EVERYBODY HAS SOMEONE, TO BLAME. WE HAVE HEARD THAT IT'S THE HOSPITALS, THE GROWING NUMBER OF ELDERLY, IMPROVED TECHNOLOGY, THE PHYSICIANS, THIRD PARTY COVERAGE, GOVERNMENT REGULATIONS, ETC. CLEARLY IT'S A PROBLEM IN WHICH ALL THESE THINGS SHARE SOME BLAME. BUT IT'S ALSO, MORE THAN ANYTHING ELSE, A PHYSICIAN PROBLEM.

IT IS THE PHYSICIAN WHO DRIVES THE HEALTH CARE SYSTEM. HE OR SHE ORDERS THE TESTS, ADMITS THE PATIENT, PERFORMS THE SURGERY, AND PRESCRIBES THE DRUGS. PERHAPS MORE IMPORTANTLY IT IS WHAT HE OR SHE DOES NOT DO THAT SIGNIFICANTLY CONTRIBUTES TO

THE PROBLEM. HE OR SHE DOES NOT, IN THE OPINION OF MANY,  
CONSIDER WHAT IT COSTS TO PROVIDE THE SERVICES HE PRESCRIBES.

HOSPITALS HAVE ALSO BEEN IN THIS SITUATION WITH RESPECT TO  
MEDICARE. COST REIMBURSEMENT PROVIDED HOSPITALS WITH FINANCIAL  
INCENTIVES TO PROVIDE MORE SERVICES, EXTEND LENGTHS OF STAY, AND  
ADOPT NEW TECHNOLOGIES, WHETHER COST-EFFECTIVE OR NOT. THOSE  
DAYS ARE OVER. PROSPECTIVE PAYMENT WAS ADOPTED AS A WAY OF  
CHANGING INCENTIVES, REWARDING EFFICIENCY, AND CURBING COST  
GROWTH. BUT HOSPITAL PROSPECTIVE PAYMENT IS NOT THE ENTIRE  
SOLUTION.

THERE ARE THOSE WHO HAVE ALREADY BEGUN TO PRESS FOR THE  
ESTABLISHMENT OF A NEW PRESIDENTIAL COMMISSION TO ADDRESS THESE  
ISSUES. I WOULD ARGUE THAT FIRST WE OUGHT TO ALLOW THE CONGRESS  
AN OPPORTUNITY TO DO WHAT IT IS HERE TO DO. IN MY VIEW, WE  
SHOULD REVIVE THE BIPARTISAN SPIRIT THAT MARKED THE SUCCESS OF  
THE SOCIAL SECURITY RESCUE PLAN.

THE CUMULATIVE PROJECTED DEFICIT IN THE HI TRUST FUND IS SO  
LARGE-- \$300 TO \$400 BILLION BY 1995--THAT TO MAINTAIN SOLVENCY  
WILL REQUIRE SUBSTANTIAL POLICY CHANGES. TO BRING THE HOSPITAL  
INSURANCE PROGRAM INTO CLOSE ACTUARIAL BALANCE, EITHER OUTLAYS



WILL HAVE TO BE REDUCED BY 30 PERCENT OR INCOME INCREASED BY 43 PERCENT.

INCREASED BENEFICIARY COST SHARING, COST REDUCTIONS, AND HIGHER PAYROLL TAX RATES ARE BUT THREE OPTIONS LIKELY TO BE CONSIDERED BY THE CONGRESS TO CLOSE THE GAP BETWEEN REVENUES AND EXPENSES.

#### PHYSICIAN REIMBURSEMENT REFORM

HOSPITAL ADMINISTRATORS HAVE COME BEFORE OUR COMMITTEE AND SAID, "WELL, I DON'T PUT PEOPLE IN THE HOSPITAL. I DON'T ORDER ALL THESE TESTS. PHYSICIANS DO ALL THAT."

WE EXPECT A LOT FROM PHYSICIANS. I DON'T SUGGEST THAT A PHYSICIAN WENT TO MEDICAL SCHOOL TO BECOME A PAPER SHUFFLER OR TO FILL OUT FORMS ALL DAY LONG. BUT WE MUST HAVE SOME HELP. WE DON'T HAVE THE ANSWERS. FOR EXAMPLE, WE'RE NOT CERTAIN WHETHER WE'RE GOING TO HAVE DRG'S APPLY TO PHYSICIANS. WE HAVE SOME STUDIES GOING ON: HHS IS DOING A STUDY AND OTHERS ARE DOING STUDIES. PERSONALLY, I'D LIKE TO KNOW FIRST IF THE DRG SYSTEM IS GOING TO WORK FOR HOSPITALS.

RECENTLY, WE HAD BREAKFAST WITH THE AMERICAN MEDICAL ASSOCIATION BOARD OF TRUSTEES. DURING THE COURSE OF THE BREAKFAST, A PHYSICIAN FROM HOUSTON SAID, "I'LL JUST GIVE YOU A COUPLE OF EXAMPLES OF THE PROBLEMS WE FACE. TWENTY YEARS AGO, THE KIDS USED TO CALL AND SAY WHEN CAN WE TAKE MOMMY HOME? NOW THEY CALL AND SAY HOW LONG CAN MOMMY STAY? WE'LL PICK HER UP AFTER WE GO TO THE LAKE FOR THE WEEKEND. IF NOBODY PAYS FOR IT, WHAT'S THE DIFFERENCE? LEAVE HER IN THE HOSPITAL."

HE ALSO SAID THAT MORNING, AND MAYBE YOU WOULD DISAGREE, THAT IN THE 22 MONTHS PRIOR TO COMING TO THAT BREAKFAST, NOT A SINGLE PATIENT HAD ASKED HIM THE COST OF AN OPERATION. I'M NOT TALKING ABOUT EMERGENCY BUT ELECTIVE SURGERY.

#### COST INCREASES

BETWEEN 1975 AND 1981 THE PHYSICIAN FEE COMPONENT OF THE CPI INCREASED AT AN AVERAGE RATE OF 10.6 PERCENT; MEANWHILE RECOGNIZED CHARGES PER ENROLLEE INCREASED AT AN AVERAGE RATE OF 13.4 PERCENT AS A RESULT OF INCREASED PHYSICIAN VISITS PER ENROLLEE, THE INCREASED USE OF SPECIALISTS, AND THE USE OF MORE EXPENSIVE TECHNIQUES. RECENTLY THE SUPPLEMENTARY MEDICAL



INSURANCE (SMI) TRUST FUND ACTUARIES HAVE ESTIMATED THAT DOUBLE DIGIT RATES WILL CONTINUE FOR THE NEXT COUPLE OF YEARS.

IN FISCAL YEAR 1984, THE SMI TRUST FUND WILL SPEND \$21.3 BILLION TO PROVIDE PHYSICIAN'S SERVICES AND OTHER HEALTH SERVICES NOT COVERED UNDER THE HOSPITAL INSURANCE PLAN.

THE SMI TRUST-FUND IS CONSIDERED TO BE ACTUARILY SOUND, BUT ONLY BECAUSE MOST OF ITS COSTS ARE MET WITH INCOME PROVIDED DIRECTLY BY THE U.S. TREASURY. IN FISCAL YEAR 1984 THE TREASURY WILL CONTRIBUTE \$16.8 BILLION TO THE TRUST FUND TO KEEP IT SOLVENT--ABOUT \$3.40 FOR EACH PREMIUM DOLLAR RECEIVED FROM ENROLLEES.

IN LIGHT OF CURRENT AND PROJECTED BUDGET DEFICITS THERE IS A PROBLEM. KEEPING THE SMI TRUST FUND SOLVENT PLACES AND INCREASING STRESS ON THE U.S. TREASURY, AND CONTRIBUTES TO GREATER DEFICITS.

#### SECTION 108 CHANGES

THE INTEREST IN REFORM OF THE REIMBURSEMENT SYSTEM FOR PHYSICIANS IS NOT NEW TO THE FINANCE COMMITTEE, AS YOU ALL WELL KNOW. AS FAR BACK AS 1972, WE BEGAN TO MAKE CHANGES IN DIFFERENT

ASPECTS OF THE PROGRAM, PARTICULARLY THOSE RELATING TO TEACHING PHYSICIANS AND TEACHING HOSPITALS.

LATE IN THE 1960'S WE BEGAN TO REVIEW THE REIMBURSEMENT METHODOLOGY USED FOR HOSPITAL BASED PHYSICIANS. THERE WAS A GREAT DEAL OF CONTROVERSY THEN AS THERE IS STILL TODAY, OVER HOW BEST TO REIMBURSE PHYSICIANS SUCH AS YOURSELVES.

AT THE OUTSET, LET ME MAKE IT QUITE CLEAR THAT THERE WAS NEVER ANY INTENTION TO PENALIZE ANY ONE GROUP OF PHYSICIANS, INCLUDING PATHOLOGISTS. OUR INTENTION WAS TO MAKE CHANGES IN THE SYSTEM THAT WOULD RESULT IN MEDICARE BEING A WISE PURCHASER OF SERVICES WHILE PAYING PROVIDERS FAIRLY FOR THE SERVICES THEY PROVIDED.

THE 1982 TAX EQUITY BILL CONTAINED AN AMENDMENT DIRECTING THE SECRETARY TO DEVISE REGULATIONS WHICH WILL DISTINGUISH BETWEEN (1) PROFESSIONAL MEDICAL SERVICES PERSONALLY RENDERED TO AN INDIVIDUAL PATIENT UNDER PART B; AND (2) PROFESSIONAL SERVICES WHICH ARE OF BENEFIT TO PATIENTS GENERALLY AND WHICH CAN BE REIMBURSED ONLY ON A REASONABLE COST BASIS. THIS WAS NOT A NEW CONCEPT, IN FACT, AS FAR BACK AS 1967, ATTEMPTS HAVE BEEN MADE TO CLARIFY THE DISTINCTION BETWEEN SERVICES UNDER PART A OF THE PROGRAM AND THOSE UNDER PART B. SOME PHYSICIANS HAVE DISAGREED

WITH THIS POLICY IN THAT THEY BELIEVE THAT ALL PROFESSIONAL ACTIVITIES OF PHYSICIANS SHOULD BE REIMBURSED ON A REASONABLE CHARGE BASIS WHETHER OR NOT THEY ARE SPECIFIC SERVICES TO INDIVIDUAL PATIENTS.

IN LARGE PART, PROCEDURES FOR DETERMINING PAYMENT HAVE NOT BEEN EFFECTIVE BECAUSE OF THE RELATIVE LACK OF SPECIFICITY IN THE CRITERIA, AND THE CONTINUING DISPUTE OVER THE POLICY.

THE TEFRA CHANGE WAS AGAIN AN ATTEMPT TO MAKE CLEAR THE INTENTION OF THE CONGRESS THAT THE DISTINCTIONS BE MADE BETWEEN PART A AND B. WORK ON THE IMPLEMENTING REGULATION, OF COURSE, HAS BEEN GOING ON FOR SOME TIME AS WE TRY TO ASSIST YOU IN GETTING THE ADMINISTRATION TO REFLECT MORE FAIRLY THE REALITIES OF PRACTICE; FOR EXAMPLE, THE ACTUAL NATURE OF CONSULTING REQUESTS. THE ORIGINAL REGULATIONS CERTAINLY, IN MY VIEW, EXCEEDED THE STATUTORY INTENT. CHANGES HAVE BEEN MADE, AND I BELIEVE THE FINAL PRODUCT IS EQUITABLE. I KNOW THE DEPARTMENT OF HHS IS CURRENTLY REVIEWING SUGGESTED CHANGES IN THE INTERMEDIARY AND CARRIER INSTRUCTIONS SO THE REGULATIONS ARE CORRECTLY INTERPRETED AND IMPLEMENTED. YOUR VERY ABLE WASHINGTON BASED STAFF HAVE BEEN VERY INVOLVED IN WORKING OUT MANY OF THE PROBLEMS, AND HAVE BEEN OF A GREAT DEAL OF ASSISTANCE TO US.



FURTHER REIMBURSEMENT REFORM

RECENT DISCUSSIONS OF PHYSICIAN REIMBURSEMENT UNDER MEDICARE HAVE FOCUSED ON THREE MAIN ISSUES--THE IMPACT OF THE CURRENT PAYMENT METHOD ON BENEFICIARIES, THE APPROPRIATENESS OF REASONABLE CHARGE METHODOLOGY, AND PROGRAM COST INCREASES. IN RESPONSE TO THESE CONCERNS THERE IS INTEREST IN A NUMBER OF PROPOSALS.

TO INCREASE PHYSICIAN ASSIGNMENT WE MIGHT CONSIDER THE "PARTICIPATING PHYSICIAN" CONCEPT, UNDER WHICH A PHYSICIAN WOULD VOLUNTARILY AND FORMALLY AGREE TO ACCEPT THE MEDICARE-DETERMINED CHARGE AS PAYMENT IN FULL FOR ALL COVERED SERVICES RENDERED TO HIS PATIENTS. THE ADVANTAGE OF SUCH AN ARRANGEMENT IS THAT BENEFICIARIES KNOW IN ADVANCE THAT A PHYSICIAN TAKES ASSIGNMENT AND THEY WOULD THEREFORE NOT BE LIABLE FOR CHARGES IN EXCESS OF THOSE PAID BY THE PROGRAM. TO MAKE THE CONCEPT ATTRACTIVE TO PHYSICIANS A NUMBER OF INCENTIVES HAVE BEEN SUGGESTED INCLUDING SIMPLIFIED BILLINGS, PAYMENT FOR ADMINISTRATIVE COSTS, COLLECTION OF COST SHARING BY THE PROGRAM INSTEAD OF THE PHYSICIAN, AND CREDITS FOR CONTINUING PROFESSIONAL EDUCATION.

SUGGESTED CHANGES IN THE REASONABLE CHARGE METHODOLOGY INCLUDE THE LIBERALIZATION OF REASONABLE CHARGES TO INCREASE VOLUNTARY ASSIGNMENT AND ELIMINATE DIFFERENTIALS, AND ADOPTION OF STATEWIDE OR NATIONAL PREVAILING CHARGE SCREENS.

ALTERNATIVE PAYMENT METHODOLOGIES HAVE BEEN SUGGESTED TO STEM INCREASES IN FEDERAL OUTLAYS. PROSPECTIVE PAYMENT IS ONE SUGGESTED ALTERNATIVE.

EARLIER THIS YEAR, THE SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES WAS REQUIRED BY THE CONGRESS TO BEGIN THE COLLECTION OF DATA NECESSARY TO COMPUTE BY DIAGNOSIS RELATED GROUPS (DRGS) THE AMOUNT A PHYSICIAN CHARGES FOR SERVICES FURNISHED TO HOSPITAL INPATIENTS. IN 1985 THE SECRETARY IS REQUIRED TO MAKE RECOMMENDATIONS TO THE CONGRESS ON THE ADVISABILITY AND FEASIBILITY OF PROVIDING FOR A DRG TYPE PAYMENT SYSTEM FOR PHYSICIAN SERVICES.

NEGOTIATED FIXED FEE SCHEDULES HAVE ALSO BEEN SUGGESTED. THEY ARE EASY TO UNDERSTAND AND ADMINISTER BUT, LIKE A PROSPECTIVE PAYMENT SYSTEM BASED ON DRGS, A MECHANISM WOULD HAVE TO BE DEVELOPED TO ACCURATELY REFLECT THE VALUE OF THE SERVICES PROVIDED.

THE FINANCE COMMITTEE HAS MADE AVAILABLE A COMMITTEE PRINT WHICH PROVIDES AN OVERVIEW OF PHYSICIAN REIMBURSEMENT PATTERNS UNDER MEDICARE. BESIDES PROVIDING DETAILS OF REASONABLE CHARGE DETERMINATIONS AND THEIR EFFECTS ON BOTH PHYSICIAN AND PATIENT, IT REVIEWS THE PAYMENT OPTIONS WHICH ARE CURRENTLY UNDER DISCUSSION. THE COMMITTEE WILL MOVE FORWARD WITH HEARINGS TO MORE FULLY EXPLORE THE PROBLEM AND THE SOLUTIONS.

I WOULD LIKE TO EXAMINE WHAT WE CAN DO TO REFORM THE PHYSICIAN REIMBURSEMENT SYSTEM IN WAYS THAT MAKE SENSE, ENSURE THE AVAILABILITY OF QUALITY CARE, AND PROVIDE POSITIVE RATHER THAN NEGATIVE INCENTIVES. I WOULD LIKE TO KNOW WHETHER PROSPECTIVE PAYMENT FOR PHYSICIAN SERVICES IS THE ONLY MECHANISM AVAILABLE WITH A REASONABLE CHANCE OF SUCCESS.

PHYSICIANS, I BELIEVE, RECOGNIZE THE PROBLEM WE ARE FACING. I HAVE HEARD FROM VARIOUS PHYSICIAN GROUPS WHO ARE WILLING TO SPEND THE TIME AND EFFORT NECESSARY TO COME UP WITH WORKABLE SOLUTIONS. CERTAINLY THESE ORGANIZATIONS SHOULD BE INVOLVED IN THAT EFFORT. REFORM IS NEEDED NOW, NOT SOMETIME DOWN THE ROAD WHEN IT IS TOO LATE.



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## United States Senate

COMMITTEE ON FINANCE  
WASHINGTON, D.C. 20510

RODERICK A. DEARMENT, CHIEF COUNSEL AND STAFF DIRECTOR  
MICHAEL STERN, MINORITY STAFF DIRECTOR

TO: SENATOR DOLE  
FROM: FINANCE COMMITTEE STAFF  
SUBJECT: ASHLAND OIL COMPANY  
9:00 a.m., Saturday, December 10

Attached are the following materials for your meeting  
with Ashland Oil Company's top management:

1. Talking Points on Reducing the Deficit Now
2. Deficit Reduction Package and Chart
3. Proposed Across-the-Board Tax on Energy
4. Alcohol Fuels Tax Exemption
5. Background on Tax Issues Relating to Tertiary Oil Producers

TALKING POINTS ON REDUCING THE DEFICIT NOW

- o 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.
- o Over that 6-year period, unless something is changed these deficits will cumulate to \$1.2 trillion--just about doubling the national debt.
- o 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.
- o 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.
- o Over the next 5 years financing costs for the interest on this additional debt would amount to \$100 billion.
- o 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.
- o 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.
- o 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.



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- 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 entrepreneur 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 otherwise 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.



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- o Since 1981, we have brought about spending cuts amounting to \$109 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.

Latest revision  
as of 11/22/83  
PRELIMINARY

Senate Finance Committee  
Deficit Reduction Package  
(Billions of Dollars)

	<u>Fiscal Year</u>				<u>1984-86</u>	<u>1984-87</u>
	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>		
Senate Finance Committee—Phase I	1.8	4.5	7.1	7.7	13.4	21.1
Energy tax (eff. CY 85-87): 2-1/2%	—	5.3	7.8	7.9	13.1	20.9
High income surcharge <sup>1/</sup> (eff. CY 85-87): 2-1/2%	—	0.7	2.0	2.3	2.7	5.1
Indexing limitation (eff. CY 85-87):	—	0.7	1.8	3.2	2.5	5.6
ZBA—increase by \$100/200 in 1985 and an additional \$100/200 in 1986	—	-1.1	-2.9	-3.4	-4.0	-7.4
2-1/2% tax on corporate economic income (eff. CY 85-87)	—	3.1	5.2	6.2	8.3	14.5
Treasury-supported proposals on tax shelters, accounting abuses and corporate reform <sup>2/</sup>	1.2	3.4	3.8	4.6	8.4	13.0
Total	3.0	16.6	24.8	28.5	44.4	72.8

<sup>1/</sup> The surcharge on individual income tax is calculated before credits. The surcharge would be 2-1/2 percent on taxes over \$10,000 on joint returns (over \$7,500 on single returns). The resulting surcharge increases taxes above adjusted gross income levels of approximately \$60,000 on joint returns (\$42,500 on single returns).

<sup>2/</sup> Treasury estimates.

Joint Committee on Taxation  
November 18, 1983

November 29, 1983

BASIC COMPONENTS OF PROPOSED FINANCE COMMITTEE  
DEFICIT REDUCTION PACKAGE

Overview

- The Finance Committee has aimed for \$150 billion in total deficit reduction over the next 4 fiscal years, with most of the savings coming in fiscal years 1985 through 1987.
- The package will have at least one dollar in guaranteed spending cuts for each dollar of revenue increases.
- The Finance Committee will undertake to enact one-half of the spending reductions, and look to the other Senate Committees to produce an equivalent amount of savings.
- Any new revenue increases (other than pure loophole closers) will be expressly contingent on a certification that spending cuts have been achieved and will be triggered off if Congress later reneges on these spending cuts.

I. Spending Reduction Proposals Within the Jurisdiction of the Senate Finance Committee

The total package, including provisions totalling \$5.3 billion in savings incorporated in the Reconciliation Act of 1983 as reported by the Budget Committee, would result in a savings of \$38 billion over 4 years. The majority of the proposals would have an effective date of January 1, 1985.

- Rounding of Social Security COLA. Proposal modifies the COLA paid in 1985, 1986 and 1987 by rounding the increase to the next lower whole percentage amount.

FY 1984-87: \$5.1 billion

- Modify timing and rate of increase in Part B Premium. The premium would be permitted to increase each year until it reached 35% by 1990. (Modification of 1983 Administration proposal)

FY 1984-87: \$2.9 billion

- Delay In Initial Eligibility for Medicare Entitlements. Delays 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)

FY 1984-87: \$1.0 billion

- Restructure Medicare Cost Sharing/Apply Co-Pays to Hospital Days and Provide Unlimited Hospital Days. Modifies cost sharing on hospital stays and nursing home stays and provides catastrophic protection under Part A of Medicare. (Modification of 1983 Administration proposal)

FY 1984-87: \$1.6 billion

- Modification of Working Aged Provision. Modifies 1982 provision which made Medicare benefits secondary to benefits under employer group health plans. (Strongly supported by OMB and HHS)

FY 1984-87: \$1.2 billion

- Participating Physician Program. Freezes certain physician fees for 2 years and creates incentives for physicians to take assignment. (Modification of 1983 Administration proposal)

FY 1984-87: \$2.2 billion

- Limit Increase in Hospital Costs Per Case. Limits increases in hospital costs per case to the increase in the hospital market basket price index. (Modification of 1983 Administration proposal)

FY 1984-87: \$2.9 billion

- Fee Schedule for Clinical Laboratory Services. Establishes fee schedule for payment to all laboratories for services provided to Medicare patients.

FY1984-87: \$0.9 billion

- Extend Reduction in Federal Payments. Extends the existing reduction in Federal Medicaid payments to States for 2 years. (Modification of 1983 Administration proposal)

FY 1984-87: \$1.0 billion

- Debt Service. The reduced outlays and increased revenues would decrease interest on the Federal debt by \$13.9 billion over FY 1984-87.

## II. Revenue Provisions

The total package, including provisions totalling \$21.1 billion incorporated in the Omnibus Reconciliation Act of 1983 as reported by the Budget Committee, would increase revenues by \$72.8 billion over 4 years.

### A. Contingent Revenue Increases

The following revenue provisions, totalling \$59.8 billion over 4 years, would take effect on January 1, 1985 only upon verification that the required reductions in Federal outlays have, in fact, been achieved:

- Energy Tax. A two and one-half percent tax would be imposed on the sale of sources of energy consumed in the United States.

The President's 1984 budget included a \$5 per barrel excise tax on domestic and imported oil.

FY 1984-87: \$20.9 billion

- High Income Individual Surcharge. A surcharge of two and one-half percent would be imposed on income above approximately \$60,000 for joint returns (\$42,000 for single returns).

The President's 1984 budget included a surcharge on individuals approximately equivalent to one percent of taxable income.

FY 1984-87: \$5.1 billion

- Tax on Corporate Economic Income. A two and one-half percent tax would be imposed on the economic income (over \$100,000) of corporations.

The President's 1984 budget included a surcharge on corporations of approximately one percent of taxable income.

FY 1984-87: \$14.5 billion

- Rounding Down of Indexing. Indexing of brackets, exemptions, and the zero bracket amount would be computed with reference to the Consumer Price Index rounded down to the next lower full percentage point. This proposal would be consistent with the modification of Social Security COLA's.

FY 1984-87: \$5.6 billion

- Zero-Bracket Amount (ZBA) Increased. The ZBA (formerly the "standard deduction") would be increased by \$100 (\$200 for



joint returns) in 1985. Heads of households would be given a ZBA halfway between simple and married taxpayers, with a new rate schedule.

FY 1984-87: \$7.4 billion

B. Treasury-Supported Revenue Reforms.

The deficit reduction package would include proposals, totalling \$13 billion, supported by Treasury testimony to the Finance Committee limiting tax shelters and accounting abuses and reforming the taxation of corporations.

FY 1984-87: \$13.0 billion

III. Summary

	<u>Fiscal Years</u> <u>1984-1987</u>
Spending Restraint Already Agreed to by the Finance Committee	5.3
Spending Restraint Proposals Within Finance Committee Jurisdiction Contained in Proposed Package	32.7
Spending Restraint Requirements Within the Jurisdiction of Other Committees	37.5
Revenue Increase Already Agreed to by the Finance Committee	21.1
Revenue Increase Proposals in Proposed Package	<u>51.7</u>
TOTAL	148.3



### PROPOSED ACROSS-THE-BOARD TAX ON ENERGY

- One of major components of the deficit reduction package that the Finance Committee has been considering is a 2 1/2% tax on the value of all forms of energy to take effect in 1985.
- Like all of the tax increases being considered (other than pure loophole closers), this tax will take effect only if the spending reduction targets are achieved.
- It is estimated that this 2 1/2% energy tax will raise about \$20.9 billion over 3 years (FY 1985-87).
- This energy tax will be imposed on 2 1/2% of national average value of the following energy products:
  - (1) Oil -- tax imposed on the first sale of a refiner. (Imports of petroleum products would be taxed at the border.)
  - (2) Natural Gas -- tax imposed on the sale of gas to local distribution company or direct sale to end user of natural gas.
  - (3) Natural Gas Liquids -- tax would be imposed on sale by a gas processing plant.
  - (4) Coal -- tax would be imposed on sale to a major fuel burning installation.
  - (5) Electricity -- tax would be imposed on the sale of electricity to users.
- This energy tax would exempt feedstock use and energy produced for exports.
- This tax spreads the burden beyond oil to all fuels, so that it should have a more even regional impact than the Administration's proposal to put a \$5 per barrel excise tax on oil.
- The 2 1/2% energy tax will raise gasoline prices by about only 2 to 3 cents per gallon.

ALCOHOL FUELS TAX EXEMPTION

Ethanol Fuel Incentives

- One set of tax incentives that I believe experience has clearly proven to be economically efficient are the incentives for the domestic production of alcohol fuels.
- I am proud to have one of the original authors, along with Senators Carl Curtis and Birch Bayh, of the legislation in 1978 that established the exemption for alcohol fuel from the 4-cent per gallon gasoline tax.
- Since 1978 we have improved on the original excise tax exemption.
- In 1981, we extended the 4-cent per gallon alcohol fuel exemption through 1992, added an optional production tax credit for alcohol fuels, extended the energy tax credit for alcohol fuel production equipment and streamlined some of the regulatory requirements that had proven to be an impediment to expanding alcohol fuel production.
- Last year as part of the gas tax bill, we are able to increase the alcohol full exemption to 5 cents per gallon.
- The response to these tax incentives has proven to be nothing short of miraculous since we have witnessed the birth of a significant and growing new energy industry.
- Since these incentives were enacted, the alcohol fuels industry has invested hundreds of millions of dollars in nearly 100 commercial facilities. Fuel ethanol blend sales will exceed 4 percent of the total gasoline pool in 1983, with over 5 percent or 5 billion gallons expected to be sold in 1984.

Alcohol Fuels

- In addition, I know that many of you are interested in S. 1931, the Renewable Fuels Tax Incentive Act, introduced by Senator Durenberger.
- S. 1931 would increase the excise tax exemption for alcohol fuel blends to 9 cents per gallon and would reimburse the Highway Trust Fund for the revenue loss of the increased exemption from the "Windfall Profit Tax" account of the general fund.
- I have long supported increasing the alcohol fuel excise tax exemption to 9 cents per gallon. The Senate version of the gas tax bill passed last December increased the exemption to 9 cents, but that figure was reduced in conference to 5 cents because of strong House opposition.



- I continue to strongly support increasing the alcohol fuel exemption. Nevertheless, achieving this legislative goal will not be easy.
- As part of the Finance Committee Deficit Reduction package, I am supporting increasing the alcohol fuel tax exemption by 1 or 2 cents per gallon.
- To the extent we expand the energy tax credit provisions of current law, we should also increase the fuel tax exemption for our most efficient and successful energy provision--the alcohol fuels tax exemption.
- However, I cannot support the provision in S. 1931 that would reimburse the Highway Trust Fund from the Windfall Profit Tax for the revenue loss of the increased fuels tax exemption for alcohol fuels.
- Every legislative effort to assist the alcohol fuel industry has originated in the Senate.
- If we are going to be successful in increasing the exemption, this industry is going to have to neutralize the intense opposition of senior members of the House Ways and Means Committee.

ENERGY TAX CREDIT EXTENSION IN DEFICIT REDUCTION PACKAGE

- The tax credits for cogeneration equipment would be extended through 1985; a new affirmative commitment rule for solar, wind, geothermal, biomass, qualified hydroelectric and ocean thermal property would be extended; the affirmative commitment rule for qualified synthetic fuel production equipment would be added.
- In addition, tar sand property would be made eligible for the general 10 percent energy credits and the extended affirmative commitment rule; shale oil hydrogenation equipment would be made eligible for the extended affirmative commitment rule; and the five-cent per gallon exemption from the Federal fuel excise tax for alcohol fuel would be increased by one cent.



## BACKGROUND ON TAX ISSUES RELATING TO TERTIARY OIL PRODUCERS

### Definition

- Tertiary oil production generally follows secondary oil production, which is the production of oil by pumping water into a reservoir to force more oil out. Tertiary oil production techniques include the injection of special chemicals, like detergents or carbon dioxide, or the injection of steam, or even starting an underground fire to unlock trapped oil.
- Much of the oil in California is low gravity heavy oil that is produced by means of steam injection or other tertiary recovery techniques.

### Percentage Depletion for Secondary and Tertiary Production

- Except for small independent producers and royalty owners, the Tax Reduction Act of 1975 generally repealed the percentage depletion deduction for oil and gas production.
- Under the small producer exemption, the percentage depletion rate for oil and gas production was gradually phased down from 22 percent in 1980 to a permanent rate of 15 percent in 1984.
- The 1985 Act contains a special rule for percentage depletion for secondary and tertiary production. Percentage depletion is allowed at a rate of 22 percent on production resulting from secondary and tertiary recovery methods until 1984.
- In 1984 the 22 percent rate of percentage depletion for secondary and tertiary production was intended to be reduced to the permanent rate of 15 percent on up to 1,000 barrels a day.
- As drafted, the 1975 Act has the unintended result of allowing no percentage depletion on secondary and tertiary production after 1983.
- I introduced S. 1661 in order to correct this unintended drafting result and to allow percentage depletion on secondary and tertiary production at the permanent rate of 15 percent after 1983.
- At the end of this legislative session, the Senate Finance Committee tentatively approved an amendment to correct the secondary and tertiary depletion problem.
- Since transfers of interests in secondary and tertiary production were not subject to the anti-transfer rules

of the 1975 Act, the proposal approved by the Finance Committee would allow transferees of these interests to continue to take percentage depletion on interests transferred before September 19, 1983.

- Unfortunately, because of an end-of-the-session legislative impasse on tax issues, none of the expiring tax provisions were dealt with including this proposal to correct the depletion problem.
- We hope to deal with this issue, along with other time sensitive tax issues, early next year after Congress returns.

#### Windfall Profit Tax Treatment

- Under the Windfall Profit Tax the incremental amount of oil produced as a result of tertiary production is classified as Tier 3 oil and taxed at a relatively low 30% tax rate for both majors and independents.

#### Expensing of Tertiary Injectants

- As part of the Windfall Profit Tax, I offered an amendment, which became law, that permits producers to deduct the cost of tertiary injectants in the year that they are injected into the reservoir.
- This provision clarified the previously uncertain tax rules relating to the deductibility of tertiary injectants and aided considerably the planning of expensive tertiary projects.