The original documents are located in Box 9, folder "FY 1977 - 9/18/75, Budget Reduction Proposals (1)" of the White House Special Files Unit Files at the Gerald R. Ford Presidential Library.

1977

BUDGET

REDUC-

TIONS

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

THE PRESIDENT HAS SEEN....

SEP 18 1975

ACTION

MEMORANDUM FOR: THE PRESIDENT

FROM: James T. Lynn

SUBJECT: Further Action to Hold Down the 1977 Budget Deficit

On August 8 you asked that we prepare suggestions for keeping down the 1977 budget deficit. The attached binder identifies specific reduction possibilities, mainly by cutting back on Federal expenditure growth but also, to a small extent, by increasing revenues through tax law revisions. Given current economic forecasts, these approaches would result in a 1977 budget presentation in January showing Federal expenditures of about $395 billion with a deficit of around $46 billion if tax cuts are extended or around $29 billion if they are not extended. This reduction from the earlier figures we have given you results from both the cuts and new estimates of a "starting point" for such cuts.

Background

My memorandum to you of July 1 noted that the planning guidance to the agencies was aimed at holding the 1977 budget deficit to $34 billion in comparison to a $60 billion target this fiscal year. I also noted that by the time your budget is to be submitted next January we might be looking at deficits of $70 billion (or more) in fiscal 1976 and $56-$60 billion in fiscal 1977 (assuming continuation of the tax cuts). However, our "starting points" for the July 1 memo and this latest cutting effort have changed due to a number of factors. These differences are summarized in Tab A, which should be read.

The table below summarizes the deficit outlook if the ideas for deficit cuts suggested in the attached binder are adopted (after taking out about $2 billion from the binder expenditure cuts to cover possible losses as such ideas are refined):

	(In billions) FY 1976	FY 1977
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Estimated deficit reduction if full presently estimated revenue increase is added	3.4	4.6
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The above estimates assume

-- Sudden oil decontrol, elimination of import fees, and a windfall profits tax (energy) completely redistributed to the economy. (Alternatively, your 39-month proposal would reduce the deficits shown by roughly $3 billion in 1976 and $5-1/2 billion in 1977.)

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-- Further add-ons by the Congress this session of $2.5 billion for 1976 (mid-point of a $2 to $3 billion range) and $5.25 billion for 1977 (mid-point of a $4.5 to $6 billion range).

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As you know, the estimates are highly sensitive to the forecast of future economic activity. For example, an error of one percent in forecasting 1976-77 money GNP can result in a $4 to $5 billion error in our forecast of the 1977 deficit. Based on past experience, it is quite possible that errors in forecasting GNP will exceed one percent.

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A more detailed breakdown is set forth at Tab B.

While we have tried and will continue to try to identify budget cuts that are clearly justified on programmatic grounds, less than half (in dollars) of the listed decreases can be explained on that basis. For example, we have included $3.2 billion in reductions for programs that are tied to the consumer price index. The cuts are equal to 40% of the percentage increase each of those programs might otherwise receive. We think this is better than a fixed percentage increase (like the 5% "cap") because the latter falls very unequally on the various programs. Frankly, in lieu of the 40% reduction, which is arbitrary, we would prefer a proposal to tax social security benefits in excess of contributions with accompanying repeal of the retirement income credit. This action would reduce the deficit by a smaller amount -- about $2.4 billion -- but would fall less heavily on those with low income than the arbitrary limit. However, this alternative -- while more equitable -- probably is worse politically than the 40% method, particularly if we are not going to put forward total social security reform proposals at the same time that would "ease the blow." We are also exploring an alternative which would limit indexing increases to wage increases realized by the working sector. This approach would have worked well for 1976 but application for 1977 may not yield any cut-back. We will have more on this within a few days.

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The point is emphasized by the situation for Defense. The current Defense program for 1977 of $104 billion is $5 billion above the planning target you approved in July. The reductions identified in this memorandum would reduce Defense outlays by an additional $5 billion. Thus, there is a potential gap of $10 billion between the Defense Department internal planning level and the programs identified in this memorandum. However, chances of getting the reductions for domestic programs -- small at best -- will be diminished still further if it appears that Defense and foreign aid were spared. The reduced figures for Defense now result in the following year-to-year comparisons (in billions):

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These problems as to Defense are discussed more at Tab C.

Finally, our figures now include only a very modest $1 billion allowance for agency appeals.

These facts plus the economic forecasting vagaries discussed above plus other uncertainties (e.g., offshore receipts) make the expenditures, revenues and deficits shown in this memorandum quite vulnerable to considerable change between now and January.

Strategy for fiscal year 1976

Last year's experience taught that cutting a budget once a fiscal year has begun is exceedingly difficult, especially now that Congressional acquiescence is needed under the Impoundment Control Act for virtually any proposed reduction.

About $5 billion in outlay reductions could be proposed. Cuts of this magnitude for 1976 would be very difficult in any event and will not be possible at all unless specific proposals are presented to the Congress by November 1 and the Congress accepts them in time for an effective date of January 1. In order for that deadline to be met, you would have to review and approve a set of proposed reductions no later than October 15. About $3-1/2 billion of the $5 billion would require substantive legislation; the remaining $1-1/2 billion would take the form of deferrals and proposed rescissions.

Alternatively, proposed reductions intended primarily to affect fiscal year 1977 but with a $1-1/2 billion effect in fiscal year 1976 could be transmitted with the January budget.

The Congress is not likely to accept much, if any, of a November 1 package and will be antagonized by it. This is not to say that a November package might not have value; repeated Presidential warnings about the size of the deficit may be necessary to produce the cumulative effect essential to their acceptance. The more important disadvantage of a November package is its potential for diluting the impact of a much more drastic set of reduction proposals in the 1977 budget, particularly since the most that would be gained from a November package -- even if the Congress accepted it -- would be an additional $3 or $4 billion.

Strategy for fiscal year 1977

Several strategies need to be considered. First is the question of a general strategy with respect to budget cuts. For example, shall we

-- Aim for massive and sometimes arbitrary reductions of $25 or $30 billion from "Current Services" in a wide variety of programs stressing the lowest possible deficit; or

-- Seek to make such massive cuts more saleable by packaging them with one or more "carrots," e.g., tax reduction proposals, increases in aid to the poor, larger general revenue sharing, further crime initiatives, new "chronic unemployment" initiatives, etc.; or

-- Try to be selective in identifying those reductions that are most saleable, even though none is easy (limiting reductions to $10 or $15 billion)?

Secondly, there are questions involving narrower strategies including:

-- The need to show that cuts in domestic programs are accompanied by decreases in defense and international programs versus the fact that budget amounts for defense and international programs are likely to be cut by the Congress;

-- The desirability of proposing no funds for bad or low-priority programs versus a reduction approach that simply aims to restrain those programs.

Next Steps

We need your guidance on our approach to budget reductions and request a meeting with you for this purpose.

Attachments

TAB A

TAB A

DIFFERENCES BETWEEN ORIGINAL PLANNING TOTALS
AND CURRENT BASE ESTIMATES
(In billions)

	FY 1976	FY 1977
Deficit		
Planning totals	$60.0	$33.6
Outlay increases (net)	12.4	21.4
Receipt decreases (net)	6.1	12.7
Current deficit (base) estimate	78.5	67.7
	****	****
Receipts		
Planning totals	298.4	364.1
Revised estimates and economic assumptions	3.4 a/	4.7 a/
Extension of tax cuts (1974 Act)	-4.0	-12.9
Maintenance of lower withholding rates	-1.9	-4.4
Deletion of import tax and other previous energy proposals	-5.6	-.4
Increased taxes due to decontrol	6.9	6.8
Rebate of increased taxes due to decontrol	-6.2	-5.8
Highway program -- transfer of 1¢ gasoline tax to States	---	-1.0
Capital formation tax proposals	---	-1.2
Other adjustments including revised treatment of earned income credit	1.3	1.5
Current base estimate, receipts	292.3	351.4
Outlays		
Planning totals	358.4	397.7
Continuation of emergency employment programs -- initially planned to end in December 1976	---	3.8
Unemployment benefits -- recent experience and revised outlook	2.9	-1.3
Interest on the debt -- higher rates and larger deficit	1.8	6.0
Energy equalization payments -- deletion	-5.8	-7.0
Middle East, Greece and Portugal initiatives	.5	2.2

	FY 1976	FY 1977
Outlays -- Continued		
Education appropriation (veto override)	.4	.8
Congressional inaction on budget reduction proposals heretofore made	6.5 b/	8.5
Potential Congressional initiatives	2.5 c/	5.25 d/
Energy (rebate) payments	.7	1.0
Earned income credit (treatment as outlays instead of receipts)	1.2	1.2
All other changes	1.6	.9
Current base estimate, outlays	370.8	419.1

---

a/ Tentative Treasury estimates would double these amounts; the lower amounts are used here because of uncertainties in the estimates.

b/ Of this increase, $2.0 billion has already occurred.

c/ This is the mid-point of a $2 to $3 billion range.

d/ This is the midpoint of a $4.5 to $6.0 billion range.

TAB B

BASIS FOR JUSTIFICATION OF OUTLAY REDUCTIONS
(In billions)

		Outlay effect in 1977
Programmatically justifiable		$-9.2
Justifiable on grounds that the Federal role should be reduced vis-a-vis States, local governments, or educational institutions		-1.6
Justifiable on grounds of fiscal restraint (i.e., essentially arbitrary):		
° Place limits on increases for inflation on programs tied to cost-of-living:		
-- Limit increases of indexed programs to 60% of what they would be under current law	-3.2	
-- Limit increase in Federal salaries to 5%	-3.6	
-- Other limits (Medicare and Medicaid)	-3.7	
Total, limits on increases		-10.5
° Federal employment reduction		-.9
° Other		-3.3
Total outlay reductions listed		-25.5
Less "refinements"		2.0
Total (as included in reduced budget totals)		-23.5

REDUCTIONS THAT ARE PROGRAMMATICALLY JUSTIFIABLE
(Dollars in billions)

	Outlay effect in 1977
Child nutrition program -- enact block grant program to reduce participation by non-needy children and allow use of food stamps for school meals (thereby reducing duplication of Federal nutritional support)	-1.1
Food stamp program -- seek changes in eligibility	-1.1
Curtail Temporary Employment assistance program	-1.1
Defense program cuts in research and development, procurement, and intelligence activities. Reduce overtime and pay-related costs	-1.1
Veterans programs	-.9
GSA stockpile sales (increase in receipts)	-.8
Eliminate Social Security monthly retirement test and retroactive payment of actuarially reduced benefits	-.7
Slow spending rate for EPA waste water construction grants	-.4
Accelerate foreclosure and sale of assigned multi-family housing mortgages financed by the Federal Housing Administration fund	-.2
Repeal work incentives law and terminate program	-.2
CCC price support and related programs	-.2
All other	-1.3
Total	-9.2

REDUCTIONS THAT WOULD REDUCE
THE FEDERAL ROLE
(Dollars in billions)

	Outlay effect in 1977
Reduce Federal matching rate for Social Services (from 75% to 65%)	-.9
Restrict Federal matching rate for AFDC	-.1
Limit amount of grant funds that cities can use for transit operating expenses	-.2
Eliminate non-student assistance programs in higher education	-.1
Reduce Federal share of college work-study program	-.1
All other	-.3
Total	-1.6

REDUCTIONS THAT ARE JUSTIFIABLE ON
GROUNDS OF FISCAL RESTRAINT
(Dollars in billions)

			Outlay effect in 1977
Limits on increases for inflation on programs tied to cost-of-living:			
Limit increases to 60% of what they would be under current law:			
OASDI	-2.4		
Food Stamps	-0.2		
SSI	-0.2		
Civil Service retirement	-0.1		
Railroad retirement	-0.1		
Military retired pay	-0.1		
Child nutrition	-*		
Black lung benefits	-*		
Total, limit of 60%		-3.2	
Limit increases in Federal salaries to 5%:			
Civilian agencies	-1.0		
Military pay	-2.4		
Military wage-board	-0.2		
Total, limit in Federal salaries		-3.6	
Other limits:			
Medicare	-2.5		
Medicaid	-1.2		
Total, other limits		-3.7	
Total, limits on cost-of-living increases			-10.5
Federal employment reduction:			
Military programs		-0.7	
Civilian programs		-0.2	
Total, Federal employment reduction			-0.9
Other actions:			
Defense, Operations and Maintenance		-0.8	
Defense, Military construction		-0.5	
Labor, Summer Youth employment		-0.5	
Export-Import Bank direct loan program		-0.4	
Space programs		-0.2	
Veterans programs		-0.2	
Corps of Engineers, construction		-0.2	
Other		-0.5	
Total, other actions			-3.3
Total			-14.7

* $50 million or less.

TAB C

DECISION

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

TAB C

SEP 16 1975

Mr O'Neill

MEMORANDUM FOR: THE DIRECTOR

FROM: DON OGILVIE

SUBJECT: FY 1977 Defense Budget Gap

Our best estimates indicate a gap of up to $10 billion between the current Defense and OMB outlay estimates for 1977. This memo identifies the broad areas of difference and recommends specific actions required if the lower outlay levels are to be achieved.

1977 Defense Outlays

A table summarizing the 1977 Defense outlay picture follows:

1977 Defense Budget Development

(outlays - $ billions)

	1975	1976	1977 OMB	1977 DOD
FY 1976 President's Budget	85	93	104	104
Outlay reestimates	+1	+2		
Estimated FY 1976 Congressional Action.		-3	-2	-2
OMB Planning Target			-3	
Defense Program Review				+2
September Reduction Exercise		-1	-5	
Current Projection	86	91	94	104

In January Defense and OMB reached agreement on 1977 Defense and MAP outlays of $104 billion. Since that time the following has occurred:

- Actual 1975 outlays were $1 billion higher than anticipated; an increase of $2 billion in 1976 outlays is anticipated.

- Congressional action on the FY 1976 budget is expected to reduce outlays by $3 billion in 1976 and by $2 billion in 1977.

- The Defense internal program review has just been completed and calls for 1977 outlays of $104 billion, in effect adding $2 billion in program to offset anticipated congressional reductions.

- The OMB planning target for Defense included anticipated congressional cuts and further Defense/MAP reductions of $3 billion. These adjustments are still considered realistic.

- The recent $25 billion reduction exercise would require $5 billion in Defense outlay reductions below the 1977 planning target. The resulting $94 billion Defense level would be about $3 billion below the 1976 outlay level in real terms. Proposed actions include a maximum 5% pay raise for both October 1975 and October 1976. All existing force levels are preserved but lower operating and investment cost levels will have some adverse impact upon readiness.

In summary, Defense has assumed, incorrectly in our opinion, that the January planning target is independent of congressional action and that program additions can be substituted for congressional reductions. The OMB planning target, by contrast, accepts the congressional reduction and includes further program adjustments. Thus, there is a $5 billion gap between Defense and OMB initial planning levels. The September outlay reduction exercise widens this gap to $10 billion. These are extremely large differences that will require major changes to the Defense budget submission. This, in turn, requires understanding and acceptance on the part of Secretary Schlesinger if these kinds of reductions are to be achieved.

1977 President's Budget Presentation

Also of considerable importance are the year by year Defense totals which will appear in the President's Budget and the signals the President desires to send with his Defense budget. The FY 1977 level will be, in large measure, closely related to what Defense receives in 1976. This is normally true in any year, but the emphasis is now even greater with the current services budget serving as a potential baseline for congressional review.

The 1977 Defense budget request should start from the 1976 level allowed by Congress, and then add factors for inflation, real program growth and congressional cut insurance.

The current projection of TOA and outlays for Defense is as shown:

		($ billions)	1977	
	1975	1976	OMB	DOD
Defense TOA (see attached table)	89	98	104	117
Defense outlays	86	91	94	104

These are the amounts that would appear in the President's Budget for 1977. The FY 1976 program will be about $10 billion in TOA and $5 billion in outlays higher than the actual FY 1975 experience. Recognizing continued inflation, real program growth and congressional cut insurance, the FY 1977 growth over FY 1976 should probably be a minimum of $12 billion in TOA and $6 billion in outlays unless real program reductions are acceptable. However, the FY 1977 Defense internal planning growth of $19 billion in TOA and $13 billion in outlays appears clearly excessive in the absence of any major emergency or dramatic change in the world situation. If the President decides on a $2-3 billion TOA increase in strategic programs as the result of unsatisfactory progress in the SALT II negotiations, this would increase FY 1977 Defense outlays by up to $1 billion.

Recommendations

Because of the magnitude of the gap between Defense and OMB in FY 1977, I recommend:

1. That you seek explicit Presidential guidance on Defense planning levels in your upcoming meeting on the FY 1977 budget.

   ___ Approve

   ___ Disapprove

2. That you meet with the Secretary of Defense and reach closer accord on the FY 1977 Defense budget level within the next two weeks, prior to the October 1 start of the OMB/DOD joint review.

   ___ Approve

   ___ Disapprove

1977 Defense Budget Development

(TOA - $ billions)

	1975	1976	1977 OMB	1977 DOD
FY 1976 President's Budget	89	105	117	117
Estimated FY 1976 congressional action		-7		-1
OMB Planning Target			-6	
Defense Program Review				+1
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These facts plus the economic forecasting vagaries discussed above plus other uncertainties (e.g., offshore receipts) make the expenditures, revenues and deficits shown in this memorandum quite vulnerable to considerable change between now and January.

Strategy for fiscal year 1976

Last year's experience taught that cutting a budget once a fiscal year has begun is exceedingly difficult, especially now that Congressional acquiescence is needed under the Impoundment Control Act for virtually any proposed reduction.

About $5 billion in outlay reductions could be proposed. Cuts of this magnitude for 1976 would be very difficult in any event and will not be possible at all unless specific proposals are presented to the Congress by November 1 and the Congress accepts them in time for an effective date of January 1. In order for that deadline to be met, you would have to review and approve a set of proposed reductions no later than October 15. About $3-1/2 billion of the $5 billion would require substantive legislation; the remaining $1-1/2 billion would take the form of deferrals and proposed rescissions.

Alternatively, proposed reductions intended primarily to affect fiscal year 1977 but with a $1-1/2 billion effect in fiscal year 1976 could be transmitted with the January budget.

The Congress is not likely to accept much, if any, of a November 1 package and will be antagonized by it. This is not to say that a November package might not have value; repeated Presidential warnings about the size of the deficit may be necessary to produce the cumulative effect essential to their acceptance. The more important disadvantage of a November package is its potential for diluting the impact of a much more drastic set of reduction proposals in the 1977 budget, particularly since the most that would be gained from a November package -- even if the Congress accepted it -- would be an additional $3 or $4 billion.

Strategy for fiscal year 1977

Several strategies need to be considered. First is the question of a general strategy with respect to budget cuts. For example, shall we

-- Aim for massive and sometimes arbitrary reductions of $25 or $30 billion from "Current Services" in a wide variety of programs stressing the lowest possible deficit; or

-- Seek to make such massive cuts more saleable by packaging them with one or more "carrots," e.g., tax reduction proposals, increases in aid to the poor, larger general revenue sharing, further crime initiatives, new "chronic unemployment" initiatives, etc.; or

-- Try to be selective in identifying those reductions that are most saleable, even though none is easy (limiting reductions to $10 or $15 billion)?

Secondly, there are questions involving narrower strategies including:

-- The need to show that cuts in domestic programs are accompanied by decreases in defense and international programs versus the fact that budget amounts for defense and international programs are likely to be cut by the Congress;

-- The desirability of proposing no funds for bad or low-priority programs versus a reduction approach that simply aims to restrain those programs.

Next Steps

We need your guidance on our approach to budget reductions and request a meeting with you for this purpose.

Attachments:

cc: DO Records
Director's Chron.
Director
Deputy Director
Mr. Collier
Mr. Mitchell
Mr. Ogilvie
Mr. Penner
Mr. McOmber
Mr. Modlin
Mr. Mathiasen
Ms. Walker

DO:JTLynn:lh 9/17/75

TAB

A

DIFFERENCES BETWEEN ORIGINAL PLANNING TOTALS AND CURRENT BASE ESTIMATES
(In billions)

	FY 1976	FY 1977
Deficit		
Planning totals	$60.0	$33.6
Outlay increases (net)	12.4	21.4
Receipt decreases (net)	6.1	12.7
Current deficit (base) estimate	78.5	67.7
	****	****
Receipts		
Planning totals	298.4	364.1
Revised estimates and economic assumptions ..	3.4 a/	4.7 a/
Extension of tax cuts (1974 Act)	-4.0	-12.9
Maintenance of lower withholding rates	-1.9	-4.4
Deletion of import tax and other previous energy proposals	-5.6	-.4
Increased taxes due to decontrol	6.9	6.8
Rebate of increased taxes due to decontrol ..	-6.2	-5.8
Highway program -- transfer of 1¢ gasoline tax to States	---	-1.0
Capital formation tax proposals	---	-1.2
Other adjustments including revised treatment of earned income credit	1.3	1.5
Current base estimate, receipts	292.3	351.4
Outlays		
Planning totals	358.4	397.7
Continuation of emergency employment programs -- initially planned to end in December 1976	---	3.8
Unemployment benefits -- recent experience and revised outlook	2.9	-1.3
Interest on the debt -- higher rates and larger deficit	1.8	6.0
Energy equalization payments -- deletion	-5.8	-7.0
Middle East, Greece and Portugal initiatives	.5	2.2

	FY 1976	FY 1977
Outlays -- Continued		
Education appropriation (veto override)	.4	.8
Congressional inaction on budget reduction proposals heretofore made	6.5 b/	8.5
Potential Congressional initiatives	2.5 c/	5.25 d/
Energy (rebate) payments	.7	1.0
Earned income credit (treatment as outlays instead of receipts)	1.2	1.2
All other changes	1.6	.9
Current base estimate, outlays	370.8	419.1

---

a/ Tentative Treasury estimates would double these amounts; the lower amounts are used here because of uncertainties in the estimates.

b/ Of this increase, $2.0 billion has already occurred.

c/ This is the mid-point of a $2 to $3 billion range.

d/ This is the midpoint of a $4.5 to $6.0 billion range.

TAB

B

BASIS FOR JUSTIFICATION OF OUTLAY REDUCTIONS
(In billions)

		Outlay effect in 1977
Programmatically justifiable		$-9.2
Justifiable on grounds that the Federal role should be reduced vis-a-vis States, local governments, or educational institutions		-1.6
Justifiable on grounds of fiscal restraint (i.e., essentially arbitrary):		
° Place limits on increases for inflation on programs tied to cost-of-living:		
-- Limit increases of indexed programs to 60% of what they would be under current law	-3.2	
-- Limit increase in Federal salaries to 5%	-3.6	
-- Other limits (Medicare and Medicaid)	-3.7	
Total, limits on increases		-10.5
° Federal employment reduction		-.9
° Other		-3.3
Total outlay reductions listed		-25.5
Less "refinements"		2.0
Total (as included in reduced budget totals)		-23.5

REDUCTIONS THAT ARE PROGRAMMATICALLY JUSTIFIABLE
(Dollars in billions)

	Outlay effect in 1977
Child nutrition program -- enact block grant program to reduce participation by non-needy children and allow use of food stamps for school meals (thereby reducing duplication of Federal nutritional support)	-1.1
Food stamp program -- seek changes in eligibility	-1.1
Curtail Temporary Employment assistance program	-1.1
Defense program cuts in research and development, procurement, and intelligence activities. Reduce overtime and pay-related costs	-1.1
Veterans programs	-.9
GSA stockpile sales (increase in receipts)	-.8
Eliminate Social Security monthly retirement test and retroactive payment of actuarially reduced benefits	-.7
Slow spending rate for EPA waste water construction grants	-.4
Accelerate foreclosure and sale of assigned multi-family housing mortgages financed by the Federal Housing Administration fund	-.2
Repeal work incentives law and terminate program	-.2
CCC price support and related programs	-.2
All other	-1.3
Total	-9.2

REDUCTIONS THAT WOULD REDUCE
THE FEDERAL ROLE
(Dollars in billions)

	Outlay effect in 1977
Reduce Federal matching rate for Social services (from 75% to 65%)	-.9
Restrict Federal matching rate for AFDC	-.1
Limit amount of grant funds that cities can use for transit operating expenses	-.2
Eliminate non-student assistance programs in higher education	-.1
Reduce Federal share of college work-study program	-.1
All other	-.3
Total	-1.6

REDUCTIONS THAT ARE JUSTIFIABLE ON
GROUNDS OF FISCAL RESTRAINT
(Dollars in billions)

			Outlay effect in 1977
Limits on increases for inflation on programs tied to cost-of-living:			
Limit increases to 60% of what they would be under current law:			
OASDI	-2.4		
Food Stamps	-0.2		
SSI	-0.2		
Civil Service retirement	-0.1		
Railroad retirement	-0.1		
Military retired pay	-0.1		
Child nutrition	-*		
Black lung benefits	-*		
Total, limit of 60%		-3.2	
Limit increases in Federal salaries to 5%:			
Civilian agencies	-1.0		
Military pay	-2.4		
Military wage-board	-0.2		
Total, limit in Federal salaries		-3.6	
Other limits:			
Medicare	-2.5		
Medicaid	-1.2		
Total, other limits		-3.7	
Total, limits on cost-of-living increases			-10.5
Federal employment reduction:			
Military programs		-0.7	
Civilian programs		-0.2	
Total, Federal employment reduction			-0.9
Other actions:			
Defense, Operations and Maintenance		-0.8	
Defense, Military construction		-0.5	
Labor, Summer Youth employment		-0.5	
Export-Import Bank direct loan program		-0.4	
Space programs		-0.2	
Veterans programs		-0.2	
Corps of Engineers, construction		-0.2	
Other		-0.5	
Total, other actions			-3.3
Total			-14.7

* $50 million or less.

TAB
C

DECISION

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

TAB C

SEP 1 8 1975

Mr O'Neill

MEMORANDUM FOR: THE DIRECTOR

FROM: DON OGILVIE

SUBJECT: FY 1977 Defense Budget Gap

Our best estimates indicate a gap of up to $10 billion between the current Defense and OMB outlay estimates for 1977. This memo identifies the broad areas of difference and recommends specific actions required if the lower outlay levels are to be achieved.

1977 Defense Outlays

A table summarizing the 1977 Defense outlay picture follows:

1977 Defense Budget Development

(outlays - $ billions)

	1975	1976	1977 OMB	1977 DOD
FY 1976 President's Budget	85	93	104	104
Outlay reestimates	+1	+2		
Estimated FY 1976 Congressional Action.		-3	-2	-2
OMB Planning Target			-3	
Defense Program Review				+2
September Reduction Exercise		-1	-5	
Current Projection	86	91	94	104

In January Defense and OMB reached agreement on 1977 Defense and MAP outlays of $104 billion. Since that time the following has occurred:

- Actual 1975 outlays were $1 billion higher than anticipated; an increase of $2 billion in 1976 outlays is anticipated.

- Congressional action on the FY 1976 budget is expected to reduce outlays by $3 billion in 1976 and by $2 billion in 1977.

- The Defense internal program review has just been completed and calls for 1977 outlays of $104 billion, in effect adding $2 billion in program to offset anticipated congressional reductions.

- The OMB planning target for Defense included anticipated congressional cuts and further Defense/MAP reductions of $3 billion. These adjustments are still considered realistic.

- The recent $25 billion reduction exercise would require $5 billion in Defense outlay reductions below the 1977 planning target. The resulting $94 billion Defense level would be about $3 billion below the 1976 outlay level in real terms. Proposed actions include a maximum 5% pay raise for both October 1975 and October 1976. All existing force levels are preserved but lower operating and investment cost levels will have some adverse impact upon readiness.

In summary, Defense has assumed, incorrectly in our opinion, that the January planning target is independent of congressional action and that program additions can be substituted for congressional reductions. The OMB planning target, by contrast, accepts the congressional reduction and includes further program adjustments. Thus, there is a $5 billion gap between Defense and OMB initial planning levels. The September outlay reduction exercise widens this gap to $10 billion. These are extremely large differences that will require major changes to the Defense budget submission. This, in turn, requires understanding and acceptance on the part of Secretary Schlesinger if these kinds of reductions are to be achieved.

1977 President's Budget Presentation

Also of considerable importance are the year by year Defense totals which will appear in the President's Budget and the signals the President desires to send with his Defense budget. The FY 1977 level will be, in large measure, closely related to what Defense receives in 1976. This is normally true in any year, but the emphasis is now even greater with the current services budget serving as a potential baseline for congressional review.

The 1977 Defense budget request should start from the 1976 level allowed by Congress, and then add factors for inflation, real program growth and congressional cut insurance.

The current projection of TOA and outlays for Defense is as shown:

	($ billions)			
			1977	
	1975	1976	OMB	DOD
Defense TOA (see attached table)	89	98	104	117
Defense outlays	86	91	94	104

These are the amounts that would appear in the President's Budget for 1977. The FY 1976 program will be about $10 billion in TOA and $5 billion in outlays higher than the actual FY 1975 experience. Recognizing continued inflation, real program growth and congressional cut insurance, the FY 1977 growth over FY 1976 should probably be a minimum of $12 billion in TOA and $6 billion in outlays unless real program reductions are acceptable. However, the FY 1977 Defense internal planning growth of $19 billion in TOA and $13 billion in outlays appears clearly excessive in the absence of any major emergency or dramatic change in the world situation. If the President decides on a $2-3 billion TOA increase in strategic programs as the result of unsatisfactory progress in the SALT II negotiations, this would increase FY 1977 Defense outlays by up to $1 billion.

Recommendations

Because of the magnitude of the gap between Defense and OMB in FY 1977, I recommend:

1. That you seek explicit Presidential guidance on Defense planning levels in your upcoming meeting on the FY 1977 budget.

   ____ Approve

   ____ Disapprove

2. That you meet with the Secretary of Defense and reach closer accord on the FY 1977 Defense budget level within the next two weeks, prior to the October 1 start of the OMB/DOD joint review.

   ____ Approve

   ____ Disapprove

1977 Defense Budget Development

(TOA - $ billions)

	1975	1976	1977 OMB	1977 DOD
FY 1976 President's Budget	89	105	117	117
Estimated FY 1976 congressional action		-7		-1
OMB Planning Target			-6	
Defense Program Review				+1
September reduction exercise			-7	
Current Projection	89	98	104	117