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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

July 1, 1975

DISCUSSION OF AGENCY PLANNING CEILINGS
FOR 1977 BUDGET

Wednesday, July 2, 1975
12:00 noon (45 minutes)
Cabinet Room

From: James T. Lynn

I. PURPOSE

To discuss the current budget outlook and 1977 budget planning figures

II. BACKGROUND, PARTICIPANTS AND PRESS PLAN

A. Background:

Major agencies should now be given guidance on 1977 budget plans including ceilings on their fall budget requests. Discussion will provide opportunity to discuss the current 1976 and 1977 budget outlook.

B. Participants:

Bill Simon, Alan Greenspan, Paul McAvoy, Bill Seidman, Jim Cannon, Don Rumsfeld, Jim Lynn, Paul O'Neill and Dale McOmber.

C. Press Plan: None

III. TALKING POINTS

See Tab A

Talking Points
Agency Planning Ceilings and the Budget for 1977

Jim Lynn, I see that we are now looking at a deficit for 1977 that could get as large as our 1976 deficit. I'd like to know how the figure can get so large.

But first we might discuss the November "current services" budget.

Jim, can you explain what is meant by "current services"?

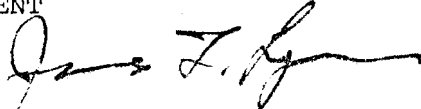


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JUL 1 - 1975

ACTION

MEMORANDUM TO THE PRESIDENT

From: James T. Lynn 

Subject: Agency Planning Ceilings for the FY 1977 Budget (with related information on FY 1976 and 1977 Budgets)

The purpose of this memorandum is to outline for you

- the requirements of the "Current Services" budget to be submitted November 10th and our estimates as to FY 1976 and 1977 deficits on a "current services" basis;
- estimates as to what your 1976 budget -- the Presidential budget as opposed to "current services" -- will look like as of November and as of January;
- Our proposed planning ceilings for 1977 to be given the agencies now;
- estimates as to actual 1976 and 1977 numbers, all toward seeking your approval of 1977 planning figures and your preliminary guidance as to the approach we should follow in the months immediately ahead with respect to the 1977 budget.

I. Current Services Budget

Under the Congressional Budget Act of 1974, you are to submit for the first time on November 10th a so-called "current services" budget for 1977 (which will also include 1976 figures for comparison purposes). This budget is prepared on a programmatic "as is" basis. Specifically, it is to assume no changes, additions or deletions in programs beyond those that have become law by November 10th.

Preparation of a current services budget is harder than it looks at first blush. What do we assume as to program levels for so-called "controllable" programs, e.g., defense procurement, EDA grants, etc.?

We are still discussing such questions with Congressional staff and GAO and have not reached agreement with them yet. For this and other reasons, it is extremely difficult to estimate now what the November 10th presentation will show, particularly as to 1977. However, our present calculations indicate that the deficit figures to be shown in the November current services budget will be about \$64 billion for 1976 and \$40 billion for 1977.

The 1976 deficit figure reflects an interplay of a number of actions and inactions (happening by November) including expected reductions in defense and foreign aid, elimination of the further taxes on oil and natural gas and rebates provided in your energy program, failure of Congress to have adopted your remaining proposed budget reductions (for "caps" etc.), and anticipated Congressional expenditure additions.

The 1976 and 1977 deficits on a current services basis also assume that the tax cut will not be extended. If by November 10th it is clear such cuts are to be extended, the current services deficit estimates of \$64 billion for 1976 and \$40 billion for 1977 would increase by \$4 billion and \$13 billion, respectively.

II. Presidential Budget for FY 1976 as of November 10th and as of 1977 Budget Submission in January

Your budget differs from a current services budget in that the Presidential budget reflects your proposals for change. Since the June 1 official budget update, some actions have been taken that will increase the deficit, including adoption of the Labor-Management Committee proposal on utilities, proposals in your crime message, decisions on highways, WMATA, railroads, and Congressional increases. However, notwithstanding these increases, we are still, as of now, within your \$60 billion 1976 deficit limitation. The principal reason is that, although we had not planned on it, certain mortgages acquired by HUD under its Tandem Plan that were intended for sale in FY 1975 will be sold in FY 1976, thereby increasing the 1975 deficit by about \$2 billion (to a presently estimated total of about \$45 billion*) and decreasing the FY 1976 deficit by a similar amount.

However, as we get deeper into FY 1976, the deficit as reported on a Presidential budget basis will increase above the \$60 billion and look more and more like the current services budget.

Our best estimate at this point is that by the time of the November 10th current services budget submission, the 1976 deficit, on a Presidential budget basis, will be about \$62 billion. Perhaps it

* This figure compares with an estimate of about \$35 billion in the February budget.

goes without saying, but these are very rough figures. For example, both these 1976 figures and the 1977 figures discussed below (except for some of the planning ceilings to be given out now) assume that by November you will have changed your energy program. Thus the figures assume:

- (a) a \$2 tax on crude imports and 60¢ on refined imports;
- (b) no tax on domestic oil or gas;
- (c) no energy equalization payments to taxpayers, States or local governments, or the poor;
- (d) the labor-management utility tax incentive proposals;
- (e) adoption of tax incentives for home insulation and payments for insulating homes of the poor;
- (f) adoption of your NPR 4 and oil storage programs;
- (g) decontrol of old oil over a three-year period commencing September 1, 1975, without windfall profit taxes (or with windfall with complete plowback); and
- (h) further budget decisions increasing expenditures somewhat, including decisions with respect to AMTRAK and the Northeast Rail Corridor.

Further, if between now and November or January, you decide to abandon as hopeless any of your budget cuts, the stated deficit will increase by the amount of such cuts that otherwise would have impacted in the remaining months of FY 1976.

Likewise, if economic conditions should take an unexpected turn for the worse, the deficit would be increased still further by revenue shortfalls and perhaps by further efforts to stimulate the economy, taken with or without your initiative or concurrence. In addition, it should be noted that our revenue estimates have been quite inaccurate in recent years, even when we have predicted economic conditions accurately.

The figures used in this memorandum also assume offshore oil receipts of \$8 billion in 1976 and again in 1977. A large sales of rights off Southern California is presently scheduled for October 1975. If this sale goes as planned, it is likely that the \$8 billion figure for FY 1976 will be accurate. If the sale gets delayed or is disappointing,

the \$8 billion 1976 receipts figure could be reduced by, say, \$3 to \$4 billion, with a corresponding increase in the 1976 deficit. However, we have no basis at this time to make any kind of an accurate prediction as to either 1976 and 1977 receipts and thus the \$8 billion used for each year must be viewed as more or less a "plugged" figure.

Last but not least, the 1976 deficit on a Presidential budget basis will be about \$4 billion higher if by the November or January submission dates the tax cut has already been extended (or you have signalled concurrence with a similar proposal in lieu of your original energy tax rebate proposal).

III. FY 1977 Planning Ceiling

Our most urgent immediate need is for your approval of planning ceilings for the 1977 budget. As you know, planning ceilings are given to major agencies at about this time each year to provide a guide for developing their September budget submissions. The proposed ceilings for 1977 are set forth in column 2 of Tab A.

Subject to the same caveats and assumptions noted above, the planning ceiling for 1977 recommended by OMB would result in 1977 outlays of \$398 billion and a 1977 deficit of about \$34 billion (\$47 billion if the tax cut is extended).

IV. Probable Changes Between Planning Figures and 1977 Budget to be Submitted in January

The planning figures are, of course, on the "lean" side and to some extent unrealistic. Between now and the time you make final decisions on the budget, the agencies will seek increases and will be at least partially successful.

First, they will appeal program levels. A rough estimate would be that this kind of appeal will increase the 1977 expenditure level (and the deficit) in the budget appeal process by somewhere between \$4 and \$8 billion. See Tab B for details.

Also, however, you may well decide to abandon certain efforts toward budget cuts that have now been tried for one or more years without success or which are new (and reflected in the planning ceilings). Examples include the efforts toward changing matching requirements on Social services and changes in Medicare and Medicaid cost sharing. The Medicare proposals in one form or another have been tried for three years without success. You may also have to accept a number of changes by the Congress in these and other proposals prior to your January submission of the budget that will affect 1977 numbers.

We have "guesstimated" a further rise in 1977 outlays and the deficit, for these reasons, of about \$7 billion. See Tab C for details.

Thus, our current best guess is that the 1977 expenditure level as shown in your January budget submission will be somewhere in the range of \$409 to \$413 billion, producing a 1977 budget deficit in the range of \$43 to \$47 billion if the tax cut is not extended, and a range of \$56 to \$60 billion if it is extended.

It should be added that, except for the assumed changes in the energy program discussed above, none of the receipts estimates in this memo assumes "tax reform" changes. If, indeed, there is any Congressional action on taxes beyond extending the tax cut, it is doubtful that there would be any net revenue gain. If anything, the opposite will occur -- with corresponding increases in deficits for 1976 and 1977 -- but we have no way of knowing at this point by how much. Also, neither the 1976 nor 1977 figures reflect any effort toward welfare or health reform.

V. Actual FY 1977 Budget Picture

For purposes of economic forecasting, it is of course essential to look not only at Presidential budgets but also at where the figures will probably come out. In other words, even though there is some easing from the tighter 1977 planning figures in arriving at your initial 1977 budget to be submitted in January, you will undoubtedly deny other appeals in the budget process, only to lose at least some of them in Congress. Further, notwithstanding the firmest effort on your part, Congress will increase outlays here and there after your budget has been submitted. It is impossible to predict, some two years in advance, final figures for FY 1977. However, based on history, there is a realistic threat of Congressionally produced spending increases resulting in 1977 outlays in a range of \$414 to \$420 billion and 1977 deficits in a range of \$48 to \$54 billion (\$61 to \$67 billion with extension of the tax cut). See Tab D.

The following table may be helpful to seeing the overall picture as it appears now:

1977 BUDGET OUTLOOK
(in billions of dollars)

	<u>FY</u> <u>1975</u>	<u>FY</u> <u>1976</u>	<u>Trans.</u> <u>Quarter</u>	<u>FY</u> <u>1977</u>
<u>May 30, 1975 Estimates</u>				
Receipts	281	299	87	364
Outlays	<u>324</u>	<u>359</u>	<u>96</u>	<u>398</u>
Deficit	-43	-60	-9	-34
Deficit: tax cut extended	---	-64	-11	-47
<u>Current Services Budget to be</u> <u>Submitted in November 1975</u>				
Receipts	281	296	87	368
Outlays	<u>326</u>	<u>360</u>	<u>97</u>	<u>408</u>
Deficit	-45	-64	-10	-40
Deficit: tax cut extended	---	-68	-12	-53
<u>Presidential Budgets as of</u> <u>November 1975</u>				
Receipts	281	294	87	366
Outlays	<u>326</u>	<u>356</u>	<u>95</u>	<u>397</u>
Deficit	-45	-62	-8	-31
Deficit: tax cut extended	---	-66	-10	-44
<u>Current Planning Figures</u>				
Receipts	281	298	87	364
Outlays	<u>326</u>	<u>358</u>	<u>96</u>	<u>398</u>
Deficit	-45	-60	-9	-34
Deficit: tax cut extended	---	-64	-11	-47
<u>Presidential Budgets as of</u> <u>January 1976</u>				
Receipts	281	294	87	366
Outlays	<u>326</u>	<u>360</u>	<u>98</u>	<u>409 to 413</u>
Deficit	-45	-66	-11	-43 to -47
Deficit: tax cut extended	---	-70	-13	-56 to -60
<u>Estimated Actual Budgets as of</u> <u>June 30, 1977</u>				
Receipts	281	294	87	366
Outlays	<u>326</u>	<u>361</u>	<u>98</u>	<u>414 to 420</u>
Deficit	-45	-67	-11	-48 to -54
Deficit: tax cut extended	---	-71	-13	-61 to -67

July 1, 1975

VI. Fiscal Policy Implications

Everything discussed above is based on a bottom-up approach, that is, building up to a total from individual program estimates by aggregating what the numbers show and will show for each program, assuming continuation of present policies and programs much in the same way as at present. However, the totals must also be looked at from the standpoint of whether they are consistent with fiscal and economic policy and, if not, what should and can be done about it. If such figures, particularly the deficits, appear to be too low, it will not be difficult to bring the figures into line with your economic policy. On the other hand, if the deficits shown are too high from an economic policy standpoint, the problem is substantially greater. As no one knows better than you, it is extremely difficult to find further cuts that can be imposed administratively without Congressional interference and even harder to impose cuts requiring Congressional action. The Impoundment Control Act of 1974 adds to the problem.

However, if you believe that something must be done to cut back from the outlay patterns shown above, we must start now in a renewed effort to find ways. There is no way to do it without cutting back substantially on the growth of domestic assistance programs. But each cut can be used by those who represent the affected clientele to show that "we don't care" about some particular need or some particular group of people in the country. Generally, we cannot make a persuasive argument that any one program is no good. We do not yet have the benefit of first class program evaluation in most cases. Further, from past experience, I have found that the best way to cut programs is to look at a period of four to five years out and make progress in year one by offering an expanded level of expenditures for a new approach as a carrot for getting rid of the old programs. Yet 1977 deficits do not permit the luxury of such an approach.

In my opinion, the only way we would have any chance of successfully applying major surgery to reduce spending in 1977 from the figures we show would be to develop a consensus in the country as a whole that the need for budget restraint, for the good of everybody -- including the elderly and the poor -- outweighs the desirability of continuing to help everybody through our 1,009 domestic assistance programs. If there is to be such major surgery, it will be necessary not only for us to plan the operation but also to start giving signals as early as possible that this is our diagnosis.

This would all be "a tough row to hoe."

Action Requested

We need your guidance on the planning numbers as well as on where we go from here over the next few months with respect to efforts, if any,

to change the course of fiscal policy inherent in the figures discussed in this memorandum. I suggest that our meeting on this memorandum be attended by Bill Simon, Alan Greenspan, Paul McAvoy, Bill Seidman, Jim Cannon and Don Rumsfeld.

Attachments

AGENCY BUDGET TOTALS
(outlays in millions of dollars)

<u>Civilian Programs:</u>	<u>1976 Estimate</u>	<u>Recommended planning ceiling, 1977</u>
Agriculture	13,037	13,947
Commerce	1,840	2,049
Corps of Engineers	1,922	2,122
Health, Education, and Welfare	122,615	136,692
Housing and Urban Development	5,490	8,381
Interior	2,469	2,186
Justice	2,221	2,309
Labor	23,155	22,326
State	1,174	1,134
Transportation	11,971	12,250
Treasury	43,545	48,389
Energy Research and Development Adminis- tration	3,813	5,345
Environmental Protection Agency	3,185	4,864
General Services Administration	-394	-227
National Aeronautics and Space Adminis- tration	3,496	3,805
Veterans Administration	17,119	16,818
Civil Service Commission	8,061	9,170
Export-Import Bank	---	1,700
Federal Energy Administration	208	194
National Science Foundation	720	775
Railroad Retirement Board	3,443	3,567
Small Business Administration	383	500
Tennessee Valley Authority	731	820
Foreign Economic Assistance	2,947	2,462
 <u>Military Programs:</u>		
Department of Defense	91,133	98,200
Military Assistance	1,666	1,000
All other agencies	5,752	5,167
Allowances:		
Pay adjustment	550	2,600
Contingencies	400	3,000
Energy tax equalization payments	5,800	7,000
Undistributed offsetting receipts:		
OCS receipts	-8,000	-8,000
Other	<u>-12,057</u>	<u>-12,804</u>
 Total	 358,395	 397,741

CHANGES FROM 1977 PLANNING CEILINGS
 THAT ADMINISTRATION MIGHT ACCEPT
 (Outlays in billions)

Defense -- Rejection of OMB cuts in support, personnel, and modernization (\$2.1 billion) and acceptance of arguments that real growth in excess of the 4% guideline is needed for operations, procurements, and research and development	\$4.1
Military assistance -- Proposal for aid to the Middle East (\$.5 billion) and reallocation of funds for Cambodia and Laos to other countries (\$.3 billion) .....	.8
HEW -- Increases for various health and education programs including: alcohol, drug abuse, and mental health; cancer, and other biomedical research; health capitation grants, health service delivery projects; and elementary and secondary education for the disadvantaged .....	.6
Justice -- Full funding for LEAA to reduce crime in heavily populated areas and juvenile delinquency and expand general support (\$.4 billion); added funds for prison construction ...	.5
Foreign economic assistance -- Supporting assistance for Middle East, Portugal and Cyprus .....	.5
Agriculture -- Increases in export credit program to offset lagging exports (\$.35 billion) and price support loan rates to avoid Congressional increase .....	.4
ERDA -- Added research (above major increases already planned) on non-nuclear energy technologies and controlled thermo-nuclear fusion .....	.3
HUD -- Release of additional mortgage purchase authority under Tandem Plan (above amount just released) and various other small increases .....	.2
Interior -- Acceptance of argument that a more orderly reclamation construction program will require higher funds .....	.2
DOT -- Higher funding for AMTRAK, FAA and Highway safety .....	.1
EPA -- Additional authorization of \$5 billion for construction grants	.1
All other (Treasury and State)	*
Total	\$7.8
Say	\$4.0 to \$8.0

* Less than \$50 million.

POSSIBLE ABANDONMENT OF
BUDGET REDUCTIONS FOR 1977

	1977 <u>Outlays</u> (in billions)
Medicare and Medicaid cost-sharing proposals	\$2.5
"Cap" of 5% on cost-of-living increases:	
Federal personnel retirement programs	1.6
Military and civilian pay	(1.7) ^{a/}
Social security and related benefits	(2.5) ^{b/}
Food stamp program and other .....	.3
Reduction in Federal matching rate for Social services ..	1.3
Public assistance reforms to adopt revised AFDC formula and administrative provisions .....	.5
Proposed repeal of 2-year extension of GI bill benefits and proposed reimbursement by private insurers for veterans' medical care	<u>.5</u>
Total, budget reductions that might be abandoned	6.7

^{a/} The planning figures assume virtually no savings in 1977 because of a planned return to comparability. A 5% "cap" on October 1977 pay increases would save \$1.7 billion, however.

^{b/} The effect of a "5% cap" on Social security, SSI and related benefits was not included in planning figures because the June 1975 increase went into effect with no limit enacted by Congress. A 5% "cap" on next year's increase might save about \$2.5 billion.

DERIVATION OF ESTIMATED*ACTUAL BUDGET
 AS OF JUNE 1977
 (Outlays in billions)

	<u>1976</u>	<u>Transition Quarter</u>	<u>1977</u>
Totals as they might appear in January 1976	\$359.8	\$97.5	\$409 to 413
Congressional actions next session:			
Appropriation action:			
Defense	---	---	-2.5
Foreign assistance	---	---	-.5
Other appropriations ...	---	---	3.0
Other actions:			
Liberalization of OASDI retirement test	---	---	1.6
Other bills (rough guess)	.5	.2	2.5 to 4.5
Administration initiatives and reestimates above contingencies (guess)	<u>.5</u>	<u>.1</u>	<u>1.0</u>
Totals	360.8	97.8	414 to 420

July 2, 1975

JMC:

There will be no advance paper for the Budget meeting.

All papers will be distributed at the meeting.

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