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National Performance Review

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Section I

Introduction

Department of Health and Human Services

Introduction

The Department of Health and Human Services (HHS) administers over 1,000 programs, including Medicare, Social Security, and an array of health and welfare programs. HHS touches nearly all Americans so that improvements to existing operations present a showcase opportunity to improve government services and build public confidence.

HHS employs more than 126,000 people at headquarters, regional, and field offices in five operating divisions and the Office of the Secretary. The five divisions are the Social Security Administration (SSA); the Health Care Financing Administration (HCFA); the Public Health Service (PHS), which includes the Food and Drug Administration (FDA) and the National Institutes of Health (NIH); the Administration for Children and Families (ACF); and the Administration on Aging (AOA). The President's fiscal year 1994 budget request included \$622 billion for HHS, which is approximately 40 percent of the federal budget.

The department faces significant challenges which require significant changes to current practices and invite reinvention. The department's leadership is needed to provide focus to the operating divisions in terms of service delivery issues and strategic planning and to provide effective cabinet level representation as the HHS agencies respond to dramatic increases in workload. To remove redundant layers which add no value to agency mission accomplishment, the department must streamline management structures. Each HHS agency is faced with the need to re-engineer service delivery systems to provide improved customer service at least cost. Trust fund reserves are no longer considered adequate to meet expected program growth, and must be better managed to reduce incidents of fraud, waste and abuse and meet fiduciary responsibilities to the public. The national food inspection system must adopt modern cost-effective practices to provide improved protection to the public.

From existing reports and analyses and interviews with customers, staff and managers, the National Performance Review (NPR) team looked for opportunities for HHS to redefine its relationships with service providers and customers, to focus on results, promote effective management of the trust funds, integrate customer services, and reduce

bureaucracy. NPR has identified issues under four themes.

Theme 1: Shifting From Red Tape To Results

This report proposes actions to help HHS move from red tape to results by: improving service integration efforts; streamlining and providing better focus to the regulations process; re-engineering the nation's food inspection system; and consolidating health profession educational grant programs.

HHS provides an array of benefits and services to some of the most needy people in America. However, existing organization boundaries and program designs prevent HHS from independently working toward multi-faceted goals such as helping impoverished single mothers move off of welfare rolls. For example, about 340 programs are available government-wide for children and families at a funding level of about \$60 billion. These programs are administered by 11 separate cabinet agencies. Program recipients and employees both regard the current systems with frustration. Too much time is spent pursuing and checking documents that verify benefit eligibility. Program beneficiaries often get the runaround, and eligibility workers become fact checkers instead of case managers who can really help people and help prevent future social costs.

Prior attempts to streamline or eliminate programs have met with limited success. Through health and welfare reform and other efforts emerging in HHS, there exists tremendous potential to move from red tape to results. For example, HHS should explore ways to use technology and partnerships with the private sector to streamline eligibility processes. In the interim, within existing structures, HHS can increase its collaborative efforts with other departments and take steps to foster integrated service delivery in local communities. The Secretary of HHS should take an active role in interdepartmental roundtables with the Domestic Policy Council and work to set up teams to work on issues involving clients shared with other departments. Within HHS, grants processes need to be re-engineered. In addition, the HHS leadership, through strategic human resources management, should work to foster a culture that encourages collaborative efforts and makes continuous improvement in such activities a high priority.

The report recommends that the HHS rules and regulations process be re-engineered to eliminate delays in issuing regulations. Delays in issuing regulations for Medicaid program activities have resulted in avoidable litigation, sanctions to states forced to act

without sufficient guidance, and non-standard implementation of congressionally mandated programs. There are numerous instances in which it has taken over three years from the enactment of a law to issue regulations.

The present food inspection system is outdated and lacks sufficient enforcement authority to protect the consumer. Inspection intensity and frequency are inconsistent and not based on a formal risk analysis process and does not reflect the level of risk inherent in food products. In addition to the FDA, four other agencies have primary responsibility for a large portion of the Nation's food supply. These agencies have conflicting laws, different enforcement authorities, and inconsistent frequencies and intensities of inspection. This report proposes to re-engineer the nation's food inspection system.

In summary, the issues relating to this theme propose to integrate programs and improve service delivery, reduce the length of time taken to publish regulations, increase confidence in the safety of the nation's food supply, and consolidate health professions educational grant programs.

Theme 2: Now Is The Time

Social Security, Disability, Medicare and Railroad Retirement Board programs and associated trust funds are under increasing pressure and scrutiny as expenditures continue to grow at ever increasing rates and the financial stability of funds is questioned. Trust fund reserves are not expected to meet future projected growth in entitlements and agency workloads continue to grow. These trends have resulted in declining public confidence and deteriorating service to beneficiaries. Funding of program management oversight activities is apportioned each year from the trust funds. Too often, funding for handling competing workload activities takes priority over funding those which would help control program expenditures and safeguard trust fund assets.

The report proposes actions to safeguard our public trust funds and improve customer service by: eliminating lengthy delays in processing disability benefit claims and removing individuals no longer disabled from the disability rolls; providing sufficient oversight of trust fund expenditures to assure that trust fund assets are protected; assuring the effective use of death information to reduce costs for all federal benefit programs; collecting outstanding debts owed to the Social Security Trust Fund; providing options for delivering benefits to railroad industry employees and retirees at lower costs; and

implementing user fees for specific services provided by FDA with regard to imports and exports.

Theme 3: Quality Management

Since its establishment in 1953 as the Department of Health, Education and Welfare, the size and complexity of HHS have presented challenges to effective central management. The Office of the Secretary must exercise an exceptionally broad span of control to provide policy guidance, operations management and cabinet level representation and leadership before Congress. In practice, HHS is a "confederation of independent affiliates." Management at the Secretary's level in previous administrations has been cited as lacking in central strategic planning, providing insufficient leadership to address the resource needs of operating divisions and affording inadequate attention to the challenges the divisions face. The department operates in many ways on the basis of hierarchical management, which contributes to duplication of review processes, layering of management levels, and delays in decision making and rules promulgation. This report proposes major changes to the HHS organization structure to address and eliminate these problems.

The Social Security Administration is confronting the challenges of significant growth in workload coupled with increasing demands for improvements in customer service. SSA will be redesigning the ways it delivers service to its customers, and has developed plans to take full advantage of technology and improve the quality of the services it provides to an ever growing segment of the population.

Theme 4: Introducing Marketing Dynamics

This report also proposes to take the fullest advantage of market dynamics to reduce costs, to improve Medicare claims processing performance and customer service by authorizing HCFA to fully compete Medicare contracts and utilize creative procurement approaches and incentives to achieve desired results.

Agency Reinvention Activities

HHS has been an active partner in the Vice President's National Performance Review. The Department has demonstrated a commitment to continuous improvement by adopting three themes to frame their activities-- fostering independence through

empowering the people served; preventing future problems; and improving service to customers. They have undertaken various reinvention efforts and laboratories which include: a model TQM facility at the PHS Alaska Native Medical Center; a reinvention laboratory at HCFA to improve the regulatory process and test improvements in three areas: a negotiated Hospice Wage Index involving two national hospice organizations; a negotiation process to extend inpatient psychiatric care to settings other than psychiatric hospitals which would involve public and private interest groups and provider and patient organizations; and negotiated operational and oversight standards for Health Care Prepayment Plans involving national service provider interest groups, beneficiary interest groups, and employer/union sponsored plans.

The department has further demonstrated its commitment to quality and reinvention activities by involving each of its employees in the challenge to improve service delivery. The Secretary has committed resources and leadership talent to this critical initiative and has clearly shown that this is a continuing challenge which will become an integral part of normal business activities.

Fiscal Impact Summary

The fiscal impact of adopting the recommendations proposed is summarized in a separate section of this report. The overall impact is a reduction of \$3.4 billion in outlays over six years.

Shifting from Red Tape to Results

HHS SHOULD INCREASE COLLABORATIVE EFFORTS TO PROMOTE INTEGRATED SERVICE DELIVERY FOR ITS CUSTOMERS

Background

The U.S. Department of Health and Human Services (HHS) provides an array of benefits and services to some of the most needy people in America, including people in poverty, the frail and elderly, and the disabled. However, existing organizational boundaries and program designs prevent HHS from independently working toward multifaceted goals such as helping impoverished single mothers move off welfare rolls or assisting the elderly or disabled to live independently.

Examination of the sheer number and categorical nature of programs for children, especially those in poverty, presents a powerful illustration of the challenges facing state and local administrators trying to strengthen their communities and carry out HHS and other federal programs. Governmentwide, about \$60 billion in federal funds was spent for children for fiscal year 1989 on at least 340 programs administered by 11 separate cabinet-level agencies.¹ In the area of juvenile justice, ninety-one programs exist in eight federal agencies just to conduct and support evaluations of results achieved by federal juvenile justice delinquency programs and activities.² Despite the availability of these resources, one out of every four children under the age of six is poor, and homicide, suicide and juvenile crime rates for 15-19 year olds are at alarming levels, but merely creating more programs is not the answer.³

On July 30, 1993, Vice President Gore chaired a conference on family policy and facilitated roundtable discussions with experts and advocates to exchange ideas about reinventing services for families. Families with multiple-needs were of particular concern, and many ideas were put forth about how to reduce fragmented service delivery. The need to link human services with effective economic policies was emphasized along with the importance of promoting programs and practices designed to prevent many family crises before they occur. After hearing about numerous successful community programs, HHS Secretary Donna Shalala said, "What can government do? We can get out of the way and let these talented people do their thing....One size never fits all." She talked about ongoing

efforts to reform the cumbersome health care and welfare systems and stressed the importance of flexibility, prevention, and service "integrated across the system." ⁴

In general, existing programs have not been created based on any strategic approach to promote good health or strengthen families. Rather, most programs were created piecemeal, in reaction to emerging needs such as those for AIDS research or in response to public concern and outcry over problems such as rising drug abuse and school violence. Program mandates or expected outcomes of individual or related programs are often unclear, and rarely are there requirements for joint planning. Data collected on programs is often limited to output measures such as payments made to welfare recipients or administration of immunizations, rather than on contributions to broad, social goals.⁵

Attempts at service integration are often impeded by issues of turf or competing priorities, as indicated by the recent efforts of the Texas health department to obtain permission to have the nurses who work at the WIC (Special Supplemental Food Program for Women, Infants and Children) clinics administer immunizations. The WIC program, administered by the U.S. Department of Agriculture (USDA), was authorized by Congress to provide participants with specific nutritious supplemental foods, nutrition education and health care referrals. The practice to date has been for the WIC nurses merely to refer clients to separate health clinics for immunizations. Despite efforts to make these referrals and to emphasize the importance of the immunizations, many clients never make it to the health clinics due to a lack of transportation and other constraints. The immunization rate in the state is at an alarmingly low rate of 30 percent. The state has worked with intergovernment relations offices, obtained letters of support from Congress, and written to the Secretary of Agriculture.⁶ However, since the USDA program is only authorized to provide food supplements, it will not allow its nurses to administer the immunizations unless the state develops a cost allocation plan⁷ viewed as an unnecessary burden by the state agency.

In federal departments, tremendous resources are expended on reviewing applications from each state or other entity that applies for funding under each program. Parallel processes exist for preparing awards, monitoring, and reviewing performance reports. However, in many federal offices, additional staffing resources have not been provided as

new programs have been authorized. As a result, many offices experience difficulties in processing grant awards on time, and technical assistance or monitoring requested by grantees may go undone. Exhibit 1 illustrates the complexity of the process followed for awarding funds under a typical discretionary grant program. Often, it is this type of program that is used for demonstration projects or innovative approaches. However, application time frames are often inconsistent for compatible programs, and this impairs proper planning or coordinated program development.

Perhaps worst of all, eligibility requirements for related programs are often so complex and confusing that they merely serve to frustrate and discourage eligibility workers and the people they are trying to help. One known expert aptly described the problem as follows:

...AFDC [Aid to Families with Dependent Children] rules state that a family cannot own a car worth more than \$1,500 in equity value. In food stamps, the family cannot own a car worth more than \$4,500 market value. In Medicaid, the value can range from \$1,500 equity value to total exemption, depending on which categorical group you are applying under. In food stamps, the car can be exempt if it is used for work or training or transporting a disabled person, but in AFDC there is no exemption for the car under any circumstance. The question is: Why can't we talk about the same car in all three programs, or better yet, exempt the car in all three programs? After all, if you are trying to promote self-sufficiency and access to preventive services, why impose a resource test on the family car?⁸

Thus, from the client's perspective, obtaining benefits from social welfare programs involves a maze of bureaucratic requirements.⁹ Applicants must have money to pay for verification documents (e.g., birth certificates). They need a telephone, copy machine, and transportation to make several trips to the eligibility offices and to other offices where verification documents can be secured.¹⁰ They also need the cooperation of third parties who really do not have a stake in whether they become eligible or not, such as estranged husbands, landlords, and employers¹¹. Application processes are equally daunting for eligibility workers who feel that their performance is evaluated based on how well they avoid sanctions for erroneous eligibility determinations rather than on how well they have

helped people.¹² Program accountability is based on the accuracy of eligibility determinations, with no incentives to curb improper denials.¹³

One method of improving service delivery would be to revise policies surrounding program eligibility requirements. Work in this area dates back to the 1970s.¹⁴ The most recent effort includes a Federal Welfare Simplification and Coordination Advisory Committee charged by Congress to study eligibility processes for food stamps, AFDC, Medicaid and public housing. In its June 1993 report, this group's primary recommendation was to replace the numerous programs that currently serve the needy with one, family-focused, client-oriented, comprehensive program.¹⁵ The committee also recommended expanded authority for demonstration projects, modified audit and evaluation procedures to focus on the success of families in reaching self-sufficiency, and other streamlining measures.¹⁶

Many other recent studies covering barriers to helping families become self-sufficient recommend greater coordination of child and family policies in the executive branch and Congress.¹⁷ These studies also recommend decategorization of federal programs, uniform eligibility requirements, streamlined application processes, incentives for demonstration projects and other experiments in coordination and collaboration of services at the state and local levels, and new accountability measures that focus on enhanced child and family well-being rather than solely on administrative processes.

Despite the continued existence of complex eligibility requirements in related programs and other barriers, HHS has worked to improve the coordination of related programs by serving on interagency committees, entering into formal memoranda of understanding and initiating organization development efforts. For example, HHS participates in the Federal Coordinating Council for Science, Engineering and Technology (FCCSET) and the Interagency Council on the Homeless. Both of these efforts have resulted in the identification of shared goals and the avoidance of duplication. The MOU between HHS and the Department of Transportation resulted in the 1989 joint publication of Best Practices in Specialized and Human Services Transportation Coordination.

The organization development effort now underway in the Administration on Aging (AOA) is another, less traditional approach to improving service coordination. The Older

Americans Act, funded at about \$900 million for fiscal year 1993, requires the AOA to coordinate services. However, as reported in April 1991, by the General Accounting Office (GAO), despite the legislative mandate, the AOA's efforts in the 1980's did not keep pace with growing coordination needs.¹⁸ Currently, AOA is working with advisors from the Office of Personnel Management, and using employee input and other information, AOA is seeking to develop a culture that better serves its customers through service coordination and other means.¹⁹ To help bring this about, AOA has plans to revise its hiring, performance assessments, training and other human resource management processes to place greater emphasis on service coordination.

Despite progress made by HHS to coordinate with other departments, more efforts are needed, especially those that promote comprehensive, coordinated service delivery in local communities. Increasingly, administrators, experts and advocates are seeking better interagency coordination and service integration, a term used to describe a system aimed at more comprehensive human service delivery through a wide variety of activities ranging from collocating services available from several agencies to creating state and local interagency service planning and budgeting.²⁰ The HHS Inspector General (IG) has reported that "agencies believe that the costs of providing comprehensive, integrated services to children and families are justified because they prevent far more costly social problems, such as delinquency, teen parenting, and substance abuse."²¹ Collaboration, a process for reaching goals that cannot be realized singly,²² is an effective means for bringing about service integration.

One example of a collaborative effort at the community level is "New Beginnings," a project that brought together executives from major public agencies serving children and families in San Diego County, California.²³ Participants found that their agencies served many of the same families, but no single agency was able to focus effectively on preventing negative outcomes for children in poverty.²⁴ Certain basic principles tie the project together: services and activities for families need to be focused on prevention; services need to be for families as a whole, not fragmented by the presenting problem or single client; services need to be responsive to the needs of families and not the convenience of agencies and their staff; agencies need to reallocate and realign existing resources that already exist

before looking for infusions of new money; and implementation of the collaborative process and the basic principles needs to be adapted to the needs of each community.²⁵ The first application of these concepts was a multiservice center designed to provide accessible, non-fragmented access to families in a school attendance area.²⁶ Services included information and referral, parenting and adult education classes, case management and other services.²⁷ To be successful, collaborative efforts require agencies to jointly develop sets of common goals and directions, share responsibility for obtaining these goals and work together to achieve those goals while using the expertise of each collaborator.²⁸

In order to cope with the continued existence of numerous programs with unique and complex eligibility requirements, many state and local governments have implemented their own successful service integration efforts. For example, some states have begun using important technological innovations, such as "expert systems," which use advanced computer algorithms and detailed input from employees to create routines that make eligibility determinations automatically. Touch screen and voice recognition technologies are also available and can open up data entry and retrieval to persons who do not have access to keyboards. Imaging technology allows the capturing of all types of documents such as birth certificates.²⁹ common intake forms, and outstationing of workers or collocation of eligibility screening to reduce travel time for potential clients.

In addition, states have obtained federal waivers to collapse separate data intake processes. The Alabama Avenues to Self-Sufficiency through Employment and Training Services (ASSETS) program is one example of a use of waivers to collapse separate intake processes for AFDC, food stamps, JOBS and child support.³⁰ Waivers are also used for demonstration projects, which allow for program innovation.³¹ The level of waiver authority, the process for seeking waivers, criteria for approving waivers, and the mechanisms for measuring the effects of waivers vary significantly across government. These differences pose barriers which could be minimized through an intergovernmental, interagency coordinating body.

Another issue related to waivers has to do with the need for agencies to use them as a valuable customer feedback tool to consider when making policy. For example, 48 state agencies have waivers from the Medicaid program allowing them to provide community-

based services as an alternative to nursing home care, which is the service routinely covered by Medicaid.³² Many elderly people need services stemming from hip injuries and injuries resulting from strokes.³³ Often, meal service and assistance with bathing can be provided to people in their own homes, at a lesser cost than would be charged at a nursing home.³⁴ It is difficult to understand why a policy persists when as many as 48 states have sought and obtained relief from that policy. Improved data collection and analysis on waiver requests appears needed so that HHS can support and pursue needed changes in program policies, including those based in law.

More flexibility to achieve better service integration might also be achieved through the creation of legislation that allows states to apply for separate, related programs with multiple funding sources under one application. Such authority used to exist under the Joint Funding Simplification Act, which expired in 1985 under a sunset provision.

Advocates for linking the delivery of services do not agree on how best to change the current system.³⁵ Block grants are often cited as one alternative to categorical grants, but opponents fear that accountability will be lost and that funds might be absorbed by other state programs.³⁶ Prior attempts to consolidate or eliminate existing programs have met with resistance from interested parties who perceive that funding and needed services will be lost. Another alternative is to develop grant programs built around entrepreneurial government.³⁷ So-called "challenge grants" with formulas that force concentration on state-developed missions and results have been successful.³⁸ This type of approach could be used for example to restructure the programs for at-risk families to allow communities to develop programs around agreed-upon program outcomes. In lieu of current compliance auditing practices, under a challenge grant approach, audits and evaluations would be conducted to assess the integrity with which performance data was collected.

One school of thought advocates a federal government that "steers, rather than rows."³⁹ While true service integration will occur at the local level of government, the federal government can take certain steering actions to encourage such efforts and help make them successful. Included should be efforts to facilitate collaborations within and across government, with private and nonprofit stakeholders, and with clients themselves.

Recommendations

HHS should develop a comprehensive strategy to promote service integration within its own culture and across agencies and levels of government to better assist its clients. To manage programs more effectively and to provide better service delivery within existing structures, a new approach is needed in which federal officials in various departments routinely form issue or customer-focused teams to address complex areas. At the same time however, steps should be taken to simplify existing program designs and reengineer grants processes so that customer access can be improved. The HHS strategy should include some or all of the following elements:

1. **The Secretary of HHS should actively seek to develop collaborative efforts both within HHS and across the federal government focused on empowering communities to strengthen families and work on other major initiatives.** Strengthening communities and families calls for collaborations among federal departments which include the Departments of Housing and Urban Development, Agriculture, Education, Labor and Justice, which have responsibility across government for programs that include housing, nutrition, preschool, employment and other services. The common goal, for which agency leaders should be held accountable, should be to provide seamless service delivery to families in a way that focuses on family strengths and empowers families by involving them in constructing solutions. Department leaders should identify strategies and promote programs and practices that prevent unneeded health or social costs through leveraging and coordination of programs and services such as those for health education, prenatal care, parent education, dropout prevention and many others. Collectively, departments should find ways to overhaul existing grant-by-grant program evaluation efforts. Performance measures that emphasize agreed-upon, long-term outcomes are needed. Other independent evaluation efforts should assess the effectiveness of programs used in combination to bring about service integration efforts.

The Secretary or other senior staff should participate in roundtables that provide a forum for the exchange of information and opportunities to share ideas and seek advice from leaders in private industry, representatives working with clients, and the clients themselves, whenever possible. This group should work to establish lines of

communication with congressional leaders and include them in collaborative goal setting.

A related interagency effort, welfare reform, is already in progress under the Domestic Policy Council. The council was created to bring together department or agency heads to work on policy. Issue groups, such as one on welfare reform, will work on defined priority issues. Elements found successful under the FCCSET and Interagency Council on the Homeless should be adopted by issue groups. For example, FCCSET has a clear mission, and the FCCSET members have authority to make budget commitments. FCCSET initiatives undertaken are published along with current and outyear budget projections, and existing staff and budget authorities are used. The Interagency Council on the Homeless uses policy and working level groups and regional participation, which may also be helpful in carrying out some of the activities described in the recommendation below. As needed, MOUs can be developed, but they should articulate the common mission and lay out specific responsibilities and/or planned activities.

Other important initiatives that require HHS participation include the National Education Goals to have all children start school ready to learn and to eliminate illiteracy, promoting independence among the elderly or the disabled and improving the quality and access to long-term care.

Elements found successful in local collaborative efforts such as New Beginnings should also be used at the federal level: collaborative goal setting, shared responsibility for attaining goals, and working together to achieve the goals, based on using the expertise of each collaborator.

2. **HHS must use technology, private-public partnerships and other means to promote streamlining efforts.** Welfare reform task force members have already committed to championing streamlining efforts, which should include eligibility simplification, especially since so much has been done in this area. HHS should explore ways to promote the use of case management to better integrate services to individuals and families. HHS should accelerate existing efforts to use technology to calculate program eligibility. Another alternative is for HHS to use private contractors to set up "one-stop shopping" points of common intake to determine client eligibility and make referrals to case managers. In addition, particularly in the context of health care reform, HHS should work

with other departments to identify ways to focus on integrating the delivery of services at the community level, for example, using community health centers as multiple service delivery sites.

3. HHS should lead an effort to establish interagency customer service efforts focused on improved service integration across health and human service programs.

Such efforts should include "customer service representatives" (CSRs) committed to assisting grantees (i.e., state and local governments and other administering entities) to obtain information about waivers and to act as advocates in obtaining assistance from other agencies on service integration efforts. Representatives should have responsibility for convening cross-agency/department program staff to promote, review and approve collaborative efforts involving multiple agencies or departments. They should disseminate information about successful collaborative approaches and use "marketing" techniques to promote their replication. CSRs should also perform "customer satisfaction" surveys. They should analyze survey results, information from waiver requests, and other sources of information to gain information about laws, policies or practices that need to be revised to promote flexibility for service integration efforts. This information should be used for the development of HHS or interagency administrative or legislative proposals to address the problems identified.

Action should include efforts to: (a) streamline procedures for states and other entities to obtain waivers under current program authorities, including consideration of "interagency waiver boards," and seek legislation to expand waiver authorities to other programs; (b) recognize and disseminate information about successful service integration efforts; (c) develop incentives for integration and innovation, such as additional funding, regulatory relief, or priority in discretionary grant competitions; (d) establish a research agenda for the use of available funds that focuses on service integration approaches; (e) pool available funds to set up resource centers that operate as clearinghouses of information on successful service integration approaches and offer technical assistance for start-up and evaluation efforts; (f) develop plans and processes for procuring technology needed to streamline service delivery; and (i) work to resolve real or perceived issues surrounding confidentiality or information to be exchanged between departments.

4. **HHS should seek available opportunities to re-engineer its grant award processes to promote flexibility and better customer service, reduce duplication and obtain desired outcomes.** Any or all of the following should be considered: (a) coordinate within HHS and with other departments to assure that related programs have consistent application dates and program periods to facilitate better planning and implementation of service integration efforts. In addition, take such actions as issuing joint grant announcements, bundling grant announcements from separate programs or issuing unified grant announcements for sets of programs with a lead federal agency assuming responsibility for administering the grants; (b) under the auspices of welfare reform or other collaborations, take action to consolidate separate grant programs. Efforts are needed to reduce programs that are duplicative or no longer needed. In particular, grant programs currently funded at less than \$100 million should be looked at for elimination or repackaging as challenge grants or as part of larger, consolidated grants. For example, the area of Children and Family Services Programs currently includes about 20 programs each funded at less than \$25 million for runaway and homeless youth, child abuse and neglect and other purposes which could still be served even though the programs were combined; (c) for established grant competitions, give funding priority to applicants that demonstrate they have established linkages and coordinating mechanisms with other community-based programs; (d) draft a legislative proposal that would reauthorize the Joint Funding Simplification Act, with certain improvements, so that funds from related programs can be combined. This authority would fund projects that demonstrate collaboration and include plans for service integration efforts intended to provide results greater than those achievable by separate categorical grants. Through regulations, entities that demonstrate successful prior performance could be given priority to develop innovative programs. In lieu of being held to stringent recordkeeping and eligibility determinations, projects would be held to agreed-upon performance outcomes subject to periodic reassessment; and (e) use cooperative agreements to describe project plans and outcomes at entities receiving multiple funding streams.
5. **The Secretary and the HHS leadership team should express a commitment to collaborative efforts, model behaviors that demonstrate this commitment at every**

opportunity and be held accountable for achieving important goals that cross agency or department lines. In addition, HHS leaders should take actions to foster an agency culture that values collaborative efforts and seeks opportunities to bring them about to improve service delivery. Agency leaders should review agency mission statements and program mandates for proper emphasis on service integration; employee input should be sought when developing or revising such statements. Policies and procedures should be put in place to ensure there is an emphasis on the ability to work in teams when recruiting and hiring personnel, planning and implementing employee development programs, and assessing employee performance. Budget requests should include requests for adequate resources for travel or technology needed to contact other agencies or work with grantees. In addition, during yearly appraisals, agency officials should lead a self-evaluation of the efforts made by individuals and agencies to promote, carry out and improve collaborative efforts and improve customer satisfaction. The results of this assessment should be used for future planning.

Implications

These recommendations are intended to expand client access to benefits and improve customer service. Existing projects demonstrate that expanded coordination efforts can result in a greater leveraging of federal resources. As a result, more clients can be served, and in particular, multiple-needs customers can be served more comprehensively.

These recommendations call for a rethinking of the traditional rowing versus steering, "stewardship" approach to grants administration which has been in place for the last twenty or thirty years. However, over that same time period, the magnitude of the targeted problems -- poverty, juvenile delinquency, long-term care, and so forth -- have increased greatly and are continuing to strain limited fiscal resources. In the past, the solution was to add more programs, however, a new approach is called for that brings concerned stakeholders together to set priorities and work toward solutions.

Fiscal Impact

These recommendations are not expected to result in a deficit reduction, but rather, a

better use of federal funds which will be realized because more clients will be reached, and as a result, more future costs can be avoided. In addition, with improved access to benefits and other improvements, the federal, state and local governments providing these services will be viewed with greater public confidence.

In a recent speech, Attorney General Janet Reno stated that she would never be able to build enough prisons 18 years from now for children who are born today from drug-involved mothers....⁴⁰ Further, she indicated that failure now to focus on complex problems affecting children could result in the lack of future workforces needed to maintain business in America as first-rate.⁴¹ She strongly advocated prevention services such as prenatal care: "for every dollar spent on prenatal care we save three dollars within three years for health care costs related to low birth weights arising from lack of prenatal care."⁴²

The HHS IG⁴³ has identified some specific instances in which project administrators or others have quantified the costs that can be avoided if comprehensive integrated services are provided. For example, one estimate indicates that it costs society \$300,000 in welfare and other costs for each child who "fails."⁴⁴ Another source indicates that, "If \$2,700 [for project costs] per young child seems expensive, it pales in significance when compared to as much as \$10,000 that can be spent per child on remediation or up to \$50,000 that can be spent on special education throughout a child's school life."⁴⁵ According to the State of Michigan, the \$4,500 one-time cost of its Families First intervention program is small when compared with the \$10,000 recurring annual cost of foster care.

	In Millions of Dollars				
	1994	1995	1996	1997	1998
Budget Authority	\$ xxx.x	\$ xxx.x	\$ xxx.x	\$ xxx.x	\$ xxx.x
Outlay	\$ xxx.x	\$ xxx.x	\$ xxx.x	\$ xxx.x	\$ xxx.x
Change in FTEs	xx.x	xx.x	xx.x	xx.x	xx.x

(Exhibit to be provided: flow chart detailing discretionary grants process)

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REENGINEER THE DEPARTMENT OF HEALTH AND HUMAN SERVICES PROCESS FOR ISSUING REGULATIONS

Background

Federal agencies often must adopt regulations clarifying the responsibilities of those affected by congressional legislation. In other cases, where Congress has left the statutory language vague, the responsible agency decides whether clarification is necessary to carry out legislative intent.

Growth of the volume and complexity of programs under the direction of federal agencies has spawned a similar growth of the volume and complexity of underlying regulations. The Rochester Institute of Technology has estimated that the annual economic cost of federal regulations is between \$595 billion and \$667 billion; in other words, nearly \$7,000 per household every year.

There are few, if any, agencies whose responsibilities extend as far as the Department of Health and Human Services (HHS) in the context of administering a myriad of programs affecting millions of individuals. The department's duty to adopt regulations occurs amid a variety of often competing interests. The department must balance the regulations mandated by Congress with the current Administration's position and prioritization of the relevant issues. Just as importantly, the department must also address regulatory issues involving state and local government jurisdictions in program administration. In addition, the department must strive for effective administration of its programs while maximizing participation by eligible individuals.

If affected parties perceive a departmental regulation as unfair, they may challenge the validity of the regulation through the courts. The difficulty of adopting regulations that satisfy all of the competing interests, and the fear within the department of litigation over the fairness of its regulations, has combined to make the process of adopting regulations disorganized and excessively time-consuming.

Under the current process, the department sub-agency responsible for program administration distributes regulations drafted by its staff for internal comment within the sub-agency. There are often no time constraints for this or any other stage of review. In

cases where time constraints have been established, they are often not enforced. Each stage of this review occurs in a linear fashion; that is, the regulations are reviewed, and revised, then reviewed, and revised, then reviewed, and revised, and so on. In time, the regulations are ripe for comment by the administrator of the sub-agency. Following the completion of revisions to satisfaction of the administrator, the sub-agency forwards the regulations to department staff outside the sub-agency. Here, the department's Budget division, Planning and Evaluation division, and Office of General Counsel, review the regulation. When comments from these sources have been addressed satisfactorily, the regulations make their way to the office of the Secretary. The Secretary's comments are then addressed and appropriate revisions made.

Following the Secretary's approval, the sub-agency sends drafts of the regulations to the Office of Management and Budget (OMB) for review and comment. Again, there is often no time limit for this review. Eventually, the regulations are forwarded to the Director of OMB for approval.

Following OMB sign-off, the regulations return to HHS and filed in the *Federal Register*. Only at this point do affected parties outside the department, e.g., state governments, program clients, and the public at large, get a glimpse of the manner in which the legislation is to be interpreted and the program administered.

The current process often produces months, and in some cases, years, of delay before finally adopting regulations. Department personnel who are experienced with the current process view these delays as a major reason for the resentment of the process held by both department staff and outside parties. It is important to note that, as the department has added layer upon layer of review and expertise to this process to get better-drafted regulations, delays have dramatically increased due to the fragmented and task-oriented management of the process.

Two examples illustrate the problems with the current process.

HCFA's failure to issue timely regulations mandated by legislation has in many cases forced states to adopt program guidelines without knowing the terms acceptable to HCFA. Several states have been sued over the alleged "improper" administration of the

program, albeit in the absence of regulations HCFA should have adopted well before the scheduled implementation date for the state guidelines. In those lawsuits that have gone to trial to date, courts have ruled that such administration was in fact "improper," and held states financially liable. As of the end of December 1992, there were a total of 42 regulations and reports required by law backlogged at HCFA. Over 75 percent of these items were past statutory deadlines. Despite its problems, HCFA has shown a commendable willingness to change. HCFA has been approved by the National Performance Review as a pilot laboratory for experimentation with reg-neg proceedings. In a letter to the Secretary dated June 2, 1993, HCFA's Administrator expressed confidence in the potential for the successful use of neg-reg proceedings in selected situations as an alternative to the current process.

The department's Administration For Children and Families (ACF) is responsible for the administration, in conjunction with state and local jurisdictions, of child-care programs designed to aid millions of individuals. Research performed in connection with this project indicates that ACF has been responsive in the provision of regulations to clarify many of the parameters of legislation. Predictably though, given the sheer size and nature of programs providing aid in this context, questions constantly arise that require guidance as to the department's policies under the related legislative and regulatory framework. States have on many occasions submitted requests for such guidance to the department's regional offices, only to wait months for a response. ACF's delay in responding to such requests reflects many of the same problems that characterize the process of adopting regulations by the department (e.g., lack of organized interdepartmental communication, and excessive time-delays).

The delay, or failure, by HHS to respond quickly to the need for guidance on issues relevant to department programs has had a chilling effect on program administration. Not only does the propriety of the program's administration by state and local jurisdictions become instantly vulnerable to attack through litigation, but adequate permitted coverage of eligible individuals is jeopardized. However, by acquiring a "mission driven" approach that stresses results, the department will bring added speed, accountability, and employee satisfaction to the process of promulgating regulations.

Recommendations

1. HHS should use planning and control procedures to encourage the adoption of regulations more quickly and to promote the efficient use of available department resources.

(a) The department should select staff to serve on a department-wide policy group to prioritize regulatory initiatives among sub-agencies. This would promote the coordination of department action among programs, and efficiently channel the efforts of department mid-and upper management. This policy group would produce a list which prioritized regulation-adoption projects and other policy issues (subject to the Secretary's approval and periodic review for compliance and updating).

(b) Regulation action plans should be compiled by the responsible sub-agency's administrator promptly upon the passage of the related legislation. In many cases, regulatory development work could begin before the statute is enacted. Plans should include the following information:

- (1) specific description of the nature of the anticipated regulation;
- (2) the identity and number of parties likely to be affected by the legislation;
- (3) the identity of the person(s) responsible for researching and drafting the regulation, and those who will review the regulation in draft form prior to the Secretary's review (should include the name of back-up staff member for each named participant below the level of administrator);
- (4) identity of the OMB contact for the regulation
- (5) the nature and extent of research required prior to drafting the regulation;
- (6) parties outside the department who will be contacted for input on the content of the regulation, when they will be contacted, and the time frame for such input;
- (7) whether use of a negotiated rule making committee is appropriate;
- (8) a maximum time frame for the drafting and review of the regulation prior to publishing in the *Federal Register*, proposed as "milestones," and encompassing each stage of research, drafting, and review.

Regulation action plans, reflecting the priorities of the policy group and the Deputy Secretary, should form the basis for a regulation tracking system. Obviously, unforeseeable

events might require deviation from the regulation action plan (at the discretion of the sub-agency administrator and the Deputy Secretary).

For projects that leave substantial discretion to the department as to the content of the regulations, the creation, performance, and monitoring of the regulation action plan is imperative to achieving necessary levels of planning and control. However, projects which can be easily and promptly completed might, at the discretion of the policy group, use regulation action plans merely for prioritization and tracking purposes.

(c) The department should institute a regulation tracking system so that those involved at every stage of the regulation promulgation process could be currently advised of the status and content of all pending projects. Preferably, this system would be on-line, permitting immediate access by interested parties within the department and by the designated OMB liaison. A report summarizing the status of all regulation projects could be compiled monthly and reviewed by the Deputy Secretary.

(d) Stages of review within the sub-agency should be consolidated through use of a team approach in the drafting stage. This would entail the aggregation of ideas from all reviewers through direct conversations with those drafting the regulation. Those to be involved in this process would be identified in the regulation action plan.

(e) Consideration should be given to the production of a brief video explaining the steps in the reengineered process. The video could also emphasize, through comments by the Secretary, the goals of increasing employee motivation through the recognition of exceptional performance. The video could be supplemented by offering additional training for staff involved in the drafting of regulations. Such training would emphasize technical writing skills and encourage staff to conceptualize project goals using "best practices" techniques in a cost-effective manner.

2. In drafting regulations affecting programs for which administrative responsibility is shared with states, the department should solicit states' assistance about the nature and extent of administrative matters to be addressed in the regulations. To accomplish this, the department should request the assistance of the National Governor's Association or a similar organization in devising a plan for grouping states into regions for these purposes. Each region would appoint one representative to attend a work session with the department staff responsible for researching and drafting the regulation. Such work sessions would be

held following the approval of the regulation action plan (see recommendation 1(b.)), and would secure the input of significant subject matter expertise through the regional representatives.

Cooperative efforts among federal and state agencies have proven effective in implementing and administering consumer protection programs. The department surrenders none of its discretion as to the content of its regulations through the conduct of these work sessions.

3. In instances of OMB review of the department's regulations, an OMB analyst should be assigned as a liaison to each sub-agency within the department. This liaison could be solicited by the staff drafting the regulations for input on content. OMB has recently announced its intention to limit its future review of regulations to only those of highest priority to the administration. OMB will advise agencies of instances where it intends to conduct a regulatory review.

4. In cases where potential regulations involve the balancing of highly competitive interests, or where there is substantial potential for future litigation, the department should use a negotiated rule-making committee (i.e., a reg-neg proceeding) pursuant to the Federal Administrative Procedures Act (see 5 U.S.C.A. §563.) Such a committee, which could include key department staff, state and/or local administrators, as well as private sector expertise, would provide a fertile ground for achieving a substantially more integrated process for accumulating data and drafting the regulation than now occurs.

5. HHS should consolidate its internal reviews to reduce the multiple layers of reviewers in the current process. Ideally, all reviewers and drafters should meet to discuss a regulation draft. This would reduce review time.

6. For instances when the states' deadline for program implementation will precede the publication of regulations, the department should institute a program akin to the Internal Revenue Service private letter ruling process. States could then submit a profile of their proposed implementation methodology to the department in the absence of regulations. The department would be required to rule as to the adequacy of the proposal within a defined time period (e.g. 120 days with a one-time 30 day extension to be used only if more data is required to rule). The department's failure to respond to the proposal within the prescribed time frame would automatically approve the proposal. Such a

"private letter ruling" type of program would allow states to obtain at least some degree of assurance as to the propriety of methodology they propose to use in implementing legislative provisions that are frequently complex, ambiguous and/or vague.

Implications

While the prospect of implementing these recommendations simultaneously might seem intimidating, a thoughtful review of each recommendation will reveal that this reengineered process achieves separate aspects of the department's "mission."

The prioritization of regulatory and other policy issues will aid the department by allowing the assignment of each issue to staff aware of the relative importance of their timely performance on the assigned issue. Decentralizing decision-making regarding the vast number of programs administered by the department will improve the quality of administration, empower mid-level managers, and provide, through the central policy group, a forum for managing the department's policies on a coordinated "mission-driven" basis.

The regulation action plan allows sub-agency administrators to develop an overall schedule, complete with a roster of participants, for the promulgation of a regulation before the process ever begins. The plan promotes a more efficient allocation of time by all department staff, increases accountability at each stage of the process, and empowers employees at the mid-management and staff levels to plan and perform in a more coordinated manner.

Work sessions with state administrators in regulatory projects requiring dual administration will bring substantial subject matter expertise to the process and assist department staff in drafting regulations that are sensitive to many perspectives. Participation by administrators at all levels will reduce subsequent complaints and requests for clarification from state and local administrative bodies. This in turn would reduce the workload for department regional and central staff.

Although negotiated rule making is highly labor intensive and somewhat more expensive than the current process, the Environmental Protection Agency has demonstrated that it can be a successful process. Such a process would be helpful in deflecting antagonism over a position taken on controversial regulations. However, negotiated rule

making must be used sparingly in light of its potential to consume a great deal of time and effort, and in view of the binding nature of conclusions reached by the rule making committee. That negotiated rule making may not be advisable in every case should not prevent the department from taking steps early in the process to solicit as much information from as wide a variety of affected parties as possible.

For programs where states have administrative responsibility in tandem with the department, the availability of a proceeding similar to the private letter ruling procedure in place at the Internal Revenue Service would provide guidance to state administrators responsible for making significant decisions about program implementation. Such guidance would in turn improve the likelihood of uniform administration of programs among all states. Further, such a procedure would have the potential to reduce drastically the financial liability states might face in a successful court challenge.

The imposition of a time deadline on the department might appear to be a simple yet effective way to reduce delays under the current process. The use of such a deadline, however, may in the long run do more harm than good. The existence of a deadline is indicative of the fragmented and individual task-oriented management of the current process. While a tracking system and status report would promote accountability at all points in the process, a mere time deadline would not. Instead, a time deadline denotes the attitude that the process must be micro-managed to be effective. Such an attitude is a disincentive to employees participating in the process.

Fiscal Impact

While the fiscal impact of implementing the recommended reengineered regulation promulgation process is difficult to quantify, a variety of identifiable sources of savings are evident. These include:

- (1) a significant reduction of department staff time in researching, drafting and reviewing regulations;
- (2) a substantial reduction in litigation costs relative to matters involving regulation validity and/or interpretation
- (3) a substantial reduction in the volume of complaints and requests for clarification from

all sources, particularly state and local administrators, and from affected parties whose input was solicited in the drafting process (whether or not such input is reflected in the positions assumed in the adopted regulation

(4) a reduction in political costs arising from Congressional interests who have not had adequate

opportunity for input to the department's policy formulation, prioritization, and regulation drafting processes; and

(5) a significant reduction in the department's time spent reviewing and integrating Congressional input into the process at stages that may result in the need for re-review by several layers of department management.

DEVELOP A NATIONAL, UNIFORM, SCIENTIFIC, RISK-BASED INSPECTION SYSTEM TO ENSURE A SAFE FOOD SUPPLY

Background

The Centers for Disease Control and Prevention, (CDC), U.S. Department of Health and Human Services, (HHS), estimates at least 9,000 Americans die from foodborne illness each year, and that 6.5 million become sick from eating contaminated foods.¹ Because many of these cases go undiagnosed, the actual figure is probably much higher than the conservative estimate of 6.5 million annually. Officials at FDA have estimated at least 24 million cases can be attributed to contaminated foods.² There is not a mandatory system for reporting diagnosed cases of foodborne illness at the national level. A greater problem is the lack of resources to investigate foodborne illness so that outbreaks can be recognized. Inconsistent disease incidence data limits our ability to accurately measure the effectiveness of our food safety inspection system in protecting our nation's food supply.

Most of the cases of foodborne illness today can be traced to meat, poultry, eggs, milk and shellfish.³ Shellfish alone caused 21 percent of all reported food poisonings arising from meat, fish, or poultry between 1978 and 1987.⁴ Food can be contaminated with harmful microorganisms (such as bacteria, viruses, and fungi); parasites (such as tapeworms, roundworms, and flukes); chemicals (such as pesticides, animal drugs, flavor and color additives, or industrial chemicals); and natural poisons (such as the toxins in some shellfish). Since 1985, we have had significant outbreaks of foodborne illness caused by highly pathogenic bacteria, including cheese contaminated with *Listeria*, milk and cantaloupe contaminated with *Salmonella*, canned mushrooms contaminated with *Staphylococcus*, and hamburger contaminated with *E. coli* O157:H7. In addition to these acute outbreaks, chemical contamination of foods with animal drugs and pesticide residues may contribute to unknown increases in cases of cancer and birth defects.

Some of the increases in foodborne illness seem to be an outgrowth of major changes in our population, food processing system, and consumer habits. Some increases may also be attributed to improved detection and reporting methodologies. The prevailing food safety laws were passed in the early 1900's. Much has changed since then. Today we have high speed mass production food processing instead of simpler food processing within our

homes. We transport more food across the country, and import more from other countries.

In 1993, few consumers stay home and spend hours preparing food, but rather eat on the run. We buy from carry outs, eat at fast food chains, and cook in microwave ovens. More and more of our food is bought partially prepared. We are also physiologically different than we were in the 1900's. The baby boomers are an aging population. Lowered immunity can be a natural part of the aging process, increasing individuals' susceptibility to infectious diseases, including foodborne illness.⁵ Today consumers are more likely to live with chronic illnesses that also increase our susceptibility to foodborne illness. Two of the most important illnesses are Acquired Immunodeficiency Syndrome (AIDS), and cancer which most often requires radiation or chemotherapy. Some foodborne bacteria, including *Salmonella*, have been associated with chronic diseases such as arthritis.⁶ The parasite *Toxoplasma gondii* has been shown to cause dementia in immunocompromised individuals, including more than 50 percent of AIDS patients.⁷ The incidence of *Mycobacterium avium* in immunocompromised persons is also rapidly on the rise.

The prevention and control of foodborne illness and foodborne disease outbreaks is of great economic importance. These illnesses and outbreaks are expensive not only for those who are ill, but also for society. An April 1985 *Journal of Food Protection* article estimated that foodborne illnesses in the U.S. costs between \$1 to \$10 billion annually. This figure includes direct medical costs, lost wages and productivity, and industry loss through embargo, voluntary destruction and recall. The article stated that "Any money spent on research, surveillance and public education would be only a small fraction of the cost otherwise borne by the economy when disease occurs...In most instances food supplier losses in the form of recalls, lost business, legal fees, legal settlements and wages exceeded the medical costs and lost earnings of the victims, thus the indirect cost to the economy may equal or even double the patient-related cost estimates."⁸

A July 1988 *Journal of Food Protection* Article indicated that a preliminary estimate (based on an estimate of 12.6 million cases of foodborne illness per year) is \$8.4 billion annually. The article stated that "Microbiological disease (bacterial and viral) represent percent of the United States' costs with salmonellosis: \$4 billion; staphylococcal: \$1.5 billion; toxoplasmosis: \$445 million; listeriosis: \$313 million; campylobacteriosis: \$156 million; trichinosis: \$144 million; *Clostridium perfringens* enteritis: \$123 million; *E. coli*:

\$123 million; Botulism: \$322,200 per case..."⁹

In June 1993, Agriculture Outlook reported "USDA's Economic Research Service (ERS) has estimated that medical costs and productivity losses from foodborne disease caused by several major bacterial pathogens--Salmonella, Campylobacter jejuni or coli, E. coli O157:H7, and Listeria monocytogenes are between \$2.5 and \$3.4 billion annually. Costs for several major parasitic foodborne diseases--Toxoplasma gondii, Trichinella spiralis, Taenia saginata, and Taenia solium were estimated at \$2.6 billion annually." These annual estimates for 1992 excluded toxoplasmic encephalitis infections in 2,250 - 10,200 AIDS patients, 50 percent of which may have a foodborne origin."¹⁰

The New England Journal of Medicine, August 1978 published a study conducted by CDC on the impact of one foodborne disease--salmonellosis. The study showed that "salmonellosis is much more than an inconvenience --it is responsible for complications, operations and hospitalizations of five to six days for previously well persons in all age groups, not just infants and the elderly. The study also demonstrated that "salmonellosis is expensive not only for those who are ill, but also for society because such outbreaks adversely affect the economy." The study states "Since salmonellosis is a preventable disease, the cost of public-health programs to detect, control, and prevent salmonellosis must be measured against the unnecessary medical expenses and loss-of-productivity costs, which may be more than a billion dollars a year."¹¹ It is clear that as this administration works diligently to improve the economy, reduce the deficit, and reform health care, that the prevention and control of foodborne disease outbreaks must be thoroughly addressed.

The present food safety and inspection system has not kept up with its changing environment. It is outdated and is in need of a major overhauling. It is a complex regulatory system consisting of as many as 35 different laws and involving 12 agencies. Of the 12 federal agencies, five have primary responsibility for food safety and quality inspections. The specific food product determines which agency has oversight. The Food and Drug Administration (FDA) is responsible for the safety of most foods. Within the U.S. Department of Agriculture (USDA), the Food Safety and Inspection Service (FSIS) is responsible for ensuring the safety of meat and poultry products; the Agriculture Marketing Service (AMS) for ensuring the safety of eggs and egg products and for grading products

such as fruits, nuts, and vegetables; and the Federal Grain Inspection Service (FGIS) for ensuring the safety of exported grain products and for grading domestic and imported grains and related commodities. The Department of Commerce's National Marine Fisheries Service (NMFS) is responsible for grading seafood products. The FDA and the FSIS are responsible for approximately 95 percent of all food inspections mandated by law.¹²

There are inconsistent and illogical differences between agencies' approaches and enforcement authorities which weaken the system's effectiveness. Frequently, a food processing plant is inspected, and the actions taken to enforce the regulatory standards for safety are determined by the legislation that governs the responsible agency and not an assessment of risk that product poses to public health. An optimal inspection system is one with different levels of intensity of inspection, reflecting the degree of public health risk at various stages in the processing of foods. It has a reliable monitoring system and an accurate compliance history for each establishment in the food industry. It also reflects the special needs of the consumer. Our present inspection system does not meet these criteria. Also, differing regulatory approaches, jurisdictional conflicts among agencies, and the inability to reallocate resources across agencies have hampered inspection efforts to address public health concerns.¹³ Viewed in its entirety, the existing regulatory structure is inefficient, cumbersome, and costly.

1) The present food safety inspection system is not adequate to protect the consumer against foodborne illness. A scientific risk-based system is needed. Inspectors continue to inspect using methods developed in the early 1900's when the Food, Drug, and Cosmetic Act, the Federal Meat Inspection Act, the Poultry Products Inspection Act, and other food safety statutes were enacted. The method is known as "organoleptic inspection," which simply means using the five senses to determine product wholesomeness. The organoleptic approach has effectively removed dead, dying, diseased and disabled animals from the market for meat and poultry inspection, and continues to be important in protecting the consumer by removing diseases that exhibit visible lesions. However, public health experts and other scientists now realize that the most serious causes of foodborne illness in this decade are pathogen microorganisms inherent in the food production process. These experts are also concerned about the potential risks from residues. These hazards cannot be detected by organoleptic inspection alone. Additional more scientific inspections including

chemical and microbiological testing, or other appropriate verification steps, must be developed and implemented if regulatory agencies are to be successful in reducing foodborne illness. Rapid on-site microbiological and chemical diagnostic tests are needed to keep pace with the daily food production volume. Process control must be a priority to prevent product contamination.

There is a viable approach to process control which allows the industry to focus on public health related hazards in the food production process. In 1971, the National Aeronautics and Space Administration (NASA), the U.S. Army Natick Laboratories, and the Pillsbury Company developed the Hazard Analysis Critical Control Point (HACCP) approach to process control for the production of food products. This was to assure that products produced by Pillsbury for use by the astronauts in space were wholesome and essentially pathogen free. Pillsbury demonstrated that if the manufacturing process was adequately controlled, there would be a high degree of assurance that the end product would be safe.

In 1985, the National Academy of Science Committee on the Scientific Basis of the Nation's Meat and Poultry Inspection Program, and the National Academy of Science Subcommittee on Microbiological Criteria of the Committee on Food Protection, embraced the HACCP concept as an effective and efficient approach to manufacturing safer food products. FDA has successfully applied the HACCP principles in the control of the safety of low-acid canned foods.¹⁴

HACCP is a system for sanitation and process control for the manufacturing and processing of food products. It improves food safety and wholesomeness. The HACCP principles are defined differently by different users, thus making it imperative that there be a clear and consistent definition understood by the food industry. The original NASA HACCP program consists of seven basic HACCP principles.

If food inspection agencies mandate HACCP implementation by all appropriate food manufacturers under their regulatory authority, each manufacturer would be required to develop its own specific HACCP plan for each category of products produced. The program would be reviewed and approved by the agency and monitored on a risk-based determined frequency. HACCP would be a beginning for the industry to take responsibility for identifying and controlling public health hazards.

It is not enough, however to just implement HACCP. It is not a regulatory program. HACCP only assists the industry in taking responsibility for producing a safer product. The National Academy of Sciences indicates that the characteristics of an optimal inspection system is one with different levels of intensity based on the degree of public health risk at various stages in the production process. It has a reliable monitoring system, and an accurate compliance history of each processing plant, while addressing the special needs of the consumer. HACCP only addresses process control, concentrating on Critical Control Points in the process that potentially pose public health risk. Without a food safety regulatory agency having a reliable monitoring system and an accurate compliance history of food establishments, the inspection system would be missing vital components for effectively protecting consumers.

2) The current food safety inspection system is inconsistent in the intensity and frequency of inspection for foods posing similar risk. FDA inspectors responsible for inspecting the nation's food supply are also responsible for inspecting firms that produce medical devices, drug manufacturing facilities, and blood banks. Due to limited inspection resources, these medical support firms are usually assigned a higher priority than food processing plants producing high-risk foods (low acid canned foods and infant formulas). They are always assigned a higher priority than low-risk food facilities (bakeries, warehouses, and bottling plants). Although FDA attempts to assign a risk priority to foods by categorizing them as "high" or "low" risk, the assignment of inspection frequency is inconsistent and not based on risk analysis principles. The frequency is usually based on the availability of resources. Availability is often controlled by the presence of a crisis in the drug or medical device industry, or with the nation's blood supply. Such a crisis usually demands that FDA concentrate its limited resources on the crisis issue, thus reducing the inspection of food manufacturing firms.¹⁵ A recent GAO report indicated that on an average, FDA inspects food establishments once every three to five years.¹⁶

The Federal Meat Act of 1907 and the Poultry Products Inspection Act of 1957 mandate that the Department of Agriculture provide continuous inspections at slaughter establishments, examining every carcass. The Acts also mandate that inspectors visit meat and poultry processing plants on a daily basis. These laws are inflexible, not allowing FSIS to vary the frequency of inspections to concentrate its resources on risk and issues

significant to the public's health as recommended in the National Academy of Science's report of 1985.¹⁷ FSIS's current system is labor intensive and needs major revamping to concentrate on risk.

GAO Report RCED-92-152 states " ...in fiscal year 1991, FSIS devoted about 9,000 staff years to oversee about 6,100 establishments, while FDA devoted about 255 staff years to oversee an estimated 53,000 food establishments." ¹⁸ This statement referred to the inspection of domestic food establishments, and did not include import inspections. The two agencies also have different approaches for foods posing similar risks. For example, beef broth is inspected daily by FSIS, while plants manufacturing chicken broth may be inspected by FDA once every three to five years. Meat and poultry products are inspected daily by FSIS, while shellfish are not subject to mandatory federal inspection. These are only a few examples of inconsistencies in inspections in the present system.

According to the National Academy of Sciences and others, the frequency and intensity of inspection should be based on food safety risk. The risk should be determined by a form of risk analysis which takes into account hazards associated with the food product, the process by which the product is manufactured, and the compliance history of the establishment producing the product.¹⁹ This could allow federal agencies responsible for food safety inspections to use their resources more efficiently.

3) The food safety inspection system also has inconsistent enforcement authority. Legislation authorizing FDA activity allows food to enter the market without preapproval. This limits the agency's ability to head off food safety problems before they occur. FDA must prove there is actual or potential contamination or establish that conditions are unsanitary. FDA lacks the necessary enforcement authorities to assure a safe food supply. Most of FDA's findings of insanitary conditions or practices, or adulterated products, are resolved through voluntary compliance. At times, FDA must legally take control of suspect products by a federal court warrant. This can be a very lengthy process. While the inspector is obtaining the warrant, the product could end up in the market place, unless the states use their authority to seize or detain the product. FDA does not have immediate authority to detain adulterated food products. Under the Food, Drug and Cosmetic Act, it lacks the authority to recall adulterated product from the market place; access company safety and quality control records; and pre-approve food labels.²⁰ FDA also lacks a

mandatory registration requirement. Establishments that are not identified by the agency go uninspected.

The FSIS contrast requires that the industry prove safety before food products can be marketed. It has the above authorities not granted to FDA, but lacks authority to seize or prevent the shipment of known infected animals to the market for slaughter.

The food safety inspection system has little incentive for food establishments to exceed the minimum requirements. There should be a system of incentives for companies to regularly exceed standards for wholesomeness. These incentives may be positive or negative, such as increased inspection costs for less than desirable compliance.

4) Food safety research is also duplicative and driven by varying missions from some 21 agencies. A January 1993 report by the Committee on Food, Agricultural, and Forestry Research of the Federal Coordinating Council for Science, Engineering, and Technology reports that some 21 Federal agencies spend approximately 200 million dollars on food safety research under approximately 50 laws that directly or indirectly authorize such research. These agencies are within the Department of Health and Human Services, Department of Agriculture, Environmental Protection Agency, Department of Defense, Department of Commerce, National Science Foundation, Department of the Treasury, Department of State, and the National Aeronautics and Space Administration. This research may be basic or applied, laboratory based or social studies research. It may be broadly or specifically focused, and carried out in federal laboratories, through contracts, cooperative programs, or grants to academia and the private sector.

The areas or categories of research include infectious disease agents and their toxins, drug and pesticide residues, food additives, natural marine toxins, environmental and industrial contaminants, food product processing, storage and packaging, diet and nutrition, and food production from preharvest to harvest. Each area of research may address improved methods to identify hazards, prevention and control, mechanisms of action, risk assessment and risk management methods, or consumer behavior studies.²¹

There is a great need for single coordinated effort for food safety research, driven by a single mission and being accountable to a single authority. This would eliminate the duplication of expensive research projects, and provide effective communications and sharing of information between researchers.

5) The food safety inspection system has overlapping and duplicative inspections. Inspection efforts are poorly coordinated. Coordination agreements under which agencies are required to notify responsible agencies of plant problems or deficiencies found during inspection do not ensure that food safety problems are corrected. A recent GAO report states that unsanitary and other unacceptable conditions persist in food processing plants because notifications do not always take place, or the problems referred to the responsible agency are not always promptly investigated.²² The effective use of interagency agreements has been hindered by a lack of agency resources to follow up once referrals have been made. There is not an adequate internal process for assigning and tracking reported problems. GAO reports that products under FDA's authority that are also processed under other agencies' oversight, or fall under other agencies' voluntary inspections or grading programs are often duplicative and responsibilities are overlapping.

Past efforts to correct deficiencies in the food safety inspection system have failed because the agencies have continued to operate under different regulatory approaches. The division of responsibility between USDA and FDA "has resulted in a regulatory program which is often duplicative, sometimes contradictory, undeniably costly, and duly complex...There is no rationale, other than a historic one, to justify maintaining two separate, inconsistent, and costly systems for inspecting and otherwise regulating production of processed foods" reported the Senate Committee on Governmental Affairs in 1977.²³ A new structure for food safety inspection, based on uniform enforcement authorities and an assessment of the risk food products pose to the public will help Congress to oversee, fund, and enact legislation on a single federal food safety inspection system.

Recommendations

Create a single food safety agency responsible for administering a uniform set of scientifically based foods safety laws. The President and Congress must establish a new single, food safety agency responsible for food safety, inspections, and food safety research. The authority for enforcing all federal food inspection laws and regulations, and all personnel, facilities and equipment currently utilized by such programs, should be transferred to the new agency. The location of the new agency within the Executive Branch of government must be such that the Congressional committees responsible for the appropriation of its funds are unlikely to be those which have a special interest in

promoting the inspected industries.

The current laws regulating federal food inspection must be reviewed immediately to identify areas where changes in the laws are needed to base food inspections on sound science and strengthen regulatory authority. The new agency should also begin a review of the current regulations governing federal food inspection for the purpose of producing uniform regulatory requirements, taking into consideration the inherent risk in the product or its production, and the unique nature of the foods and the industries that produce them. It is also imperative that the new agency begin immediate studies to determine the program objectives that are to be addressed in order to have the maximum preventive impact on problems of food safety.

An immediate study should be made by the new agency of current staff and resources, and the policies governing their utilization, and the information obtained is to be used to construct a new organizational structure, a management system, and inspection procedures capable of meeting public health based objectives.

This new food safety agency must serve as a reinvention model. Its primary mission must be consumer protection and food safety. It will be customer driven, listening to and meeting the needs of the consumer within the boundaries of sound science. Prevention of foodborne illness and prevention of poor sanitation and manufacturing practices will replace crisis management. There will be in place a management system for continuous improvement, concentrating on the continuous reduction of risks of foodborne illness. This will include continuous evaluation and reduction in the numerical regulatory standards for sanitation, microorganisms, and residues that assist in reducing risks. Empowering the front line food inspector and eliminating cumbersome layering and complicated chain-of-commands will simplify decision making in the field and improve regulatory effectiveness.

The new agency should also be given the authority to impose user fees for appropriate services to aid in the cost of improving inspection processes. User fees should be considered for food establishments requiring additional inspection enforcement effort due to repeated noncompliance with the regulations. Also, diagnostic laboratory testing conducted to release detained or recalled product where there is known or potential contamination of product, and for other regulatory reasons outside of the normal monitoring or surveillance

sampling could be subjected to a user fee. User fees should be considered for overtime, additional shifts requiring inspection oversight, inspection of imported food products, certification of exported food products, agency responses to FOIA (Freedom of Information) requests, and other special services as appropriate.

The single food safety agency would eliminate the need for interagency agreements for coordinating inspection activities between agencies, and will eliminate duplicative inspections in establishments with similar products under the authority of different agencies.

It is recommended that the new Food Safety and Inspection Administration meet the following criteria:

1) Hazard Analysis Critical Control Points (HACCP), or an equally effective science-based system, must be mandated for all food processors. HACCP, or an equivalent system must lay the foundation for a science-based inspection system, and place the responsibility for producing a safe product on the food industry. Each food processing firm would be required to have a federally approved HACCP plan for each category of food products it produces. The industry would be responsible for operating the HACCP program. Federal food inspectors would monitor the industry program on a risk-based determined frequency. User fees may be collected for the application approval process. This fee could guarantee the industry an expedient and accurate HACCP plan approval process, and help fund federal resources required for the application approval process. Appropriate verification testing would be an integral part of each HACCP program.

2) An automated reporting system must be developed to aid in setting inspection frequencies. An automated reporting system could assist in identifying food establishments that are consistently out of compliance with federal regulations. This system could be adjusted to determine inspection frequency for each establishment based on the type of product manufactured (and its inherent safety risks) and the compliance history of the manufacturer. Establishments producing high risk foods and with a poor compliance history would be inspected at a higher frequency than establishments producing low-risk foods and maintaining a good compliance history. Each inspector would be required to enter compliance data on each establishment into the automated system. They would also provide each inspector with an inspection schedule generated by the system. The automated system could assist in keeping accurate records on consistently "bad performers,"

and could be used to establish a user fee for those establishments requiring additional federal oversight.

3) New food safety laws must provide uniform regulatory action, and provide inspectors sufficient enforcement authority. Incentives are also needed for companies who consistently exceed minimum requirements in producing a safe product. This agency must have authority over all food products. The term "food" includes meat, poultry, milk, eggs, fish, shellfish, fruits, vegetables, grain products, bottled water, alcoholic and other beverages, and any other item eaten by humans. For meat and poultry products, this authority must cover all species, including both domestic and exotic animals. It is imperative that food safety inspectors be given sufficient enforcement authority to adequately protect the consumer from unsafe products and fraud. This legislation should give the agency the authority to seize, detain, or embargo suspected contaminated or adulterated products, or food ingredients; order recalls of potentially unsafe products in the market place, pre-market the approval of labels, and have access to industry quality control, food safety, product inventory, and shipping records. Authority must be granted to require the registration of all food establishments, which may be done in conjunction with approving HACCP programs for each establishment.

It is imperative that the law give the agency criminal prosecution authority, authority to impose civil penalties, and authority to terminate operations as appropriate. Authority should also be granted to control eminent hazards from the farm (or production environment), to the market place. For meat and poultry products in particular, an adequate trace-back system from the farm to the consumer is necessary, with full authority to take corrective action at any point in the process as appropriate. Authority should also be granted to destroy imported products known to be public health hazards.

In addition to enforcement authority, the legislation must also provide incentives to encourage the food industry to produce a safe and wholesome product above the required sanitation and processing conditions. These incentives may include, but are not limited to the following: (a) authorizing certain labeling criteria for those establishments producing product under standards and conditions above those required by the regulations, (b) publicizing the names of plants with consistently high safety records, (c) making plants compliance records available to the public, (d) releasing the names of consistent violators to

the public, and (e) imposing user fees for establishments requiring additional enforcement oversight due to repeated regulatory noncompliance.

4) All food safety research functions must be included in the single food safety agency. All food safety research must be mission driven and have a "protected budget" for research only. This should be a separate and independent line item in the budget. New food safety legislation should allow for in house research capabilities, and allow for contracts with the best available scientists to conduct necessary research. All data and results should be published and made available to the scientific community on a competitive basis.

Research must address and improve the scientific validity, applicability, and efficiency of inspection procedures, control measures, and risk assessment methodologies. Studies examining cost effectiveness of options for the control of food safety hazards to conserve federal resources must be conducted as part of the continuous improvement process.

Implications

The creation of a single food safety agency will provide enforcement of uniform scientifically based inspection laws. It will eliminate unnecessary regulations, and allow for a more efficient use of inspection resources. Mandating HACCP for the food industry will provide the industry with a "road map" for ensuring the consistent production of a safe and wholesome product. It will provide the agency with the basis for risk-based distribution of inspection resources, and reduce the number of annual foodborne outbreaks. HACCP coupled with the use of an automated system for tracking the history of all food establishments, will provide the new food safety agency with a more effective and efficient food safety inspection system.

The consumer organizations will embrace the idea of a single food safety agency. There may be some agency territorial concerns from those departments giving up their food safety programs.

The meat and poultry industry will highly object to being regulated by an agency that has consumer protection and public safety as its mission. The food industry will however welcome consistent laws and regulations that will simplify regulatory compliance. The labor union organizations may object to the creation of a new food safety agency, for it may eliminate the present labor-management contracts and require the formation of a new

union organization with new negotiations. The impact on labor organizations could be minimized by transferring the present labor agreements.

The Office of Management and Budget has also expressed concerns that the level of foodborne illness in this country is not high enough to warrant the formation of a separate agency to resolve present ineffectiveness and inefficiencies. It is possible to develop a uniform set of food safety laws to be administered by the present food safety agencies. This would eliminate the inconsistent treatment of food products posing similar health risks. This option would not, however, address the issue of overlapping and duplicative inspections without requiring additional interagency agreements and the resources necessary to keep these agreements updated and effective. A single food safety agency would allow inspection resources from present agencies to be appropriately distributed to areas of highest risk. Implementing a uniform set of food safety laws administered by the present agencies would not allow this efficient use of resources, for it will be impractical to remove inspectors from FSIS and place them in FDA to meet the resource requirements of a uniform risk-based inspection system. Multiple agencies would continue to operate under separate appropriations. FSIS would continue to operate in conflict with the mission of the Department of Agriculture. Any savings incurred by one agency could not easily be redirected to another agency with a shortage of resources. There would also remain duplicative administrative functions and management positions in at least five agencies that could be eliminated, drastically reducing the cost of operating a food safety program if food safety were under a single agency. Many cost cutting opportunities inherent in operating a single food safety agency would be missed.

Fiscal Impact

OMB is presently working with the HHS team to determine the fiscal impact of creating a new food safety agency.

AGENCY	RESPONSIBILITY	LEGISLATION
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U.S. Department of Agriculture

Food Safety and Inspection Service	Meat and Poultry Safety	Federal Meat Inspection Act, as amended (21 U.S.C. 601 et seq.) Poultry Products Inspection Act, as amended (21 U.S.C. 451 et seq.) Talmadge-Aiken Act of 1962 (7 U.S.C. 450 et seq.)
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Agriculture Marketing Service	Eggs/Egg product Safety Inspects/Grades Quality of Egg, Dairy, Fruit, Vegetable, Meat, and Poultry Products	Egg Products Inspection Act, as amended (21 U.S.C. 1031 et seq.) Agriculture Marketing Act of 1946, as amended (7 U.S.C. 1621 et seq.) Agriculture Marketing Agreement Act of 1937, as amended (7 U.S.C. 601 et seq.) Export Apple and Pear Act, as amended (7 U.S.C. 581 et seq.) Export Grape and Plum Act, as amended (7 U.S.C. 591 et seq.)
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Federal Grain Inspection Service	Inspects Quality of Grain, Rice, and Related Products	U.S. Grain Standards Act, as amended (7 U.S.C. 71 et seq.) Agriculture Marketing Act of 1946, as amended (7 U.S.C. 1621 et seq.)
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Animal and Plant Health Inspection Service	Protects Animals and Plants From Diseases and Pests	None
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Agriculture Research Service	Performs Food Safety Research	Department of Agriculture Organic Act of 1862 (7 U.S.C. 2201 et seq.) Research and Marketing Act of 1946, as amended (7 U.S.C. 427 et seq.) National Agriculture Research, Extension, and Teaching Policy Act of 1977, as amended (7 U.S.C. 3101 et seq.)
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Department of Health and Human Services

Food and Drug Administration	Safety of All Foods, Except Meat, Poultry, and Eggs Safety of Animal Drugs and Feeds	The Federal Food Drug and Cosmetic Act (FFDCA), as amended (21 U.S.C. 301 et seq.) Others Public Health Service Act, as Amended (42 U.S.C. 201 et seq.) Pesticide Monitoring Improvements Act of 1988 (21 U.S.C. 1401 et seq.) Egg Products Inspection Act, as amended (21 U.S.C. 1031 et seq.) Safe Water Drinking Act, as Amended, (21 U.S.C. 349) Infant Formula Act of 1980, as amended (21 U.S.C. 350a) Federal Anti-Tampering Act (18 U.S.C. 1365) Federal Import Milk Act, as amended (21 U.S.C. 141)
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Centers For Disease Control	Investigate Foodborne Disease Problems	The Public Health Service Act, as amended (42 U.S.C. 201 et seq.)
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Environmental Protection Agency

	Regulates Pesticides Establishes Pesticide Tolerance Levels	Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA), as amended (7 U.S.C. 136 et seq.) Federal Food, Drug, and Cosmetic Act, (FFDCA), as amended (21 U.S.C. 301 et seq.)
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U.S. Department of the Treasury

Bureau of Alcohol, Tobacco and Firearms	Regulates Production, Distribution, and Labeling of Alcoholic Beverages	Federal Alcohol Administration Act (27 U.S.C. 201, et seq.) Internal Revenue Code (26 U.S.C. 5311) and (26 U.S.C. 7302). Alcoholic Beverage Labeling Act of 1988 (27 U.S.C. 213 et seq.)
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United States Customs Service	Examines/Collects Food Import Samples for Other Federal Agencies	Tariff Act of 1930, as amended (19 U.S.C. 1654)
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U.S. Department of Commerce

National Marine Fisheries Service	Conducts Voluntary Seafood Inspection Program	Agricultural Marketing Act of 1946, as amended (7 U.S.C. 1621 et seq.) Fish and Wildlife Act of 1956 (16 U.S.C. 742a et seq.) Lacey Act, as amended (16 U.S.C. 3371 et seq.) Magnuson Fishery Conservation and Management Act, as amended (16 U.S.C. 1801 et seq.) National Ocean Pollution Research and Development and Monitoring Planning Act of 1978 (33 U.S.C. 1701 et seq.)
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Federal Trade Commission

-	Regulates Advertising of Food Products	Federal Trade Commission Act (15 U.S.C. 41, et seq.)
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Fiscal Impact

{Pending}

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RECONFIGURE SUPPORT FOR HEALTH PROFESSIONS EDUCATION

Background

The American health care crisis with calls for reform has spotlighted new attention on the supply and mix of health professions. Commissions, foundations, and recent legislation agree on three areas of need in the supply of health professions:

First, more primary care and public health professionals are needed. Present educational and market forces lead to such specialization that only 24 percent of medical school graduates are entering primary fields.¹ This is far below the 50 percent that health policy experts believe should be deployed in general medicine (family practice, general internal medicine, and general pediatrics).² Alternatively, many needs can be met by more physician assistants, nurse practitioners, certified nurse midwives, or even new professions.³ Increased community-based care and more attention to prevention through public and environmental health services will also shape workforce needs in new directions.

A second area of need is for more health professionals for under-served rural and inner city areas. Nationally, physician/population ratios are higher than ever,⁴ but the ratio is much lower in rural areas than in urban areas (96 per 100,000 for "nonmetro" areas compared to 223 per 100,000 for urban areas in 1988).⁵ Of the Health Professional Shortage Areas in the United States, 658 out of 2,271 (29 percent) are in metropolitan areas.⁶ Increasing shortages of nurses and allied health personnel are expected in many communities.⁷

Finally, more minority health professionals are needed because such professionals are currently underrepresented in the health care workforce. African Americans, Hispanic Americans, and Native Americans are 22 percent of the population but only 10 percent of entering medical students and seven percent of practicing physicians.⁸ Of registered nurses, about seven percent are African American; three percent, Hispanic.⁹ Increasing the number of minority health professionals will redress past exclusion,¹⁰ increase the health workforce willing to serve minority and under-served areas,¹¹ and remove language and cultural barriers to care.¹²

Not only are these the generally agreed-upon goals for health professions education, there is also agreement that federal action is necessary to meet health workforce needs.

Ever since the federal government began direct aid to health professions education in the 1960s, the question of federal involvement has been less on *whether* to provide aid than on *what* assistance to provide. The Health Reform Task Force is also addressing this question, and any final recommendations for change will depend on Task Force proposals. However, the National Performance Review can also address this question from the perspective of reinventing government.

The majority of federal efforts to directly influence the supply of health professions involve programs of categorical assistance to institutions and students administered by the Bureau of Health Professions in the Health Resources and Services Administration (HRSA) of the Public Health Service, U.S. Department of Health and Human Services (DHHS).

These programs are not, however, the only federal programs that directly or indirectly support health professions education. Federal funds are also provided by (1) the professional training programs administered by the of the Substance Abuse and Mental Health Services Administration (SAMHSA) of DHHS, (2) the Department of Education's institution and student support programs that are not specific to profession, (3) programs of the National Health Service Corps, the Indian Health Service, the Department of Defense (DoD), and the Department of Veteran Affairs (DVA) that support students (mostly medical students) in return for service to these programs or agencies after graduation, (4) Medicare reimbursements for teaching hospitals. and (5) biomedical research supported by the National Institutes of Health.

While HRSA programs generally address the workforce goals outlined (increasing primary care, staff in under-served areas, and minority professionals), other federal funding sources do not all influence the national health workforce in desired directions. Medicare reimbursements to teaching hospitals and biomedical research inadvertently reinforce other social forces that create an oversupply of medical specialists and an undersupply of generalists.¹³ Hospital nurse training receives Medicare funding unavailable to community-focused programs. Although policy attention has now turned to correcting such unintended consequences,¹⁴ the country should still get the most from the relatively small funding for health professions workforce programs (\$267 million in fiscal 1993 compared to \$15 billion from Medicare, DoD and DVA medical training, and biomedical research.)¹⁵

Today's health professions education programs are derived from legislation that

began in the 1960s with the Health Professions Educational Assistance Act of 1963 and the Nurse Training Act of 1964. Early programs were aimed at goals set by several government and private commissions and have been judged a success both at increasing the number of physicians and nurses and at encouraging new health delivery approaches, e.g., nurse practitioners.¹⁶ During the 1980s Congress continued to develop new programs. However, because of rising deficits and a pro-market, anti-planning philosophy in the administration, health professions programs were not fitted to a comprehensive, consistent federal health workforce policy.¹⁷ While legislation does link HRSA programs with current health workforce goals, many of the nearly 50 separate categorical programs administered by the Bureau of Health Professions appear to reflect the interests of individual professions rather than a clear assessment of America's needs and the policy tools available.

HRSA programs provide a highly specific mix of institutional and student support.¹⁸ In some cases the law requires separate programs; in others HRSA uses discretion to fund specific methods to increase the supply of health professions in line with legislated objectives. In any case, HRSA currently administers some seven programs in support of training of primary care physicians, eight programs targeting education of nurses and allied health personnel, and eight programs having the primary objective of increasing the numbers of health care providers from minority/disadvantaged backgrounds. There are separate programs of aid for area health education centers, health education and training centers, geriatric education centers, and rural health interdisciplinary training projects. HRSA operates three separate programs to increase the number of nurse anesthetists (traineeships, curriculum development, and faculty fellowships). Congress recently authorized new programs in chiropractic, emergency medicine, and geriatric optometry. A national program to develop minority faculty repays educational loans for only 33 faculty members nationwide.¹⁹ Programs of support for students entering a specific profession, such as medicine, vary in the resources they provide (grants or loans) and in their requirements such as whether graduates must work in specific health fields.

This configuration of programs needs to be reexamined in light of current health care policy and the workforce implications of that policy. With health care now representing percent of Gross National Product and labor a high portion of health care's share,²⁰ it is not surprising that new policy data and analyses are available to assist such an

examination.

Congress has signaled its interest in health workforce issues through new information gathering and through legislation that requires funding to be linked to program outcomes.²¹ Congress has added to ongoing information requirements by establishing the Council on Graduate Medical Education and the National Advisory Council on Nurse Education and Practice. It recently (1992) authorized the new National Commission on Allied Health.²² Congress has also sought information about health professions needs from the Office of Technology Assessment²³ and the Institute of Medicine (National Academy of Sciences).²⁴ The Health Professions Education Extension Amendments of 1992 include a new authority for research on health professions education, including factors affecting careers in primary care. The same law requires the General Accounting Office to evaluate the effectiveness of health professions programs in increasing the number of primary care providers, improving the geographic distribution of health professionals in medically underserved or rural communities, and recruiting minority students.

Several foundations including the Robert Wood Johnson Foundation, the Josiah Macy, Jr. Foundation, the Pew Charitable Trusts, and the Kellogg Foundation are promoting health workforce initiatives and developing policy proposals.²⁵ The most comprehensive policy proposals for state and federal government, for schools, and for professional associations have come from the Pew Commission on the Health Care Professions.²⁶

Existing health workforce policy proposals describe where America should go (the goals) and suggest changes in Medicare education reimbursements to promote primary care and experimentation with service delivery models.²⁷ Existing proposals do not yet address HRSA programs, but the Bureau of Health Professions has committed itself to developing specific action plans.²⁸ In the meantime, themes contained in these analyses imply first steps for change.

First, federal health professions programs are and will remain a minor source among several for funding health professions education.²⁹ The value of funding from the Bureau of Health Professions is well below its fiscal 1973 high (the equivalent of \$2.4 billion in 1993 dollars)³⁰ and a tiny percentage of the more than \$25 billion spent annually on health professions education.³¹ State and local governments, hospitals, the health insurance industry, philanthropy, and student tuition (all of which, in addition to the federal

government, support health professions education) also can and should influence the direction of that education.

Second, money is not the sole driver in the health workforce. Accreditation bodies, health care providers, and curriculum developers shape the supply and mix of health professions. Health education markets are highly complex, and the public must participate in the decisions that shape them lest narrower professional interests dominate.³²

Third, the federal government must play a role in meeting health workforce needs. Health care objectives are increasingly being set at the national level, and the federal government must help correct workforce shortages and imbalances that occur in spite of market forces and the independent actions of State governments, professional associations, foundations, and schools. The federal government can ameliorate shortages and encourage new educational approaches with direct program expenditures. The federal government can also provide leadership to influence accreditation standards and curriculum development and to promote quality improvement in health education and practice. Federal programs that are counterproductive in their effects on the health workforce can be reshaped.

What emerges from these themes is a vision of the Federal government as partner and catalyst. The Pew Health Professions Commission illustrates this view when it states that "The federal sector is not charged directly with training health professionals or in deciding how they are utilized. However, it holds enormous leverage through other programs that impact the operation of health professions schools and patterns of professional practice. In this regard the federal sector can play a unique leadership role in fostering change."³³

The catalyst role is not well supported by the current array of health professions programs. The federal government needs flexible strategies to leverage scarce resources in partnership with States and others to meet emerging needs. The current programs tie the federal government to a specific mix of approaches that precludes the desired level of experimentation. Moreover, current programs generally fund schools directly. They bypass the State governments whose planning activities are critical to meeting the needs of their States as well as the workforce needs of the nation as a whole. The federal government could be more effective if legislation authorizing aid to health professions were less specific and focused on the desired outcomes of federal support for health professions education

rather than on the type of support. Legislation that authorized programs to meet recognized goals (for example, increasing the supply of health care providers to under-served areas) without specifying the methods would allow the federal government to foster experimentation.

While federal support for health professions education needs to be flexible, it should not be ad hoc. Federal action should be based on knowledge; policy participation cannot be effective without information.

The customers for policy information include not only the federal government but also state and local government, professional associations, academia, industry, foundations, and others. Indeed, many of these customers provide valuable non-federal data. However, because health professions information is an expensive public good, only the federal government, working with these other non-federal data-gathering sources, can put all the data where the public can use them.

During the 1980's funding for HRSA's health professions data and research activities was cut drastically.³⁴ Reversing the trend, the President's fiscal 1994 budget calls for a 250 percent increase over fiscal 1993 funding for a new total of \$6.3 million.³⁵ Any examination of the federal role in health professions education should strike a healthy balance between research and direct funding for education.

Recommendations:

Whatever the outcome of the Health Reform Task Force, several actions can be started now to strengthen the federal role in the health workforce:

- 1. HHS should work with Congress to develop a comprehensive national health workforce policy. In this context, HHS should consider the direct and indirect effects of all its programs on the number, mix, and quality of health professionals.**
- 2. HHS should restructure the support of training hospitals provided by Medicare and biomedical research to increase the ratio of generalists to specialists in the health workforce.**

3. HHS should work with Congress to consolidate and refocus existing health professions education programs to meet current needs for more 1) primary care physicians, physician assistants, nurse practitioners, and certified nurse midwives; 2) health professionals for under-served areas and hard to reach populations; and 3) minority health professions. HHS should propose programs of support that make schools agents of institutional change and accountable for program results.
4. HHS should restructure health professions student aid programs to simplify administration and promote education for national workforce needs while continuing to provide access for needy students to health professions careers.
5. The Congress and the Department of Health and Human Services should allocate more of existing funds for health professions education to the development and linkage of information on health workforce deficiencies, their causes, and alternative federal strategies to overcome shortages and imbalances. The Department should work with the health community to identify and obtain the knowledge the federal government needs to be an effective partner with state and local government, academia, industry, foundations and others. The Department of Health and Human Services should disseminate information and collaborate in strategies that use this information to meet workforce needs.

Implications:

Correcting America's health care problems will require changes in our system with attendant changes in workforce needs. Health care is a national issue; ensuring the needed workforce is, therefore, also a national issue.

Fiscal Impact:

There are no fiscal impacts of these recommendations. They aim to reallocate existing funds to make the federal government's efforts to improve the health workforce more effective.

Endnotes

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4. I.e., 244 per 100,000 population in 1990 (*Report of the Josiah Macy, Jr. Foundation*, 1992, p. 15).
5. Bureau of Health Professions, HRSA/PHS/DHHS, *Rural Health Professions Facts -- Supply and Distribution of Health Professionals in Rural America* (Rockville, Maryland, 1992).
6. Division of Shortage Designation, Bureau of Primary Health Care, HRSA/PHS/DHHS, *Selected Statistics on Health Professional Shortage Areas As of December 31, 1992* (Rockville, Maryland, January 1993), Table 2. See also David A. Kindig, Hormoz Movassaghi, Nancy Cross Dunham, Daniel I. Swick, and Charles M. Taylor, "Trends in Physician Availability in 10 Urban Areas from 1963 to 1980," *Inquiry*, vol. 24, no. 2 (Summer 1987), pp. 136-146.
7. HRSA/PHS/DHHS, *Health Personnel in the United States: Eighth Report to Congress, 1991* (Rockville, Maryland, September 1992); U.S. Congress, Office of Technology Assessment, *Health Care in Rural America*, p. 14-15; DHHS, *Commission on the National Nursing Shortage: Final Report* (Rockville, Maryland, September 1991), pp. 133-146.

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12. Council on Graduate Medical Education, *Improving Access to Health Care*, p. 9.
13. Fitzhugh Mullan, Marc L. Rivo, and Robert M. Politzer, "Doctors, Dollars, and Determination: Making Physician Work-Force Policy," *Health Affairs* (Supplement 1993), p. 141. For a discussion of reasons for specialization, see Fitzhugh Mullan, "Missing: A National Medical Manpower Policy," *Millbank Quarterly*, Vol. 70, No. 2 (1991), p. 382.
14. Council on Graduate Medical Education, *Improving Access to Health Care*, p. 13. Pew Health Profession Commission, *Primary Care Workforce 2000*, p. 1.
15. Fitzhugh Mullan, et. al., "Doctors, Dollars and Determination," p. 142.
16. Ibid., p. 139.
17. Ibid., p. 139; Peter P. Budetti, "Achieving a Uniform Federal Primary Care Policy: Opportunities Presented by National Health Reform," *Journal of the American Medical Association*, Vol. 269, No. 4 (January 27, 1993), pp. 498-501.
18. Bureau of Health Professions, HRSA/PHS/DHHS, *Fact Sheets on Programs* (Rockville, Maryland, February 1993).
19. U.S. Department of Health and Human Services, *Fiscal Year 1994 Justification of Estimates for Appropriations Committees, Public Health Service, Volume 1: Health Resources and Services Administration*, p. 91.
20. Physician Payment Review Commission, *Annual Report to Congress, 1993* (Washington, D.C., 1993), p. 1. Data for 1987 supplied by the Bureau of Labor Statistics indicate about two thirds of the costs of health care are for direct labor.

21. For example, the Health Professions Education Extension Amendments of 1992 (Public Law 102-408) require the Public Health Service, in awarding Health Administration Traineeships and Special Projects, to give preference to applicants that have 25 percent of their graduates in practice in medically under-served communities and that recruit students from such communities. To be eligible for New Minority Faculty Fellowships, schools must demonstrate ability to provide health services to rural or medically under-served populations.
22. Information on the research activities of the Bureau of Health Professions under section 708 of the Public Health Service Act, as amended, is contained in *Compendium: Bureau of Health professions, Section 708 Fiscal Year Procurement* (Rockville, Maryland). See also *Health Personnel in the United States: Eighth Report to Congress, 1991* (HRSA/PHS/HHS, 1991).
23. U.S. Congress, Office of Technology Assessment, *Health Care in Rural America*.
24. For example, Public Law 99-129, the Health Professions Training Assistance Act of 1985, required HHS to contract with the National Academy of Sciences for a study of the role of allied health personnel in health care delivery. See *Role of Allied Health Personnel in Health-Care Delivery* (National Academy of Sciences: Washington, D.C., 1988).
25. See Fitzhugh Mullan, "Missing: A National Medical Manpower Policy," p. 282; Commission on Medical Education: The Sciences of Medical Practice, *Medical Education in Transition*, Robert Q. Marston and Roseann M. Jones, editors (Princeton, New Jersey, The Robert Wood Johnson Foundation, July 1992); *Report of the Josiah Macy, Jr. Foundation*; Pew Health Professions Commission, *Primary Care Workforce 2000*.
26. Pew Commission on Health Professions, *Health Professions Education for the Future: Schools in Service to the National*, (San Francisco, 1993).
27. Policy statements of the foundations and Congress.
28. HRSA/PHS/DHHS, *An Agenda for Health Professions Reform* (Rockville, Maryland, February 1993), p. 6.

29. See Eli Ginzberg, Miriam Ostow and Anna B. Dutka, *The Economics of Medical Education* (New York, New York: The Josiah Macy, Jr. Foundation, March 1993).
30. Updated figure using OMB estimates for fiscal 1993 Consumer Price Index. The figure in 1973 dollars was \$740.7 million (September 1980 table provided by HRSA/PHS/HHS).
31. Edward O'Neil, Unpublished data, 1990.
32. For a discussion of factors in health care labor markets, see Paul J. Feldstein, *Health Care Economics* (New York, John Wiley and Sons, 1988), particularly "Health Manpower Shortages and Surpluses: Definitions, Measurement, and Policies" (pp. 347-367); "The Market for Physician Manpower" (pp. 368-384); "The Market for Medical Education: Equity and Efficiency" (pp. 385-405); "The Market for Registered Nurses" (pp. 406-436); "The Role of Government in Health and Medical Care" (pp. 510-526).
33. Pew Health Professions Commission, *Health Professions Education for the Future*, p. 23.
34. Bureau of Health Professions, HRSA/PHS/DHHS, *Strategies for Health Personnel Data Collection: A Report to the Congress* (Washington, D.C., October 1, 1991), p. 7. The fiscal year 1993 appropriation for data collection under Section 708 of the Public Health Service Act is \$649,000 compared to \$3.2 million in fiscal year 1981.
35. U.S. Department of Health and Human Services, *Fiscal Year 1994 Justification of Estimates for Appropriations Committees, Public Health Service, Volume 1: Health Resources and Services Administration*, p. 13. These figures are for the Health Professions Data System and for the newly authorized (fiscal year 1992) Health Professions Educational Research. Additional funds come from the one percent of Public Health Service program funds that are set aside for evaluation. The Bureau of Health Professions receives about \$1 million a year from this last source.

Now Is The Time

RESTRUCTURE THE MANAGEMENT OF RAILROAD INDUSTRY BENEFIT PROGRAMS

Background

The Railroad Retirement Board (RRB), an independent agency headquartered in Chicago, Illinois, administers retirement, disability, and unemployment/sickness benefits for railroad industry employees. Since its establishment in 1934, RRB's mission has been to provide comprehensive retirement survivor and unemployment-sickness insurance benefits for the nation's railroad workers and families. In fiscal year 1992, RRB paid approximately \$7.8 billion in railroad retirement and unemployment insurance benefits to about 950,000 beneficiaries. (Cost Saver and Revenue Enhancement Guide) The RRB has the only private industry, pay-as-you-go pension embedded in federal law and administered by a federal agency. In fact, a former Office of Management and Budget (OMB) Director referred to the federal role in rail industry benefits as "one of the most complex subjects in the world." (CRS Report)

The railroad industry was the first "big business" to provide company pension plans. In fact, as early as 1874, railroad companies started formal provisions for retirement income. (CRS Report) However, because of arbitrary retirement policies, many covered railroad employees did not qualify for any benefits upon retirement. In response to this problem, labor organizations established their own pension plans -- financing the plans out of employee contributions assessed at a rate sufficient only to meet the current demands for payment. Not surprisingly, as more and more beneficiaries demanded benefits, union pensions began to fail. Further, a decrease in rail traffic due to the depression of the 1930's along with increased competition from other modes of transportation, abolished company profits and threatened the financial integrity of many company-sponsored pension plans.

Following the market crash of 1929, employment in the rail industry fell which resulted in younger workers often being furloughed for long periods. With the threat of pension insolvency and the need for older workers to retire, both rail workers and management supported an industry-wide, federally-administered rail pension system. As a result, in 1935, 1937, and 1938, Congress enacted legislation bringing rail workers' retirement and unemployment benefits under federal jurisdiction.

The RRB maintains roughly 100 regional, district, branch, and base point offices located in many of the nation's major cities. Beneficiaries file claims in all field offices as well as at the Chicago Headquarters. The agency is governed by a three member Board representing labor, management, and the general public's interests. The composition of the Board has had a significant effect on railroad retirement policy and agency operations; allowing RRB to become a "clientele" agency dominated by rail sector interests. This organizational structure fosters policies that favor both rail carriers and voting union members often at the expense of taxpayer and beneficiary interests. Executive authority is further diluted by RRB's legislative bypass authority. No federal official or agency can require prior review of the Board's budgetary or legislative communications. As a result, the labor and management Board members have repeatedly testified against Administration proposals before Congress, seeking administrative increases not always supported by sound planning and justification.

The RRB administers two overall programs: social security for rail workers and their families -- social security equivalent benefits (SSEB), and a rail industry pension program. The social security component includes Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) and Medicare Part B. (Part B of Medicare covers such costs as payments for doctors, laboratories and other medical services.) The Health Care Financing Administration (HCFA) reimburses RRB for the associated administrative costs and transfers that amount from the medicare trust fund. The Travelers Insurance Company, the carrier for Part B claims of railroad Medicare enrollees, made payments totaling \$723 million for fiscal year 1991. (1992 Annual Report) In addition to the rail pension program, RRB administers the Railroad Unemployment Insurance Program, railroad windfall-benefits, and a supplemental retirement annuity.

SSEB's are computed using the social security formula, with an employee's combined social security and railroad earnings as the basis for determining average monthly benefits. These benefits are financed by a combination of social security payroll taxes, Federal income tax revenue on social security equivalent benefits, financial interchange transfers from the OASDI Trust Funds, and interest on investments. A common cause of confusion is RRB's complex financial relationship with the Social Security Administration (SSA). Each year since 1951, the two programs have determined what taxes and benefits would

have been collected and paid by social security had railroad employees been covered solely by social security. The principle behind this "financial interchange" is that social security should be in the same financial position it would have been had railroad employment been covered from the onset by social security. Originally, the interchange favored social security. However, with the decline in the ratio of rail workers to beneficiaries, this situation has reversed, and since 1957 all transfers have been from social security to railroad retirement. (Federal Financial Involvement)

The rail industry pension benefits are based entirely on the employee's railroad service and are financed by payroll taxes. The relative share of employer and employee financing of these benefits is collectively-bargained, and reflects compromises not directly related to retirement, e.g., compensation tradeoffs inherent in reaching labor/management agreements. The rail industry pension is specifically exempt from the minimum funding provisions of the Employee Retirement Income Security Act (ERISA). This act requires that pension plans be "advanced funded" meaning the pension system must receive enough income each year to fund benefits for employees over their working lifetimes. In contrast, the rail industry pension is currently being funded on a modified "pay-as-you-go" basis thus the system receives only enough income each year to cover benefits and expenses for the year. In fiscal year 1993, RRB estimations, using ERISA standards, indicated that the rail industry pension's unfunded accrued liability (assuming a closed system) was \$33 billion. (Bush Budget) The unfunded accrued liability for an existing plan is the excess of the accrued liability over the funds at hand.

In 1938, The Railroad Unemployment Insurance Act (RUIA) established a system of benefits for unemployed railroad workers. This replaced the various State unemployment insurance programs already in existence. In 1946, sickness insurance benefits were added to the program even though most states do not offer this benefit. In 1992, RRB paid \$78 million in employment and sickness insurance benefits to 46,000 claimants. (Cost Saver and Revenue Enhancement Guide) Further, the RUIA is financed entirely through railroad employer payroll taxes. The RUIA has authority to borrow from the rail industry pension account if its own funds are insufficient to meet benefit payments for the year. During the rapid decline in industry employment in the 1940's to early 1980's -- (from 1.7 million rail employees in 1944 to a level of 270,000 in 1991) RUIA was forced to borrow extensively

from the rail industry pension account, reaching a peak level of \$850 million at the end of 1986. (Railroad Retirement and Unemployment Insurance Systems)

As a response to this problem, the Railroad Unemployment Insurance and Retirement Improvement Act of 1988 legislated the establishment of an Experience Rating System to be phased in over a three year period, starting in 1991. Under experience rating, employers pay contributions reflective of benefits paid to their employees, with some risk sharing among participating employers. However, the 1991 contribution rates were not calculated in accordance with these provisions, resulting in the contribution liabilities being understated by \$10 million and overstated by \$1 million -- losing approximately \$1 million in interest on the uncollected funds. (Review of the Experience Rating System)

Windfall-benefits (known also as dual-benefits) are awarded to workers who received both social security and railroad retirement benefits prior to 1974. The Railroad Retirement Act of 1974 eliminated any future opportunity to qualify for the windfall advantages. Fiscal year 1992, approximately one-fourth of RRB's beneficiaries, 111,100 out of 873,000 retirement and survivor beneficiaries, received windfall benefits. In 1991, RRB received from general revenue appropriations (excluding \$22 million from Federal income tax transfers), \$319.1 million for windfall-benefits. (1992 RRB Annual Report)

Throughout the life of RRB, numerous legislative changes have increased benefits and added social insurance features similar to those provided under social security. In addition, because of the retirement system's continuous financial problems, both Congress and the executive branch commissioned several in-depth studies of RRB and its activities i.e., the Commission on Railroad Retirement 1970, the Grace Commission 1983, the Railroad Unemployment Compensation Committee 1984, the Commission on Railroad Retirement Reform 1990, and an OMB Management Review 1990. Federal financial involvement in the railroad retirement program has continued to increase, affecting general revenues and involving other federal trust funds. Previous administrations have proposed the privatization of the rail pension plan, dual-benefits, and supplemental benefits several times. Other proposals include the transfer of SSEB activities to SSA and Medicare Part B to HCFA. Unfortunately, only small sections of the above studies were actually implemented.

In 1990, OMB undertook a management review of RRB to: (1) assist RRB in

identifying solutions for a number of highest risk management control problems; (2) recommend specific corrective actions; (3) reach agreement between RRB, OMB, and Congressional Committees to commit the necessary resources; and (4) restore confidence in the operations and integrity of RRB's system. OMB identified over 40 management control findings, including major claims backlogs (80,000 cases), significant error rates, beneficiary fraud, underpayment of railroad employment taxes, and inadequate systems. As a result, OMB and RRB agreed on a prototype performance agreement with specific measure of results as a tool for improving the most pressing management and administrative control problems. In fiscal year 1992, the administration proposed an increase to RRB's administrative budget, \$13.9 million (over 5 years) from the rail industry pension and RUIA, to correct inefficiencies and difficulties that the OMB Management Review task force identified. As of October 1992, the RRB/Office of Inspector General (OIG) reported to OMB that RRB exceeded its objectives for the first year of the five year plan. The OMB/RRB performance agreement was designed to achieve substantially improved service to RRB beneficiaries and restore confidence in the operations and integrity of the railroad retirement system. Consequently, it does not address the structural problems of RRB's duplication of existing programs i.e., Social Security, Medicare, and the federal-State unemployment insurance programs.

The RRB programs and their clients have benefited financially from federally funded retirement and unemployment programs separate from social security and the state-administered unemployment insurance programs. Railroad employees benefit from close ties with the social security program including annual transfers of funds from the social security trust funds, general revenues to pay for windfall benefits, and special treatment regarding taxation of benefits, tax revenues, and investment authority. (Federal Financial Involvement)

In conclusion, Congress originally adopted a statutory Railroad Retirement system in 1935 for three principal reasons: (1) to assure workers that they would receive the retirement benefits which they were earning; (2) to allow workers to move from one railroad employer to another without losing service credits; and (3) to encourage early retirement in the railroad industry to open new jobs for young persons entering the work force. (Commission on Railroad Retirement Reform) However, today's market does not

justify creating a statutory retirement plan for railroad workers. First, even if unemployment levels were high, there is little justification for imposing a system that encourages early retirement in only one sector of the national economy. Second, in recent years, Congress has responded to concerns regarding unfunded liabilities of retirement plans by providing basic protection for participants in private plans in ERISA. The railroad industry no longer has special needs that require Congress to mandate pension rules that are different from other pension plans within the transportation sector. Existing federal and state programs coupled with appropriate private sector involvement can effectively meet the retirement, Medicare, and unemployment insurance needs of railroad employees.

Recommendations/Options and Implications:

- 1. The administration of railroad retirement should be simplified by transferring management responsibility for calculating and paying social security benefits to SSA.**

Transferring administration of SSEB benefits (including disability benefits) to SSA would greatly simplify RRB's mission and allow the agency to focus on paying only private railroad pension benefits. This will allow RRB to decrease its workload and case backlogs. The exclusion of railroad employment from Social Security has been the subject of debate and controversy since 1940. This recommendation has been proposed to Congress on several occasions. However, due to intense political pressure from both organized labor and railroad management, Congress has failed to take action.

Upon implementation of recommendation #1, RRB should reduce and eliminate many of its field offices and centralize most remaining functions. The existing interaction between SSA and RRB is so complex that it would be difficult to operate the present system without extensive face-to-face contact. However, with the elimination of this interaction, the new RRB could be administered in the same way as other retirement programs -- where information would be distributed and explained by company personnel offices and/or union officials. There may be little Congressional support for this recommendation since members do not generally favor the closing of field offices and their districts. In addition, rail labor groups, which favor the current structure for

service delivery, will most likely oppose the elimination of field offices.

2. Railroad unemployment insurance should be transferred to the jurisdiction of the Federal/State unemployment insurance system.

The railroad industry is the only private industry that is not currently covered by the federal/state unemployment insurance system. In 1984, two members of The Railroad Unemployment Compensation Committee representing rail management, recommended that the RUI system should be covered under the federal/state system. The sickness benefit component could be transferred to the private multi-employer pension plan (see recommendation #3).

3. RRB, OMB, and representatives of the rail industry and employees should develop a legislative proposal to establish a privately funded and administered multi-employer pension plan. The RUIA could be administered by a new, private multi-employer pension plan. Alternatives for assuring the financial security of the private pension fund without Federal subsidies or undue financial strain on the rail industry should be developed. Consequently, privatization will place the burden of establishing prudent benefit and funding levels on railroad labor and management. There will be no quasi-government role to use as a veil for subsidies. In 1983, the Grace Commission recommended that the rail industry pension portion of railroad retirement should be turned into a private multi-employer pension plan. Further, in 1988 OMB sent to Congress a bill "to restore the administration of the rail industry pension plan to the railroad industry; to move toward the establishment of a private pension system for rail workers; to enhance the ability of the private system to continue benefit payments to all railroad retirees and employees... and for other purposes." (See Staff Memorandum No. 24 for more detail.) A similar proposal was also submitted by OMB in 1990. Overall, if the railroads had fully-funded plans that complied with industry pension standards, most of the problems and criticisms that confront the current Railroad Retirement pension system would not exist. (Commission on Railroad Retirement Reform)

4. Medicare Part B claims for RRB beneficiaries should be administered by HCFA and processed by HCFA carriers. The RRB has used its authority to contract with

"The Travelers Insurance Company" as the single nationwide carrier for railroad retirement beneficiary claims since 1966. However, it would be more efficient and cost effective for Medicare Part B claims to be processed by HCFA contractors. The United States General Accounting Office (GAO), in June 1979, and again in September 1984, recommended that Medicare Part B claims applicable to beneficiaries of the RRB be processed by the same contractors that process such claims for most other Medicare beneficiaries. The GAO estimated that this change would result in annual savings of about \$6 million. In addition, a Department of Health and Human Services (DHHS)/OIG report 1990, recommended similar findings -- estimating a savings of \$9.1 million annually. (Executive Summaries of Reports with Significant Findings) Medicare payments aggregated in one area could improve service delivery and decrease administrative costs, and would be in concert with ideas included in the pending recommendations of the Health Care Task Force.

Fiscal Impact (Currently under development)

Each of these recommendations raises significant scoring issues which will need to be addressed.

	In Millions of Dollars						
	1994	1995	1996	1997	1998	1999	Total
Budget Authority	currently under development						
Outlays	currently under development						
Change in FTEs	currently under development						

Endnotes (Endnotes will be added at a later date)

THE SOCIAL SECURITY ADMINISTRATION SHOULD MORE EFFECTIVELY MANAGE THE DISABILITY PROGRAM TO BETTER SERVE PEOPLE WITH DISABILITIES AND SAFEGUARD TRUST FUND ASSETS

Background

The Social Security Administration's (SSA's) disability programs have experienced dramatic growth in recent years. Serious challenges face these disability programs as workloads eclipse SSA's ability to manage them effectively. SSA administers two disability programs, Disability Insurance (DI) and Supplemental Security Income (SSI), which provide benefits to people with disabilities. The DI program provides monthly benefits to about five million disabled workers and their families.¹ Benefits are paid out of the DI Trust Fund. Related program management costs are apportioned by the Office of Management and Budget (OMB) from the trust fund on an annual basis. SSI provides cash assistance to about 5.8 million needy aged and needy disabled children and adults.² SSI benefits and all related program costs are paid out of general revenues which are appropriated by the Congress annually.

SSA claims representatives in local field offices take initial disability claims information from applicants and forward applications to state disability determination services (DDS) offices for further processing. DDSs make initial determinations of disability, process initial appeals of denial decisions, and are responsible for periodically reassessing the medical condition of program participants through the use of continuing disability reviews (CDRs).

Disability claims processing is seriously backlogged. Disability claimants routinely wait about three months for initial eligibility to be determined, and some DDSs are taking five months to process applications. Claimants filing appeals of initial determinations routinely wait a year for resolution of their case from the time they filed their initial claim.³

Although SSA and the DDSs have demonstrated improvements in claims processing productivity, increases in productivity have been more than offset by an increase in claims. DDS productivity increased by more than 20 percent between 1988 and 1993.⁴ The current number of disability decisions pending is estimated at over 700,000 including about 570,000 initial disability determinations. SSA budget justifications project that even with

modest increases in state staffing levels, the number of pending decisions will grow in fiscal 1993.⁵

The fiscal 1994 budget includes \$1.048 billion for DDSs, an increase of almost ten percent over 1993.⁶ Although the intent is that this increased funding (as well as modest funding increases proposed each year through 1998) will help reduce delays and reverse service declines, pressure on the disability system persists. Applications for disability benefits reached an all-time high of 2.4 million during fiscal 1992, and are projected by SSA to reach 3.7 million in fiscal 1994. This will result in pending disability decisions of more than 1.2 million by the end of fiscal 1994.

Long-term trends suggest continuing growth in disability workloads. The Advisory Council on Social Security estimated in 1991 that the size of the elderly disabled population will grow from about 5.5 million in 1990, to almost 9.0 million in 2020, and to more than 13.5 million in 2040.⁷ These projections were based on current disability rates and take into consideration the increase in the number of elderly in the population.

In an effort to keep from falling even further behind in the processing of initial claims, SSA has reduced the number of CDRs conducted. SSA is required by the Social Security Disability Amendments of 1980 to periodically assess the condition of all DI beneficiaries, and conduct reviews at least once every three years for individuals whose impairment is not thought to be permanent. There are an estimated one million CDRs past due, and SSA data suggest that there are over 350,000 cases that have not been reviewed in which beneficiaries were expected to improve.⁸

Thousands of beneficiaries continue to receive benefits whose medical condition has improved, or who with assistance could return to work. The GAO estimates that over 30,000 ineligible individuals may still be receiving disability benefits.⁹ SSA's Office of the Actuary estimates that SSA's failure to conduct the required number of CDRs during fiscal years 1990 through 1993 will cost the trust funds \$1.4 billion by 1997.¹⁰

Conservatively, the rate of return for conducting traditional, full medical CDRs is estimated at \$3 for every \$1 spent to conduct required reviews. SSA is now sending a new mail questionnaire to beneficiaries as a first step toward developing a more efficient CDR process. Only those individuals with the likelihood of medical improvement will then be referred for a full medical CDR. SSA expects to send out approximately 92,000 mail

questionnaires in fiscal 1993 and 1994, and anticipates that about 50,000 full medical CDRs will be needed in each of these years.

SSAs tactical plan calls for 800,000 mail questionnaires to be sent out annually in fiscal 1995 through 1999. This volume is expected to allow SSA to process an estimated one million backlogged CDRs by the year 2000, as well as keep up with the approximately 500,000 CDRs that come due each year. Resources will be needed to process mail questionnaires in fiscal 1995 through 1999, as well as for the 300,000 to 400,000 full medical CDRs that would be required annually. Preliminary data from use of mail questionnaires indicates that the rate of return using the questionnaire will be substantially greater the current level of about \$3 saved for each \$1 spent on reviews. SSA estimates savings of about \$6 for every \$1 spent with the use of mail questionnaires.

Funding for CDRs competes with funding needed to process initial disability claims. The growth of the disability claims workload continues to outstrip increases in funding made available each year by the Congress and OMB. The current budget structure was created in the 1980's by putting trust fund related administrative costs "on budget" (i.e., part of the unified budget and subject to a broad range of rules and constraints) and by controlling resources devoted to these activities. Savings achieved in trust fund programs from safeguard activities, such as CDRs, can not be used directly to fund additional such activities which yield net savings to the trust funds. Savings which accrue from CDRs are returned to the trust funds. Constraints on the use of savings from CDRs, along with continuing increases in program workloads, have precluded SSA from making needed investments in these activities despite the fact that they have excellent rates of return.

One way to ensure that the needed investments are made in safeguard activities, including CDRs, would be to adopt the appropriations language and structure used for the Internal Revenue Service (IRS). To emphasize the importance of compliance activities and clearly restrict reductions to appropriated funds directed to these purposes, the IRS is provided separate appropriations for Administration and Management, Processing Tax Returns and Assistance, Tax Law Enforcement, and Information Systems. The transfer of funds between appropriations is limited to four percent of each appropriation. Similar appropriations language and structure could be used by the Social Security Administration to achieve the desired results of ensuring the timely processing of disability claims, and

providing priority funding for safeguard activities such as CDRs.

SSA continues to fund improvements in automation. Each DDS has its own automated system which has been developed and is maintained at federal expense, but individual DDS systems are not generally compatible. SSA officials believe that workloads could be better managed if all DDSs used a single, uniform federal disability claims system. Use of a common, federal claims system would allow SSA and DDSs to more easily move workloads (i.e., automated case information and systems) from one DDS to another to help manage peaks in workloads. The fiscal 1994 budget request included a multi-year appropriation of \$1.125 billion for automation,¹¹ and SSA plans to use of portion of these funds to develop a uniform federal disability claims system.

SSA is currently required to work through 54 separate DDSs, and experiences difficulties in managing these state-run operations. SSA officials have suggested that the quality and timeliness of claims processing by DDSs is inconsistent, and that DDSs in some states are required by state law, or federal anti-deficiency rules, to slow or halt claims processing when federal appropriations are delayed. One effect of these operational and funding problems is that the quality of services provided is not consistent from state to state. The Social Security Act and SSA regulations limit SSA's ability to move processing workloads from one DDS to another. SSA must demonstrate that an individual DDS has failed performance standards for both timeliness and accuracy to take work away from a DDS, and such a decision is subject to appeal.

In addition, performance standards contained in SSA regulations were implemented in 1981 based upon 1979 performance data and that these standards no longer reflect current processes.¹² SSA regulations do not currently specify how, or how frequently, performance standards should be updated, and do not authorize SSA to use contractors to process disability workloads.¹³

SSA officials are developing a number of incremental improvements to disability claims processes, e.g., enhanced training, changes in the responsibilities of SSA's field offices, face-to-face interviews of applicants by the decisionmaker, and improvements and efficiencies in the administrative appeals process. However, more radical innovation is needed. SSA officials have stated that they plan to begin a project to re-engineer the initial disability claims process.

Former SSA Commissioner Robert Ball has suggested that disability claims processing should be federalized. This would give SSA the ability to more fully and flexibly manage disability program workloads and activities. Former Commissioner Ball suggested that state DDS employees be converted to federal service, and that to the extent practical, state DDS operations be merged into the existing SSA field structure. SSA officials noted that while this would not necessarily result in cost savings, it could greatly improve control over operations. Federalizing DDS operations as currently staffed would add about 12,000 people to federal employment.

Recommendations:

- 1. SSA should re-engineer the disability programs to improve the quality and timeliness of service provided to people with disabilities.** The disability program needs to be re-engineered from beginning to end. All options for redesign of disability processes and workflows - from the initial claim through determinations, appeals, and CDRs - should be fully explored. This federally funded activity has reached a crisis point and the current structure, including built-in duplication and inflexibility, doesn't help. The role of the DDSs should be fully examined and evaluated as part of a larger effort to re-engineer the disability process.
- 2. To restore disability program service to acceptable levels, focus more attention on activities that will remove individuals who are no longer disabled from the rolls, and protect trust fund assets, an appropriations structure like that used for the IRS should be adopted for SSA.** Use of separate appropriations from the Social Security trust funds, and from general revenues, should be provided for use by SSA to reduce disability claims backlogs and ensure adequate funding for CDRs and other cost-effective safeguard activities. Separate appropriations should be made available to SSA for administration and management; processing claims and providing assistance; trust fund safeguards; and information systems. Language should also be adopted which limits the transfer of funds between appropriations. Budget documents should include specific goals for return on investment, and other expectations for results. HHS, SSA and OMB should also evaluate other innovative approaches which could be used to assure that cost-effective safeguard

activities are adequately funded.

3. The Social Security Act and SSA regulations should be amended to provide SSA management with greater flexibility to move disability workloads. Specifically, the Secretary of the Department of Health and Human Services should be authorized to move work from any DDS which fails to meet performance standards for either accuracy or timeliness. Regulations should permit the Secretary to move work from any DDS to any other DDS, and to allow for the appropriate use of contractor or federal personnel to perform required work. SSA's regulations should be changed to update DDS performance standards and provide for periodic updates of these performance standards based upon an appropriate methodology.

4. SSA should continue development of a single nationwide disability claims processing system. This would allow SSA and DDSs much greater flexibility to move work around as needed to manage peaks in workloads. Adequate funding for automation must be provided if SSA is to put in place the systems it needs to effectively manage the continued growth of the disability rolls.

Implications

SSA continues to seek improvements in the management of the disability program and the DDSs have demonstrated significant increases in productivity over the last few years. However, under the existing structure and funding levels, SSA has been unable to keep up with increasing workloads. The result has been harmful delays in providing needed benefits to people with disabilities, and in benefit payments being made to people who should no longer be on the rolls.

Streamlining and re-engineering disability program work flows and processes should create efficiencies that will allow SSA to improve current processing within existing resource constraints. Federalizing the functions currently performed by DDSs represents one approach to giving SSA the ability to better match resources to workloads. Adding approximately 12,000 current DDS employees to the federal payroll would, however, present numerous organizational, budget, personnel management and compensation

concerns. Other approaches to improving disability workload management could include: more effective use of performance measurement, use of contractors, and redesigning the disability adjudication process. These approaches may be more feasible than adding 12,000 employees to the federal payroll.

Funding of safeguard activities should yield positive returns, and should be viewed as an investment which is designed to avoid unnecessary public expenditures. Proposed changes in the SSA appropriation structure and language to provide both emphasis and more certain funding to cost-effective safeguard activities should provide visibility, focus and some structural protection for investments in such activities.

Fiscal Impact

Since disability payments are made to recipients retroactively, the cost of getting disabled individuals on the rolls more quickly would be limited to interest costs incurred.

The recommended actions would enable SSA to more effectively manage the disability programs and restore funding for safeguard activities which have positive rates of return. Making a larger allocation from the trust funds to support the performance of required CDRs would result in a net savings in disability payments totalling billions of dollars. SSA estimates that additional funding of CDRs over the next five years could return as much as \$10 billion to the Disability Trust Fund. Taking into consideration the time it takes to remove ineligible from the rolls, including the appeals process, the expected fiscal impact of additional funding of CDRs over the next five years is as follows:

	In Millions of Dollars						
	1994	1995	1996	1997	1998	1999	Total
Savings to Trust Funds	-49.0	-254.0	0.0	400.0	800.0	1,100.0	1,997.0
Change in FTEs	220	1,379	1,571	1,381	1,381	1,219	

Endnotes

	In Millions of Dollars						
	1994	1995	1996	1997	1998	1999	Total
Savings to Trust Funds	-49.0	-254.0	0.0	400.0	800.0	1,100.0	1,997.0
Change in FTEs	220	1,379	1,571	1,381	1,381	1,219	

Endnotes

1. U.S. Department of Health and Human Services, "Fiscal Year 1994 Justification of Estimates for Appropriations Committees," p. 105.
2. Ibid.
3. Social Security Administration, Baltimore, Maryland, interview with selected officials from the Office of Disability, June 19, 1993.
4. Social Security Administration, "Disability Determination Services Staffing and Workload Analysis Report," Baltimore, Maryland, FD-15.
5. U.S. General Accounting Office, "Management Problems, Department of Health and Human Services: Eligibility Determinations Are Not Timely or Accurate," 1992, p. HHS-5.
6. U.S. Department of Health and Human Services, "Fiscal Year 1994 Justification of Estimates for Appropriations Committees," p. 117.
7. 1991 Advisory Council on Social Security, "Income Security and Health Care: Economic Implications 1991-2020," Washington, D.C., December 1991, p. 60.
8. U.S. Congress, House Committee on Government Operations, *Managing The Federal Government: A Decade of Decline*, report prepared by the Majority Staff, Washington, D.C., 1992, p. 162.
9. U.S. General Accounting Office, "SSA's Processing of Continuing Disability Reviews," testimony of Jane L. Ross before the House Select Committee on Aging on March 9, 1993, GAO/T-HRD-93-9, p. 3.
10. Ibid.

11. U.S. Department of Health and Human Services, "Fiscal Year 1994 Justification of Estimates for Appropriations Committees," p. 69.
12. *Federal Register*, vol. 46, no. 103, May 29, 1981, p. 29209.
13. *Ibid.*, p. 29190-29217.

PROTECT SOCIAL SECURITY, DISABILITY AND MEDICARE TRUST FUND ASSETS BY REMOVING BARRIERS TO FUNDING PRODUCTIVE OVERSIGHT ACTIVITIES

Background

The Social Security Administration (SSA) and Health Care Financing Administration (HCFA) have in recent years constrained funding for oversight activities because trust fund-related administrative costs are subject to a spending cap, and handling increasing program workloads has been the highest priority. Examples of oversight activities which have not been fully funded include: continuing reviews of beneficiary eligibility; determinations of proper liability for medical costs; and the collection of overdue debt.

Activities such as Continuous Disability Reviews (CDR's), which yield rates of return that are estimated to be between \$3.00 and \$8.00 saved for every \$1.00 spent, are not adequately funded due to an explosion of disability cases and a current backlog of over 700,000 initial claims taking priority. Similarly, HCFA has been forced to limit safeguard activities in Medicare claims processing relating to secondary payer liability for medical charges which yield over \$10.00 to every \$1.00 invested. Under current budget procedures and appropriation structures agencies must decrease other program management expenses to fund increases in highly cost-effective administrative oversight activities.

The current budget structure was created in the 1980's by putting trust fund related administrative costs "on budget" (i.e., part of the unified budget and subject to a broad range of rules and constraints) and by controlling resources devoted to these activities. Funds for program administration are generally in the discretionary part of the federal budget, and program benefits are generally in the entitlement part. Savings achieved in program benefits from oversight activities can not be used directly to fund oversight activities. Furthermore, savings which accrue from these oversight activities are not plowed back into the oversight activity but are returned to the trust funds. These constraints along with continuing increases in program workloads severely limit the ability of administrators to make investments in oversight activities that have excellent rates of return.

Current budget procedures result in the following paradigm--payment safeguard funding can only be increased by cutting spending elsewhere. The arbitrary division

between mandatory and discretionary funding has created fences that result in barriers to good management.

In HCFA's fiscal 1992 financial report, which was released in March 1993, the following statement was made with respect to the Program Management account which funds administrative and oversight activities:

The most salient characteristic of Program Management is the essential budgetary disconnect between it, as a discretionary account, and Medicare and Medicaid, as mandatory programs. With each passing year, it is more difficult to effectively administer rapidly expanding entitlement programs within appropriated discretionary funding, which is subject to far stricter constraints under Federal budget rules.¹

Budget reductions have been taken in the payment safeguard area even as workloads have risen. From 1989 to 1992, while Medicare claims volumes rose by 40 percent, contractor funding for payment safeguards was cut by four percent. In its fiscal 1993 budget, HHS did increase funding for Medicare's payment safeguard activities by 15.4 percent over fiscal 1992 levels.

The General Accounting Office has found that contractors have failed to collect overpayments to hospitals of over \$170 million; and have made over \$2 billion in Medicare payments that should have been paid by other insurers.² GAO has also found that there is strong evidence that Medicare payment safeguard activities have been consistently cost effective. The magnitude of potential savings related to this program could be billions of dollars.

In the Report of the Appropriations Subcommittee on Treasury, Postal Service and General Government on 1994 Appropriations, a specific appropriation structure and language have been incorporated for the Internal Revenue Service to emphasize the importance of compliance activities and clearly restrict reductions to appropriated funds directed to these purposes.³ This type of structure could be used in Social Security Administration and Health Care Financing Administration appropriations to achieve the desired result of providing priority to oversight activities.

In SSA and HCFA, there is a very obvious dichotomy between recognizing the real benefits of oversight activities and providing appropriate resources to these activities. In

an ideal environment, oversight activities which yield returns greater than costs would be funded at levels only constrained by points of marginal diminishing returns and/or capacity limits of agencies to effectively perform oversight activities.

Recommendations

1. **Payment safeguard activities should be given a high priority and appropriate levels of resources by implementing the precedent set in the IRS appropriation structure with respect to funding compliance activities.** This enables IRS to fund enforcement activities without having to take spending cuts elsewhere. HHS should propose changes in the SSA and HCFA appropriation structure and language to provide both emphasis and more certain funding to productive oversight activities. This would provide visibility, focus and some type of structural protection to investments in such activities. Budget documents could include specific goals for return on investment, and other expectations for results.
2. **HHS, OMB, SSA and HCFA should perform a thorough review to determine what other innovative approaches can be used to assure effective oversight activities are given adequate resources.** At a minimum, the study should consider such areas as: alternative funding mechanisms, e.g.; revolving funds; and ways to provide incentives for such activities including contract provisions and personnel performance appraisal standards.

Implications

There is a realistic expectation for both short and long range benefits here. If HCFA and SSA are empowered to manage programs and to allocate funds as appropriate to the highest payoff areas. The trust funds will benefit from increased recoveries due to greater safeguard activities. Strong enforcement will be possible.

Congress will be given clear cut choices with regard to funding oversight activities, and will be given the opportunity to make decisions with regard to investments in these areas based on justification presented during the budget process.

HCFA and SSA management can be evaluated on specific performance measures

and goals that can be agreed to early in a given fiscal year and evaluated without structural funding constraints limiting ability to meet goals and objectives.

Trust Funds will recover more funds than the cost of these efforts.

Fiscal Impact

Depending on what estimates are used (IG, GAO, Congress, etc.), and what oversight activities are included, there is a realistic expectation of recoveries of billions of dollars. The range of the estimate is dependent on the size of investment in these activities; the mix of oversight activities pursued, and their relative rates of return. Issue papers on SSA Debt Collection, Management of Disability Programs, and Medicare Contractor Management address savings associated with funding such oversight activities. Most of the results of these activities are classified as cost avoidance by OMB, and are shown as reductions against future outlays.

Endnotes

1. Health Care Financing Administration, "HCFA Financial Report for Fiscal Year 1992," (Baltimore, Maryland, March 1993), p. 27.
2. U.S. General Accounting Office, "High Risk Series---Medicare Claims," GAO/HR-93-6, (Washington, D.C., December 1992), p. 12.
3. U.S. Congress, House, *Subcommittee on Treasury, Postal Service and General Government Appropriations Report on Appropriations Bill, 1994*, Report 103-127, (Washington, D.C., June 14, 1993), pp. 26-36.

THE SOCIAL SECURITY ADMINISTRATION SHOULD PROVIDE LEADERSHIP IN THE USE OF DEATH INFORMATION TO PROTECT FEDERAL PROGRAM ASSETS

Background

The Social Security Act, section 205(r) requires the Social Security Administration (SSA) to collect and maintain death information and authorizes SSA to share this information with other federal and state agencies. SSA regularly obtains death information directly from state vital statistics offices under agreements with each state (except Virginia). In 34 of these agreements, states restrict the disclosure of their death data by SSA. As a result, SSA provides limited data to other states and federal agencies.

The federal government makes hundreds of billions of dollars in payments to individuals under entitlement programs each year and tens of billions more annually through welfare programs administered by the states. The use of timely and complete death information could reduce erroneous payments and prevent fraud in dozens of federal and state benefit, insurance and loan programs.

SSA recently analyzed its ongoing death matching activities and concluded that they have identified more than \$227 million annually in incorrect payments through death matching at an estimated annual cost of under \$6 million.¹ SSA's experience indicates that considerable additional savings are possible if federal and state agencies systematically use death reporting information.

In 1991, the U.S. General Accounting Office (GAO) found that federal agencies' lack of a timely and effective way to detect unreported beneficiary deaths caused them to pay millions of dollars in erroneous payments to deceased beneficiaries.² GAO documented annual savings of \$48.8 million which could have been realized in seven large federal payment programs using unrestricted SSA death data.

In May 1991, the Ways and Means Subcommittee on Oversight found that federal agencies were paying millions of dollars each month to thousands of deceased individuals, and that information gathered by SSA was not being effectively used.³ The Subcommittee determined that this situation was caused by the lack of any requirement that other federal

agencies use SSA death information in a timely manner, and limits placed on the use of death data by SSA which are imposed by some states. The Subcommittee recommended that:

- federal agencies be required to regularly acquire SSA death data and match it against agency benefit rolls; verify SSA death information which indicates possible beneficiary deaths; promptly terminate benefit for deceased individuals and recover overpayments, and share agency death information with SSA;
- SSA modify agreements with all state and local jurisdictions to permit disclosure of state and local death reporting with other federal agencies;
- Treasury reduce the time required for agencies to cancel checks and stop electronic funds transfers to deceased beneficiaries;
- SSA modify its current Social Security number verification systems to routinely provide death information to states for their use in processing welfare benefit claims and payments; and
- SSA conduct a study of how death information can be more efficiently and effectively collected and disseminated.

While some progress in implementing these recommendations has been made, more needs to be done. On January 15, 1992, the Office of Management and Budget (OMB) issued Bulletin No. 92-04 which contained guidance for terminating federal benefits to deceased beneficiaries. This bulletin established that beginning March 1, 1992, federal and federally-assisted benefit payment agencies should obtain SSA's death data base, match it against their payment files, independently verify beneficiaries' deaths, terminate benefits and initiate recovery of erroneous payments.

In response to this bulletin, only seven federal agencies currently provide required quarterly data to the Department of Treasury on the number and value of erroneous payments made to deceased beneficiaries. Reporting to date has been inconsistent and fragmented. Treasury's first report, completed in May 1993 for calendar year 1991, indicates that the reporting agencies made over \$850 million in erroneous payments to over 1.5 million deceased individuals. OMB and Treasury officials are not able to provide complete and reliable information on savings which have to date been realized through

federal and state death matching, nor on the potential savings possible if death reporting were effectively used in all federal payment programs.

SSA currently provides the death data base to: the Department of Veterans Affairs, the Office of Personnel Management, the Department of Defense, the Railroad Retirement Board, the Department of Labor, the Department of Education, and the Internal Revenue Service. In a report issued in July 1993, GAO reported that while SSA regularly provides death data to these seven agencies, SSA does not generally provide death data to other federal agencies or to states for use in state-administered welfare programs.⁴ Based upon limited state compliance, and preliminary reporting by federal agencies as required under OMB Bulletin 92-04, it appears that much remains to be done to fully implement the intent of this OMB requirement.

Significant savings could be realized if restrictions on the sharing of data were removed from the 34 state agreements which preclude SSA from sharing death information. GAO estimates that annual savings of \$5.5 million could be achieved if SSA were permitted to share currently restricted state death reporting with federal agencies.⁵ Congressman Jake Pickle has introduced legislation which requires states to eliminate restrictions on the use of death information to correct federal program data. Under this legislation, SSA death information would be provided to the states without charge, and states not willing to allow their data to be shared would be prohibited from using federal Social Security numbers for some state purposes.⁶

SSA has worked successfully with the Treasury Department and the National Automated Clearinghouse Association (NACHA) to expedite the electronic recovery of payments erroneously made to deceased beneficiaries.⁷ Electronic death notifications are now sent by SSA to financial institutions to flag deceased customer accounts and recover any Social Security (or other government payments) that are subsequently received. In June 1993, SSA and the Department of the Treasury established a telecommunications link that allows SSA to intercept otherwise erroneous direct deposit payments from being issued when reports of death are received late in the processing month.

The GAO has also reported that SSA does not currently provide death information to the states when states verify Social Security numbers.⁸ GAO's recommendations for

use of death data included: (1) modifying current Social Security number verification systems to routinely provide death information to the states, and (2) issuing appropriate instructions on accessing and using this information, including the need to verify SSA-provided death information and to give people advance notice before initiating actions to stop, deny, or adjust payments.

GAO emphasized the need to verify deaths reported upon finding that 13 percent of deaths reported by the Health Care Financing Administration (HCFA) contained inaccuracies.⁹ GAO recommended that SSA carefully follow procedures for verifying state and HCFA death information, and that death information shared with other agencies be annotated to reflect whether death information has been verified by SSA.

Recommendations:

- 1. The Social Security Act, section 205(r) should be amended to direct that SSA shall provide for a federal clearinghouse for death information and reporting.** The Act should be amended to authorize the Secretary of the Department of Health and Human Services to take into consideration the cost of fair reimbursement to the states for death data, and to recover from participating agencies their fair share of any additional costs incurred by SSA to manage the clearinghouse. Federal agencies should be required to promptly share agency death information with SSA, and SSA should obtain agreements with all state and local jurisdictions to permit disclosure of death reporting with other federal, state and local agencies.

- 2. All federal and state agencies administering federal programs should be required to regularly acquire SSA death data and match it against agency benefit rolls.** All agencies administering federal programs, including state agencies, should be required to obtain and verify SSA death information, promptly terminate benefits for deceased individuals and recover overpayments. Federal agencies responsible for programs administered by the states should seek appropriate legislative or regulatory authority to require the appropriate and cost-effective use of SSA death data by state and local agencies making federally assisted benefit payments. Consideration should be given to replacing

OMB Bulletin 92-04 with an Executive Order which clearly enumerates agency responsibilities and oversight requirements.

3. SSA should modify its current Social Security number verification systems to facilitate the routine use of death information by states in processing welfare benefit claims and payments. Information provided by SSA should include whether or not SSA has verified the reported death.

Implications

Death reporting information should be used by agencies in a controlled and systematic way so as to avoid making erroneous benefit payments. SSA is uniquely positioned to provide leadership in this area. Laws in some states which currently restrict the use of death data need to be addressed. SSA staff have indicated that simply passing a federal law which would supersede existing state restrictions on the use of death data is problematic in that this is an area in which states rights have traditionally prevailed. Losses in state revenue may be an issue in gaining cooperation from states in those cases where states currently generate revenue from the sale of vital statistics information. Reimbursements to states by SSA for death data provided could at least partially offset any related losses in revenue.

Fiscal Impact

Millions could be saved in federal and state benefit, insurance and loan programs through the coordinated collection and dissemination of accurate death reporting to avoid payments to individuals who are deceased. The recommended actions should enable a variety of government agencies to achieve savings by avoiding erroneous payments to deceased individuals. The five-year fiscal impact would be as follows:

	In Millions of Dollars						
	1994	1995	1996	1997	1998	1999	Total
Savings in Federal Programs	65.0	52.0	13.0	13.0	13.0	13.0	156.0
Change in FTEs	0	0	0	0	0	0	0

Endnotes

1. Social Security Administration, "Final Report on the Review of the National Death Match," Baltimore, Maryland, November 27, 1993, p. 7.
2. U.S. General Accounting Office, "Federal Benefit Payments: Agencies Need Death Information From Social Security to Avoid Erroneous Payments," GAO/HRD-91-3, Washington, D.C., February 1991.
3. U.S. Congress, House Committee on Ways and Means, *Report of the Subcommittee on Oversight on Payment of Federal Benefits to Deceased Individuals*, 102nd Cong., 1st Session, May 9, 1991, p. 7.
4. U.S. General Accounting Office, "Status of Agency Use of SSA Death Information," GAO/HRD-93-31, Washington, D.C., July 20, 1993, p. 1-2.
5. Ibid., p. 5.
6. U.S. Congress, House, *Report of the Committee on the Budget, Omnibus Budget Reconciliation Act of 1993*, 103rd Cong., 1st Session, May 25, 1993, H.R. 2264, Section 13020.
7. Social Security Administration, "Introducing DNE: The Death Notification Entry," Baltimore, Maryland, 1992, p. 1.
8. U.S. General Accounting Office, "States Need Social Security's Death Data to Avoid Payment Error or Fraud," GAO/HRD-91-73, Washington, D.C., April 1991, p. 2.
9. Ibid., p. 5.

MORE AGGRESSIVE ACTIONS ARE NEEDED TO COLLECT OUTSTANDING DEBTS OWED TO THE SOCIAL SECURITY TRUST FUND

Background

According to debt collection officials at the Social Security Administration (SSA), most of the debt owed to the Social Security Trust Fund results from overpayments to people whose entitlements have changed. Efforts to collect outstanding debt have had partial success and the General Accounting Office (GAO) reported that the rate of SSA collections of such debt stagnated in the late 1980s at 28 percent of outstanding debt.¹

When the Debt Collection Act of 1982 was enacted, Congress and various interest groups representing recipient constituencies were very much concerned about how this act would be applied to overpayments made by the Social Security Administration. Congress specifically precluded SSA from the Act's provisions and as a result SSA was not allowed to use the full range of debt collection tools used by other agencies. For example, SSA does not use collection agencies or credit bureaus in its debt collection activities, and does not have authority to assess interest and recover collection costs.

SSA officials indicate that there is a very real opportunity to increase collection of funds owed the government if the agency is given authority to apply federal debt collection procedures to that portion of debt owed by specific classes of individuals no longer on government benefit rolls. Such selective targeting for employing more aggressive debt collection tools will require legislation. One group of individuals with whom more aggressive debt collection activities may be appropriate is students who received benefits to which they were not entitled. Other former beneficiaries who could also be more aggressively pursued to return excess benefits include former recipients of disability payments who return to work and do not report this information; and parents who receive benefits for children in their care whose status changed and was not reported. These individuals arguably were never intended to receive the protection that Congress imposed on SSA debt collection. Current SSA practice is to record the debt which is owed by these individuals, and seek recovery by offsetting benefits they will receive decades later when they become eligible for retirement benefits.

Under the Deficit Reduction Act of 1984, SSA was permitted to use tax refund offsets

to collect overpayments under Title XVI. This is a process whereby the Internal Revenue Service (IRS) offsets a refund that a taxpayer is scheduled to receive by the debt they owe the federal government, and credits the appropriate agency with the funds received.. The Omnibus Budget Reconciliation Act of 1990 authorized the use of tax refund offsets for the Retirement and Survivors Program, which was implemented in fiscal 1992 for debt previously written off. This yielded \$50 million in collections. Fiscal 1993 results are estimated at \$18 million. SSA plans to expand the use of tax refund offsets to current delinquencies and expects an additional yield of \$50 million in fiscal 1995. Projections for fiscal 1996 and beyond are about \$25 million per year for both old and current delinquencies combined.

In SSA's 1992 financial statement, the following information on debt management operations was provided.² Total outstanding debt has increased from \$2.8 billion in fiscal 1989 to \$3.3 billion in fiscal 1992. New debt as a percentage of benefit outlays has declined from 0.8 percent in fiscal 1989 to 0.6 percent in fiscal 1992. Total write-offs have increased from \$269 million in fiscal 1989 to \$337 million in fiscal 1992. Lastly, the cost to collect \$1 of debt has declined from 13 cents in fiscal 1989 to 11 cents in fiscal 1992.

While some areas show improvement, SSA has additional opportunities to increase its collections from former beneficiaries. The collection of overpayments from individuals who leave the benefit rolls has not been fully effective because there are limits imposed on the debt collection tools which SSA can employ. SSA officials have stated that they can improve SSA's debt collection performance if they are empowered to expand the types of debt collection tools used coupled with the authority to utilize a portion of collections to improve recovery practices.

The types of tools and authorities contained in the Debt Collection Act of 1982 which SSA requires to increase the effectiveness of its debt collection efforts include authority to: refer delinquent debt to credit bureaus and collection agencies; assess interest on debts owed and charge debtors with the cost of collection; and recover overpayments from salaries and pensions of federal employees.

Recommendations

1. **Legislation should be introduced to authorize SSA to fully apply federal debt**

collection standards contained in the Debt Collection Act of 1982 with regard to debt owed by individuals not currently in a benefit status. The use of the full range of debt collection tools that are available should increase collections.

2. SSA should be authorized to use a percentage of its collections to fund administrative costs incurred, and to support debt collection activities. In addition to improving collections of debt, SSA should continue activities to identify the root causes of debt, and determine what programmatic changes can be made to reduce this incidence of overpayments that create such debt.

Implications

Improvements in collecting SSA overpayments will reduce the magnitude of annual write-offs and will improve collection performance considerably. The decrease in the use of SSA trust funds used to pay people who are not entitled to these funds, will help assure the continued soundness of the trust fund and will provide resources that could be used to strengthen service delivery and improve customer satisfaction.

Fiscal Impact

If the Social Security Administration is empowered to implement a full range of debt collection activities to collect debt owed by individuals who are not on government benefit roles, an estimated additional \$ 280 million could be collected from fiscal year 1995 through fiscal year 1998.

	In Millions of Dollars					
	1995	1996	1997	1998	1999	Total
Additional Recoveries	100.0	70.0	55.0	55.0	55.0	335.0
Change in FTEs	600	(-)220	(-)80	0	0	1,880

Endnotes

1. U.S. General Accounting Office, "Debt Management: More Aggressive Actions Needed to Reduce Billions in Overpayments," GAO/HRD 91-46, Washington, D.C., July 9, 1991.
2. Social Security Administration, "Annual Financial Statement for Fiscal Year 1992," Baltimore, Maryland, February 1993.

INSTITUTE AND COLLECT USER FEES ON FDA'S INSPECTED IMPORTED AND EXPORTED PRODUCTS

Background

The FDA is responsible for ensuring that imported products meet the same safety and labeling requirements as products produced domestically. This responsibility is granted under the Federal Food, Drug, and Cosmetic Act. Imported products not meeting federal requirements are detained at the port of entry locations. They must be reconditioned or relabeled to bring into compliance, or destroyed or exported back to the country of origin.

Since 1984, FDA has examined more than 1,500,000 annual imported products (entries). During this period, the percentage of entries examined increased from five percent to 10 percent. The increase in import inspection resources were diverted from other FDA inspection programs.

The inspection of these products has become more challenging as the numbers of entries continue to increase. There are more products from countries with inspection systems inferior to the United States' inspection system, and there are more finished products being distributed directly to the consumer (vs raw products for further processing). In addition, more than 20 percent of FDAs inspected import entries are detained at the port of entry due to noncompliance with U.S. regulations.

In spite of FDA's improvements in its import program, it is neither comprehensive nor cost efficient. Regulation of imported products by labor intensive inspections at the port of entry is twice as costly as the domestic program. The ideal program would be to have a safety and quality system in place that could assure that products are safe and wholesome before leaving the country of origin. The foreign manufacturer presently does not pay for import inspections. Any cost is charged to the American tax payer. The industry in the country of origin should share in the costs of these inspections.

The FDA is also responsible for the certification of domestic food products presented for export to other countries. These certifications are required by the government of the receiving country and assures that the products are produced according

to FDA's regulatory standards. Many of our trading partners are increasing their demands for the certification of U.S. exports. These new demands require additional resources to assure that U.S. export activities are not delayed. Exports solely benefit the industry producing the product. The cost is charged to the American taxpayer. The U.S. industry should share in the costs of these certifications.

Recommendation

1. Legislation should be drafted to grant FDA authority to collect user fees to recover costs for U.S. export certifications.
2. Legislation should be drafted to grant FDA authority to collect user fees for the inspection of imported products. FDA needs authority to collect user fees for FDA regulated imported products.
3. All user fee should be returned to the agency and should be unrestricted in their use.

Implications

The collection of user fees for the inspection of imported products and the certification of exported products would provide the FDA with additional resources needed to keep pace with the increasing demands of international trade.

Canada and Mexico account for approximately 40 percent of all FDA regulated import entries. User fees may not be appropriate for these trading partners as the North American Free Trade Agreement (NAFTA) is enacted. If the NAFTA causes products from Canada and Mexico to be treated the same as U.S. domestic product, then the need for import inspections and user fees would no longer be an issue for these trading partners.

*Charges in excess of those that normally apply to similar domestic products is prohibited under Article III of the General Agreement on Tariffs and Trade (GATT). User fees for imports could receive opposition based on these provisions.

*The frequency of import inspections in FDA's import program is based on the risk inherent in the imported product and its manufacturing process, and the compliance history of the imported product. Imposing a user fee for inspection of these products would be difficult to administer on a fair and equitable basis. On the other hand, this could serve as an incentive to improve the import compliance history of the importing country.

Fiscal Impact

The FDA has estimated that charging user fees for the inspection of imported products and the certification of exported products would provide the agency \$80 million per year to use to improve their import/export program.

FISCAL IMPACT TABLE-Imports

In Millions of Dollars

	1994	1995	1996	1997	1998
Budget Authority -	-\$82	-\$82	-\$82	-\$82	-\$82
Outlay -	-\$82	-\$82	-\$82	-\$82	-\$82
Revenues	\$0	\$0	\$0	\$0	\$0
Change in FTEs					

FISCAL IMPACT TABLE-Exports

In Millions of Dollars

	1994	1995	1996	1997	1998
Budget Authority-	-\$1.3	-\$2.0	-\$2.6	-\$2.6	-\$2.6
Outlay-	-\$1.3	-\$2.0	-\$2.6	-\$2.6	-\$2.6
Revenues +Change in FTEs 22/yr	\$0	\$0	\$0	\$0	\$0

THE SOCIAL SECURITY ADMINISTRATION SHOULD REDESIGN SERVICE DELIVERY AND MAKE BETTER USE OF TECHNOLOGY TO PROVIDE IMPROVED ACCESS AND SERVICES TO CUSTOMERS

Background

The Social Security Administration's (SSA's) field structure is the foundation of its service delivery system. It currently includes 10 regional offices, 6 processing centers, 37 teleservice centers and over 1300 local field offices. The public makes contact with SSA either through field offices or teleservice centers.

Each year the public makes about 25 million visits to local SSA field offices to handle the full range of social security business including taking and processing claims for benefits. Over 60 million people telephone the teleservice centers to obtain general information, schedule appointments for field office visits and handle less-complicated matters.¹

The recently completed Inspector General (IG) survey suggests that while overall Social Security client satisfaction remains around 80 percent, the trend over the past three years suggests a decline in satisfaction. According to IG studies in recent years, client satisfaction has declined gradually from 84 percent in 1990 to 83 percent in 1991 to 79 percent in 1992 and 77 percent in 1993.² The IG suggests that lengthy office waiting times, slow responses to mail, and poor telephone access contribute to declines in client satisfaction.³

SSA's strategic plan references recent surveys which indicate growing use of telephone service and this trend is expected to continue. The IG reported that the percentage of SSA's clients who prefer doing business with SSA by telephones remains at around 75 percent.⁴ SSA estimates that transactions processed during a visit to a field office cost 75 percent more than if the same transaction were processed over the phone.⁵ It is expected that local offices in the future will likely be dealing primarily with more complex retirement and survivor situations as well as Supplemental Security Income (SSI) recipients and people with disabilities. More types of transactions will likely be handled by telephone.

Disability claims processing backlogs continue to grow and represent a serious impediment to the delivery of services to eligible disabled individuals. The current backlog of pending claims is estimated at over 700,000. SSA projects that even with modest increases in State funding levels, the backlog of pending claims will grow to 1.2 million by the end of 1993 with a projected processing time of over 30 weeks.⁶

Over the next decade, SSA will experience significant changes in the demographics of its clients resulting in corresponding workload growth as well as changes in the geographic distribution of demand for service. SSA is taking a number of steps to respond to these changes including taking advantage of technologies and making programmatic changes. SSA's fiscal year 1994 budget includes a \$1.125 billion investment in automation which SSA plans to use over the next few years to improve customer service.⁷

Changes in the way services are delivered and the SSA field structure can improve the timeliness and quality of services that SSA provides, as well as better control the costs of serving the public. SSA plans to improve its programmatic business processes and restructure its service delivery organization to respond to workload growth and demographic changes. The objectives of the process and organizational restructuring are to position SSA to handle increasing workloads and workload peaks, achieve operational efficiencies, deliver complete service at the first point of contact, and provide equitable levels of service throughout the country.

SSA is currently developing a Service Delivery Plan that will describe the changes to the SSA service delivery system including changes both to processes and organizations. The plan will describe how SSA will go about improving its service delivery system, including public input, testing new business processes and organizations and phasing-in changes over a number of years. SSA's current information systems development plans pre-date the Service Delivery Plan and may need to be revised based upon anticipated changes in SSA's approach to service delivery. Planned computer hardware, software and telecommunications acquisitions may need to be reconsidered, and the assumptions used in planning new information systems may need to be revisited.

Another of SSA's major workload problems is responding to peaks in demand for service. SSA and others have for many years considered spreading Title II Social Security

benefit payment dates throughout the month, an approach called cycling, as a way to even out SSA's workload. SSA pays 41 million Social Security beneficiaries on the same day (the third) of the month, and about 5 million SSI recipients on the same day (the first) of the month.⁸ The compression of payments results in a surge of work during the first week of every month for SSA as well as for Treasury Department, the Federal Reserve, the Postal Service and the banking system.

SSA's operating practices, including staffing patterns and resource allocations, must accommodate the "first week peak" in SSA's workloads, i.e., SSA must redirect staff from other work to handle peak workloads. Increased volumes of walk-in and telephone traffic during the first week of the month degrade service and this problem will continue and worsen in the future as the number of beneficiaries continues to increase regardless of other service delivery changes. Staggering Title II benefit payment dates (payment cycling) would spread SSA's workload more evenly throughout the month and result in improved customer service. Staggered payment dates would also reduce somewhat the risk of theft of social security checks from recipient mailboxes.

Recommendations:

- 1. SSA should continue to evaluate its business processes, organizations and customer preferences, and make appropriate changes to improve its service delivery system and control costs.** SSA should move quickly to complete its Service Delivery Plan which will describe the changes to processes and organizations and how SSA will go about improving its service delivery systems. Existing offices should be evaluated to determine whether they are efficiently staffed and operating in a cost effective manner. Since SSA's current information systems modernization plans will pre-date SSA's new Service Delivery Plan, SSA should re-evaluate planned computer acquisitions, as well as the assumptions used in planning new information systems, to ensure that planned systems will fully support SSA's future service delivery requirements.
- 2. SSA should begin assigning new Title II beneficiaries payment dates which are on a staggered schedule of three to four dates throughout the month.** This

recommendation will not adversely affect current beneficiaries. Payment cycling should be offered to beneficiaries already on the rolls at their option. The anticipated growth in SSA's workloads makes this a critical initiative which should be taken now to avoid deterioration of service in the future.

Implications

SSA's current field structure has evolved over the last 30 years, and political pressures to keep SSA's facilities open to provide services to constituents tend to make closing offices difficult.

Based on current trends and the costs of providing service using varying methods, SSA will likely need to continue to expand telephone services.

It may be necessary to redeploy and retrain personnel depending on the results of evaluation of current offices as well as longer term changes in the SSA service delivery system.

SSA currently projects that future workloads, without work process changes, technology and structural changes, could require substantial increases in staffing.

SSA should be able to avoid the costs associated with increased workloads over the next several decades through enhanced use of improved work processes, technology and the redeployment of resources to areas most in need.

By requiring staggered payment dates only for new Title II beneficiaries, SSA could help avoid resistance from existing beneficiaries and other problems associated with changing an existing business practice.

Fiscal Impact

The recommended actions should allow SSA to meet the demands of increasing workloads without incurring significant ongoing increases in administrative costs. Additional, one-time expenditures would likely be required to retrain and redeploy personnel if SSA's Service Delivery Plan requires the relocation or consolidate of existing facilities. Savings from payment cycling implemented prospectively will likely produce savings in the future but these savings will not likely be realized for several years.

Endnotes

1. Social Security Administration, "The Social Security Strategic Plan: A Framework for the Future," Baltimore, Maryland, September 1991, p. 33.
2. U.S. Department of Health and Human Services, Office of Inspector General, "Social Security Client Satisfaction: Fiscal Year 1993," June 1993, p. 3.
3. Ibid., p. 3-9.
4. Ibid., p. 12.
5. Social Security Administration, "The Social Security Strategic Plan: A Framework for the Future," Baltimore, Maryland, September 1991, p. 33.
6. U.S. General Accounting Office, "Management Problems, Department of Health and Human Services: Eligibility Determinations Are Not Timely or Accurate," 1992, p. HHS-5.
7. U.S. Department of Health and Human Services, "Fiscal Year 1994 Social Security Administration Justification of Estimates for Appropriations Committees," p. 69.
8. Social Security Administration, "Payment Cycling," paper provided by SSA officials, Baltimore, Maryland, p. 1.

STRENGTHEN DEPARTMENT-WIDE MANAGEMENT

Background:

The Department of Health and Human Services (HHS) administers over 250 programs and has a staff of approximately 127,000. The diversity of the programs, size of the operating divisions and their budgets, multiple functions, different levels of government and private sector organizations necessary to administer the programs, and variety and depth of Congressional oversight present a major challenge to the Secretary of HHS to manage the department so that it is effective and responsive. The Secretary must provide or ensure cabinet level representation, advocacy to Congress, policy and program direction to the department, and services to HHS customers. The numerous nonintegrated, often complex programs with specialized and highly detailed requirements legislated by Congress further increase the management complexity.

HHS is organized into five operating divisions that administer its programs, and the Office of the Secretary that provides staff and some administrative support. Two of the operating divisions, Social Security Administration and the Public Health Service, are very large with 64,000 and 53,000 full time equivalent employees respectively. The three others are much smaller, although one, the Health Care Financing Administration, administers many diverse programs and activities.

Approximately three percent of the 127,000 HHS employees are in the Office of the Secretary (OS), which provides staff support for the Secretary; direction to the operating divisions for particular functions on behalf of the Secretary; centralized legal, personnel, financial and other administrative services for the entire department; and a number of specialized functions, such as auditing and civil rights oversight.

Based on its structure, HHS appears to be a very hierarchical organization. Yet it has elements of both a centralized and decentralized organization, some of which are not necessarily rational or justified. For example, most program operations

are decentralized into the operating divisions, yet all grant program announcements (except for research) and planned surveys require clearance all the way through the Office of the Secretary and the Office of Management and Budget before they can be submitted to the Federal Register for public comment. Reassignment and other personnel actions affecting senior executive personnel have to be forwarded through the hierarchy all the way to the Secretary, even when the practical decision-making process is at the operating division level. In addition, regulations developed within operating divisions receive full review at several levels within the Office of the Secretary and by the Office of Management and Budget. This has led some observers to attribute delays in policy promulgation to the departments hierarchical structure.

The operating divisions are themselves diverse businesses with different responsibilities, needs, and characteristics. Given the many programs and responsibilities, it is difficult and inefficient to manage HHS on a day-to-day basis from the Office of the Secretary in the manner of a smaller organization. Additionally, both public, special interest groups, and the Congress tend to view HHS as a collection of separate, non-related programs, and to focus on them individually. A number of studies and commissions, including the Grace Commission in the early 1980s, have periodically advocated a major decentralization of the department.¹ Beryl A. Radin wrote of the department approximately twenty years ago: "Although described on paper as a Department with centralized control and authority, (it) was actually a confederation of independent affiliates, each with its own cluster of goals, constituencies, and methods of attaining public support. Although the Secretary provided some symbolic leadership -- primarily in a public relations fashion -- the gut work of the Department was done through its operating bureaus and agencies, each with its own decentralized system. Promises by the Secretary affecting existing operation thus had to be viewed with some skepticism about his ability to deliver."² Legislation is periodically introduced that would make various HHS agencies independent. For example, there is pending legislation to

make the Social Security Administration (SSA) an independent agency.

Within the diversity of HHS, there are major interdependencies and trade-off potential among department programs, and, therefore, potentially the need for central policy direction and oversight at the department or Office of the secretary level. Due to its diversity and size, the department faces significant challenges in integrating programs and forming a common focus on a central set of policy goals. For example, the department is addressing now how best to implement three themes developed by the Secretary to guide its efforts.

Another problem with the current HHS management structure is that there is central management of certain administrative activities, but less oversight of more strategic matters, such as strategic planning and setting and tracking performance in achieving objectives. A 1990 GAO report cites lack of: Department-wide planning, effective departmental financial management systems, active management of the operating divisions at the Department level, an agenda for responding to urgent human resources needs, strategic work-force planning, and effective information resources management. It also points to redundant responsibilities and unclear lines of authority within the Office of the Secretary, weak oversight of departmental activities and programs, and unclear missions for staff offices.³ Subsequent implementation of the Chief Financial Officers Act has directly addressed some of these concerns.

While progress has been made since the publication of these reports, this wide variety of views indicates the breadth of challenge inherent in operational and policy management of the department. The variety of recommendations about HHS management reflects the need for comprehensive review of responsibilities missions, functions, and structures, and management systems.

The challenge to the department is to achieve the optimal balance between delegating authority and coordinated decision making to ensure that HHS is responsive to its customers with effective service and responsible to the taxpayers and to Congress with efficient operations. The ideal structure would eliminate

duplication of services and functions by delegating appropriate authority and responsibility to the lowest practical levels, eliminating duplication of services at different levels across the department. A review of workload throughout the Office of the Secretary would provide the basis for restructuring to match resources with needs, for elimination of organizations or programs where appropriate, and for delegations of authorities and responsibilities to operating divisions.

Recommendations and Implications:

The Department should conduct a comprehensive review of organizational structure and management systems to determine what the appropriate balance should be between centralized and decentralized functions.

All major functions, including procurement, information systems, personnel, evaluation, strategic planning, and other Office of the Secretary activities, should be examined. The review should include management systems and organizational structures of the operating divisions and the Office of the Secretary and their relationship.

In this review, priority consideration should be given to : 1) expanding the use of innovative communications and management technology, 2) streamlining existing management and support systems across the department and within operating divisions by, among other methods, eliminating duplicate activities and inappropriate or redundant management reviews, including reviews by the Office of Management and Budget, and 3) delegating appropriate authority and responsibility to the lowest practical levels in order to share the broad management challenge presented by the large scale and diverse activities of the department with the team represented by the heads of operating divisions. The review should be conducted in the context of Department themes, goals and objectives, particularly the need to focus away from categorical and nonintegrated programs toward more integrated and more effective customer services.

The appropriate level and circumstances for delegation of authorities should be determined in the context of how best to support the Department mission and the goals in each operating division. Integration and coordination of programs for more effective delivery of customer service, cost effectiveness and efficiencies of scale should be high priorities.

To accommodate the full spectrum of the Department's responsibilities and the tension between appropriate decentralization and desirable integration of programs and services, a customer oriented review of service delivery and program effectiveness should be conducted throughout the Department as one of the bases for revisions of organization and process. The standards for change should serve the goal of enabling managers and staff to provide integrated customer services responsive to local service area needs, providing service that meets the full spectrum of customer needs in a manner that makes the complexities of program categories and multiple funding streams addressed to the same target populations invisible to customers, empowering managers and staff at all levels with decision making authority for timely and effective service and enabling cross-organizational teamwork to achieve program goals.

Duplicate activities and redundant management reviews should be identified and eliminated wherever practical.

In conducting the review, consideration should be given to opportunities for expanding authorization to operating divisions to directly publish certain rule-making documents. Activities within the Office of the Secretary that duplicate the responsibilities delegated to the divisions could be eliminated either in the operating divisions or at the Office of the Secretary level as appropriate, and resulting available staff resources converted to assessment or other priority activities.

The Secretary and the operating divisions should push responsibility to the lowest practical level.

Review of organizational structure should include consideration of options for reducing management layers wherever possible.

The goal of simplified structure and reduction of layering and bureaucracy obviously has to be balanced with the goals of effective coordination and integration of programs and services.

Appropriate delegations of policy and management decisions to the operating divisions would ensure these activities are adapted and responsive to the particular needs of each operating division. Reducing the time required to formulate policy and enact management decisions in these areas by limiting Departmental reviews where appropriate would allow the operating divisions to respond more timely to customer needs.

Fiscal Impact:

Fiscal impact will be directly related to resulting streamlining. Reducing duplicate activities and redundant management reviews will make HHS a more agile organization by reducing time required for department approvals of management decisions placing services closer to the customers, and allowing quicker response in all operating divisions to evolving customer needs.

Endnotes:

1. President's Private Sector Survey on Cost Control, *Report on the Department of Health and Human Services*, (Washington, D.C., August 1983), p. 20.
2. Beryl A. Radin, *Implementation, Change, and the Federal Bureaucracy* (New York: Teachers College Press, Columbia University, 1977), p. 33.
3. General Accounting Office, Management of HHS: Using the Office of the Secretary to Enhance Departmental Effectiveness, GAO/HRD-90-54 (Washington, D.C., February 1990), p. 5.

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3. General Accounting Office, Management of HHS: Using the Office of the Secretary to Enhance Departmental Effectiveness, GAO/HRD-90-54 (Washington, D.C., February 1990), p. 5.

REVIEW THE FIELD AND REGIONAL OFFICE STRUCTURE OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES AND DEVELOP A PLAN FOR SHIFTING RESOURCES TO MATCH WORKLOAD DEMANDS

Background:

Regional office structure and leadership issues are a small scale replication of the management issues the Department of Health and Human Services (HHS) faces. As a significant aspect of the face HHS presents to the public and to state and local governments, the field structure of the department should be modeled to provide customer-oriented, effective and efficient service.

Currently HHS has approximately 7,000 staff assigned to its regional structure in ten regional offices in ten federal regional cities. This does not include other field staff in other places, such as Social Security district offices and the Indian health service hospitals and clinics.

The basic shape of this regional structure was set in the early 1970s when the federal government standardized its field structure in ten standard regions. At that time, the Department of Health, Education, and Welfare (later HHS) conducted several organizational studies and consolidated its regional offices, setting regional staffing levels, organization and responsibilities across the department.

Since that time, there have been significant changes in HHS programs and communications technology, but only little change in the regional structure. For example, regional administrative support centers were established to provide consolidated administrative support to the regional offices. Staff and responsibilities of the ten HHS regional directors were reduced significantly. Yet a variety of changes in HHS programs, such as the block grants established in the early 1980s, the later recreation of many new small categorical programs, the rapid expansion of Head Start and the slower expansion of community health centers, and the creation of new and large programs, such as the child care block grant suggest by themselves that it is time to reexamine the regional structure.

These changes, the flow of new HHS programs created by Congress and the critical

need to integrate new program requirements and operations with those of existing programs, pressure on staff resources, plus a variety of reports and other observations regarding the adequacy of and problems with the regional structure, combine to indicate the need for a comprehensive review of responsibilities, structure, and staffing for HHS regional and field structures.

A number of state officials who administer HHS programs have described innovative local efforts to provide integrated service delivery. These staff describe such efforts as successful independent of, or in spite of, HHS regional office functions. They emphasize that deriving local service delivery solutions is essential to coping with the complexities and challenges of multiple program service delivery and that such efforts should be expanded. They observe that the department's regional structure is rarely able to participate effectively in catalyzing action for local solutions.

Some state officials interviewed expressed concern about the currency of regional office staff information about Department programs. In some instances regional office staff have been anecdotally cited for providing misinformation, for being solely compliance oriented and less interested in providing assistance, and, in some instances, for adding to the burdens of local service providers.

Regional program directors report to the Associate Administrator for Operations in the Office of the Secretary rather than to the Regional Administrator. The difficulties presented by this arrangement were described in Beryl A. Radin's *Implementation, Change, and the Federal Bureaucracy*.¹ An excerpt from the book was transmitted by a letter dated May 6, 1993, to a member of the National Performance Review by National Treasury Employees Union President Robert M. Tobias who states: "I'm enclosing for your information a passage from a book which points out that the OPDIV (operating division)/Regional structure has been inefficient and ineffective since 1953. Perhaps it is time for a change?"²

Ideally, regional offices and field operations should be structured to provide efficient and effective customer service. The principal functions of regional and field offices should be defined in terms of customer service needs and program purposes. Resources should be

appropriately distributed to regional or field offices and other areas of immediate need for timely service. The department should ensure that its field managers are well informed and empowered to make decisions necessary to operations. Workforce distribution should match workload and program goals in all operating divisions and field offices. Authority should be delegated to the lowest possible level, and duplication and overlap of authority and responsibility eliminated. State and local governments should be included as partners in program administration and operations in order to strengthen the working relationships, communications and levels of understanding between field representatives of the department and local service providers.

Recommendations and Implications:

In the context of a federal government-wide effort, the department should conduct a comprehensive review of HHS regional and field office structure, functions, and resource allocations to determine their appropriateness, and should determine which functions should be decentralized and which should be consolidated.

In conducting this review HHS should explore with other departments involved in the delivery of health care and human services the opportunities for collocation and coordination of service delivery. The department should consider how regional and field offices should be structured to provide efficient and effective customer service and to accomplish program goals. The assessment should provide the basis for reengineering structure and operations across the department with the goals of providing localized service, delegating responsibility to empower local operations and maintaining accountability through outcomes oriented assessment of program effectiveness.

The review should include consultation with state and local representatives, HHS employees, appropriate congressional principals and committees, and with genuinely representative customer groups.

As a result of this review, HHS should clarify the mission for each regional office and for field stations in terms of program intent and client needs, eliminate redundant operations, empower local staff with decision making authority to ensure success of

programs and activities they are responsible for, clarify lines of authority and accountability for field and regional offices, instill customer service orientation among staff by setting goals in the service context and rewarding that performance, and by conducting results oriented evaluation to determine the service delivery effectiveness of regional and field activities.

Comprehensive change, consolidations, collocation with other federal departments, decentralization from regions, collocation with state and local service providers, or alternative field structure may be appropriate.

Fiscal Impact:

Long term savings in reorganizing field structure will depend on the extent of change implemented by the department. Restructuring offers the opportunity to place resources where workload demands and to eliminate structures and resources less valuable to the accomplishment of program goals and effective service delivery. Reduction of field operations expenses by X per cent per year over the next five years would yield savings of:

In Millions of Dollars

	1994	1995	1996	1997	1998	1999
Budget -						
Authority	\$XXXXX	\$XXXXX	\$XXX	\$XXX	\$XXX	\$XXX
Outlay	\$XXXXX	\$XXXXX	\$XXXXX	\$XXXXX	\$XXXXX	\$XXXXX
Change in						
FTEs	XX	XX	XX	XX	XX	XX

Endnotes:

1. Beryl A. Radin, *Implementation, Change, and the Federal Bureaucracy* (New York: Teachers College Press, Columbia University, 1977), p. 33.
2. Letter from Robert M. Tobias, President, National Treasure Employees Union, to Roy Tucker, Health and Human Services, May 6, 1993.

THE HEALTH CARE FINANCING ADMINISTRATION'S CONTRACTING AUTHORITY SHOULD BE AMENDED TO ALLOW FOR COMPETITIVE CONTRACTING

Background

The Health Care Financing Administration (HCFA), in the Department of Health and Human Services (HHS), is responsible for the overall administration of Medicare, the federal health insurance program, which pays a portion of the health care cost for persons 65 and older, some disabled persons under age 65, and individuals with end-stage renal disease, regardless of age. When primary coverage is available through employer or large group health plans and automobile liability or no-fault insurance (all regarded as primary insurers), Medicare benefits are available only to make secondary payments. This process is called Medicare Secondary Payer (MSP).

Medicare is the fourth largest item in the federal budget after defense, social security, and interest payments on the national debt. Moreover, the program has grown considerably. Since 1975, beneficiary enrollment has grown from 25 million to about 35 million, while claims volume has increased by over 450 percent.¹

Medicare pays for necessary medical care for beneficiaries and has two parts. Part A (Hospital Insurance), which is financed primarily by Social Security payroll taxes, assists with inpatient hospital costs, skilled nursing facility care, home health care and hospice care. Medicare Part B (Supplementary Medical Insurance), which is a voluntary program financed by enrollee premiums and federal contributions from general revenues, helps pay for outpatient hospital services, physician services, physical therapy, durable medical equipment and other medical services and supplies not covered under Part A.

HCFA operates Medicare through agreements with "fiscal intermediaries" and contracts with "carriers" that process and pay Medicare claims for Part A and Part B, respectively. In fiscal year 1992, fiscal intermediaries and carriers processed over 650 million claims for program benefits.² Currently, 47 fiscal intermediaries process Part A claims and 33 carriers process claims for Part B.

These 80 contractors use 14 different claims processing systems. HCFA reports that this process contributes to variations in coverage and other inconsistencies in implementing Medicare laws and policies. HHS plans to put forth a Medicare Transaction System (MTS) legislative proposal to employ a single system for claims processing by 1997.

Intermediaries and carriers are paid under cost reimbursement contracts. This means they are reimbursed only for necessary and reasonable costs for administering Medicare activities. However, non-competitive cost reimbursement is not always the most effective method of procurement. Competitive bidding, unlike the non-competitive process, typically presents the opportunity for reducing administrative costs and assuring a fair and reasonable price and quality of services.

Currently, the General Accounting Office (GAO) is conducting two ongoing studies--one on the MTS and the other on contracting practices with insurance companies. Reports are due on both studies this Fall, but unofficial preliminary findings are said to be more favorable of competitive contracting than GAO reports in previous years.³ In addition, amendments to Sections 1816(c)(1) and 1842(c)(1)(A) of the Social Security Act to eliminate the requirement of cost reimbursement contracting are now being considered in Congress.

Under current law (Section 1816 of the Social Security Act), Part A "providers" (hospitals, hospices, nursing homes, and others) have the right to select the intermediary that will process their claims. These intermediaries are all insurance companies. At its inception, Medicare was not broadly accepted in the provider community. To foster acceptance of Medicare and promote health services to the beneficiary population, providers were able to select a fiscal intermediary who would, in essence, process the beneficiary's claim and insure the provider a payment. Medicare is now widely accepted and consequently, the right to nominate is now an antiquated concept. The nomination process impedes the Secretary from consolidating intermediary functions into a limited number of contractors who would be better suited to process these millions of claims annually.

For processing Medicare Part B claims, HCFA can only contract with insurance companies who are contracted to handle all claims in a specified geographic area, usually a state.⁴ Because insurance companies are not always the organization that can best meet HCFA's requirement of an intermediary or carrier, the statutes which limit the Secretary's contracting authority to these entities compromise the efficient administration of the Medicare program.

The contractor, in many instances, is the beneficiary's insurer, therefore, making Medicare the secondary payer. This often creates a conflict of interest. In addition, insurance companies are often in direct competition. Contractors, who are also insurers, may have a strong disincentive to share information on those they insure with other companies.

Current law also requires that Part B claims for beneficiaries entitled to Medicare under the Railroad Retirement Act of 1974 be processed by a separate carrier or carriers with which the Railroad Retirement Board (RRB) has contracted.⁵ These claims represent about 13 million or 2.5 percent of the total annual Medicare claims volume. This separate carrier (or carriers) follows the same rules in processing claims as are used to process claims for all other Medicare beneficiaries. It would be more efficient and cost effective to have these claims processed through the local carriers.

Medicare's current contractor structure is unique to HCFA as no other government agency operates under the same constraints as HCFA in managing its contractors. Statutory amendments are necessary to eliminate special contracting provisions and bring carrier contracts into compliance with other government contracts and Federal Acquisition Regulations (FAR) requirements. Amendments to this special contracting provision would, for example, eliminate the statutory right of a contractor to a hearing in the event of a termination based on performance deficiencies. Amendments would also require the awarding of contracts on a competitive, annually renewable basis rather than the current non-competitive practice of awarding contracts that can be renewed indefinitely.

In addition, the implementing regulations found at 42 CFR 421.100 and 421.200 have established procedures more stringent than the statute and, as a result, further impede

HCFA's ability to contract in the most efficient and effective manner. These regulations prevent HCFA from moving individual functions from a contractor performing those functions poorly to a contractor who can perform them more efficiently and effectively.

These contracting constraints lead to deficiencies in program performance including: HCFA's ability to increase efficiency in its contractors, ensuring uniformity of expenditures and ensuring appropriate levels of service to Medicare beneficiaries and providers. Barriers to eliminating these deficiencies include the following:

- (1) Statutory and regulatory provisions for acquiring contractor services limit the pool of eligible contractors, compromise the MSP function and recovery activities and nullify possible cost savings and performance enhancement that ensue from open competition among bidders⁶;
- (2) Current law requires that Part B claims for beneficiaries entitled to Medicare under the Railroad Retirement Act of 1974 be processed by a separate carrier or carriers with which the RRB has contracted⁷;
- (3) The existing incentive structure does not foster improvements in payment accuracy and responsible fiscal management; and
- (4) Medicare contractors currently use 14 different claims processing systems that contribute to variations in coverage and other inconsistencies in implementing Medicare laws and policies.

Resolutions to these impediments should, at a minimum, include regulatory and legislative amendments to the Secretary's contracting authority, increase incentives for contractors and develop a single Medicare claims processing system.

Recommendations

1. **Amend the Secretary's contracting authority to allow contracting with entities other than health insurance companies.**

An amendment to Section 1842(f) would redefine "carrier" and an amendment to Section 1816(f) would redefine "fiscal intermediary." These changes would enable the Secretary to administer the program more efficiently and effectively.

2. **Eliminate the right of Part A providers to nominate organizations to serve as fiscal intermediaries.**

Section 1816(e) bars the Secretary from reassigning providers to other organizations not already having an agreement to process Medicare Part A claims. This statute impedes the Secretary from consolidating intermediary functions into a limited number of contractors who would be better suited to process these millions of claims annually. Elimination of this statute would promote more efficient management of contractors.

3. **Amend HCFA's contracting authority to eliminate special carrier contracting authorities.**

Amendments to Sections 1842(b)(1) and 1842(b)(5) would grant the Secretary greater administrative flexibility in removing poor performing contractors and strengthen MSP function and health care cost recovery activities.

4. **Amend HCFA's contracting authority to eliminate requirement for cost reimbursement contracting.**

Contracts that provide for payment on an other-than-cost basis would allow the Secretary greater flexibility to determine what form of contracting is best in a particular situation and would strengthen HCFA's ability to negotiate with inefficient contractors.

5. **Amend HCFA's contracting authority to eliminate the separate carrier for railroad retirement beneficiaries.**

Again, railroad retirement beneficiaries represent about 2.5 percent of the total annual Medicare claims volume. It is inefficient and less effective to have a separate contractor(s) process these claims. Since the local carrier follows the same rules as the separate carrier in processing claims, services to the railroad retirement Medicare beneficiary would not be compromised.

6. **Revise regulations to permit HCFA to move functions among contractors.**

Regulations found at 42 CFR 421.100 and 421.200 impede HCFA's ability to contract in the most efficient and effective manner. Revision of these regulations

would permit HCFA to move individual functions from a contractor performing those functions poorly to a contractor who can perform them more efficiently and effectively. This revision would strengthen HCFA's ability to administer the Medicare program both in its current structure, as well as a future structure contemplated by the aforementioned proposed statutory amendments.

7. Develop a single database system to eliminate the use of 14 different claims processing systems.

The MTS would result in a consolidation and enhancement of claims processing sites, save on administrative costs and lend to a more uniform, better managed administrative system. As previously indicated, HHS would like to change the restrictive contracting laws. Without this change--without an environment of full and open competition among bidders--HCFA would be limited to installing the MTS at existing contractor sites rather than with entities who could best perform MTS functions.

Implications

Insurance companies and other special interest groups may oppose the consolidation of contractors and a full and open competition among bidders for Medicare claims processing contracts. One large insurer has already sought a congressional delay to the department's effort to continue with its request for proposal for the design of the MTS pending the Fall release of GAO's report on competitive contracting.

Fiscal Impact

HHS currently spends approximately \$900 million annually on Medicare claims processing activities. Legislative amendments to the Secretary's contracting authority and HCFA regulations can begin as early as fiscal year 1994, with MTS implementation following shortly in fiscal year 1997. Reasonable cost estimates provided by HHS and supported by the Health Division of the Office of Management and Budget follows:

In Millions of Dollars					
	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999
Outlays	\$50	\$90	\$150	\$300	\$300

Endnotes

1. General Accounting Office/Human Resource Division (GAO/HRD), *Medicare Claims*, 93-6, p. 10.
2. United States Senate Subcommittee on Regulations and Government Information, Before Committee on Governmental Affairs, *"Faulty Information System Costs Millions in Medicare Payments,"* testimony by Carol J. Walton, Director, Bureau of Program Operations, Health Care Financing Administration, April 2, 1993.
3. GAO/HRD-86-48, Medicare, Existing Contract Authority Can Provide for Effective Program Administration.
4. Compilation of the Social Security Laws (As Amended and Related Enactments Through January 1, 1993), Volume 1, Section 1842.
5. Compilation of the Social Security Laws (As Amended and Related Enactments Through January 1, 1993), Sections 1816 and 1842.
6. Ibid.
7. Compilation of the Social Security Laws (As Amended and Related Enactments Through January 1, 1993), Section 1842.

Section III

Agency Reinvention Activities

AGENCY REINVENTION ACTIVITIES

Themes for Continuous Improvement

The process of reinventing government at HHS began in January 1993 when Donna E. Shalala was sworn in as Secretary. In her greeting to HHS employees on January 28, Secretary Shalala said that it was time to return "the focus of HHS to the everyday needs of all Americans."

To that end, the Department has adopted three themes to bring intellectual coherence to its many programs and policies and to foster continuous improvement at HHS. These themes are *fostering independence* through *empowering* the people served; *preventing* future problems; and *improving services to our customers* through modern management approaches.

These themes guide HHS decisions on strategic planning and priority setting. The HHS proposed budget for FY 1994 controls government spending and is fiscally responsible. At the same time, HHS is investing in the future through pre-school immunizations, Head Start, women's health, reductions in infant mortality, AIDS research and other priority areas. All of these initiatives will protect the health and well-being of the American people -- and prevent, in the long run, unnecessary spending on the preventable consequences of illness and poverty.

The two major initiatives that will have the greatest impact on improving the delivery of services to HHS customers are Health Care and Welfare Reform. Soon after this report, the Administration will announce major initiatives in these areas.

HHS Internal Reinvention Process

DHHS is undertaking "reinvention" through a program of continuous improvement of the department, its programs and how it does business. This is reflected in the Secretary's message to managers and employees that this will not be a one time effort, but continual progress toward quality improvement. HHS efforts will continue well beyond the release of this report. To guide this effort, Secretary Shalala has named a Steering Committee on Performance Review, chaired by Deputy Secretary, Walter Broadnax, with

membership composed of the senior administrators of all HHS agencies and major policy offices. The Steering Committee's charge is to review systematically Department programs and management operations in order to identify ways to make these efforts more effective, efficient, and responsive to our customers. Guiding the Steering Committee will be the three themes of prevention, independence and customer service. Staff support and day-to-day direction to the effort is provided by an interagency Advisory Group to the Steering Committee of senior career officials from around the Department. Outreach to HHS employees and their representatives and external customers will be key elements in the program.

Laboratories for Invention

At the Vice President's request, HHS named two "laboratories for invention" for the National Performance Review. They are the Alaska Native Medical Center and the regulation development process of the Health Care Financing Administration. Other "labs" are under development in both programmatic and administrative areas in HHS, e.g., new approaches to performance management and manager/employee dispute resolution.

Alaska Native Medical Center (ANMC) Reinvention Laboratory

The Indian Health Service (IHS) provides health care to approximately 1.3 million American Indians/Alaska Natives. The ANMC facility is one of the better facilities and has already begun implementing principles of TQM and HHS sees this as an opportunity to develop a model facility for health care delivery to native americans. The Department is identifying administrative impediments both internal and external to the organization and providing or seeking authority to remove them. Actions are underway to reduce unnecessary paperwork, eliminate multiple levels of review, and increase flexibility to pay, hire, and retain employees. The outcome is intended to enhance the ANMC's ability to deliver high-quality medical service, to improve its ability to evaluate and improve its services, and to identify needs for new services. At the same time, ANMC hopes to improve its ability to recruit and retain quality staff, and make the organization a more rewarding place to work.

Health Care Financing Administration (HCFA) NPR Reinvention Lab

The HCFA manages the Medicare and Medicaid programs. This "lab" intends to improve the HCFA regulatory process using a negotiated rulemaking process (reg-neg). "Reg-neg" has been promoted by the Administrative Conference of the United States as an alternative means of "dispute resolution" in cases where regulations involve adversarial conflicts among clearly identifiable private parties, and where there is a high probability of litigation. HCFA will test this approach on up to three regulations:

Hospice Wage Index: HCFA proposes to negotiate over the wage index, source data, and phase-in period with two national hospice organizations. The wage index adjusts Medicare payments to reflect wage differences across localities without affecting aggregate payments.

Inpatient Psychiatric Services: HCFA proposes to negotiate the extension of coverage of inpatient psychiatric care to settings other than psychiatric hospitals. The proposed negotiators include the American Psychiatric Association, the National Association of State Mental Health Program Directors, the State Medicaid Directors Association, and other groups interested in psychiatric treatment services for children.

Health Care Prepayment Plan (CPP): HCFA proposes to negotiate operational and oversight standards of HCPPs with the Group Health Association of America, Kaiser Foundation Health Plan, employer/union sponsored plans, and beneficiary interest groups such as the American Association of Retired Persons.

Employee Involvement

On July 22, Secretary Shalala and Vice President Gore hosted a Town Hall meeting with HHS employees. More than 400 employees *from the Washington metropolitan area participated on site, while approximately 10,000 employees from Alaska to Puerto Rico took part via satellite hookups. The Town Hall was a grand success demonstrating that

HHS employees are committed to providing better services and have excellent ideas on how to do it.

HHS consulted with employees at all levels and included national union leaders in the design and testing of an extensive employee outreach program for ideas to improve the administration of its programs. In July 1993, the Department pilot-tested this outreach program with over 2000 employees. One month later, all 130,000 employees were contacted individually and asked to suggest ways to improve the quality of the Department's services. The employees are responding using a special form and FAX number to the Secretary's "continuous improvement" team. A special data base has been created to record and track action on these responses.

The Start of a Journey

In July, the Secretary held a staff retreat with the Steering Committee and other senior career and political officials in the Department. The Retreat focused on identifying the customers, partners and recipients of the various programs of HHS. It also looked at how services can be delivered in a cooperative, integrative, and inclusive way, and at how to break down internal and external barriers to improvement.

This action plan, developed and implemented under the leadership of the Secretary and her Steering Committee for Continuous Improvement, and with employee and National Performance Review input, will guide the Department in making significant improvements in what it does and how it does it; breaking down barriers, improving customer services, empowering the people HHS serves and preventing future problems.

In January, 1994, the Secretary and her senior staff will hold a second retreat to assess how well the Department is doing and what more must be done.

Section IV

Fiscal Impact Summary

HEALTH AND HUMAN SERVICES FISCAL IMPLICATIONS SUMMARY

		CHANGE IN OUTLAYS Numbers in Millions							
Ch.		Fiscal Year							Change
Ref.	Recommendation	1994	1995	1996	1997	1998	1999	6-YRS	in FTEs
HHS 1	Integrated Service Delivery	0	0	0	0	0	0	0	0
HHS 2	Re-engineer HHS Regulations Process	0	0	0	0	0	0	0	0
HHS 3	Develop Food Inspection System	0	0	0	0	0	0	0	0
HHS 4	Health Professions Education	0	0	0	0	0	0	0	0
HHS 5	Restructure Railroad Benefit Programs	0	0	0	0	0	0	0	0
HHS 6	Improve SSA Disability Program	-49	-254	0	400	800	1,100	1,997	1,205
HHS 7	Remove Barriers to Oversight	0	0	0	0	0	0	0	0
HHS 8	SSA Leadership in Death Information	0	65	52	13	13	13	156	0
HHS 9	SSA Debt Collection	0	100	70	55	55	55	335	1,880
HHS 10	FDA User Fees	0	0	0	0	0	0	0	0
HHS 11	Redesign SSA Service Delivery	0	0	0	0	0	0	0	0
HHS 12	Strengthen Department Management	0	0	0	0	0	0	0	0
HHS 13	Restructure Field & Regional Offices	0	0	0	0	0	0	0	0
HHS 14	Abolish Office of Consumer Affairs	0	0	0	0	0	0	0	0
HHS 15	Competitive Contracting for Medicare	0	50	90	150	300	300	890	0
Total, Health and Human Services		-49	-39	212	618	1,168	1,468	3,378	3,085

HEALTH AND HUMAN SERVICES FISCAL IMPLICATIONS SUMMARY

CHANGE IN BUDGET AUTHORITY Numbers in Millions									
Ch.		Fiscal Year							Change
Ref.	Recommendation	1994	1995	1996	1997	1998	1999	6-YRS	In FTE
HHS 1	Integrated Service Delivery	0	0	0	0	0	0	0	0
HHS 2	Re-engineer HHS Regulations Process	0	0	0	0	0	0	0	0
HHS 3	Develop Food Inspection System	0	0	0	0	0	0	0	0
HHS 4	Health Professions Education	0	0	0	0	0	0	0	0
HHS 5	Revamp Railroad Benefit Programs	0	0	0	0	0	0	0	0
HHS 6	Improve SSA Disability Program	0	0	0	0	0	0	0	0
HHS 7	Remove Barriers to Effective Oversight	0	0	0	0	0	0	0	0
HHS 8	SSA Leadership in Death Information	0	0	0	0	0	0	0	0
HHS 9	SSA Debt Collection	0	0	0	0	0	0	0	0
HHS 10	FDA User Fees	0	0	0	0	0	0	0	0
HHS 11	Redesign SSA Service Delivery	0	0	0	0	0	0	0	0
HHS 12	Strengthen Department Management	0	0	0	0	0	0	0	0
HHS 13	Restructure Field & Regional Offices	0	0	0	0	0	0	0	0
HHS 14	Abolish Office of Consumer Affairs	0	0	0	0	0	0	0	0
HHS 15	Competitive Contracting or Medicare	0	0	0	0	0	0	0	0
	Total, Health and Human Services	0	0	0	0	0	0	0	0

NOTE: Savings impact trust funds
and are shown as outlays versus
budget authority per OMB

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HUD

Divider Title: _____

**THE DEPARTMENT OF
HOUSING & URBAN DEVELOPMENT
AGENCY TEAM REPORT**

NATIONAL PERFORMANCE REVIEW

INTERNAL WORKING DOCUMENT-- NOT FOR DISTRIBUTION
AUGUST 2, 1993

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Section I

Introduction

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

INTRODUCTION

The Department of Housing and Urban Development(HUD) is the federal agency primarily responsible for housing programs, enforcement of fair housing laws and improving the quality of life in the nation's cities, towns and villages. More than ten million Americans benefit directly from HUD's single family mortgage insurance and housing subsidy programs. Millions more benefit directly and indirectly through HUD's other major programs, such as community development block grants. With a fiscal 1992 budget of \$25.1 billion, HUD ranked eighth among the fourteen cabinet level department, less than a tenth of the largest department (Defense) and approximately ten times the size of the smallest (Commerce).

- The major functions of the Department are to:
- Expand home-ownership opportunities;
- Increase the supply of affordable rental units for families, the elderly, the homeless and the physically challenged;
- Stimulate economic and community development in urban and rural areas;
- Promote and enforce fair housing and equal housing opportunity;
- Link the capital markets to the primary mortgage markets through the Government National Mortgage Association (Ginnie Mae); and
- Regulate the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

The Department has approximately 13,500 employees, 3,500 in its Washington headquarters and 10,000 in its ten regional offices and 70 area offices across the country.

A Brief History

The Federal Housing Administration (FHA) was established in 1934 to create jobs in housing construction and related industries and to increase the nation's housing stock. FHA provided home mortgage default insurance to banks and savings and loans to stimulate private lending for housing construction and rehabilitation, an activity that had virtually

come to a halt as a consequence of the Great Depression. FHA quickly became the nation's leading residential mortgage insurer and set mortgage underwriting rules that became the industry standard.

In 1937, the U.S. Housing Authority (USHA) was created to "...rid cities of blighted areas; rehouse slum dwellers; to provide employment; to encourage a thoroughly decentralized housing program drawing its strength from local initiative and responsibility...." USHA was empowered to create the first major public housing program by making loans to local housing agencies for project construction and to provide rent-reducing subsidies once the project is completed.

The functions of FHA, USHA and the Federal Home Loan Bank Board were consolidated into the National Housing Agency by Executive Order of President Roosevelt in 1942. This wartime agency was replaced by the Housing and Home Finance Agency (HHFA) in 1947. HHFA subsequently assumed responsibility for the Community Facilities Service, which administered grants and loans for college and elderly housing and Fannie Mae, which maintains mortgage market liquidity by buying and selling FHA mortgages on the secondary mortgage market. HHFA also created the Urban Renewal Administration to establish programs for slum clearance, urban renewal and acquisition of open space land in inner cities.

The Department of Housing and Urban Development (HUD) was established as a cabinet level agency in 1965, replacing HHFA and charged with the broader mission of both creating and maintaining decent, affordable housing and stable communities.

HUD was devastated by scandals in the 1980s, following revelations that senior political appointees in the agency had misappropriated HUD funds for personal and political benefit. The HUD Reform Act of 1989 was designed to deter such abuses in the future and to create a greater degree of financial accountability in the agency through the establishment of the positions of Chief Financial Officer and FHA Comptroller. A separate Office of Ethics was created in 1990. Finally, the Office of Lead-Based Paint Abatement and Poisoning Prevention was established in 1991 to reduce the lead-based paint hazards in the federally assisted and private housing stock.

Current Policy Priorities

Internal and external reviews by HUD's Inspector General, the Office of Management and Budget, the General Accounting Office and the independent accounting and consulting firm of Price Waterhouse document the need for substantial changes at HUD to address a number of critical management problems. Among the most serious of these problems are:

- The inadequacy of HUD's financial, management, data and control systems;
- Poor servicing of the insured multifamily housing portfolio;
- Inadequate asset management of the single and multi family housing inventory; and
- Ineffective management by the HUD regulated Public Housing Agencies (PHAs).

Among these multi-faceted issues, the National Performance Review analysis indicates that the most pressing problems and the greatest opportunities for improvement are in management of public housing and asset management and disposition.

When the Federal Public Housing program began in the 1930s, it was hailed as an enlightened response to the squalid living conditions of the waves of European immigrants crowded into unsafe, privately built tenements in cities across the country. While public housing remains the primary source of affordable housing for the nation's poor and working poor, by the 1970s, it had come to symbolize all that was wrong with the so-called liberal approach to social problems. Inflexible, universal standards set in Washington combined with local political realities led to the construction of large, high rise projects in the worst sections of our cities, inhabited almost exclusively by single parent families on public assistance.

While only 24 of the nation's more than 3,000 housing authorities are classified as troubled, these troubled authorities account for 18 percent of all public housing units, receive over 30 percent of all public housing operating subsidies, will consume over 25 percent of all future modernization funds, and have an average vacancy rate of 13 percent. Over the past two years, HUD has been forced to take over the PHAs in Philadelphia and Chester, Pennsylvania and Kansas City, Missouri and is currently considering the takeover of several others. At the same time, more than \$6 billion in rehabilitation funds remains

unspent in the public housing modernization pipeline.

During the 1980s, innovative state and local governments, frustrated by the virtual abandonment of the federal government's commitment to decent, affordable housing, began to experiment on their own with new methods of providing low income housing. These models relied on public-private partnerships, community-based nonprofit management, homeownership, program flexibility and devolution of decision-making to the state and local communities. Both *Mandate For Change* and *Reinventing Government* single out the public housing program as suffering from excessive regulation and centralization and point to the models developed at the state and local levels as potential solutions.

The National Performance Review recommends a comprehensive five-point program to reinvent the nation's public housing program. Particular focus is on the need to shift from red tape to management by results and to discipline project management and empower tenants by introducing market dynamics. The program includes the radical devolution of control to local PHA's with an excellent performance record, a cooperative effort of federal and local officials and public housing tenants to eliminate unnecessary HUD requirements and a hard-hitting targeted HUD initiative to resolve the problems of the relatively few troubled PHA's. HUD should also be authorized to use new construction and modernization funds to develop demonstration models that give public housing tenants market powers and freedoms, mixed-income developments that fund portable tenant subsidies and the sale of existing public housing units where the proceeds could guarantee replacement of the units in greater numbers and with enhanced housing options for public housing tenants.

HUD also faces an overwhelming and worsening task in managing problem single-family and multi-family loans and in the disposition of foreclosed properties. HUD has historically managed and sold these assets "in house" using government staff. However, the workload has increased dramatically in recent years and threatens to increase even more rapidly in the future while the HUD staff available has declined. In view of the overall federal budget deficit, the addition of HUD employees sufficient to manage even the existing workload is unlikely. HUD must do more with less. The secret to doing so is to use public/private partnerships which use a market dynamic to achieve results in managing

and disposing of real estate assets. HUD staff will measure businesslike performance, rather than administer through government bureaucracy and red tape.

The current inventory of multi family units is approximately 48,000 units and growing. Assuming no change in policy, HUD would require \$2 billion in budget authority to process this inventory, a twenty fold increase over the fiscal 1993 appropriation. In addition, nearly \$1 billion in HUD coinsured loans are already in default and existing audits indicate that billions more in defaulted loans are expected. HUD also has an inventory of over 90,000 single family loans, valued at about \$3.3 billion, about half of which are not current. Last year, approximately 17,000 new assignments were taken and only 1,700 were resolved through foreclosure.

HUD should use public-private partnerships to manage and dispose of separate pools of multi-family and single family problem loans and properties instead of using in-house staff. HUD should also contract out loan servicing for assigned single family loans and for the administration of a temporary financial assistance program for qualified single family, assigned mortgages. Finally, HUD should develop a Loss Mitigation Program for early intervention with FHA insured homeowners in financial difficulty.

The National Performance Review believes that comprehensive, intensive effort to overcome the problems faced by HUD in public housing and single and multi family loan and asset management will have a substantial, positive impact on quality and quantity of affordable, low and moderate income housing in America and dramatically improve the effectiveness and efficiency of the US Department of Housing and Urban Development.

Agency Reinvention Activities

Secretary Cisneros has been extremely aggressive in making HUD Reinvention a central theme in his management of the Department. He has involved all HUD staff in all of the widespread HUD offices to help better define HUD's mission and identify problems and solutions. Two full time teams of top HUD career staff are now working to give meaning to the grassroots input by introducing immediate change in Departmental practices. For the long term, the teams will focus on management and systems improvements and on program policy review and innovation.

Reinvention Labs are underway in an experimental reorienting of sales of single family properties in cooperation with non-profit organizations and their communities and in innovations in public housing management, affirmative marketing, a homeless initiative in the nation's capital, and a community partnership against crime.

A full description of HUD's extensive efforts is provided in Section III.

Fiscal Impact Summary

The most important past, present and future commitment of taxpayer funds through HUD is represented in the outstanding portfolio of 1.4 million public housing units, the 2.2 million privately owned units assisted under contract by HUD, the \$378 billion of outstanding FHA insurance, the \$12 billion of real estate and loan assets held by HUD and the annual flow of HUD funds mandated to support those assets and liabilities. The annual discretionary funding of HUD is minor in comparison.

The HUD NPR review thus focused primarily where the money is and the innovative recommendations in management of public housing and the assisted and insured private housing stock if well implemented could result in large returns in benefits gained and money saved. Those financial savings will not necessarily show in budget figures, at least in the short run. Some of the useful, but less significant recommendations will cause some specific measurable financial benefits expected to be ____ in budget authority and ____ in outlays over five years.

Section II

Issue Papers & Recommendations

Shifting from Red Tape to Results

STREAMLINE AND DEVOLVE PUBLIC HOUSING DECISION MAKING AND EXPERIMENT WITH MARKET DISCIPLINED, MIXED INCOME PUBLIC HOUSING WITH EMPOWERED PUBLIC HOUSING TENANTS

Background

When the federal public housing program began in the 1930s, it was hailed as an enlightened response to squalid living conditions of the waves of European immigrants crowded into unsafe, privately built tenements in cities across the country.

The program represented a partnership between federal, state and local governments, with the federal government providing construction and (later) operating subsidies as well as comprehensive and detailed regulations concerning how tenants were to be selected and projects operated. States assisted the federal government in enforcing compliance with federal regulations, and local public housing authorities (PHAs) operated the housing projects.

By the 1970s, public housing had come to symbolize all that was wrong with the so-called liberal approach to social problems. Inflexible, universal standards set in Washington combined with local political and social realities led to construction of large, high rise "projects" in the worst sections of our urban centers. The size and architecture of these projects, often dictated by well motivated federal regulations, added to the stigma of living in the projects. Rigid federal management rules limit the ability of managers to apply common sense, for example, by prohibiting provision of air conditioning even when most reasonable. Finally, inflexible rent rules based on income, give residents who achieve working class income status strong incentive to move out of public housing. As a result, many projects are inhabited by an overwhelming majority of single parent families on public assistance, without the hope, role models, and stability that those who are making it would provide. The most visible, big city, "problem PHAs" combine politicized staffing and other locally created inefficiencies with the federal limitations to seriously discredit the entire, well intended, federal effort in low income housing.

During the 1980s, innovative state and local governments, frustrated by virtual

abandonment of the federal government's commitment to affordable housing for the poor, began to experiment on their own with new models of developing, designing, financing, managing and owning low income housing. These models included the use of public-private partnerships to develop housing, use of community based, nonprofit organizations to manage and/or own housing and direct, low income family ownership of housing. The successful efforts tailored the housing to the unique characteristics of the community in which it was built and hence minimized use of strict, centrally developed regulations. Program flexibility was essential to their success. Devolution of decision making to the lowest possible level is key.

While HUD did begin to respond to the need for rethinking its management of our public housing resource with the HOPE effort to sell public housing to tenants interested and capable of buying their apartments, that effort has proven to be slow, expensive and to date of limited applicability. Both *Mandate for Change* and *Reinventing Government* single out the public housing program as suffering from excessive regulation and centralization. For example, HUD field staff spend substantial amounts of time annually reviewing and approving detailed budgets from local PHAs even though those reviews have no impact on federal funding decisions.

Recommendations

1. HUD should radically devolve control of public housing to local PHA's with histories of excellent management, providing the required ongoing operating subsidies subject only to the local PHA meeting a series of performance targets. Individual demonstrations would vary, but all federal rules would be open for waiver so long as HUD can successfully measure performance in providing long-term affordable housing to those federally targeted as being most in need. Devolution in these demonstrations would go far beyond the broad streamlining of rules for all PHAs envisaged in Recommendation 2.. below.

In order to implement this recommendation and recommendation 3, below, HUD will require legislative authority for the Secretary to waive statutory and regulatory

requirements for the purpose of carrying out specific, well monitored demonstrations. All such waivers, and the results of demonstrations, would be reported to the Congress.

2. **HUD should work closely with local PHAs, their national organizations, public housing tenant representatives, and state and local government officials to eliminate unnecessary HUD requirements and procedures (such as the current annual budget review) and to identify those rules and regulations that should be eliminated altogether and those that could be more effectively administered at a level of government closer to the customer.** As part of this effort, HUD should replace its detailed procurement and operating manuals and design and site selection requirements with performance measures, using annual ranking of local PHA's to encourage better service and greater accountability. HUD should also work with Congress to develop an alternative to the current rent rules which create strong disincentives for working families to remain in public housing.

3. **HUD should be authorized to target federal public housing new construction and modernization funds to both HUD and locally developed demonstration models that seek to give public housing tenants market powers and freedoms, including the power to move to units outside of public housing with their housing subsidies.** Some of the new funds would go to demonstrations HUD develops. The rest could be awarded to local PHA's and governments on a competitive basis, funding a wide array of models that seek to empower public housing tenants, achieve a better income mix, and provide market disciplined incentives to project managers to improve and preserve the long term viability of our public housing assets. Similar demonstrations should be established with some existing public housing not receiving modernization funds.

4. **HUD should make a hard hitting targeted effort to resolve the severe difficulties of those few public housing agencies identified as "problem PHAs."** Use of an outside team of experts from the public housing industry for a "new look" should be included, followed by wide ranging recommendations which may include putting services now handled by the PHA out for bid by private companies, non profit organizations or neighboring PHAs. HUD should use all of its leverage with these agencies to incorporate the recommendations into a specific memorandum of agreement enforceable by HUD.

5. HUD should be permitted to authorize sale of public housing units with flexible requirements for replacement housing in those limited circumstances when sale prices would be high (relative to the benefits currently received by existing tenants) so that sales proceeds could guarantee long term replacement housing in greater numbers and with improved tenant options. The key would be that the replacement arrangement would be a superior guarantee of a long term housing resource than the project to be sold. A combination of mixed income development and "endowed" certificates or vouchers may be such an option in some cases. This approach would replace, when appropriate, the relatively rigid current rule for "one for one" replacement of public housing with new public housing as a prerequisite to sale or demolition of public housing.

Implications

Elimination of excessive and unnecessary regulations and actual transfer of total operating authority of units to localities should reduce the cost of administering the public housing program at the federal level and apply a greater percentage of subsidy dollars at the local level to improving the physical environment and tenant services. Intelligent deregulation will also enable HUD to use its limited staff resources to steer more effectively the nation's low income housing policy and better protect our substantial existing subsidized, low income housing stock.

Directing new construction and substantial modernization appropriations to federally and locally initiated demonstrations should begin to transform public housing from its image as the provider of high rise, deteriorating "projects" to the facilitator of innovative, mixed income, community managed or tenant owned affordable housing, tailored to the local environment.

Unlike conventional public housing, mixed income, market oriented developments implemented as part of the recommended demonstrations will not raise the same negative stereotype that public housing harms neighborhoods. The greater acceptability of the new, demonstration public housing developments, combined with waivers of restrictive rules governing placement and construction of new public housing, will facilitate making early use of the existing backlog of unused funding for public housing new construction.

Facilitating new construction of public housing will also allow the tearing down of some of the worst old projects. That demolition has been blocked by a lack of replacement public housing and the rigid rule of one for one replacement of public housing units with only other public housing units.

If these changes are implemented, public housing tenants will receive better housing for the same rent and at the same level of public subsidy. Local communities will benefit from the improved environment in public housing in that crime in public housing is likely to decrease and tenants will have a much better chance of living productive lives. The newly constructed public housing will also become a neighborhood benefit rather than a symbol of deterioration and crime. State and local governments benefit by being better able to target the federal housing assistance they receive to local needs. HUD benefits by using its existing resources to better service its customers, construct new affordable housing that is truly a long term asset, and freeing up staff from what was necessary but not value added work and reassigning them to vast amounts of necessary and value added work that is currently not being done.

Fiscal Impact

At a minimum, the recommended changes would substantially reduce the waste of housing assistance and staff time on the construction, rehabilitation and operation of housing that does not work and regulations that do not achieve any meaningful objectives.

While it is not possible to quantify savings at this point, it is reasonable to assume that the reduction in unnecessary and often counter-productive regulations will actually cut the cost of maintaining public housing and at the same time provide a higher level of housing services to the tenants. New construction designed to community needs and standards should be less expensive per unit to construct and require lower maintenance costs compared to the centrally dictated, often undesirable projects constructed previously.

Public and Indian Housing (PIH) currently employs approximately 1,300 people at headquarters and in the field. If deregulation and devolution of authority were implemented, federal employment could be substantially reduced over time without layoffs, given HUD's historic attrition rate of 12 percent.

An alternative to staff reduction, or potentially part of a mixed approach, is to redeploy HUD staff freed from regulatory duties to several pressing needs in PIH, including expediting the \$6 billion stalled in the public housing modernization pipeline and reforming the PHAs classified as "troubled."

Introducing Market Dynamics

IMPROVE MANAGEMENT AND DISPOSITION OF HUD'S PORTFOLIO OF PROBLEM MULTI-FAMILY LOANS AND REAL ESTATE

Background

The Department of Housing and Urban Development (HUD) has an unmanageable and still growing workload of problem multi-family loans and foreclosed properties, the management and disposition of which are hampered by outdated practices and restrictive and unrealistic statutory rules. Additional staff is not a practical alternative. The problems are different for "subsidized" or "formerly subsidized" projects and for market rate rental apartment buildings and loans secured by such apartment buildings.

"Market rate" rental properties and mortgage loans owned by HUD are those HUD held assets which do not have statutory mandates concerning their use other than the mandate to protect taxpayer resources and the financial viability of the appropriate insurance fund. Those assets should be identified for separate treatment from the "subsidized" housing projects and the loans on the subsidized housing projects. The market rate properties and loans should be considered as primarily financial assets, the value of which should be maximized by efficient asset management and disposition. As with all of its asset disposition, HUD is traditionally geared to manage and sell these assets "in house" with primarily government staff and governmental decision making. Negotiating compromises and restructures and selling (or securitizing) loans returned to performing status and managing and selling foreclosed collateral are business functions performed most effectively by skilled business persons with their own money at risk and who have a direct financial stake in the outcome. Government cannot create a comparable environment within a governmental context. Loans owned by HUD because of the now defunct co-insurance program (and other such loans which may be coming) are "market rate" assets which are a particularly appropriate pool for HUD to use new public/private techniques.

HUD should consider a variety of alternatives (bulk sales, securitization and contract management), but the alternative which best turns over management of business decision making for market rate assets to the private sector with the least discount in the financial return to HUD is probably a public/private limited partnership arrangement. Several large

scale transactions appropriate as models for HUD have recently been closed by the Resolution Trust Corporation (RTC).

HUD multi-family loan and real estate assets involving subsidized units have extra complications hindering use of pure private sector, asset value maximizing mechanisms. In recent years, Congress has tightened requirements for HUD to sell foreclosed multi-family housing properties which are classified as formerly subsidized. Sales may only be for long term use as subsidized housing. Current requirements are that 15 year project-based rent subsidies must be attached to 100 percent of the units.

HUD estimates that it would require \$6.5 billion in additional appropriation of rental assistance funds over a five year period to permit selling the current inventory of HUD-held and foreclosure properties covered by these requirements. The result is that properties are being held in HUD inventory with a continuing decrease in their value. It is becoming a large federal public housing stock. The restrictions on sales also make it difficult for HUD to discipline poor borrowers because they are aware that HUD cannot afford to foreclose. It is important that HUD gain some relief from these statutory restrictions on sale and demolition of HUD held formerly subsidized properties.

Recommendations

1. HUD should identify those market rate real estate assets and HUD held loans secured by such market rate real estate as primarily "financial assets" and HUD should set it's goal for those assets as maximizing present value financial return.

2. For the identified "financial assets," HUD should use the "best practice" models of public/private partnerships for management and disposition of problem loans and real estate, as opposed to working those assets with in house staff.

3. Statutory restrictions on HUD disposition of formerly subsidized multi-family properties held as a result of FHA insurance programs should be relaxed. Preferably, lower income tenants should be protected through "portable" subsidies and the properties should then be managed and disposed of through public/private partnerships. At the least, Congress should enact a more limited relaxation of present restrictions. Such proposals are presently being formulated by HUD.

Implications

Using state of the art public/private partnerships will release HUD staff from the detailed work of asset management and disposition. Partnerships with private entrepreneurs will bring highly skilled business persons with positive financial incentives to the business decision making of working out problem assets. For those assets which HUD may treat as primarily financial assets (i.e., statutory restrictions do not dictate otherwise) financial return will be maximized.

Releasing restrictions on HUD property disposition would assist HUD in dealing with the major build up of HUD's portfolio of formerly subsidized, owned real estate which is diminishing in value under government management. HUD would also have increased leverage to negotiate with and/or discipline recalcitrant borrowers.

Fiscal Impact

The above recommendations will not result in immediate reduction of government appropriations or budgeted outlays, but, because these are the major areas of HUD financial investment and operations, improved efficiency will have significant long term impact on the cost of HUD to the American taxpayer.

**STREAMLINE MANAGEMENT AND DISPOSITION OF 90,000 HUD-HELD
SINGLE FAMILY LOANS THROUGH PUBLIC/PRIVATE PARTNERSHIPS AND
USE OF CONTRACTORS TO PROVIDE TEMPORARY FINANCIAL
ASSISTANCE FOR MORTGAGE PAYMENTS**

Background

The Department of Housing and Urban Development (HUD), through the Federal Housing Administration (FHA), is insuring more than \$375 billion of real estate loans. HUD is often required to pay an insurance claim to the lender and either take over the insured loan (i.e., take an assignment of the loan) or to take ownership of the real estate which was collateral for the loan. As a result, HUD has an overwhelming, and worsening, task in managing problem loans assigned to HUD and in disposing of real estate owned. In recent years, the workload, especially for loan management and real estate disposition, has been increasing while HUD staff is shrinking. Increased staff is neither likely nor is it the best way to deal with an essentially business, not government, function like management and disposition of problem assets (loans and real estate).

Legally, HUD is required to defer foreclosure and take assignment of home mortgages when it appears that it may be possible to return a home owner's loan to a performing status within a three-year period. During that time HUD may temporarily reduce or forego mortgage payments.

About one of four single family defaulted loans goes to HUD assignment rather than to immediate foreclosure. This creates an out-of-control workload and forces difficult personalized judgments on lower-level HUD staff. HUD has more than 90,000 such loans valued at about \$3.3 billion. About one-half are in default. Last year about 17,000 new assignments were taken in by HUD and only about 1,700 were resolved through foreclosure. The portfolio is thus building at a great rate. The loans are serviced "in house," which further strains HUD systems and staff capabilities. Loan servicing is a commonly available contract service performed for competitively-set prices by the private sector. Private companies operating in a competitive market can normally provide a business service (like loan servicing) more efficiently than can a government staff.

These single family home owner loans require two very different kinds of attention. Decisions as to forbearance, i.e., deciding whether a home owner is having only a temporary financial difficulty, not of his or her own making, and is thus deserving of federal assistance (by deferring payment of money due for later collection) are individualized, somewhat subjective decisions of a "social service" character. Social service oriented nonprofit (or, perhaps, for profit) private organizations can usually handle such issues with more flexibility and sensitivity than can government staff, especially when the government staff is stretched too thin.

The task of "working the assets," i.e., trying to maximize financial return from the \$3.3 billion of loans and loan-derived real estate, to protect the FHA Fund and indirectly the taxpayer, is a very different task. That requires quick, tough business decision making. For defaulted loans, legal process should be put in place quickly and loan workouts, compromises, or foreclosures and sale accomplished quickly with a focused money-making orientation. That is a suitable task for a business organization with its own money at risk and a clear profit motive tied to maximizing the net return from the assets. That is a task more suitable for the profit-motivated business sector.

It is not likely, in any event, that HUD will be able to staff appropriately for this task, either in numbers or in appropriate skills. A totally new approach is required. A public/private partnership, organized to maximize the value of the assets entrusted to it, would work well for part of the job, working the assets. A directly relevant model partnership has been used by the Resolution Trust Corporation (RTC) for about \$4 billion of loan and real estate assets in two recently closed transactions (with First Nationwide Bank for the problem assets of Columbia Savings and with Brazos Asset Management for the problem assets of New West/American Savings). These Asset Management and Disposition (AMD) Partnerships were structured essentially as 80/20 limited partnerships in which the private partner holds a twenty percent interest in net proceeds and has full management control of all business decision making as General Partner. The government is a Limited Partner with an eighty percent interest. The government has sufficient oversight authority to protect its interest, but cannot interfere in day-to-day business decision making. The AMD Partnership agreement is carefully constructed to assure that the private General

Partner has its financial interests aligned with the government Limited Partner and will maximize its financial return only by maximizing the return to the government.

Such an AMD Partnership would not be a good vehicle for the "hands on" socially oriented effort of helping home owners work through temporary financial difficulties to resurrect their mortgages. That kind of task can be farmed out on a contract basis to nonprofit organizations (or other contractors) using temporary financial assistance to help with mortgage payments (at no more cost than the comparable deferral of mortgage payments now taking place). The State of Pennsylvania has successfully done so with nonprofit organizations such as ACTION Housing in Pittsburgh.

The HUD assignment and forbearance program has as its primary purpose providing assistance to home owner borrowers. It is reasonably expected that the program will have some cost. In some circumstances, especially when a loan has just become delinquent, it may actually be a money saver, rather than a cost, for the loan insurer to provide some temporary mortgage assistance rather than to pay a mortgage claim and then collect on the delinquent loan. Some private mortgage insurers use such early intervention with home owners developing financial problems in a conscious business effort of "loss mitigation." HUD has no such program.

The single family loans in question are primarily insured under the FHA Mutual Insurance Fund which is structured to be actuarially sound, that is, self funded without requiring appropriations. Even though appropriations are not required, managers of the Fund in HUD are not freely permitted to make any and all businesslike expenditures even when they determine such expenditures to be cost effective. These limitations complicate the management task of HUD.

An overall new design is needed for attacking the problem of cost effective management of the single family home owner insurance portfolio, including replacing present authorities and requirements for making Temporary Mortgage Assistance Payments (TMAP) and for managing assigned loans.

Recommendations

1. HUD should be authorized to use the Mutual Insurance Fund for any cost

effective expenditure needed to maximize the value of the fund, including all expenditures recommended below.

2. HUD should immediately begin development of a Loss Mitigation Program on a controlled, experimental basis. Loss Mitigation should consist of a HUD contractor identifying borrowers on insured loans at an early stage of delinquency on their loan. Under program criteria, the contractor should be authorized to advance funds to a borrower by making mortgage payments on behalf of the borrower and taking appropriate security such as a subordinated mortgage. The program criteria should be designed solely with the objective of saving money for the FHA Fund (i.e., there would be no social purpose *per se*). One or more designs for early intervention with FHA-insured home owners having financial difficulties should be implemented with statistically significant groups of borrowers. Appropriate control groups of borrowers not receiving the opportunity for Loss Mitigation assistance should also be established for scientific measurement of results. If and when cost effectiveness of Loss Mitigation is established, the program should be expanded to the entire portfolio. All implementation and analysis should be performed under contract funded by the FHA Fund.

3. HUD should contract out loan servicing for the single family loans for which it accepts assignment. Loan servicing is a common business function which is not an appropriate task to be performed "in house" by a government agency.

4. HUD should bid out 20 percent General Partnership interests in 4 to 6 Asset Management and Disposition (AMD) Limited Partnerships to manage and dispose of pools of single family loans now assigned to HUD. The AMD Partnerships should be based on the RTC-developed AMD Partnership model discussed above. The purpose of these AMD Partnerships will be to maximize financial return from the loan and collateral assets. The AMD Partnerships will not be responsible for the social objective of assisting the temporarily discomfited borrowers. That function will be handled as described below.

5. HUD should contract with qualified nonprofit organizations (or other organizations) to administer a financial assistance program for temporary help with mortgage payments for HUD-held assigned mortgages and for such mortgages which have been transferred to the above described AMD Partnerships. These contractors

will work with borrowers to help them keep their homes to the extent feasible and within the funding limits provided. The contractors will have access to the standardized AMD Partnership data bases and receive appropriate notices from the AMD Partnerships so that resources can be efficiently applied. The assistance payment limits and criteria should be for a more limited period than three years and be statutorily authorized (explicitly replacing the consent decrees now limiting HUD).

Implications

By dividing the two very different tasks (helping financially strapped homeowners and maximizing financial return on problem assets) between two different types of public/private structures, each ideally designed and motivated for each of the two different tasks HUD can:

- Maximize financial return from the assets thus protecting taxpayers and making resources available for housing;
- Provide efficient, structured assistance to temporarily strapped homeowners with appropriate Congressional authorization and fund control;
- Take care of a massive workload problem without increasing HUD staff; and
- Streamline HUD operations in a difficult, staff intensive area which should facilitate consolidation of functions and offices and thus produce long term administrative savings.

An efficient Loss Mitigation Program developed experimentally using statistically valid samples of HUD's massive portfolio will reduce costs overall and greatly reduce the number of loans requiring FHA payoff under its insurance obligations.

Fiscal Impact

The FHA Funds in which these expenditures and savings or losses take place at present, and in the recommended arrangements, are self funding so they do not show explicitly in the federal budget. The savings to the FHA funds which should occur from the above management reforms will certainly be substantial compared with the present situation which is inherently wasteful of a multi-billion dollar pool of assets. Since the

taxpayers stand behind the FHA insurance funds, protecting the funds is an important indirect savings to taxpayers.

HUD SHOULD USE NEGOTIATED DEMONSTRATIONS IN SELECTED MULTI-FAMILY PROJECTS TO IMPROVE TENANT INCOME MIX AND EMPOWER TENANTS IN PROJECTS RECEIVING SECTION 8 RENT SUBSIDIES.

Background

Many apartment projects constructed under the Section 8 New Construction and the Substantial and Moderate Rehabilitation programs have FHA-insured mortgages in amounts significantly greater than that which could be justified by the inherent value of the real estate collateral if the Section 8 rent assistance ended and the real estate were operated at market rate rentals. That situation creates a problem for HUD in that HUD must continue rental assistance after current contracts end at subsidized rent levels higher than market rental value of the units or face default on FHA mortgages. Section 8 rent payments in excess of market values of apartments only benefit project owners and private holders of FHA-insured mortgages (which may be at rates much higher than current mortgage rates and are, almost certainly, at rates higher than government borrowing rates). The problem for HUD is made more complex by negative tax consequences of mortgage forgiveness through negotiation or foreclosure for limited partner project owners, who will, therefore, be more inclined to actively lobby for continued subsidy support and/or to litigate foreclosure.

It is also the case that many privately owned, Section 8 assisted housing projects have management problems similar to public housing. Tenant preference policies intending to concentrate scarce assistance resources to the most needy have resulted in concentrating the most needy into assisted housing projects. The result is a lack of positive role models for youth and increased stigmatizing and resentment of "project" living. The very benefit intended for tenants is diluted by the reduced value and comfort of the housing development.

These assisted tenants cannot achieve the position of a market rate tenant (or Section 8 certificate or voucher assisted tenant) who is a "paying customer" with the empowerment residing in that status. While the assisted tenant can complain about deteriorating conditions, he or she cannot effectively "vote with the feet" until the residence is so bad

that it's market value is lower than the "assisted" tenant's monthly payment. At that point, comparable bad housing is available at the same cost in the private, unassisted market.

This lack of leverage by the assisted tenant creates a "cushion" for even well intentioned property managers permitting them to avoid many hard decisions like firing friends who may be less than satisfactory maintenance staff or evicting the disruptive tenant. Arguably, this is a key ingredient leading to the deteriorated state of much of the stock of public housing and assisted privately owned housing.

Some of the problems of HUD assisted housing may be ameliorated by shifting to market rents, market disciplined property managers and empowered tenants with portable subsidies like the voucher. The needs of assisted tenants and the future problems of "over mortgaged" projects are such that reasonable and flexible experimentation on a voluntary and negotiated basis would seem called for and may produce some alternatives which could improve conditions for some tenants and be consistent with long term goals of preserving the affordable housing stock.

Recommendations

HUD should be authorized to conduct negotiated restructuring of assisted housing projects. HUD should have flexibility in negotiating the restructured projects, but each should be consistent with the following goals:

1. Long-term opportunities for affordable housing will be preserved.
2. Present and future tenants assisted by the project should have improved living conditions and become empowered by having the ability to move with the value of their housing assistance.
3. HUD costs should be reduced, or at least not increased.
4. The rights and legitimate interests of property owners and participants in HUD programs should be respected.

Demonstrations could include allowing project rents to float to market rates with tenants receiving their assistance in a portable format (like vouchers) to make up the difference between tenant contribution and the market rent. A tenant would be permitted to take the value of the portable assistance and use it in any other unit of her or his choice.

Funding of the portable assistance will come from conversion of some of the project-based Section 8 payments presently obligated to the project.

For the renegotiated project to be viable at market rents, the outstanding mortgage would have to be written down (reduced) to an amount supportable by the Net Operating Income of the Project. The written down mortgages would be paid off and/or refinanced by HUD if to do so would be in the financial interest of the government, or HUD could continue to make an incremental payment on the outstanding mortgage with part of the continuing Section 8 project based funds.

If an assisted tenant should leave a project with his or her portable assistance, the owner would be free to rent to an unsubsidized tenant at market rent. That would result in no income increase to the owner or diminution of the number of assisted tenants. The one assisted tenants would simply be living in a different apartment because of personal preference, i.e., the tenant is empowered to assure that the government assistance better serves the tenant's interest.

If, over time, the market value and/or Net Operating Income of the project improved because of better management or because of a better environment through improved income mix, the owner and manager should receive some of the benefit, but most should flow to HUD to finance higher portable assistance payments for tenants living in the project and more portable assistance for tenants living out of the project.

Each demonstration should be structured so that HUD payments for the project, the obligations of the owner and assistance to tenants would continue for at least as long as under contracts outstanding at the start of the demonstration. Section 8 costs would not be permitted to exceed those that would otherwise have occurred without the demonstration. Also, no additional benefits would flow to the project owner unless accompanied by additional benefits to assisted tenants. Funding for assistance after current contract periods end would be available on the same basis (under the new arrangement) as for other expiring Section 8 projects.

HUD should work with IRS to explore ways to deal with competing public objectives of the tax code and housing programs. For example, donation of a project to a non-profit with mortgage write down thereafter might meet the needs of project owners to

avoid negative tax benefit recapture problems while still meeting public interests in tax collection and provision of low income housing.

Implications

For the project owner, mortgage financing would be established at a supportable level without the uncertainty of potential foreclosure resulting from HUD failure to continue subsidies. HUD would be freed of the obligation to either maintain subsidy payments at high rent levels to the project owner or face a mortgage default. HUD would be able to continue subsidies on a market rent, portable subsidy basis (which is clearly better for the tenant) and would result in a better tenant income mix, improve the value of the property for the long run and ease management problems and costs.

The most important beneficiaries would be the assisted tenants. They would be empowered to deal with property management as would any equivalent market rate tenant. As tenant income mix improved conditions in the development, assisted tenants would have an improved environment and lose much of the "housing project" stigma as they became indistinguishable from unassisted tenants in the same development.

This demonstration should be a real experiment in modified approaches to assisted housing. There should be a substantial research element structured to track tenant satisfaction, operating costs, neighborhood impact, project and HUD image in the community, and overall cost/benefit of HUD expenditures. The demonstration should be large enough to be statistically valid and should have comparable control units for comparison. Assisted housing is a major public activity and expenditure and an important purpose of this demonstration would be to advance the state of the art.

Fiscal Impact

The demonstration activities should have no fiscal impact. In order to meet political objections to benefit cutting, the full expenditure of Section 8 assistance funds which would otherwise have occurred under present contracts would be expended for tenant assistance. The benefit from those payments should be substantially improved, however.

To the extent that HUD has to pay off and write down insured mortgages to make

outstanding mortgages reflect market values, that would be merely recognition of insurance fund losses already incurred. A loan which is only viable because HUD is making above market rent subsidy payments is already a partial loss to HUD. In addition, if the interest rate on the loan is higher than the government borrowing rate, it is a cost saving to recognize the loss and refinance the loan, paying off the amount not being amortized by the market income of the property. If this causes a problem of "scoring" a loss, the scoring system should be reviewed. Scoring should reflect economic reality and encourage economically beneficial decision making, not the reverse.

Creating a Quality Management Culture

REAFFIRM HUD'S ROLE IN STIMULATING PRODUCTION OF THE NATION'S HOUSING

Background

From the 1930s through the 1970s, the Federal government was a major force in stimulating the production of single and multifamily housing through a variety of mechanisms, including direct financing, loan guarantees, interest rate subsidies, mortgage insurance, making secondary markets, and tenant subsidies; however, over the last 12 years, the federal role in housing production was reduced, leaving a number of specific housing needs unmet.

For example, many renters find affordable housing difficult to find and must devote a high proportion of their income to housing costs. Private sector, multifamily housing production in the last decade was concentrated at the high end of the market. Although that market has softened, rents in newer projects remain out of the reach of most renters. Thus, while multifamily vacancy rates are high in some areas and in some markets, affordable rental housing remains very scarce, especially in gateway cities with large low- and moderate-income populations. Similarly, in the last 12 years, homeownership rates for younger households (age 25-39) declined sharply. While lower interest rates increase affordability, down payment and closing cost accumulation remains difficult with income growth lagging and rents high as a proportion of income.

Notwithstanding these needs, over the last 12 years, HUD has retreated from a significant role in housing production. On the multifamily side, a HUD privatization initiative of the early 1980s, coinsurance, left HUD with billions in losses and leery of multifamily production programs. Coinsurance was designed to speed processing of multifamily mortgage insurance applications. Under coinsurance, the private lender was delegated most of HUD's underwriting functions in exchange for assuming a portion of the insurance risk. However, the program did not give the lender adequate incentives to minimize risk; instead, the program encouraged lenders to use inflated appraisals and underwrite more projects to generate fees. By the time HUD shut down the program in 1990, the Department estimated that its losses would be in the billions. Other multifamily

insurance programs remained on the books, but, whether by design or mismanagement, processing of insurance applications slowed to a trickle.

In the current resource environment, FHA will never have the resources needed to underwrite significant amounts of insurance and oversee its portfolio of insurance-in-force on a loan-by-loan basis; HUD will have to rely on third party delivery systems to be effective. In fact, such partnerships may provide opportunities for innovation. However, as HUD learned from the coinsurance debacle, third party delivery systems must be carefully designed so that HUD can effectively monitor the program and HUD's partners have an incentive to minimize the government's risk as they minimize their own -- i.e. "risk-sharing."

Congress had these concerns in mind when it enacted Section 542 of the Housing and Community Development Act of 1992, which authorized HUD to conduct risk-sharing demonstrations with State and Local Housing Finance Agencies and Government Sponsored Enterprises (Fannie Mae, Freddie Mac, and the Federal Home Loan Banks) ("GSEs"). These entities offer safer partners with which to experiment because, unlike private lenders, as governmental or quasi-governmental entities, they are unlikely to disappear leaving HUD holding the bag. These demonstrations must be a high priority for HUD to help it define a new role for itself in multifamily housing production.

HUD also has failed to encourage the movement of capital into multifamily production. In fact, very limited funds are available from investors for multifamily housing. In the single family area, HUD has encouraged standardization of mortgage products and borne the risk while gaining experience from which the private sector could learn to underwrite similar risks. Thus, an efficient secondary market in single family mortgages and mortgage-backed securities has been developed, but no comparable market in multifamily mortgages exists yet.

On the single family production side, recent decisions had the effect of reducing FHA's share of single family loan origination. The Mutual Mortgage Insurance (MMI) fund is the self-sustaining, mutual fund which provides basic FHA single family mortgage insurance. In 1990, actuarial studies suggested that the business written each year during the early 1980s was unsound and was rapidly depleting the surplus that the fund had built

up during the 1970s. In response, the Cranston-Gonzalez National Affordable Housing Act of 1990 legislated a number of "reforms" including a risk-based premium structure and increased down payment requirements. These changes reduced the affordability of FHA insurance to those most in need of credit enhancement and, at the same time, made FHA insurance less competitive with private mortgage insurance, driving stronger borrowers and those refinancing to other products. The result was a significant drop in FHA's market share from 13% in 1990 to 5.6% in 1992 (based on the dollar volume of business including refinancings).

As HUD abandoned its role in housing production, state and local governments and the non-profit sector have tried to fill the void, developing innovative programs to develop housing and revitalize neighborhoods. While there may never again be federal funds on a massive scale, federal investment can be the catalyst for significant change when various forces are targeted at one area. Such a coordinated effort should be driven by the initiatives and creativity of local partners familiar with local conditions. The FHA has not played this role effectively in the past, but it has the capacity to bring housing credit, a key component of the economic revitalization of declining neighborhoods.

There is, therefore, an important role for HUD to play in housing production; however, HUD does not have all the tools it needs to play that role. Getting back in business in today's rapidly changing and complex marketplace will require yet greater financial and management sophistication. The reliance on third party delivery systems implicit in each of these production initiatives only increases the importance of having sophisticated tools to manage risk. The FHA is one of the nation's largest financial institutions and its activities affect crucial segments of our economy, yet it lacks the financial and management discipline of its private sector counterparts. The Inspector General has warned repeatedly that FHA lacks automated systems and internal controls sufficient to oversee its financial assets. Federal regulators would never permit a private sector financial institution to operate as the FHA has operated. Federal resource constraints have prevented the Federal Housing Commissioner from making investments in automation, systems, and skills that could produce significant savings.

Recommendations

1. HUD should stimulate multi-family housing development through risk sharing with Housing Finance Agencies. FHA should implement the risk-sharing demonstrations with housing finance agencies and GSEs authorized by the Congress last year and use these programs as models for developing other third party delivery systems with sufficient controls and incentives to protect the government's interests.

2. HUD should stimulate multifamily housing production by helping to develop a secondary market for loans on multifamily properties. FHA, working with the GSEs and the private capital markets, needs to develop further the secondary market in multifamily mortgages and mortgage-backed securities. This effort will require: providing the private sector with more information so that it can analyze products; working with the GSEs and the private sector to determine where FHA credit enhancement will have the greatest impact in expanding access to credit; and working to standardize investment terms and documentation. FHA might also consider moving from insuring individual loans to insuring pools of risk. FHA will need to borrow the expertise of the private sector in building the tools and models to underwrite this type of risk.

3. Congress should authorize FHA to improve access to capital and assist moderate-income, first-time home buyers in high cost areas. Police, fire fighters, teachers, and other moderate-income households would benefit from legislation increasing the FHA insurance loan limits from \$152,000 to \$172,000 in high cost areas and from \$67,000 to \$98,800 in the rest of the country. In addition, Congress should authorize a single family risk-sharing initiative like the multifamily risk-sharing demonstrations authorized last year. On the single family side, FHA and state and local governments could help moderate-income buyers in high-cost areas by sharing the insurance risk on loans up to the conforming loan limit set by FNMA and FHLMC (about \$203,000). So, for example, FHA could insure a loan of up to the FHA loan limit and the state or local agency would insure the remainder of the loan amount.

4. Congress should authorize FHA to work in partnership with local governments and non-profits striving to revitalize decaying neighborhoods by making special terms available for FHA-insured mortgages in those areas. Specifically, FHA

should make a no-down-payment option available for loans targeted to first-time home buyers with incomes below 115 percent of median in communities where coordinated affordable housing programs were being carried out, state or local agencies were targeting programs, non-profit and community development corporations were making investments, or private lenders were doing community reinvestment activities. Under such a program, the insured loan amount could equal 100% of the value of the property, closing costs could be provided through other government, non-profit, or seller contributions, and front-end mortgage insurance premiums could be deferred until sale. Certain controls would be necessary to protect the government's interest while the impact of the program is assessed: the total number of loans insured under the program should be limited to 10% of the previous year's mortgage insurance written, prepurchase counseling should be required, and the mortgage amount should be capped at the lesser of: \$75,000 or 75% of the FHA mortgage limit, whichever is greater, or 100% of property value. Such a program would permit FHA to develop experience working with various kinds of partners in revitalization areas to determine how federal credit enhancement can best be leveraged with other local programs to help turn around decaying neighborhoods and help those with the greatest need.

5. HUD should make cost-effective investments in professional, financial management. HUD must be given the resources to make cost-effective investments in: improving FHA's automated systems and internal controls; developing the financial and technical skills of FHA employees and attracting private sector expertise; and taking advantages of new workplace technologies.

Implications

HFA multifamily risk-sharing will reduce the labor-intensive underwriting and project monitoring demands on FHA staff and is a cost-effective way of dealing with severe resource shortages. Effectively, HUD staff resources used to focus on program development and control will be leveraged with the capacity of the HFA's, and the result will be a greater capacity to stimulate production. At the same time, by building solid relationships with state and local HFA's -- laboratories for innovative financing -- risk-

sharing will be the first step to developing other creative partnerships targeted to meet the needs of individual states or communities.

Development of a secondary market in multifamily mortgages that will bring more capital into multifamily lending is critical to the future of rental housing production. Developing an actuarially sound insurance product for risk pools would be an important step in the evolution of FHA from a retailer to a wholesaler and would represent a more efficient use of government resources. At the same time, by working with the private sector to develop the necessary models and expertise and share databases, FHA would develop relationships with new parts of the industry that could produce other innovative ideas to meet market needs.

Raising the single-family loan limits would provide the benefits of FHA-insured mortgages to a wider income-range of first-time home buyers and to those in areas with high housing costs who are struggling to make home ownership affordable. Simultaneously, these steps would improve the actuarial soundness of the fund through increased premium income.

The no-down-payment program can serve as a laboratory in which FHA develops relationships and learns how successful local revitalization partnerships can work. At the same time, the credit opportunities that the FHA could bring to declining neighborhoods could leverage additional investments and be the catalyst for coordinated revitalization efforts.

Cost-effective investments in expertise, systems, and technology is necessary to transform FHA into a modern financial institution with a social purpose and the business tools to get the job done.

Fiscal Impact

A multifamily risk-sharing demonstration program could be administered within the current budget for the GI/SRI credit subsidy programs. Expansion of the program could require additional resources to be determined after there is some experience with the program.

Development of a secondary market in multifamily mortgages could assist in HUD's

sale of some of its own multifamily notes inventory to the financial markets. Developing these innovative products would take staff resources, but over time these efforts would reduce HUD note servicing workloads freeing staff to more effectively monitor its loan portfolio and prevent loss.

The MMI fund (single family loans) is actuarially sound. Increasing the loan limits and state and local single family risk-sharing could have a positive impact on the fund's balance sheet. The no-down-payment program may or may not entail additional credit subsidy requirements in the future, but whether there will be a need and its extent if any can only be ascertained after some experience with the program.

Investments in systems, technology, and skills are the sort of steps that private sector organizations make to improve the productivity of their operations and ultimately will produce a more cost-effective product. These steps would require additional appropriations in the short-term.

Since its creation during the depression, the FHA has served not only to strengthen the nation's housing stock, but also to spur employment in the crucial construction sector. Thus, each of the production initiatives has the additional benefit of stimulating economic growth, which would produce tax revenues as well.

Now Is The Time

STREAMLINE HUD FIELD STRUCTURE

Background

HUD's organizational structure has been widely criticized by GAO, HUD IG, and its customers for fragmentation, lack of accountability and overlapping authority among headquarters, the ten regions and its 70 field offices.

Five Assistant Secretaries at Headquarters in charge of policy and program development rely on ten substantially independent regional offices to implement their programs. The ten regional offices reporting directly to the Secretary create a confusing bifurcation of authority and responsibility between program and administration, and a lack of coordination and accountability. The expansion from six to ten regional offices occurred only to comply with a directive from then President Nixon for all federal agencies to standardize at a ten region field organization.

Currently, workload varies widely. For example, New York regional office monitors 238,000 units of federal public housing while Seattle regional office monitors 30,000 units of public housing.

Approximately 10,000 of HUD's 13,500 employees are in the field. Given the degree of automation in recent years, the delegation of many application processing and loan monitoring activities to private vendors, and the emergence of state governments as important partners in the government's effort to provide affordable housing and the potential use of public/private partnerships for large scale asset disposition, there appears to be a very real opportunity for HUD to streamline its field office structure.

An ideal field structure would match workforce with workload, devolve work to states and private vendors or public/private partnerships where possible and economical, delegate authority to the lowest feasible level, and centralize and automate back office functions such as loan monitoring and dormant program supervision wherever possible. The structure should be responsive to accountable operating Assistant Secretaries and flexible so that different HUD functions can be managed in the most economical mode for each function.

Recommendations

1. HUD should develop a five year action plan to convert the three level organization (Washington, region, field office) of 80 offices to a two level structure with far fewer offices. Implementation should be phased over time and the two tier structure should not be so strictly interpreted as to prevent field offices from having outstationed staff in additional cities when to do so would be the most cost effective management format.

2. Program field staff should report more directly to responsible program Assistant Secretaries. Each office should have a Director whose function would be to represent the Department, oversee Secretarial priorities and administer the office. Each Assistant Secretary should be free to organize its field functions efficiently, with emphasis on consolidation of functions to the extent feasible. For example, the Assistant Secretary for Housing may find it necessary to have some functions widely dispersed across the nation, but to have another function, say, multi-family property disposition, managed out of only three offices for the whole country.

3. HUD should accelerate the privatization of single-family insurance application processing and asset management and centralize lender monitoring. This would, possibly, eliminate the need for 22 Category C and 7 Category D offices.

4. HUD should continue to devolve specific grant award decision-making to the states and localities, as is the case with the Community Development Block Grant Program and the new HOME program. Responsibility for dormant programs such as the UDAG, HODAG and 236 Subsidy programs should be centralized under the appropriate Assistant Secretary's office in Washington, D.C.

5. No one should be laid off as a result of this office consolidation, but a full attrition program should apply in the field until an appropriate level of staffing is achieved.

Implications

HUD's field structure will be greatly simplified, improving customer service, employee morale and expediting the delivery of HUD programs. Personnel and overhead

savings will be achieved as the agency moves from a three tiered, 80 office structure to a two level structure with a smaller number of offices, staffed on a differential basis, dictated by workload.

HUD, its constituents, its customers and the general public will benefit from these changes, as the cost of doing HUD business will decrease, the appropriate levels of staff skills will be established for field office functions, accountability will be maximized, HUD employee assignments will become more interesting and the development of career ladders will be facilitated and money will be saved as the number of field offices and field personnel declines through attrition.

Fiscal Impact

	Savings (\$ Millions)					
	1994	1995	1996	1997	1998	1999
Budget Auth.	N. A.	10.5	21.5	33.0	45.0	57.0
Outlays	N. A.	8.4	19.0	30.5	42.5	54.5
FTE Change	N. A.	300	300	300	300	300

HUD SHOULD CONTRACT WITH PRIVATE COMPANIES TO REFINANCE HIGH COST SECTION 235 MORTGAGES ON WHICH HUD IS MAKING INTEREST REDUCTION PAYMENTS

Background

Under the HUD "Section 235 Program," qualified homeowners have their monthly mortgage payments reduced by HUD. HUD makes a monthly "interest reduction payment" to the lender on behalf of the homeowner. That lowers the homeowner's effective interest rate and thus monthly payment. The effective interest rate for the homeowner is set based on the income of the homeowner. Obviously, the higher the interest rate being charged by the lender, the greater must be the HUD interest reduction payment to lower the effective rate. Many of these home mortgages were taken out during the high interest periods of the late 1970s and are often in double digits, with some as high as 18 percent.

It would clearly be in HUD's financial interest to replace the high interest loans by refinancing with new, lower interest, loans. That would reduce the HUD interest reduction payment. For example, if a homeowner has a \$50,000 loan for 25 years on which payments are made as though the loan was at 5 percent interest, the homeowner's payments would be \$292.30 per month. If the loan was actually made at a 14 percent interest rate, the lender will require a monthly payment of \$601.88. The difference of \$309.59 must be made up with the HUD interest reduction payment. If that loan were replaced by a loan at 8 percent interest, the payment to the lender would be \$385.91 and the HUD interest reduction payment would be \$93.61, a reduction of \$215.98, or 70 percent. The longer HUD waits to refinance, the smaller will be the savings and many years have already passed.

Arranging refinancing takes considerable bother. A new lender must be found, forms filled out, the property appraised, repairs made if required by the lender, and title must be checked and cleared if additional liens have arisen. The homeowner has little or no incentive to refinance because refinancing does not change the effective payment for the homeowner. The lender collecting the high interest certainly has no desire to refinance. HUD, however, is losing large amounts of money by making large interest reduction

payments on high interest rate loans compared to replacing the loans with current, lower interest rate, loans.

HUD has a severe shortage of staff for its workload and the steps needed to refinance these small transactions (if not done by the homeowner) are staff intensive compared with many other high dollar problems which HUD must also address. HUD has thus found it difficult over the years to accomplish very much of the refinancing needed. The function seems ideally suited for an incentive contract in which the return to the contractor would be based on a percentage of the calculated savings to be achieved by HUD from refinancing, after subtracting out all of the costs of refinancing to HUD. The contractor would have sufficient incentive to undertake all the needed steps like: finding a new lender, getting the forms filled out, arranging appraisals and repairs and getting the homeowner to sign the documents. The homeowner will need to be given enough financial incentive to, at least, provide information for the forms and to execute documents.

Recommendations

1. HUD should be given flexibility to pay whatever contract costs and incentive payments to Section 235 borrowers which may be cost-effective to induce profitable refinancing of Section 235 Program loans.

2. HUD should issue one or more incentive contracts to private companies (designed to share the net financial benefits of refinancing between HUD and the contractor) who will aggressively take all steps necessary to accomplish cost-effective refinancing including arranging the alternative source of financing.

Implications

This flexible incentive contracting approach will make effective use of the private sector to rid HUD of a long continuing embarrassment and reduce avoidable costs to the taxpayers by taking advantage of current favorable interest rates.

Fiscal Impact

In Millions of Dollars

	1994	1995	1996	1997	1998
Budget Authority	(\$1.0)	\$150.0	\$150.0	N.A.	N.A.
Outlay	(\$1.0)	\$15.0	\$30.0	\$30.0	\$30.0
Change in FTEs	N.A.	N.A.	N.A.	N.A.	N.A.

**REDUCE OUTLAYS BY PERMITTING HUD TO BASE ANNUAL SECTION 8
RENT INCREASES ON ACTUAL COST INCREASES TO THE OWNER AND
PERMIT GREATER FLEXIBILITY IN REDUCING REQUEST AMOUNTS AND
DENYING UNJUSTIFIED INCREASES.**

Background

Under Section 8 of Housing Act, HUD enters into annual rental contracts with multi-family housing owners. The statute also provides that owners of assisted housing can receive annual rent adjustments (increases) to keep pace with inflation. Initially, these increases were automatic, based on HUD's annual housing costs surveys, consumer price index data and other factors. Specifically, Section 8 (c)(2) of the statute provides that:

- 1) The assistance contract shall provide for adjustment annually or more frequently in the maximum monthly rents for units covered by the contract to reflect changes in the fair market rentals established in the housing area for similar types and sizes of dwelling units or, if the Secretary determines, on the basis of a reasonable formula; and,
- 2) Adjustments in the maximum rents as hereinbefore provided shall not result in material differences between the rents charged for assisted and comparable unassisted rents, as determined by the Secretary.

Throughout the 1980's, HUD attempted to enforce this comparability provision by conducting surveys of rents for comparable non-assisted units to determine whether rents resulting from application of the Annual Adjustment Factor (AAF) satisfy the comparability provision. It should be emphasized that the statute prohibits HUD from using the results of a comparability study to reduce rents, when it finds that comparable market rents for similar unassisted housing are below the AAF-adjusted levels. In such instances, HUD can only hold rents constant. It should also be emphasized that the AAF generally provides owners with larger increases than might be attributable to their actual increases in costs, due to such factors as the fixed nature of debt service and other costs.

The comparability provisions have been challenged by several owners and, although some lower courts have been supportive of HUD's authority in this regard, appellate

decisions have greatly complicated the issue. The Ninth Circuit Court, in Rainier View Associates v. HUD, upheld the plaintiffs in a case which challenged HUD's authority to base rent increase decisions on comparability studies. The plaintiffs claimed that HUD is not permitted to use any method other than rent increase factors based "on a reasonable formula" to adjust rents. The initial District Court decision said HUD could perform comparability studies but lacked uniform national instructions. The Ninth Circuit overruled the lower court.

Partly in response to this case, Congress passed Section 801 of the HUD Reform Act of 1989 which (1) provides for partial retroactive payments and prospective contract rent determinations where comparability studies affected rent increases in the past, and (2) recognizes HUD's authority to base rent increases on comparability studies but requires the Department to develop regulations for their future use. HUD imposed a moratorium on all comparability studies until regulations were published which, as of this date, has not been accomplished.

In April of this year, another court interpreted the comparability provision as reaching far beyond HUD's past practice. The U.S. Claims Court in Park Village Apartments v. The United States ruled that comparability studies must also be used to increase rents above the adjusted AAF rent following a request from an owner for a comparability study, and a finding that comparable rents are above the adjusted AAF rent.

In May of this year, the Supreme Court finally settled the issue of HUD's authority to use comparability studies in Alpine Ridge v. HUD. In that case, the Court ruled that HUD can use comparability studies to assist in determining Section 8 contract rent levels. However, the Court also ruled that owners could still, on an individual basis, challenge the results of a HUD comparability study.

Recommendations

The costs of implementing comparability studies under the various court opinions which permit owner requests and challenges to comparability methodology, etc., would, in all probability, exceed any savings. It is a potential legal and administrative morass which would drain substantial HUD budget and personnel resources during a period when HUD is

already seeking to do more with less. To avoid this, HUD should discontinue its use of comparability studies to assess rent increase requests and seek legislative authority to:

1. Base its annual contract rental rate increases on actual increases in costs to the owners, not on the more broadly based housing costs index and comparability methods.

2. Require owners to document and justify all operating costs, so that requested increases to cover certain costs, e. g., taxes, fuel, can be offset, if appropriate, against known reductions in other costs, such as debt service or maintenance.

3. Permit HUD to deny or reduce annual budget/cost-based adjustment requests in light of past index-based increases, which may have over-compensated owners beyond their actual increases in operating costs.

Implications

By utilizing a budget/cost-based method which limits annual rent adjustments to narrower, justifiable increases in operating costs, rather than a broader housing costs index within metropolitan areas, future year costs will reflect smaller rates of increases and, thus, lower actual outlays, than would have occurred under the Annual Adjustment Factor/Comparability methods.

The cost/budget-based method will also permit better utilization of staff resources, who will no longer be required to develop, publish, and implement the Annual Adjustment Factors, as well as the time required to conduct comparability studies, support findings, and process appeals and potential litigation. Staff needed to perform all of the foregoing activities would far outweigh the staff time needed to review budgeted rent increase requests, especially in light of the effort underway to automate the budget review process and have the owners submit their requests electronically.

Fiscal Impact

1994	1995	1996	1997	1998	1999
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Budget Auth.	N. A.	20.0	40.0	60.0	80.0	100.0
Outlays	N. A.	20.0	40.0	60.0	80.0	100.0
FTEs Change	N. A.	N. A.	N. A.	N. A.	N. A.	N. A.

SECTION 8 CERTIFICATES AND VOUCHERS SHOULD BE CONSOLIDATED INTO ONE PORTABLE RENTAL SUBSIDY PROGRAM

Background

HUD low income housing activities are most identified with programs like public housing through which eligible families are housed in "housing projects." The projects are either publicly owned, for example public housing, or owned by private developers under contract with the government, such as projects built through the Section 8 New Construction Program. In the jargon of low income housing, these are "project-based" low income housing subsidy programs. HUD also manages "tenant-based" low income housing programs. In these programs, the assisted tenant chooses an apartment in the private rental housing market, and a HUD-funded subsidy is paid directly to the private landlord to make up the difference between the tenant rent contribution and the actual rent of the apartment.

The two major HUD "tenant-based" subsidy programs, the Section 8 Certificate Program and the Section 8 Voucher Program, are very similar in concept and operation. Both programs allocate assistance to local public housing authorities (PHAs) which provide rental assistance to tenants. Both programs use the same tenant eligibility and PHA waiting list. The program differences are primarily procedural. The only apparent reason for creating vouchers as a separate program rather than merely modifying the certificate program was to give greater differentiation to the voucher initiative of the Reagan Administration.

In addition to the general advisability of combining duplicative programs to simplify administration, there is at least one substantive difference requiring attention, the voucher program "shopping incentive." The certificate program pays the difference between a required tenant contribution (calculated by HUD formula) and the actual rent charged, up to a maximum for the area (the Section 8 Fair Market Rent, or FMR). The tenant cannot use an apartment which rents above the FMR and the tenant has no saving if the actual rent is below the FMR. The voucher program makes a similar calculation of what a tenant should be able to afford and uses the same rental data as the FMR to calculate a theoretical rent cost. The difference between these amounts is the subsidy payment made on behalf of the

tenant. The tenant can choose an apartment with a rent higher than the FMR and make a higher tenant contribution (which is prohibited for a certificate tenant). The tenant also has an incentive to "shop" for an apartment with a lower rent because, subject to some limits, the tenant gets the full benefit of the rent reduction. The HUD assistance stays the same as for a higher cost apartment. That reduction in the contribution of the tenant, below the level which the HUD formula determines to be affordable to the tenant, can be viewed as an excess payment by the government which should be recaptured in whole or in part.

Recommendation

The voucher and certificate programs should be combined into one program with one set of rules. The shopping incentive should be abolished to provide a savings to taxpayers. Other differences between the two programs should be individually reviewed in light of the extensive experience to date with both programs to select the best features of each.

Implications

Data on the certificate and voucher programs show similar patterns of rental incidence below the maximum FMR despite the shopping incentive built into the voucher program. It is to be expected, therefore, that the pattern would continue for the combined programs and that tenants would not search out higher rent apartments and thus reduce the savings expected for the taxpayer. If that does appear to happen, HUD should, in the future, experiment with shopping incentives with benefits shared between the tenants and taxpayer.

In addition to savings from abolishing the shopping incentive, administrative procedures and regulations could be combined, reducing some of the bureaucratic program overhead.

Fiscal Impact

Fiscal impact calculated by HUD is as follows, assuming implementation in fiscal year 1994.

In Millions of Dollars

	1994	1995	1996	1997	1998
Budget Authority	0	0	0	0	0
Outlay	\$8.7	\$17.3	\$26.0	\$34.6	\$42.0
Change in FTEs	0	0	0	0	0

Section III

Agency Reinvention Activities

HUD REINVENTION ACTIVITIES

Getting HUD in Order

The reinvention efforts at HUD began almost as soon as Secretary Cisneros arrived. In response to reports prepared by the Inspector General, the General Accounting Office and Price Waterhouse about serious gaps in basic management and financial systems, the Secretary created task forces to address three of the most prominent management deficiencies identified -- data systems, internal controls and resource management. To assure high level attention, these task forces are headed by individuals at the Deputy and Assistant Secretary levels. The mission of these task forces is to ensure the necessary oversight, develop early warning systems, and restore confidence in HUD's accountability.

The Data Systems Task Force has already made progress in two areas. First, it has redirected the Tenant Rental Assistance Certification System, to focus on developing Section 8 budget estimates and meeting program needs. Second, the task force is developing a new plan to have a Department-wide administrative accounting system in place by October 1, 1994. The Internal Controls Task Force has developed a plan to redesign the control structure by integrating HUD's control program with the Department's program delivery, budget formulation, and execution processes.

Resource management efforts are focusing on short-term staffing needs as well as redesigning processes in the long-term. The Training Task Force is co-chaired by the Deputy Director of Personnel and the President of the local union. The Training Task Force recommended the following actions that are currently being implemented: 1) establish capabilities for distance learning, such as through satellite; 2) develop a pilot program making available the same learning to intermediaries; 3) establish a permanent infrastructure in the Office of Training to be connected to a HUD Academy; and 4) increase offerings of hard skills courses, either by HUD or outside groups.

Grassroots Participation

In addition to the work of these task forces on management issues, the Secretary developed five values to establish a mission statement for the Department. These values

define how HUD seeks to accomplish its mission: a commitment to community; a commitment to support families; a commitment to economic lift; a commitment to strengthen individual rights and responsibilities; and a commitment to reduce spatial separation by race and income.

Rather than hire additional consultants to conduct further review of the Department, the Secretary decided to seek input from the Department's employees on these values, as well as how the agency could radically change the way it does business. On March 12th, 100 employees, chosen from various offices and positions within the agency, met for the first of several work sessions. At the Secretary's request, some of the nation's top urban experts were also on hand to share their vision of a reinvented HUD.

On March 26th, Vice President Gore attended a subsequent session held to evaluate the Department's mission, values and culture, with a focus on redesigning the Department to be more mission-oriented and customer-driven. The Vice President helped launch an energizing, bottom-up internal review of the Department.

As the next step in that review, from April to May teams of headquarters staff members held sessions at headquarters and travelled to regional and field offices to conduct agency-wide discussions about how to improve HUD. All 13,000 employees were given the opportunity to participate in these sessions. Employees were enthusiastic participants and offered suggestions on topics ranging from consolidation of programs to a request for cross-training. Many employees remained past regular business hours to participate in these discussions and later submitted hundreds of written suggestions.

To obtain the input of constituent groups, similar sessions were held in selected locations throughout the country. These sessions provided a representative sample of the concerns and recommendations of those who work with the Department, and those served by the Department. HUD's Office of Policy Development and Research undertook a Department-wide effort to identify statutory and regulatory barriers to the efficient and effective implementation of the Department's programs. Following the internal effort to identify barriers, HUD also sought the input of constituent groups regarding statutes and regulations perceived to be an impediment to HUD's delivery of services through a series of focus groups conducted by teleconference.

Employees have expressed their appreciation for participating in the "Reinventing HUD" sessions, noting that their direct involvement has given them a chance to share their concerns and ideas, as well as to learn more about the agency. The sessions with employees have already improved morale by giving them a voice and providing an opportunity to learn about other aspects of the Department. The sessions with constituent groups have also given disparate groups an opportunity to interact with each other and allowed us to concentrate on ways in which we can all work toward common goals.

In response to employee requests for more information, the Office of Public Affairs has established a way to send a daily HUD message out to the entire agency. Sent via computers, fax machines and hand delivery, "The Focus" is disseminated throughout the agency, to the press and community groups. The Focus gives a brief synopsis of key events and important issues of the day.

Management Excellence Team and Policy Redesign Project

In response to the National Performance Review, and in order to analyze the volumes of recommendations provided by employees and constituents, the Secretary created two teams. The Management Excellence Team is reviewing issues related to the management infrastructure. The Policy Redesign Project is reviewing the content of programs, possible simplification of regulations, and potential need for new legislation.

A total of 30 career civil servants are currently detailed to these teams on a full-time basis. The team members include managers, bargaining unit employees, and union representatives from our field offices and headquarters.

Thousands of suggestions are being reviewed by the two teams. Catalogues of the recommendations that pertain to internal HUD issues have been prepared by the teams. The catalogues include suggestions about working conditions and labor/management relations and short and long-term policy issues. After consultation with union officials, many of these recommendations will be implemented shortly.

Reinvention Labs

- Single Family Property Disposition: The Single Family Property Disposition

reinvention lab is testing a new approach to selling properties in economically- distressed areas to nonprofits and local authorities. HUD-owned homes are being sold to these groups at a discount, which reflects savings to the Department from expedited sales. The homes are rehabilitated by non-profit groups and resold to low- and moderate-income families, many of whom are first-time buyers. The program started at the end of May and will continue through August 13 and already has resulted in signed contracts for the sale of 140 homes -- surpassing its goal of selling 100 HUD-held houses -- from the agency's Richmond and Chicago inventories. This initiative has accelerated property disposition, helped in the formation of special partnerships between the Department and key community groups -- including first-time HUD customers -- and furthered the Department's objectives of creating homeownership opportunities and rebuilding communities.

- **Reinventing Public and Indian Housing's Regional & Field Operation:** This results-oriented lab in the Chicago Regional and Illinois field offices is designed to test and evaluate staff performance in servicing and monitoring Housing Authorities. The lab has already realigned staff roles to eliminate redundancy, improved oversight and technical assistance, and engaged in problem-solving partnerships with Housing Authorities, resident groups, community and interest groups.

- **Community-Wide Affirmative Marketing Initiative:** Chicago has been selected to test HUD's Community-Wide Affirmative Marketing Initiative. This Reinvention lab will put into practice HUD's value to end spatial segregation by race, income and class. The lab seeks to create greater awareness by the lender, developer, real estate brokers, and other housing industry representatives of their responsibilities under various civil rights laws. For the first time, HUD will work with these groups to publicize and affirmatively market all fair housing assistance available in the community. This 12-month pilot program will also provide assistance in reviewing and revamping HUD's regulations and handbooks, which are used to enforce fair housing laws.

- **D.C. Homeless Initiative:** The Department has initiated a partnership with the District of Columbia government to help the city develop a strategic plan to deliver a "continuum of care" for homeless people. HUD will use the District as a laboratory to determine which policy tools and programs are most helpful to local governments in

serving the homeless. The lab will include: the development of a mission statement that provides direction for the federal role and the District's role in addressing homelessness; expanded and interactive relationships with localities, providers and advocates; and review of recent changes in the Community, Planning and Development Office of Special Needs Assistance.

- Community Partnerships Against Crime: The public housing authorities in Richmond, Memphis, and New York City, were selected to participate in HUD's Community Partnerships Against Crime lab. The pilot program brings together non-profit groups, corporations, housing officials, resident groups, law enforcement officials, and HUD staff. HUD is working with these new partners to develop creative strategies for the abatement of crime and drug activity. HUD has waived regulations and identified flexible methods to implement new strategies. This team concept leverages resources and provides services previously not available. HUD and community organizations are recording their successful approach for use in a national videoconference, which will be held in December.

- Next Steps: HUD's goal is to energize the Department to carry out the functions for which it was created. HUD will strengthen the Department's traditional role of providing a decent, affordable home in a healthy living environment for every American family. HUD will also put the "urban development" component back into HUD, and will create working partnerships with community organizations, local leaders, private business and governments at all levels.

HUD has indicated it is committed to revolutionizing the way it does business. While change is already underway, the agency recognizes radical change requires a long-term effort. The announcement of the NPR recommendations, and the measures that the Department has taken are only initial steps. With the continued participation of employees and constituents, HUD will ensure it works the way a government agency ought to work and is a partner for community improvement.

Section IV

Fiscal Impact Summary

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
FISCAL IMPLICATIONS SUMMARY

CHANGE IN BUDGET AUTHORITY
(\$ MILLIONS)

Rec. #	Recommendation	1994	1995	1996	1997	1998	1999
1	Re-invent PH	0	0	0	0	0	0
2	Multi-Family						
	Asset Dispos.	0	0	0	0	0	0
3	Single Family						
	Asset Dispos.	0	0	0	0	0	0
4.	Sec. 8 Mixed						
	Income Demo.	0	0	0	0	0	0
5.	Housing Prod'n.						
6.	Streamline Org.	0	10.5	21.5	33.0	45.0	57.0
7.	Re-finance 235	0	150.0	150.0	0	0	0
8.	Reduce Contract						
	Rent Increases	0	20.0	40.0	60.0	80.0	100.0
9.	Merge Vouchers &						
	Certificates	0	0	0	0	0	0
		-0-	180.5	211.5	93.0	125.0	157.0

CHANGE IN OUTLAYS
(\$ MILLIONS)

Rec. #	Recommendation	1994	1995	1996	1997	1998	1999
1	Re-invent PH	0	0	0	0	0	0
2	Multi-Family						
	Asset Dispos.	0	0	0	0	0	0
3	Single Family						
	Asset Dispos.	0	0	0	0	0	0
4.	Sec. 8 Mixed						
	Income Demo.	0	0	0	0	0	0
5.	Housing Prod'n.						
6.	Streamline Org.	0	8.4	19.0	30.5	42.5	54.5
7.	Re-finance 235	0	15.0	30.0	30.0	30.0	30.0
8.	Reduce Contract						
	Rent Increases	0	20.0	40.0	60.0	80.0	100.0
9.	Merge Vouchers &						
	Certificates	0	8.7	17.3	26.0	34.6	42.0
		-0-	52.1	106.3	146.5	187.1	226.5

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NASA

Divider Title: _____

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
AGENCY TEAM REPORT

NATIONAL PERFORMANCE REVIEW

INTERNAL WORKING DOCUMENT--NOT FOR DISTRIBUTION
SCIENCE AND TECHNOLOGY TEAM
August 3, 1993

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Section I

Introduction

THE NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

Today's Challenge

The President has tasked the Federal Government to move in a new direction. He has tasked the federal agencies that support American technology to explore new and better ways to meet the challenges of today's global marketplace, to forge new research and development partnerships with industry and academia, and to procure innovative products and services in leading edge technologies. The President has specifically tasked the National Performance Review (NPR) to work with the National Aeronautics and Space Administration (NASA) to develop innovative management strategies that save money, reduce red tape, and improve efficiency.

NASA was established in 1958 in response to the Soviet challenge in space. However, the realities of the Cold War that shaped NASA's mission no longer exist. Today, NASA and many other federal agencies are reinventing themselves to meet the realities of the 1990s. To better understand how NASA will achieve its new direction, it is necessary to understand where it's been.

NASA began with a complement of nearly 8,000 employees transferred from the National Advisory Committee for Aeronautics (NACA). For 43 years the NACA had been conducting research in aerodynamics, aircraft structures, and propulsion systems for both industrial and military clients. By the end of 1960, NASA's personnel rolls nearly doubled with the addition of the Redstone Arsenal in Huntsville, Alabama (the ABMA, or Army Ballistic Missile Agency, later renamed the George C. Marshall Space Flight Center), the new Goddard Space Flight Center in Beltsville, Maryland, and the Jet Propulsion Laboratory of the California Institute of Technology, a contractor owned and operated facility. The Manned Spacecraft Center in Houston and the Kennedy Space Center at Cape Canaveral were added within the next two years. The National Space Technology Laboratories (later renamed the Stennis Space Center) joined NASA's field installations in 1974.

The Programs

With the broad charter of the National Aeronautics and Space Act of 1958, NASA began an ambitious program of unmanned satellites for communications and for meteorological, geophysical and celestial observations. While still a relatively new agency, NASA launched the first successful human U.S. spaceflight missions, officially begun with Project Mercury.

The decade following was dominated at NASA by President Kennedy's challenge to place a man on the Moon and return him safely to Earth by the end of the decade. On July 20, 1969, Neil Armstrong stepped onto the Moon and returned with the three-man crew of the Apollo 11 spacecraft.

The last Apollo mission (1972) was followed by three Skylab missions (1973-74), which transformed the hardware developed for the Apollo spacecraft into an orbiting "workshop" with a specially mounted telescope. The telescope returned unprecedented knowledge about the physical properties of our Sun and their effects on the Earth's atmosphere. The real possibility of going into space to stay began with Skylab. But it was the Space Shuttle, first flown in 1981, that has provided routine access to space.

Meanwhile, NASA continued aeronautical research in its work on high-performance aircraft for commercial and civil aviation. Ongoing research at NASA research centers has resulted in design advances for more efficient short-haul aircraft such as tiltrotors and quiet steep climb and descent aircraft. At the same time, the X-15 rocket-powered research airplane, along with "super critical wing" and "lifting body" designs, are enabling hypersonic aircraft to approach the physical barrier between atmospheric and space flight. That barrier will be crossed with the U.S.'s first "transatmospheric" aircraft, the National Aerospace Plane.

While NASA's human spaceflight program has dominated much of NASA's work since 1958, finely engineered instruments on automated spacecraft have scrutinized the planets and their satellites and probed the secrets of the universe. Vikings 1 and 2 enabled humanity to "step" onto the surface of Mars in 1976, while the Pioneer Venus spacecraft, 2 years later, studied the planet Venus. Jupiter and its satellites and Saturn with its complex rings have been viewed by Voyagers 1 and 2 since 1977.

The Agency

The Cold War--notably the "Sputnik Crisis" and then the Cuban Missile Crisis--stimulated not only the creation of NASA in 1958 but its tremendous expansion in the early 1960's to carry out the Apollo program. An institutional culture inherited from NACA that placed a premium on research, innovation, and technical judgment found itself having to adapt to political imperatives in a variety of ways. The innovative risk-taking that was so fundamental to earlier missile and high-performance aeronautical research differed from the redundancy and strict programmatic controls required in the Apollo program. NASA also struggled with centralized controls inherent in large-scale program management. Competition among the former laboratories, new NASA Centers, and headquarters intensified. Because the geographically dispersed Centers housed NASA's technical expertise, they managed most of NASA's contractors and thus acquired considerable political leverage of their own.

U.S. Air Force program managers were brought into NASA, bringing with them a far greater reliance on private sector contractors than many of NASA's original employees thought tolerable; soon nine out of every ten NASA dollars would be spent on contracted goods and services. Every aspect of NASA's business became subject to the administrative requirements of federal acquisitions policy. The number of procurement actions processed by the agency quadrupled from roughly 44,000 in 1960 to almost 190,000 in 1963. By 1965, NASA was processing and monitoring almost 300,000 contracts, or almost seven times the contracts the agency was managing only five years before. The dollar value of the average NASA contract more than doubled as well. However, during the same period, NASA's civil service personnel increased by only 3.2 percent.

The federal personnel system has proven as critical to NASA as federal acquisitions policy. This system assumes that increases in rank and salary should be directly related to increasing supervisory or managerial responsibilities. For capable engineers in NASA (or throughout the government) to "get ahead" meant they would have to abandon engineering and go into management. More than four-fifths of NASA engineers recruited during NASA's first decade "advanced" into management positions. Over 90 percent of the older engineers who were employed with NASA (or the NACA) before 1958 were in

management positions by the end of the 1980s.

While the Apollo program was inarguably an enormous achievement, the rapid mobilization of funds and personnel that made success possible, impeded the gradual evolution of a broad public consensus about the nation's purpose in space. Accordingly, when urban crisis and the effects of the Vietnam War altered public priorities, NASA found itself with an uncertain political mandate. No provision was made for NASA's gradual and orderly "demobilization."

In the current decade, a "public mandate" for NASA comparable to that which supported the agency in the early 1960s has been elusive. In addition, NASA, and other government agencies, struggle to be constructive players in an era of new national and global challenges and corresponding political imperatives. Regular congressional and presidential elections, increasing congressional oversight, annual or bi-annual budget cycles, and centralized administrative controls all impose public accountability and political mediation on already overburdened government agencies.

The National Performance Review

The NPR, at the specific direction of the President, is working closely with NASA to explore innovative ways for the agency to strengthen NASA management and, ultimately, reduce bureaucracy, cut costs, and improve efficiency. In response to this directive, the NPR recommends that NASA apply the management principles developed for the redesigned space station agency wide. NASA reinvention labs initiated reforms in management, in procurement and in shuttle and payload processing at Kennedy Space Center. In addition, NPR identified new ways to cut procurement red tape but maintain accountability, to create performance-based incentives for improved quality in the products and services it acquires, and to enhance U.S. competitiveness in the global technological marketplace.

In the face of legal and administrative obstacles that often discourage industry from working with government to develop technologies, the NPR recommends (1) temporary protection for data collected from joint NASA-industry Research and Development (R&D), (2) faster reviews of technology export applications, and (3) expanded technology transfer

activities that encourage, instead of discourage, R&D partnerships. NPR also recommends that NASA develop a stronger relationship with the U.S. civil aviation industry to maintain U.S. leadership in a global aeronautics arena.

To get the best possible return on the taxpayer's dollar and to overcome the red tape that seriously inhibits NASA from effectively competing in a fast-paced technological arena, the NPR encourages NASA to use performance-based contracts, to contract wherever possible for data instead of hardware, and to use cooperative research agreements to effectively exploit high performance computing technologies. These recommendations allow NASA to benefit from market dynamics by becoming a more viable competitor.

This Post Cold War, highly competitive technological era provides NASA a compelling opportunity to combine the strengths that led to the dramatic technological advances of a decade ago with the wisdom required to maintain this Nation's leadership in a global arena.

Section II

Issue Papers and Recommendations

II. A. Shifting From Red Tape to Results

IMPROVE NASA CONTRACTING PRACTICES

Background

The National Aeronautics and Space Administration (NASA) was established to advance scientific and technological knowledge in the areas of aeronautics and space. NASA relies heavily on contracting with U.S. industry in order to achieve these objectives. Like other Federal Government agencies, NASA operates under Federal acquisition laws and regulations. Unlike many other Federal agencies however, NASA routinely contracts for large, highly sophisticated items which push the state of the art. Contracting in an environment of global competition where contractors are to perform at the cutting edge of technology has proven to be problematic.

President Clinton and Vice President Gore are encouraging agencies to "use performance-based contracting strategies that give contractors the design freedom and financial incentive to be innovative and efficient."¹ In response, NASA is re-engineering its procurement procedures to acquire new technologies in a more timely manner and to get the best value for taxpayers' money. Three specific areas where NASA has opportunities to implement innovative acquisition approaches are: (1) award-fee contracts with positive and negative incentives, (2) contracting for data instead of hardware, and (3) using cooperative research agreements to more quickly exploit high performance computing techniques.

NASA spends approximately 76 percent of its procurement budget (\$13.4 billion in Fiscal Year 1992) on cost-plus-award-fee (CPAF) contracts. While CPAF contracts can be a useful method of meeting the Agency's needs they require large amounts of NASA administrative resources to manage, they have generally placed too little emphasis on cost control or reduction, they have sometimes resulted in high fees relative to actual performance, and they have been used when other types of contracts would have been more appropriate.

CPAF contracts at NASA do not provide sufficient incentives for contractors to deliver quality products or services on time and within budget. In addition, award fee evaluations have not always been tied closely to contractor performance, including

performance of hardware after acceptance by NASA. As a result, performance was not considered and NASA assumed all the risk associated with delivery of products or services, including any cost overruns. According to NASA, in the past some CPAF contracts guaranteed a substantial fee payment, called a "base fee," regardless of how the contractor performed. Since payment is not linked to contractor performance, it removes much of the leverage that NASA has to ensure that performance.² More recently, NASA and other agencies have successfully negotiated a number of contracts without base fees.³

Alternatives to the current award-fee contracting methods are being developed by NASA. These alternatives emphasize (1) evaluation and payment of award fee based on overall contractor performance (not on an interim activity as most current award fee contracts do), (2) greater importance of cost control in determining the overall contractor award fee earned, (3) more accurate evaluation of actual contractor performance, (4) limited use of base fee, (5) no payment of any fee under an award fee contract when the contractor's overall performance is unsatisfactory and (6) use of positive and negative performance incentives on hardware contracts which provide payments of additional fees to contractors for superior performance of an item in actual use by NASA and refund of fees earned where the actual performance of the item is substandard.

Performance-based contracting essentially focuses the contract on what the government needs, not on how the contractor meets the need. While this concept is an integral part of the award fee improvements discussed above, it can be more fully implemented by considering the use of other types of contracts. The Office of Management and Budget (OMB) is, in general, encouraging NASA to move as much as feasible toward those types of contracts that allow full implementation of performance-based approaches.⁴

One possible application of performance-based contracting at NASA is in the area of acquiring data, instead of acquiring hardware needed to produce the data. NASA is hopeful that this will prove to be a more cost effective approach to acquiring some types of data. When acquiring data, NASA can act more like a commercial customer. The contractor can be left to design, build, launch and operate a satellite with little government oversight, thus saving both parties money. NASA can specify the types of data it wants more easily than

it specifies the hardware needed to produce the data, thus simplifying the contract and associated negotiations.

The contractor assumes more risk under an arrangement of this sort and, therefore, would demand more profit. However, the total cost should be less as a result of efficiencies and innovations stemming from competition and financial incentives. In addition, there may be significant commercial opportunities offering potential economies of scale and incentives for the contractor to assume more risk.

Given the fast pace of High Performance Computing (HPC) technologies and the global ramifications for technological competitiveness, innovative approaches should be available to federal agencies to foster the enhancement of U.S. industrial competitiveness in this key technology area. However, traditional contracting processes for government agencies are often not quick enough to acquire these state-of-the-art technologies in a timely manner. To deal with this problem, NASA has developed a new solicitation instrument, the Cooperative Research Announcement (CRA). This approach awards cooperative agreements as a result of competition among educational institutions, nonprofit organizations and for-profit companies. This marks the first time NASA has used a solicitation of this type for cooperative agreements and the first time NASA has extended the use of cooperative agreements to for-profit companies.

Through CRA's, NASA can promote collaborative efforts on high performance computer systems, stimulate alliances that would foster the movement of research results into the market-place in such a manner that U.S. competitiveness is enhanced, and promote test beds with high levels of expertise in computational aerospace. These test beds would provide opportunities for feedback among high performance computing systems and applications designers, developers, and users. Finally, expanded use of cooperative agreements will increase technology sharing between government and industry.

Recommendations

1. **NASA regulations should be modified to provide for positive and negative incentives to contractors through award fee contracts.** This performance-based contract policy would ensure that the contractor would receive interim payments that

are provisional until the end of the contract, when the total contractor performance can be evaluated and the amount of fee the contractor is paid is determined by its total overall performance. Performance-based contracts would be used when there is a definitive product such as hardware to be delivered under the contract. Contractors would be rewarded for a product's superior demonstrated performance, but would pay the government back a predetermined amount of fee if the demonstrated performance failed to meet contract requirements. This policy would generally eliminate base fees in contracts. NASA would be assured receiving high quality products for its dollars, would place more risk with contractors, and all award fees (including any base fee on hardware contracts) would depend on the contractor's performance.

2. **NASA and other government agencies should consider contracting out for data instead of hardware.** Agencies requiring straightforward data sets can significantly cut costs and save considerable time by purchasing data instead of the hardware to produce the data. Although such data purchases do not fit all data requirements, they do represent an approach that should be more widely explored by the scientific and technical community.
3. **NASA should extend the use of its solicitation instrument, the Cooperative Research Announcement (CRA), to for-profit as well as nonprofit and educational organizations to more quickly exploit new high performance computing technology.** The new competitive solicitation process to fund cooperative research programs in high performance computing should help ensure the continued leadership and competitiveness of the U.S. in high performance computing. Consistent with the High Performance Computing Act of 1991⁵, the objective of the CRA would be to hasten the development of High Performance Computing (HPC) systems capable of performing computational research on Grand Challenge problems - those fundamental problems in science and engineering that require the

applications of HPC to solve (i.e., modeling global systems). By stimulating research on software technology, the development of software applications, and increased collaboration with government, industry and university institutions, the CRA would promote the earliest access to leading edge technology and encourage continued U.S. leadership in high performance computing.

Implications

Use of performance incentives on award fee contracts does not require changes to any law. The Schumer Amendment (Section 401) of the FY 1993 NASA Authorization Act) directed the NASA Administrator to assess the allocation of risk between NASA and its contractors and identify options for increasing contractors' share of risk, including the use of positive and negative fee incentives. The performance incentives included in the award fee policy implement current administration policy on performance-based contracting and are designed to address congressional concerns. Industry feels that performance-based incentives are inappropriate in a cost-reimbursement environment where a lot of cost and technical uncertainty exists. However, NASA expects few, if any, contractors to not bid as a result of negative incentives and, based on past experience, no reduction in bidders resulting from elimination of base fees. NASA points out that the contractor's performance determines whether or not it earns a performance incentive. In addition, on R&D contracts, the contractor is guaranteed to receive full cost recovery--but may have to forfeit the award fee.⁶ Negative contracting incentives are compensated by the opportunities that the positive incentives offer for substantial awards.

In appropriate circumstances, the purchase of data instead of hardware used to produce data can reduce the costs and the time spent by the agency. It would generally be necessary for NASA to negotiate a schedule of cancellation payments that would be made to the contractor to cover its investment in case the government prematurely cancels the contract.⁷ This is a risk the contractor can't manage. In addition, the contractor may seek to negotiate for substantial prepayments before the satellite is even launched. In that case, should the project not be completed, or fail to provide the type or quantity of the data

promised, the government may have difficulty seeking return of those payments. However, NASA can make it clear in the solicitation that offerors will not receive prepayments and that the contractor will have to privately finance design, construction and launch--i.e., until data that meets contract requirements is delivered.

In a traditional situation where NASA awards a cost reimbursement contract for design and construction of a satellite, the contractor is guaranteed reimbursement of costs, and NASA makes periodic payments as the work is performed. Therefore, NASA does not have the option of not paying costs if the system does not produce the data required. Of course, in a traditional situation, NASA relies primarily on oversight to ensure mission success.

When expanding the use of cooperative research agreements to include for-profit organizations, larger sums of money are involved and more is at stake. Such agreements will have to be written to assure accountability to the taxpayer. As these agreements become more common, there may be a tendency to add regulatory constraints that would slow down the process. Should CRA objectives begin to reflect the agency's mission, critics may argue that NASA should make awards applying all the protections that accompany a procurement contract.

It is important to note that, in accordance with the Federal Grant and Cooperative Agreements Act, (31.U.S.C., Section 6301-6308) CRA's may only be used to "to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring property or services for the direct benefit or use of the United States Government..."⁸

These recommendations will control program costs, streamline bureaucratically-encumbered processes, and promote the interests of U.S. industry during this crucial period of intense international competition.

Fiscal Impact

Savings for these recommendations are difficult to quantify. However, cost avoidances may be substantial given the emphasis on streamlining the processes discussed.

Endnotes

1. Office of the President, *Technology for America's Economic Growth, A New Direction to Build Economic Strength*, (President's Technology Initiative, February 22, 1993), P. 23.
2. Telephone interview. Deidre Lee, Associate Administrator for Procurement, NASA, Washington, D.C., July 1, 1993.
3. Telephone Interview, Tom Luedtke, Acting Deputy Director, Procurement, NASA, Washington, D.C., July 7, 1993.
4. Memorandum from Allan V. Burman, Administrator, Office of Federal Procurement Policy, OMB, to Don G. Bush, Acting Assistant Administrator for Procurement, NASA, May 20, 1991.
5. High-Performance Computing Act of 1991, PL 102-194, 105 Stat. 1595 (1991)
6. Letter from Anne Guenther, NASA Office of Procurement, to National Performance Review, July 8, 1993.
7. U.S. Congress, House, National Aeronautics and Space Administration Authorization Act, Fiscal Year 1993, Representative Brown, Congressional Record, Sec. 6, 507, p. H11718.
8. Grants and Cooperative Agreements Act of 1982, Pub.L. 97-258, 96 Stat. 1004 (1982).

INCREASE NASA TECHNOLOGY TRANSFER EFFORTS AND ELIMINATE BARRIERS TO TECHNOLOGY DEVELOPMENT

Background

The government's ability to transfer technology effectively to the private sector and promote technology development for the benefit of both government and commercial users is hampered by various administrative, legal and other obstacles. Though the government maintains invaluable resources, both physical and intellectual, that can be of considerable benefit to industry and the general public, these resources are not being used to their fullest potential. Existing impediments provide disincentives for the private sector to invest in technology development, either independently or in conjunction with government researchers.

For example, the issue of "intellectual property rights" has been raised in many areas as an obstacle to industries' pursuit of cooperative R&D with the government. For the National Aeronautics and Space Administration (NASA), the protection of this form of property has been dealt with through the use of an untested contract clause which provides "limited exclusive rights" to private companies that work with NASA on specific technology projects. Attorneys in NASA's Office of the General Counsel recognize that the protection under this clause may be subject to legal challenge. Consequently, many private companies have been hesitant to initiate agreements for fear of Freedom of Information Act (FOIA) requests of the information from outside groups, including foreign and domestic competitors. Other agencies, such as the Departments of Defense and Commerce, are granted the authority to withhold commercially sensitive information received during joint R&D with industry through their enabling legislation or the use of other statutes. NASA does not currently have such authority.

Long delays and uncertainties in obtaining export licenses is considered one of the leading complaints of U.S. high-technology firms. In high-tech international competition, the ability of the U.S. to effectively compete is directly related to its ability to export new technologies in a timely way. Currently, these complaints are directed at the State Department. In the past, similar complaints were lodged against the Commerce

Department's Bureau of Export Administration. However, the implementation of Executive Order NSDD-53, which required Commerce to review technology export requests within a specific time period, streamlined that process and has all but eliminated such criticism against Commerce. However, the State Department is not covered under NSDD-53, and State has been criticized by many groups for long delays in approving technology exports.

Since its creation in 1958, NASA R&D efforts have resulted in enumerable technical "spinoffs" to the commercial sector in areas such as computer technology, health and medicine and public safety. However, NASA's efforts to perform technology transfer activities have been hindered by funding restrictions and an agency culture which results in disincentives for its own laboratories and contractors to consider such opportunities. This reluctance has been based in part over concern that NASA would implicitly developing that could be perceived as selecting "winners and losers" in a commercially-competitive arena. The result has been the institutionalization of a research and development program at NASA which is not oriented towards commercial applications. In fact, NASA's official mission statement and Research and Technology Plan offer no commitment to working cooperatively with industry or conducting specific technology transfer activities.

In response to the change in Administration, NASA has now begun to take steps towards working more closely with industry. However, in order to solidify these activities as a necessary component of its mission, institutional changes are necessary to consider and aggressively pursue technology transfer opportunities.

NASA will be receiving \$180 million in fiscal year 1994 for the "New Technology Investment Program" for the purposes of strengthening technology development for the U.S. space and aeronautics fields. In order to ensure that these funds are spent in the most efficient manner, ensuring sufficient industry participation and direction, NASA will need to streamline its administration of this program through the use of new, innovative management practices.

Investment in environmental cleanup technology has been identified as a significant opportunity for U.S. industry in what has become a global marketplace for such technologies. The government has the opportunity to play a key role in promoting the use and development of these technologies. For example, the Department of Energy (DOE)

has embarked on a multi-year program to clean up numerous sites currently suffering from significant environmental contamination as a result of arms production. DOE is in the process of signing agreements with the Environmental Protection Agency (EPA) for site cleanup. EPA is also renegotiating existing agreements with DOE where new technologies could be utilized. However, EPA program managers prefer that only proven technologies should be used for cleanup and that agreements reached with DOE should set credible time-frames for cleanup based on the capabilities of these available technologies. However, EPA's tendency to rely *only* on conventional technologies has resulted in a barrier to the use of new cleanup technology by the government. DOE has indicated that EPA's reluctance to consider the use of new technologies will likely result in delays in site cleanup. EPA has recognized the opportunities for improving both the effectiveness and timeliness of cleanup through the use of advanced technologies. However, EPA has failed to take sufficient action to facilitate the use of these technologies.

Based on the above discussion, key findings include: (1) the private sector is inhibited from working cooperatively with government due to fears concerning the safety of intellectual property; (2) the State Department review of technology export requests is unnecessarily lengthy; (3) NASA's technology transfer mission should be clarified and the necessary incentives adopted to aggressively pursue technology transfer opportunities; and (4) the U.S. Environmental Protection Agency does not allow sufficient opportunity for the development and use of advanced technology for environmental cleanup.

Recommendations

- 1. Enhance intellectual property rights on joint NASA-industry technology projects by allowing temporary protection from Freedom of Information Act (FOIA) disclosure.** NASA should develop a more permanent resolution to this issue based on the similar exemption currently afforded the Department of Defense (DOD)--DOD is granted authority under 10 U.S.C. § 130 to withhold specific kinds of data from FOIA requests. NASA should develop a legislative proposal to amend its authorizing legislation in a manner which would allow for the temporary (five years) denial of FOIA requests for certain types of technical data. This proposal

should strengthen NASA's ability to protect technical data generated in the performance of experimental, developmental or research activities conducted in whole or in part by NASA. It is expected that industry may take increased interest in working cooperatively with NASA once they know that data developed during joint research efforts will not be subject to immediate disclosure to any interested parties under FOIA. The legislative proposal drafted by NASA should be reviewed by the Justice Department, the Commerce Department's Patent and Trademark Office, and the Office of the United States Trade Representative prior to submission to Congress.

2. **The State Department should amend the International Traffic in Arms Regulations (ITAR) to shorten its review of technology exports.** The Department of State should issue a notice in the Federal Register by December 1, 1993, to amend the ITAR and institute a policy to review all export applications and issue a decision of approval or denial within a fixed time period. The review period limits would be set according to the various categories of applications. For applications not requiring review beyond the State Department, the time limit should be 10 to 15 working days. For reviews requiring interagency review, the limit should be 40 working days (this would apply to other agencies and/or work groups). All applications for which no decision is made at the end of these time periods would be *automatically* approved. If a dispute among reviewing agencies were to remain beyond the 40-day time limit, the issue must be settled by the Deputy Assistant Secretary for Export Controls at the State Department. Agencies would have 5 working days to register and appeal the Deputy Assistant Secretary's decision if there were disagreement. In handling appeals, the Assistant Secretary of State should convene a monthly interagency meeting to review appealed cases and make final decisions within 10 working days. However, decisions can be appealed further and should be reviewed at a cabinet-level meeting chaired by the Department of State--the Secretary of State would have final decision authority. Should there still be objections, the issue could be directed to the White House for a final decision by

the President.

3. **Expand NASA's technology transfer activities.** The following recommendations must be implemented for NASA to conduct effective technology transfer activities:
(a) NASA Centers should provide technology transfer training for all employees (this includes information regarding effective outreach to potential customers, partnership techniques and the construction of agreements, legal aspects, employee rights and responsibilities, rewards and incentives, etc.); (b) NASA should devote 10-20 percent of its budget to R&D partnerships with industry. This will require NASA to work cooperatively with trade associations, professional societies, etc., to identify opportunities and influence NASA's technology investment strategies--the 10 percent goal represents approximately a doubling of NASA's current efforts; (c) The Research and Technology Objectives and Plans (RTOPs) should be modified to include a statement requesting NASA Centers to give strong consideration to partnership arrangements with the commercial sector in conducting the NASA R&D program (these partnerships should result in commercial applications of the resulting R&D, creating new products, processes and services); (d) NASA should grant its Centers and Center Directors and/or project managers more flexibility in funding technology transfer opportunities. One percent of each Center's R&D project budgets should be set aside by the Center Director to be used solely for technology transfer opportunities emanating from such projects or for funding activities leading to the commercial application of other technologies developed at the Center. Alternatively, the Center Directors could use existing flexibility in reprogramming resources within or across their technology development programs, such as RTOPs, to achieve the same results provided the overall level of technology transfer activity thus funded is commensurate with the once percent set aside; (e) NASA should establish clear and sensible metrics to measure its technology transfer performance focusing on *results*, not just levels of activity, including new products and sales, market penetration, new jobs, and other metrics to be defined by NASA; (f) All NASA contracts should require clearly-defined technology transfer plans for the

commercial application of technologies developed for NASA missions (appropriate procedures must be developed to evaluate and reward such contractor efforts to transfer these technologies to the broader economy); (g) NASA programs offered through the Announcement of Opportunity (AO) process should state that mission objectives also include technology advancement and infusion into the private sector and that grant proposals will be evaluated on the basis of how such objectives will be achieved; (h) NASA should significantly increase its efforts to secure alliances with state and local governments and provide small business opportunities to spur technology transfer (a major goal being to stimulate and accelerate the creation and competitiveness of small business, particularly through existing mechanisms such as the National and Regional Technology Transfer Centers and of making NASA facilities and expertise available to U.S. industry, especially, its small and disadvantaged constituents); and (i) NASA's Vision-Mission-Values document should be amended to state that technology transfer is a major mission objective of the agency.

4. **NASA should implement its "New Technology Investments Program" through the use of industry-led efforts that will create and apply new technology to NASA programs as well as to the commercial marketplace.** These new programs should be implemented utilizing designated NASA program managers with minimal NASA staff and overall program coordination with the Administrator's office. These offices will be charged with ensuring that projects initiated under this program are commercially relevant, that NASA funds expended on these programs are complimented by significant material commitments from industry, that the success of each program can be measured through specific program metrics, and that full and open competition is used, where appropriate, during the NASA selection process.
5. **The Administrator of EPA should implement a policy which permits and encourages the use of new, innovative technologies for the purposes of**

increasing the effectiveness and timeliness of environmental cleanup, pollution prevention, compliance and scope reduction activities at federal facilities as well as to spur the development of advanced environmental cleanup technologies.

This would include the use of new technologies at sites where there is no existing cleanup agreement, sites where renegotiations of earlier agreements are necessary and miscellaneous sites where the use of innovative technologies would be appropriate. In pursuing the above policy, the EPA should, to the maximum extent possible, seek to obtain the participation and support of state and local governments and citizens who may be affected by the use of such technologies at individual sites. The Administrator should work closely with the State/EPA Committee, a group that includes the directors of environmental programs at states. EPA should also work to ensure that federal agencies which maintain authority over facilities where new technologies may be used will commit to meeting the ultimate cleanup standards as prescribed by the Comprehensive Environmental Response, Compensation and Liability Act or other appropriate statutes regardless of whether the new technologies prove effective.

Implications

If implemented, the results of pursuing the above recommendations should enhance both the public, private and joint public/private efforts to pursue technology development and transfer and should increase U.S. global competitiveness.

Fiscal Impacts

These proposals have no direct fiscal impact. However, they should result in increased technology transfer and development in both the public and private sectors, strengthening the economy and increasing efficiency.

INCREASE NASA COORDINATION OF PROGRAMS WITH THE U.S. CIVIL AVIATION INDUSTRY

Background

Aeronautics is a major contributor to the U.S. economy. It is the single largest positive industrial contributor to the international trade balance and provides significant benefits to the United States in terms of economic prosperity, transportation, employment, advanced technology products and commercial "spinoffs." The U.S. aircraft industry recorded over \$95 billion in sales in 1992, contributing \$28 billion to our balance of trade and employing hundreds of thousands of people in high quality jobs. Long range prospects for the industry are good with analysts projecting a global civil aircraft market to be worth more than \$500 billion through 2005 and approaching \$1 trillion through 2015.

The National Aeronautics and Space Act of 1958 mandates the National Aeronautics and Space Administration (NASA) to pursue "the improvement of the usefulness, performance, speed, safety, and efficiency of aeronautical and space vehicles," as well as "the preservation of the role of the United States as a leader in aeronautical and space science and technology and the application thereof...."¹ The growth of the U.S. industry has benefited from this mandate and a strong partnership with NASA and other government agencies. However, the environment in which the U.S. aeronautics industry exists has changed dramatically over the past 20 years due to increased foreign competition, the divergence of civil and military technologies and the end of the Cold War. Furthermore, aeronautics is now a global industry with a global infrastructure. These changes have created significant challenges that must be recognized and addressed through increased government-industry cooperation if the U.S. civil aircraft industry is to remain not only viable but a world leader.

Both Europe and Pacific Rim nations have recognized the benefit of a strong civil aeronautics industry--Europe's Airbus has been an economic success due, in part, to the direct support of European governments. Through 1969, the United States maintained a 91 percent world market share for transport aircraft. By 1991, U.S. market share had dropped to 67 percent with Airbus capturing over 30 percent of the global market. Japan, though

having less experience and infrastructure in civil aeronautics, has been steadily building up its experience base and has targeted this industry for growth.

The United States, both government and industry, have failed to address adequately these challenges or adjust to the significant changes that have occurred in this global industry. NASA development programs have not kept pace with the demand for technologies with commercial benefit to the U.S. aeronautics industry. Conversely, industry must strengthen its partnership with government, including making the appropriate private investments, to ensure that the highest-payoff research activities are pursued.

In recognition of the need to protect and increase U.S. competitiveness in civil aeronautics, NASA has begun planning an expanded aeronautics program which includes augmentation of its subsonic research program to focus on highest-payoff technologies, such as aircraft efficiency and environmental concerns, upgrading current facilities and infrastructure needs, a strong commitment to dual-use technology programs conducted in cooperation with the Department of Defense, and research in high-speed civil transport technologies. However, NASA must do more to meet the challenges facing the U.S. aerospace industry today if the United States is to remain competitive in the global market.

Recommendations

NASA should develop a closer relationship with the U.S. civil aviation industry and government partners to ensure that industry needs are addressed early and throughout the technology development process and to maximize investment through fast and efficient technology transfer activities. NASA must take the following measures to pursue attainment of this objective: (a) ensure that promising technologies are fully developed, through validation where necessary, to reduce the risk to industry of commercialization efforts; (b) increase industry participation and involvement in all phases of the research and development process, from planning to implementation as well as in the evaluation of results; and (c) improve its responsiveness to specific industry needs through increased flexibility of services and resources (facilities, people) and programmatic objectives. In pursuing the above recommendations, NASA will need to increase its efforts to effectively communicate with industry through contacts with trade associations and

professional organizations. However, NASA must also increase its contact with industry at the *laboratory* level where often the most significant technology transfer activities occur. NASA should also consider increasing the number of symposia and workshops it conducts to ensure it has an adequate understanding of industry concerns and current market forces.

Implications

Greater industry involvement in the development and implementation of NASA research projects will ensure more focused agency programs and research objectives. This should result in a more integrated NASA aeronautics program among government agencies, industry and academia. Increased attention will also be given to the protection of critical technologies to ensure a strong U.S. industry position in international leadership and partnering.

Fiscal Impacts

This recommendation should have no significant fiscal impact. Only NASA program and research priorities may change as a result of increased coordination and cooperation with industry.

Endnotes

1. Public Law 85-568 §102 (d)(2), (5)

II. B. Creating a Quality Management Culture

STRENGTHEN AND RESTRUCTURE NASA MANAGEMENT

Background

The National Aeronautics and Space Administration (NASA) achieved spectacular success in a number of its early undertakings. With a lean staff and President Kennedy's firm direction, the agency moved rapidly to catch up in the "space race." NASA helped secure the United States' position in the forefront of technology and in the span of less than two decades advanced human enterprise beyond the planet Earth.

Recent struggles--marked by the space shuttle disaster and by continuing cost overruns and delays--require an assessment of whether NASA has a mission worthy of national support or a management tradition worthy of renovation. This debate has centered most recently on the purposes and costs of the space station.

On March 9, 1993, President Clinton asked NASA to undertake a ninety-day effort to redesign the space station program in order to reduce costs. The Vice President, in turn, appointed Dr. Charles Vest to chair an advisory committee to study this matter and make recommendations to the President. The Vest committee did so.

On June 17, 1993, the President announced his Administration's position based on the Vest Committee's findings: "At a time when our long-term economic strength depends on our technological leadership and our ability to reduce the deficit, we must invest in technology but invest wisely" The President stated his support for continuing the space station program but insisted that this must include a "redesign of NASA itself" in order to "cut costs, reduce bureaucracy, and improve efficiency."¹

NASA leadership has recognized the need for an agency reinvention and management overhaul. This includes improvements in the agency's direct operations and in its contracts with private firms. (Contractor spending constitutes over 90% of the agency's budget.) The NASA Administrator acknowledges that agency management across multiple field installations is poorly conducted, resulting in "multi-loop" review and reporting. The organizational structure diffuses accountability and results in too many people doing overlapping work. Poor coordination sharpened the "turf" conflicts between offices.

Regarding the space station program specifically, both the Vest committee and the

internal NASA review team found serious inefficiencies in NASA's management. The NASA team developed alternative management scenarios which were accepted and reemphasized in the Vest committee report.

The current system for managing space station development involves three "levels" of NASA management. This includes "work packages," which are a management layer inserted into the program-office structure. The Program Manager has no direct control over the three prime contractors, as the three "work package" managers who control acquisitions are geographically dispersed and report to the NASA Center directors. The large, highly layered NASA team of about 2,300 civil servants "helps" the contractor, along with a proliferation of groups, panels and boards. In turn, contractors have established management layers to correspond to the government structure.²

Based on the President's decision and the Vest Committee's recommendations, NASA has initiated a process to transform its management structure to a more streamlined, efficient organization. This new management design will produce significant NASA staff reductions and modifications to its existing contracts. The number of contractors working on the new design may be significantly reduced. These changes represent a major shift in traditional NASA program management.

These changes must be extended beyond the space station program. Further study indicates that NASA's existing management contributes to a number of problems:

(1) NASA has an inadequate system for developing critical project definitions for either new or existing projects; (2) NASA has few means to prioritize projects within and across its many program offices; (3) NASA has no established conditions under which projects should be reviewed for potential termination; (4) NASA has no consistent process for providing "independent" cost estimates for new or ongoing projects; (5) NASA has insufficient performance measures, or "metrics," by which to assess project success and effectiveness at all levels; (6) NASA has no implemented strategic plan, including an up-to-date assessment of which facilities it needs; and (7) NASA program, project and other managers lack sufficient accountability.

Specifically, NASA programs and budgets have suffered from uncontrolled operational costs that have not been carefully managed during the definition, development

and implementation phases of programs. Excessive costs in individual programs often lead to less available funding for other programs still in the development stage. These cost overruns occur primarily as a result of poor cost estimation during the definition and development phase of a new program. Although many operational needs are difficult to assess prior to a project's implementation, NASA acknowledges that significant improvements can be made to better estimate the operational costs of new projects in order to avoid unforeseen problems and increased costs.

NASA has been able to achieve significant cost savings from programs currently in the operational phase, such as the space shuttle and the space station programs. This has derived from pressure to reduce funding levels. In response, the space shuttle program recently identified savings of \$8.4 billion from fiscal year 1992 to 1998. NASA management has acknowledged that substantial savings can be obtained from other programs currently in the operational phase if an aggressive effort is made to review these programs for reductions in operational costs.

In order to match mission and strategic resources, a NASA strategic plan would help identify actual facilities needed, including those that support the sometimes neglected commercial aeronautics area. The U.S. aerospace industry has been subject to increasing challenge by advances in aerospace technology that affect its ability to remain competitive in the global marketplace. Of course, these advances correlate with the operation of modern, highly-productive research and development facilities. Currently, there exists an overlap in government facilities in the aeronautics and space fields which reduces overall efficiency of operations and the effective use of increasingly scarce resources.

In November 1992, the NASA Administrator initiated the development of a comprehensive and integrated long-term plan for future aerospace facilities in coordination with the Departments of Defense (DOD), Energy, Transportation, Commerce and the National Science Foundation. Since that time, working groups involving all agencies have initiated a review to catalogue existing U.S. government and industry facilities that support aeronautics and astronautics research, development, testing and operations. International facilities will also be examined to determine their potential to supplement U.S. facility shortfalls. The completed plan will consider current and future government and commercial

needs as well as NASA and DOD mission requirements for the next 30 years. The plan is scheduled to identify overall facility shortfalls, new facility requirements, upgrades, consolidation, and the closure of existing facilities.

Reforms in agency management can reduce inefficiencies across the board, as well as produce significant savings in federal personnel. In addition, NASA headquarters must establish means for terminating projects which fail to meet planned objectives or which incur significant cost overruns and delays. NASA Centers must focus on an agency-wide vision of success versus individual center priorities.

Recommendations

The following measures must be taken to enhance NASA management:

1. **NASA should aggressively complete its overhaul of the space station program management.** The following recommendations must be implemented in order for NASA's space station redesign effort to succeed: (a) NASA must reduce the number of total contractor and civil service staff by approximately 30 percent; (b) NASA must reduce the number of government employees working on the space station program to approximately 1,000 (a reduction of 1,300 employees over the current program); (c) in turn, efforts should be made to make other, appropriate assignments for affected space station personnel; (d) NASA should assign a single "prime" contractor to manage all contract operations, rather than the current three, so that NASA employees no longer need to serve as contract integrator and (e) NASA should identify a single, "host" Center where the NASA management team will coordinate all space station program activities. The selection of this Center represents a considerable change for NASA program management. Under this plan, the space station program manager will be located at the host Center with a support staff of about 300 people. Approximately 700 additional people will be placed at various locations to carry out the technical tasks associated with the project. NASA Center Directors who have a role in the space station program will no longer share responsibility for execution of the program. Rather, they will lend their support to

the program manager at the host Center by making facilities and staff available as appropriate.

2. **Management principles developed for the redesigned space station program should be implemented across the agency in all areas of program and institutional management, including the following:** (a) empower the NASA Administrator to apply lean management practices and assign the appropriately skilled personnel to current tasks at hand; (b) establish clear lines of authority and responsibility, including for the management conducted by outside contractors; (c) reduce management layers and assign program authority to the Program Manager, as appropriate; (d) define the role of the NASA Center Director as that of providing personnel, facilities and other field resources to support the program, rather than managing the overall program itself, as appropriate; (e) eliminate unnecessary overlap between the Centers, with a comprehensive review of all Centers and the identification of opportunities to share functions, both developmental and operational, and facilities with other federal agencies and international organizations; (f) significantly reduce total civil service and contractor employees; and (g) reduce NASA support contractors over the next five years in order to achieve cost savings. This should be applied in a way to avoid undue effect on small and disadvantaged businesses. In general, this should allow for 85 percent of the NASA budget to continue to go to outside contractors.
3. **NASA should aggressively re-position its staff to meet the agency's new challenges, including the following personnel actions:** (a) accelerate the Presidentially mandated NASA personnel reduction by one year, so that approximately 1,000 full-time equivalent (FTE) positions will be eliminated from fiscal year 1994 to fiscal year 1995; (b) establish measures that allow this reduction to occur through attrition by early-out and "buyout" authorities, such as those granted to the Department of Defense and the Central Intelligence Agency; (c) emphasize reduction of management positions, both at headquarters and at the

Centers, with the intent to consolidate all functional management at NASA headquarters (only one official will be responsible for developing agency policy in each functional area and overseeing its implementation at all field Centers); (d) adopt means to improve communications between supervisors and employees and expand the performance evaluation system to establish clear performance expectations; (e) establish agency-wide education and training programs to ensure readiness for assignment and to provide hands-on training for future Program Managers; (f) ensure a selection process for managers that stresses technical and management excellence, interpersonal skills and workforce diversity; and (g) in particular, NASA should improve its management policies and processes in order to make all NASA managers accountable for their performance.

4. **NASA should restructure its internal management processes for program formulation and implementation by formally instituting its Program Management Council (PMC) to be chaired by the Deputy Administrator and charged with performing the following functions:** (a) ensure the development of project definitions for all NASA projects, which includes clearly stated program objectives consistent with the proposed strategic plan, proper definition and understanding of all project requirements, well defined management roles and responsibilities with an emphasis on accountability, full sets of documentation governing non-advocate reviews, cost control and performance commitments; (b) instigate its "Independent Cost Estimation Process" agency-wide for all new and existing projects for which this activity has not been done; (c) recommend an acquisition strategy consistent with program-specific objectives, risks and constraints; and (d) ensure for every project in the design and development stage the establishment of life-cycle cost estimates for development and operations. In addition, (e) require each project and program to identify tradeoffs among up-front hardware investments, annualized operations costs and schedules; (f) require Project Managers to identify potential opportunities to reduce operational costs through project modification or other means during the course of the annual budget process;

(g) provide NASA's ongoing programs with specific percentage targets for operational cost reductions, where appropriate; (h) establish project cost-overrun thresholds that will trigger PMC recommendations to the Administrator for project termination for existing NASA projects; (i) identify program termination candidates during each budget cycle beginning with the fiscal year 1995 cycle; (j) oversee implementation of its proposed NASA Strategic Plan and revised NASA Management Instruction (NMI); and (k) assign performance metrics for all programs and projects. The development of these metrics should be done by the appropriate program and project offices with the approval of the Program Management Council.

5. **NASA should work aggressively with its interagency counterparts to complete a summary report to the Vice President identifying federal aerospace facility shortfalls, new facility requirements, consolidation opportunities, and recommendations for closing by June 1994.** The report should also include estimates of cost impacts (savings and investments) as well as an assessment of other considerations which affected the reports' recommendations, such as national security concerns, commercial competitiveness, technology transfer and proprietary data rights.

Implementation of the foregoing recommendations should begin by January 1, 1994, and a report, detailing the success of their implementation shall be prepared by the Administrator and submitted to the Vice President no later than June 1, 1994. (Note: the restructuring of space station program management will occur over a faster time period than the other NASA management changes. It may be appropriate, however, to refer to the status and affects of the space station program changes in the Administrator's report to the Vice President.)

Implications

Reforms in agency management can reduce inefficiencies across the board, as well as produce significant savings in federal personnel. NASA Headquarters can establish

means for terminating projects which fail to meet planned objectives or which incur significant cost overruns and delays. NASA Centers can focus on an agency-wide vision of success versus individual Center priorities.

These recommendations will help to ensure that NASA program/project management does not focus solely on project development costs while ignoring long-term operational costs. This should enhance overall program management and help to avoid the prevalence of unanticipated operations cost overruns. This should also help prevent NASA management from becoming burdened by substantial operational budgets that may affect its ability to implement new technology or conduct new science programs.

Implementation of the facilities study should lead to a more efficient array of federal aeronautics and space facilities that address both agency and industrial needs. This should also strengthen the competitiveness of U.S. aerospace industry, particularly those aeronautics and propulsion companies involved in commercial transport aircraft design and development. Of course, recommendations dealing with consolidations and closures will face strong opposition from affected areas and constituencies.

These recommendations will significantly affect the way NASA does business. It will affect the roles and missions of the NASA Center, as it drastically changes the roles of Center Director and Headquarters Program Manager. It will establish clear lines of authority and accountability and eliminate duplication of effort. This should result in extensive improvement of agency performance.

Fiscal Impact

NASA should realize significant cost savings following the implementation of the overall NASA management recommendations, although it is impossible to estimate these savings at this time. However, the implementation of the recommendations space station management improvements should result in approximately \$300 million per year savings in space station development costs. That, combined with savings in operations and space station design simplification, will result in approximately \$4 billion in savings from fiscal years 1994 to 1998 as compared to the original Space Station Freedom program. Total contractors and civil servants on the project should be reduced by approximately 30

percent over existing levels. These reductions may impact specific sites, such as the current space station management office in Reston, Virginia, more heavily than other contractor facilities.

NASA estimates the potential savings to be achieved from an aggressive operations cost management program for both new and ongoing programs. For example, NASA has been able to achieve 10 to 25 percent savings on its ongoing operational programs.

The final report on facilities review will include cost savings to be realized by facility consolidations, "moth-balling" and closures due to overlapping technical capabilities. The report will also address new investment requirements necessary to restore U.S. technical capabilities and international competitiveness in aeronautics and space. However, at this time, it is too early to estimate either savings or investment requirements.

Endnotes

1. "Statement of the President," The White House, Office of the Press Secretary, June 17, 1993.
2. *Final Report to the President: Advisory Committee on the Redesign of the Space Station.* June 10, 1993.

Section III

Agency Reinvention Activities

AGENCY REINVENTION ACTIVITIES

Getting Started and Motivating Participation

Immediately upon assuming his duties in May 1992, NASA Administrator Daniel S. Goldin initiated sweeping innovations aimed at making the agency more efficient within a set of mission objectives. This exercise took the form of an internal review. The aims of the review were not only consistent with those of the National Performance Review (NPR) initiative, but helped to determine NASA's greatest potential efficiencies. This early initiative, called the Blue and Red team review, had the effect of giving NASA a head start on the NPR by identifying ways to make NASA programs better, faster, and cheaper.

The Blue teams reviewed NASA programs to look for significant savings, while Red teams acted as devil's advocates to assure all possible options were examined. A separate Program/Project Planning team reviewed the agency's activities and procedures to recommend improvements to reduce costs and technical risks in the future. At the same time, NASA undertook a series of procurement initiatives targeted at streamlining acquisitions, reforming incentive contracting, assessing contractor liability requirements, and improving contract management and grant processes.

Similarly, the Red, Blue and institutional teams identified a number of weaknesses in existing program management and procurement procedures which contributed to unexpected cost growth in the past. The teams developed remedies that provide the basis for management and procurement reforms upon which NASA has embarked.

In a parallel exercise, an internal "Vision" team was commissioned, and a series of Town Meetings were held to make NASA's aeronautics and space research more relevant to people's daily lives. More than 4,500 people attended, and thousands more watched via satellite broadcast--a unique opportunity for public input. Based on the information from these meetings, representatives from across the agency convened to develop a new vision statement. The statement described what NASA does, why, and how, and redefined agency priorities and mission objectives for the 1990s and beyond.

A Strategic Planning exercise in April 1993, coincided with the beginning of the NPR. The hallmark of this effort was a proposed strategic organization -- the Senior

Management Group -- with the charter to develop strategies for managing institutional change within NASA. A number of procurement and management reforms are presently in process as a result of the Red and Blue team exercises. These reforms will be tested and evaluated. Accordingly, many have been initiated as pilot tests to assess their effectiveness for across-the-board implementation. Improvements presently under review include management and procurement reforms in both processes and policies.

NASA was searching for ways to improve and measure management effectiveness, program efficiency and mission accomplishment. At NASA's request, the Inspector General conducted a study of NASA's functional management review process. The study indicated that the agency often lacked effective measurement practices. In addition, there was limited authority to affect improvements. Based on these results, the Administrator directed a Total Quality Management (TQM) initiative to develop a collaborative process for assuring excellence in agency management. To motivate participation in this initiative, an agency wide task team was formed. The team focused on empowerment, collaboration, consensus, and measuring results to ensure continual improvement.

The team, chaired by NASA's Associate Deputy Administrator, represents headquarters functional managers and program offices, eight field installations, the Internal Control Coordinator's staff, and the Inspector General. The team's collaborative partnership approach has led to new methods for evaluating management effectiveness, program efficiency, and mission accomplishments for NASA's administrative and management programs. An added benefit from this initiative is improved implementation of the Federal Manager's Financial Integrity Act. (FMFIA).

In 1989, the need for reduced Space Shuttle processing time was recognized when demonstrated flight rate capability was three per year and flight rate projections were increasing rapidly to 12 per year by 1991. It was clear that the way the Space Shuttle was processed had to change and change quickly. It would be necessary to reduce shuttle processing times from a 79 day average to less than 45 days; a reduction of nearly 50 percent.

Following the Challenger accident in 1986, initial processing activities at Kennedy Space Center (KSC) were overly conservative in order to maintain safety. The challenge,

then, was to maintain safety while reducing processing time. The solution was to initiate a systematic approach with strong management commitment. Teams were formed throughout the agency and were empowered to initiate changes within the scope of their responsibilities.

The agency's efforts to reinvent itself have taken on a greater impetus with the advent of the NPR. Moreover, the President's decision in June to support a redesigned space station program offers a very significant case in point for application of these ideas. More than just a redesign of one program, the President has called for NASA to reinvent itself, to adopt new methods for meeting its goals in the future and for the NPR to work with NASA in this effort. NASA has already significantly reduced costs with the Space Station and is moving toward the removal of an entire level of management in its major programs.

Functional Management Reinvention Laboratory (Lab)

NASA has used a centralized oversight approach, involving varying techniques to identify and correct administrative and management problems. New approaches are needed to measure effectiveness, lead to innovative improvements, and foster commitment to correct and improve programs.

The Functional Management Reinvention Lab shifts accountability for assessing the adequacy of administrative and management programs, including compliance with established policy and regulations, from headquarters to responsible line managers. The role of headquarters becomes one of policy development, guidance, and implementation oversight and conducting spot checks as needed or as requested.

This new self-assessment process will eliminate duplicate audit activity. The existing process has been separate and distinct from the internal control review and reporting requirements established by the FMFIA. The agency FMFIA vulnerability assessment questionnaires have been a compliance requirement for line managers rather than an effective management tool. NASA is attempting to move away from the focus on complying with rules to providing guidance principles and empowering line managers to conduct self-assessments for evaluating the adequacy of these programs.

By using a joint approach to develop and administer a self-assessment program, managers take ownership of their processes and improve communications. This should encourage managers to continuously share good ideas. In an atmosphere of trust and non-retribution, NASA anticipates line managers will be more comfortable identifying high risk issues for immediate correction.

Procurement Reinvention Lab

The objective of the procurement reinvention lab is to develop a model procurement process that can be replicated, as appropriate, at all NASA centers and eventually to other federal agencies. This lab will study all aspects of the acquisition process to identify and create more efficient systems and processes to accomplishing procurements. The lab consists of 52 employees in the Grants, Small Purchases, Acquisitions and Review Branches within the Office of Procurement at NASA headquarters.

The Office of Procurement is responsible for procuring goods and services for headquarters organizations. In fiscal year 1992, the Headquarters Acquisition Division obligated \$808 million in contracts, grants and interagency transfers. This represents six percent of the total NASA acquisitions. This organization is in an excellent position to conduct a procurement reinvention lab without the typical bureaucratic burdens that hamper the process today.

The Procurement Reinvention lab considered three approaches. The first was to develop a process independent of any federal laws and regulations affecting procurement. This approach would clearly need authority to waive public laws affecting competition, socio-economic preference programs, annual funding restraints, disputes and protest rights, and other agency authorities such as General Services Administration's (GSA) for Automated Data Processing (ADP) and telecommunications, while still maintaining accountability to the taxpayer.

The second, a more moderate approach, would accept some of the laws that currently exist, such as the Competition in Contracting Act and the Small Business Act. This model would involve more emphasis on streamlining internal procedures.

The third would use the existing procurement system as authorized by federal laws

and regulations and reinvent how NASA internally implements the existing regulations. As guidance from the NPR was provided to agencies having reinvention labs, it became apparent that the most radical approach was not feasible without specific authorizing legislation that would allow exemptions to specific laws. Although such authorizing language may be a result of some of the initiatives of the NPR, such enabling legislation will not be available to use on this project initially. The model selected is a combination of the other two options. It is NASA's intent to change the way it has been doing business at headquarters by revising internal NASA procedures and seeking waivers from other agencies when they impede or add no value to our procurement system. NASA will not rule out seeking specific legislative changes when it is determined to be in the public's interest to do so.

NASA Shuttle and Payload Processing lab at Kennedy Space Center

This reinvention activity involved developing more efficient launch site operations, reducing required resources, lowering energy consumption, decreasing environmental impacts, and developing long term operations plans. Under this initiative, a plan was established to schedule eight Shuttle missions per year and to do it with a 25 percent reduction in cost. Over 200 facility energy surveys were completed resulting in a 10 percent energy reduction with a plan for 20 percent by the year 2000. Thirty-two conservation projects were begun which has resulted in exceeding a self-imposed 30 percent goal of hazardous waste reduction.

Payload processing initiatives have resulted in significant reductions in processing time and manpower while increasing customer satisfaction. Schedule time was reduced 21 percent, manpower was reduced 33 percent, and the number of problems were reduced 31 percent over three comparable Spacelab module missions. These reductions were attributed to improved planning and coordination between Kennedy Space Center (KSC) and Marshall Space Flight Center (MSFC). Requirements were defined early. KSC and MSFC agreed on delivery schedules for hardware, software, and drawings. Over 100 processing changes recommended by the Spacelab Process Action teams for activities such as hardware staging, Spacelab integration and testing, and work authorization development were implemented.

Initiatives to improve payload customer satisfaction have resulted in improving NASA's understanding of customer needs and the customer's understanding of the payload processes.

Looking Ahead

The NASA Functional Management and Procurement Reinvention lab effort is just getting started and changes have just begun. However, brainstorming sessions have already resulted in worthwhile suggestions in the planning state of the project. Within three years, self-assessments will have been conducted at all locations and an evaluation of first year results will be conducted at the end of fiscal year 1994. Refinements to the process will be continual to ensure intended results are achieved. This initiative shifts roles and responsibilities, but requires no additional resources.

The NASA Procurement Reinvention lab is developing preliminary plans to revise the internal processes to effect shorter lead times by eliminating non-value-added steps and reviews. NASA is exploring with other agencies the possibility of waivers to their internal procedures that impact on NASA processes. NASA anticipates being able to share lessons learned with the other agency procuring offices, and hopes to make some far reaching recommendations to the federal acquisition process.

NASA intends to begin implementing improvements to the procurement system as they are identified. Efforts have begun in-house to delegate review and authorities to lower levels. NASA's next step is to pursue changes external to its own organization. Contacts have already been made at the Small Business Administration and have resulted in a positive response. NASA is optimistic that this project will reveal a better way to do business.

The efforts to improve the efficiency of the complex Space Shuttle and payload processing task involve cultural changes that require demonstrated management commitment. Over 11,000 employees have been trained in the principles of continual improvement and over 900 teams have been formed to analyze each stage of the Space Shuttle process at KSC. Over 700 potential enhancements have been documented and tracked with over 500 specific improvements already implemented and the remainder under

assessment.

Top management at KSC personally communicated the vision, set the priorities, committed the resources, and empowered the work force to initiate change. The successes NASA has made to date have been possible because the outyear goals have been clearly established and understood for five years and the government/contractor team has been in place, undisturbed, over this entire period.

In reducing the Space Shuttle processing time, productivity gains and customer satisfaction are compatible goals with the KSC team and the payload customer working together as partners in continual improvement. Improvements in processing are a result of a commitment by both NASA and contractor employees to provide quality processing services to the customer at reduced costs.

Many of the management and procurement challenges which face NASA are confronted government-wide. Reforms may involve regulatory changes, and perhaps statutory measures. NASA has pledged to be vigilant in the application of these reforms, and is confident that its recent initiatives combined with the NPR objectives will result in improved and more cost-effective operations, and better customer service.

Section IV

Fiscal Impact Summary

NATIONAL AERONAUTICS & SPACE ADMINISTRATION FISCAL IMPLICATIONS SUMMARY

CHANGE IN BUDGET AUTHORITY Numbers in Millions

Ch. Ref.	Recommendation	Fiscal Year						Change in FTEs
		1994	1995	1996	1997	1998	5-YRS	
NA 1	Improve NASA Contracting Practices *	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	0.0
NA 2	Increase NASA Technology Transfer	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	0.0
NA 3	Increase NASA Coordination with Civil Aviation	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	0.0
NA 4	Strengthen and Restructure NASA Management *	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	0.0
	Total, NASA	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	

CHANGE IN OUTLAYS Numbers in Millions

Ch.		Fiscal Year						Change
Ref.	Recommendation	1994	1995	1996	1997	1998	5-YRS	in FTEs
NA 1	Improve NASA Contracting Practices *							
NA 2	Increase NASA Technology Transfer	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	0.0
NA 3	Increase NASA Coordination with Civil Aviation	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	0.0
NA 4	Strengthen and Restructure NASA Management *	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	0.0
	Total, NASA	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	

* It is reasonable to expect substantial fiscal benefits from these proposals. Benefits from the space station redesign have already been counted in the President's budget, so are not reflected separately here. The agency is not able to assess the full effect of the additional cost reductions until the proposals are developed in operational detail.

DRAFT--INTERNAL WORKING DOCUMENT

NATIONAL PERFORMANCE REVIEW

AGENCY TEAMS

ISSUE DECISION PACKAGE

TEAM: Science & Technology

Date: August 3, 1993

Issue No.	Issue Title	5-Year Impact (Million \$)	NPR Team Position	Agency Position	Action from Tollgate 4 Meeting
1	Improve NASA Contracting	*	NASA spends over 90 percent of its budget on outside contractors and is subject to all the difficulties federal agencies face in the the contracting process, as well as the special problems encountered when contracting for leading-edge technology. There are key improvements that can be made in the incentive systems for such contractors, as well as innovations in techniques that assign risk more equitably.	NASA concurs with the recommendation and is undertaking steps to reform procurement.	
2	Increase Technology Transfer	0	The Administration has affirmed its policy of increasing the contributions of the Federal Government to private business. At the same time, there are barriers to ensuring that Federal R&D is available for economic growth. NASA is among the agencies that would benefit from measures to strengthen protection of intellectual property provided by private partners, as well as other measures to encourage technology transfer.	NASA concurs.	
3	Coordinate with the Aviation Industry	0	In recent years, some have criticized NASA for concentrating so heavily on space missions that the agency is not giving adequate support to the civil aeronautics industry. This includes the deterioration of test facilities and other resources needed to ensure U.S. competitiveness in this market. Measures should be taken to	NASA concurs.	

strengthen NASA-industry cooperation.

4	Restructure NASA Management	*	Some project failures, along with cost overruns and schedule delays, have produced a mounting array of criticisms of NASA's fundamental management practices. Most recently, the President called for a redesign of NASA management at the same time that NASA redesigned the space station. The Vest Committee report set a course on which the rest of the agency should proceed.	NASA concurs and has undertaken extensive measures to review and renovate its management both of the space station program specifically and of the agency overall. NASA leadership is aggressively pursuing these goals.
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* Although there are substantial fiscal benefits that should derive from these actions, NASA has not provided the data to quantify these benefits. Budgetary savings attributed to the space station program have already been reflected in the President's budget, so that those amounts cannot be shown here as additional savings generated by NPR.