THE WHITE HOUSE

WASHINGTON

November 20, 1975

MEMORANDUM FOR: JIM CANNON

FROM: PAUL LEACH Paul

SUBJECT: Budget Review For Treasury, Commerce and SBA

I assume that you will have had a chance to examine the summary information in the budget book and consequently I will limit myself to the issues.

TREASURY

1. Level of IRS Activities

   This is a highly technical "management" issue which I would let OMB and Treasury fight out between themselves.

2. Level of U.S. Customs Service Activities

   This too is a technical issue, but the arguments seem to favor the OMB position, i.e., that increased productivity can be achieved with no major increase in resources.

COMMERCE

1. Ship Construction Program

   I would recommend support for the OMB position, i.e., lower funding. It appears that the recovery in ship construction demand will be more gradual and that the OMB funding level will be sufficient.

2. NOAA Marine Programs

   I defer on this to George Humphreys (I have supplied him with the budget book materials).

3. NOAA Weather Programs

Again, I defer to George Humphreys.

4. Economic Development Administration

I would recommend approval of the OMB recommendation, i.e., reductions in planning and research, technical assistance and economic adjustment program funding totalling $21 million below the EDA/Commerce recommendation. While it is not certain that the proposed reductions can be sold on the Hill, they should be tried since the programs provide relatively small substantive benefits.

SMALL BUSINESS ADMINISTRATION

1. Management Assistance and Portfolio Management

I would recommend support for the OMB position, which provides for some increase in people and funding --- but does not provide all that SBA requests.

2. Lease and Surety Bond Guarantee Programs

I would recommend support for the SBA position on this issue. In a time of budget tightness, the lease and surety guarantee programs seem to be low cost programs with political/symbolic value which outweighs any benefit to be gained from a reduction in budget levels.

Treasury

1977 Presidential Review
Department of the Treasury
Table of Contents

Issue	Effect of issue on outlay request (dollars in millions)	
	1977	1978
1. Level of Internal Revenue Service		
a. Audit	-83	-83
b. Collection	-44	-44
c. Employee Pension Plans	-13	-13
2. Level of U. S. Customs Service Activities	-71	-71

TAB A

Department of the Treasury
1977 Budget

Summary Data

	Budget Authority	Outlays	Employment, end-of-year Full-time Permanent	Total
1975 actual	41,365	41,177	108,138	119,281
1976 February budget	43,565	43,453	xxx	xxx
enacted	43,520	43,466	xxx	xxx
supplementals transmitted	26	25	xxx	xxx
supplementals recommended	17	16	xxx	xxx
agency request	46,047	46,092	114,398	126,792
OMB recommendation	45,261	45,350	113,995	124,118
OMB employment ceiling (current)	xxx	xxx	112,309	121,809
TQ February budget	11,675	11,703	xxx	xxx
enacted	11,669	11,697	xxx	xxx
supplementals transmitted	7	8	xxx	xxx
supplementals recommended	7	7	xxx	xxx
OMB recommendation	12,353	12,381	xxx	xxx
1977 planning target	48,347	48,389	xxx	xxx
reduction target	xxx	52,799	xxx	xxx
agency request	53,562	53,589	127,304	140,520
OMB recommendation	52,857	52,831	109,940	120,632
1978 OMB estimate	56,860	56,795	109,940	120,632

TAB B

1977 Budget
Department of the Treasury
Summary and Background Information

Agency Request

Secretary Simon's initial budget request provided for a 13.6% outlay expansion in virtually every on-going program. Excluding interest on the public debt, General Revenue Sharing payments, and other uncontrollable programs, the Department's request included $2,930 million in outlays for operating programs (up $351 million from 1976) and 127,304 in employment (up 12,906 or 11.3% from 1976). The most significant increases were requested for the Internal Revenue Service and the U. S. Customs Service, which historically have accounted for over 80% of the Department's operating budget and employment requirements.

Treasury was given a revised outlay target of $2,425 million for operating programs. The revised target represented a reduction of $51 million from OMB's estimate of a 1977 adjusted base level, and a reduction of $505 from Treasury's initial request for 1977. In response to the revised planning target, Treasury proposed reductions totaling $207 million from their initial request, primarily the elimination of selected program increases. Treasury subsequently identified further reductions of $298 million which would be required to meet their revised planning target. However, the Department strongly opposes these further reductions. Because Treasury is a labor-intensive agency, budget reductions of the magnitude under discussion would primarily affect employment.

Treasury estimates that the full $505 million reduction would reduce non-personnel requirements below base levels for most operating programs and would result in work-year reductions of 20,494 (10,660 of which represent requested increases and 9,834 of which represent reductions below Treasury's request for 1976 - approximately 8.5%). The Department concludes that "such cuts would undermine productivity gains and be counterproductive to our revenue producing efforts, as well as create severe operating problems." Furthermore, they predict revenue losses of $1.7 billion associated with these reductions.

OMB Recommendation

The OMB recommendations for 1977 provide $2,457 million in outlays for operating programs and a full-time employment level of 109,940. These recommendations represent reductions below 1976 of $59 million in outlays (2.3%) and 4,055 in employment (3.6%). OMB does not believe these reductions will impair the effectiveness of on-going programs, nor result in revenue losses of any significant magnitude.

The OMB recommendation for achieving the revised planning target differs from Treasury proposals in the following areas:

-- The application of tighter standards in establishing 1977 base requirements. In this regard, the OMB recommendations assume greater productivity from the existing work force than projected by Treasury. OMB recommendations assume productivity achieved in the past, projected by Treasury, or 2%, whichever is greater.

-- Minimization of reductions in revenue producing programs.

-- Greater reductions in non-personnel programs.

-- No program expansion. Several high priority initiatives or program expansions may be desirable, but would have to be funded through reprogramming.

-- Reductions in new equipment procurement, including additional cars.

The differences in approach are illustrated on the chart at Table A.

In view of significant staff expansion (16% in last 4 years) granted to Treasury recently, OMB believes that employment granted under our 1977 recommendation will be sufficient--with increased productivity--to accommodate workload increases in tax administration, currency production, and other operating programs of the Department. (See Table B for listing of past year staffing increases provided the Department.)

Areas of Expected Disagreement with Treasury

We expect Treasury will have strong objections to the OMB recommendations regarding the Internal Revenue Service and the Customs Service. OMB recommendations for these bureaus--including the revenue loss issue--are discussed at Tab C.

Treasury also may appeal on other small issues:

- The allowance for the Federal Law Enforcement Training Center reduces staffing to reflect a more favorable student-teacher ratio, as well as reductions in the number of Federal law enforcement agents to be trained in 1977.

- The allowance for the Bureau of Alcohol, Tobacco and Firearms reduces employment in the illegal liquor enforcement program and assumes greater productivity in their enforcement programs. The allowance does preserve the 500 agents devoted to gun control strike forces--an initiative of your recent Crime Message.

- The allowance for the Secret Service assumes a freeze on employment after political conventions are concluded next summer.

- The productivity and equipment reductions are assumed for the Bureau of Engraving and Printing, the Bureau of the Mint, and the Bureau of the Public Debt. The allowance also includes a 10% reduction in the promotion program of the Savings Bond Division of the Bureau of the Public Debt.

Department of the Treasury
Outlays
Reductions Identified to Achieve Revised Target
(In millions of dollars)

	Treasury Proposals for reaching OMB Planning Target				OMB Recommendations			
	Personnel		Non-Personnel		Personnel		Non-Personnel	
	Outlays	%	Outlays	%	Outlays	%	Outlays	%
U.S. Customs Service	-20	34	-39	66	-23	32	-48	68
Internal Revenue Service	-250	76	-80	24	-165	56	-129	44
All Other	-39	34	-77	66	-34	31	-74	69
Subtotal	-309	61	-196	39	-222	47	-251	53
TOTAL		-505				-473		

DEPARTMENT OF THE TREASURY

Increases or decreases in employment provided in past Presidents' budgets and the OMB recommendation for 1977.

	1973	%	1974	%	1975	%	1976	%	1977	%
End-of-year, full-time permanent	+700	.7	+1,000	1.0	+6,700	6.4	+3,500	3.2	-4,055	3.6
Work-years, Total	+4,117	4.0	+3,796	3.5	+7,948	7.1	+2,887	2.4	-3,410	2.8

1977 Budget
Department of the Treasury
Summary of Recommended Program Reductions
($ in millions)

	1976		TQ	1977			1978	
	O	FTP Employ.	O	BA	O	FTP Employ.	O	FTP Employ.
Current base	45,613	112,664	12,371	52,621	62,614	113,569	56,823	113,569
Less Interest, General Revenue Sharing, and other Miscellaneous permanent accounts	43,117	---	11,754	50,160	50,133	---	54,342	---
Current base, Operating Accounts	2,496	112,664	617	2,461	2,481	113,569	2,481	113,569
Recommended level	2,516	113,995	640	2,455	2,457	109,940	2,472	109,940
Reductions	+39	+1,331	+23	-6	-24	-3,619	-9	-3,619

Program Reductions:

Main Treasury renovation and staff, Office of the Secretary	-1	0	0	-2	-5	+13	-5	+13
Administration of Law Enforcement Training Center	-1	0	-1	-1	-1	-133	-1	-133
Enforcement of Customs laws	0	+200	+3	-4	-14	-92	-14	-92
Manufacture of Coins	0	0	0	0	-1	+193	-1	+193
Assessment and Collection of Internal Revenue Taxes	0	+350	+5	-58	-66	+3,353	-66	+3,353

TAB C

Issue Paper
Department of the Treasury
1977 Budget
Issue #1: Level of IRS Activities

	1975 Actual	1976 Agency Request: Current Estimate	1976 Agency Request: Proposed Supplementals	1976 OMB Recom.	1977 Agency Request	Revised Agency Request	Agency Approach To Planning Target	1977 OMB Recom.: Base	1977 OMB Recom.: Program Changes	1977 OMB Recom.: Recom.
Budget Authority ($M)	1,586.6	1,646.0	44.2	1,650.0	1,916.5	1,814.5	1,603.5	1,626.3	-38.6	1,587.7
Outlays ($M)	1,601.8	1,644.0	34.1	1,647.8	1,872.4	1,770.4	1,545.4	1,616.4	-38.4	1,578.0
Work-years	82,339	84,164	1,696	84,336	94,128	89,081	75,740	81,586	-742	80,844

Treasury's original 1977 budget request for IRS proposes an increase of $270 million in budget authority and 9,964 work-years above the appropriated level for 1976. When asked to submit a revised budget reflecting restraint in Federal spending, Treasury still requested increases of $168 million and 4,917 work-years above 1976. The plan proposed by Treasury to reach the $395 billion outlay target in 1977 would require reductions below the base of 5,674 work-years and $68.8 million in IRS. Treasury estimates these actions would reduce revenues by $1.4 billion below the level achievable in its original 1977 request.

In contrast, the OMB approach to reaching the $395 billion outlay target represents a reduction of 742 work-years and $43.5 million in budget authority below the 1977 base, as calculated by OMB. There would be virtually no loss in revenues from the 1976 program level funded by the Congress. Reductions from the 1976 appropriated level would be achieved by taking 2 percent productivity cuts in all tax administration activities and making minimal additional program reductions--reducing the match of tax information documents to the 5 percent level authorized for 1976, targeting tax audits under $10,000 to those returns identified by the computer as exhibiting characteristics which indicate incorrect tax declaration, eliminating work-years previously devoted to the now-defunct narcotics traffickers tax fraud program, eliminating IRS initiatives and cutting quality control in taxpayer service, and making consistent reductions in other supporting program.

The different approaches taken by Treasury and OMB to reaching the $395 billion outlay target are graphically depicted on attachments A, B, and C. The most vivid portrait of the different approaches taken by Treasury and OMB is provided by the first graph. It shows a substantial growth in non-personnel costs under the Treasury plan above either the 1976 appropriated level, the 1977 base, or the OMB recommendation. The difference of $56.3 million between the Treasury and OMB approaches to non-personnel costs represents the resources required to fund 3,750 work-years, thereby accounting for a large measure of the differences in work-years available for the basic tax administration activities shown on the other graphs.

The graphs displaying audit, data processing (primarily processing tax returns), and collection work-years account for 80 percent of IRS personnel funded for 1976. It can be seen that Treasury projects much more severe cuts in audit and data processing than OMB believes are necessary to achieve the outlay objective. Conversely, OMB would cut more deeply into other supporting IRS personnel than would Treasury. Audit and collection are further discussed below as separate issues, as is the matter of carrying out IRS responsibilities under the 1974 employee pension plan act. Data processing is not expected to be an issue with Treasury, since the OMB recommendation would add 745 work-years to process additional tax returns expected to be filed in 1977.

Audit

IRS seeks to expand audit coverage from the current rate of 2.53 percent of all tax returns filed to a level of 2.69 percent of the 90.5 million tax returns expected to be filed. This proposal is supported by traditional arguments that every dollar invested in audit activities returns six dollars. However, an OMB analysis conducted in 1972 concluded that a ratio closer to 3.5:1 more accurately represents the relationship of yield to cost. The difference is due primarily to higher OMB estimates of the total direct and overhead cost related to audit. Using the IRS rule of thumb that the costs of the private sector are equal to or greater than the Government's cost, the net return may be as low as 2.5:1 or even 2:1.

OMB has consistently argued that a balanced tax administration program is the best approach to encouraging voluntary compliance. In constructing a constricted program at a lower base consistent with the overall budget objective of 395 billion in outlays, it is necessary to make a comparable reduction in audit coverage. However, the OMB recommendation of 2.46 percent coverage in 1977 is not expected to adversely affect revenues, because the reduction of 200,000 audit examinations in 1977 is planned to be taken from tax returns under $10,000, where revenue return barely equates to the cost of audit. In contrast, the Treasury plan to reach the agency outlay target envisions a drop down to 2.38 percent audit coverage with a corresponding revenue loss of $365 million below the 1976 level.

Collection

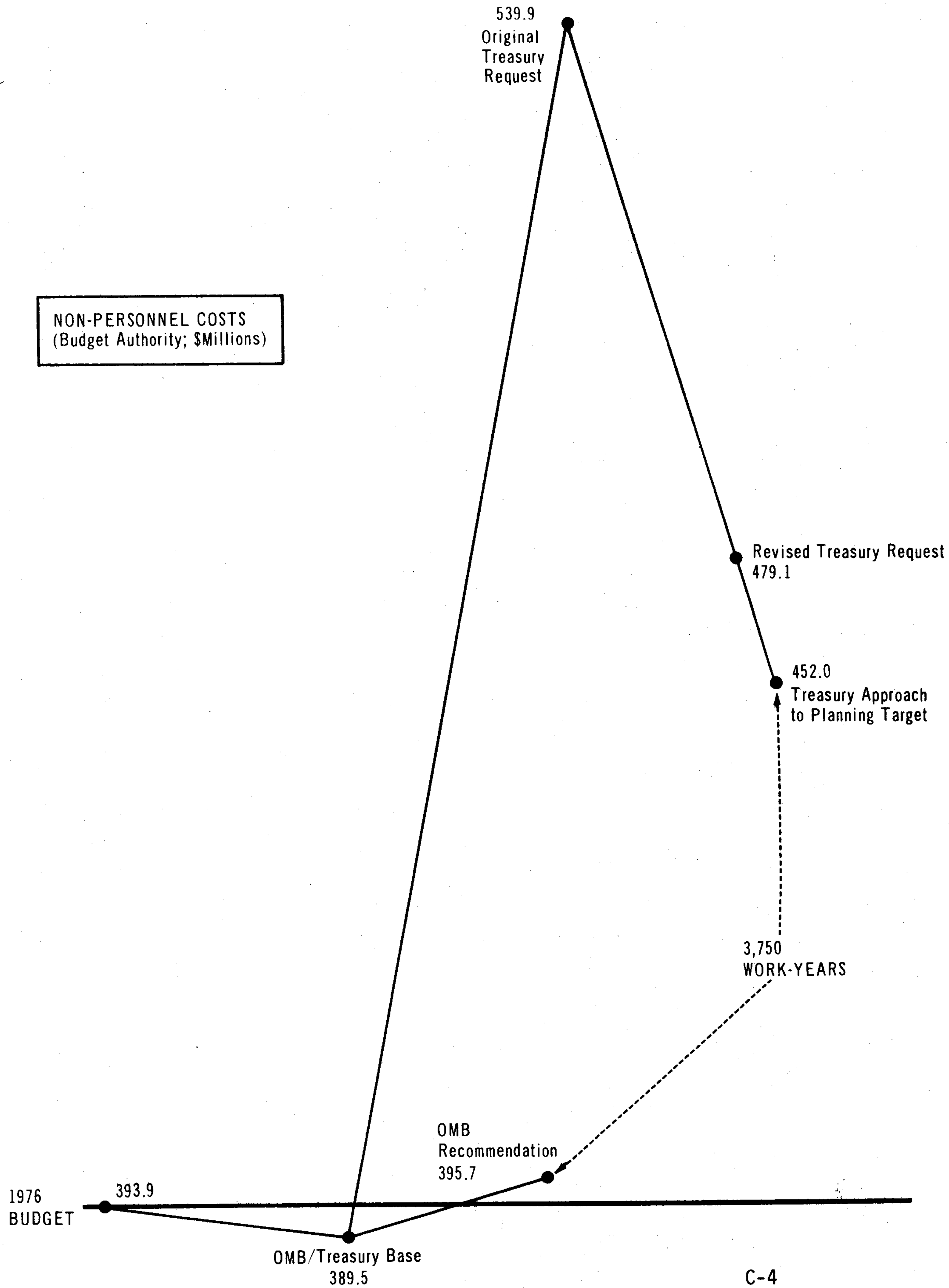
Along with audit, the collection activity is one of the two big revenue producers in IRS. The 1977 budget request proposes 415 more work-years to close additional anticipated accounts receivable and reduce inventories, 450 work-years to institute a new delinquency prevention program, and 384 work-years to identify more non-filers. The OMB mark would deny all of these additions. The inventory level is not of particular concern since the 1976 appropriation provides sufficient resources for IRS to reduce the level by 275,000 cases, from 1,125,000 to 850,000. The remaining proposals appear to be "nice to have" ideas which are not feasible to fund in the current budget environment.

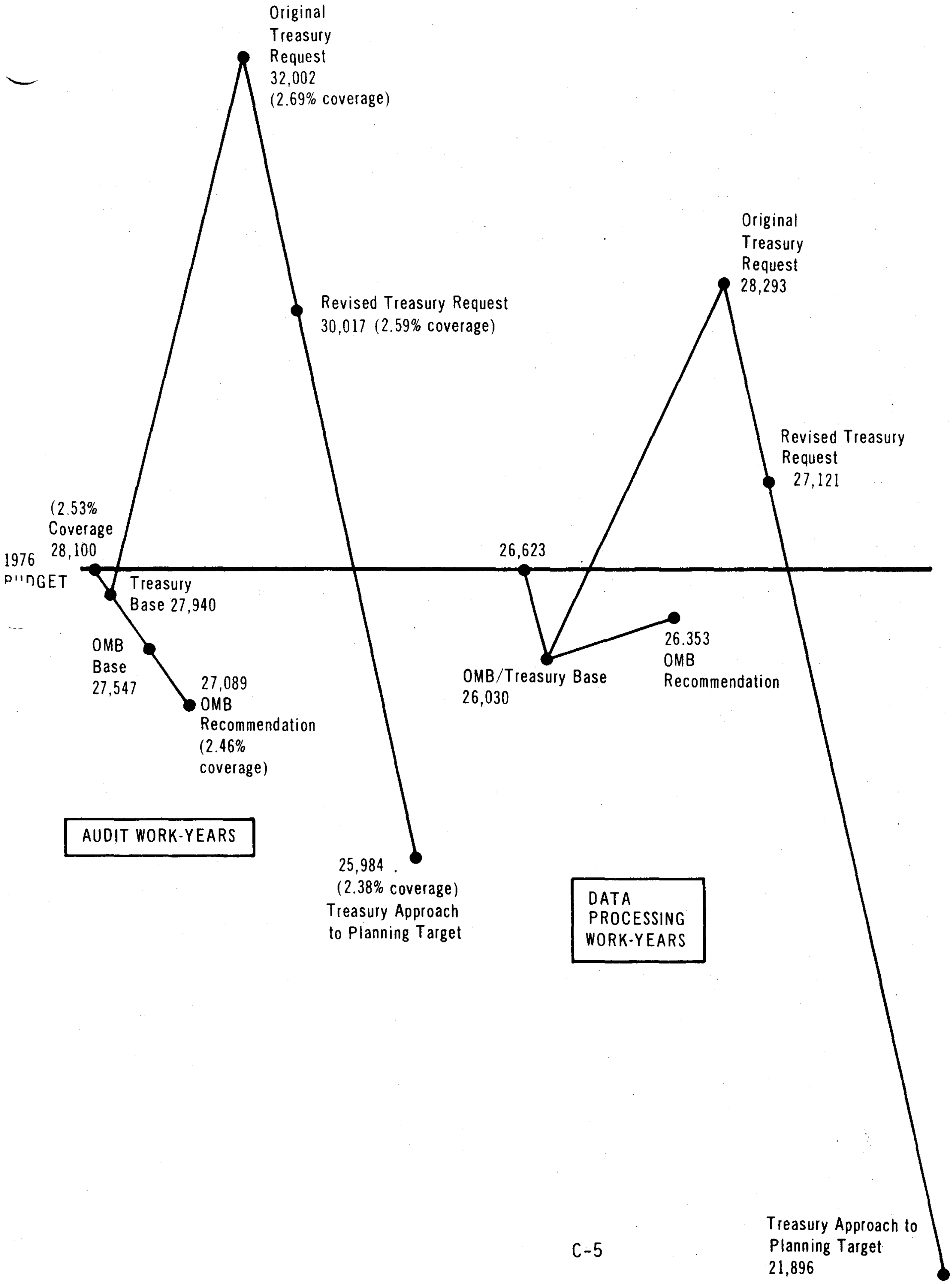
In describing the impact on IRS programs of the Presidential outlay target, Treasury identifies $250 million in lost revenues in the collection activity. Only $50 million of this amount is ascribed to the increases sought in 1977 and discussed above. The remainder is associated with a reduction of 447 work-years below the 1977 base. OMB does not agree that a revenue loss is inevitable at this work-year level. OMB calculates the same work-year reduction by assuming 2 percent increase in productivity and restricting the match of tax information documents to the 5 percent level authorized in last fall's budget review. Document matching is estimated to generate revenues at between 1:1 and 1.2:1, and so if any lost revenues are experienced in the collection activity, they should be minimal ($750,000 at most).

Employee Pension Plans

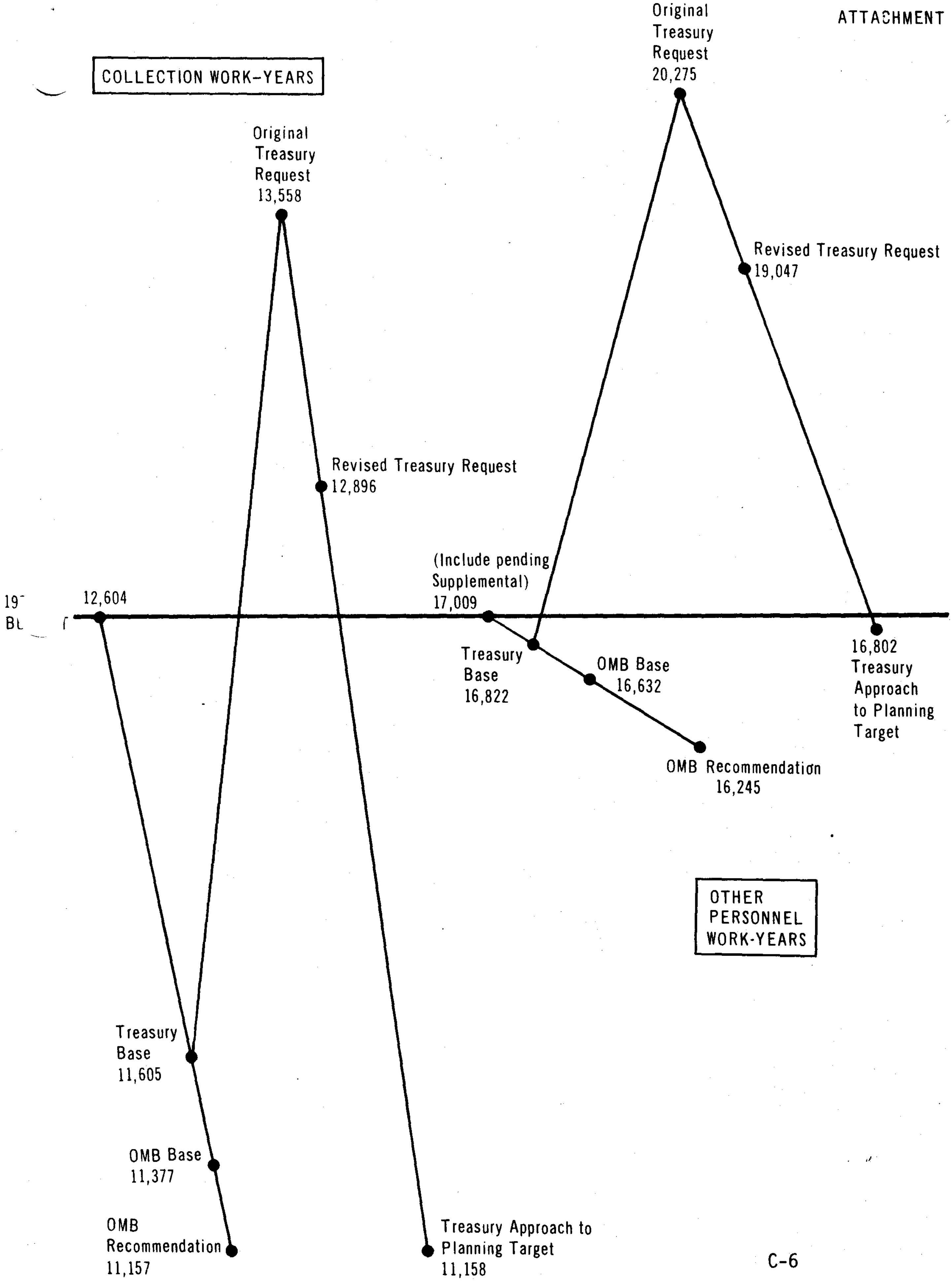
The Employee Retirement Income Security Act of 1974 (ERISA) requires IRS to review and certify an estimated 520,000 employee plan applications, amendments, and terminations. The bulk of this workload is expected to arrive at IRS during 1977. Consequently, IRS seeks 867 additional work-years to address this workload, plus 110 personnel to expand investigation of delinquent tax returns related to these plans. The 1975 IRS Long-Range Plan estimates that 91% of the increased personnel resources needed in 1977 will no longer be required in succeeding years, after the one-year workload bulge. On its own initiative, the House Appropriations Committee has included in the 1976 Supplemental Appropriation Bill, recently reported to the House, an increase of $4 million for IRS which would provide an additional 172 work-years for this program.

Instead of adding more personnel for this task in 1977, the approach recommended by OMB would temporarily redeploy personnel presently assigned to lower priority functions in this and its companion program, reviewing tax exempt organizations. The OMB approach would reapply productivity savings already identified by IRS in examining employee pension plans to the reduced program level which Treasury spoke to in constructing its plan to reach the OMB outlay target. At the same time, IRS would be expected to defer delinquency investigations and examinations of tax returns filed by pension plans and exempt organizations in order to mount a maximum effort to review the new proposals within the legal time requirements. When these management actions are combined with the 172 additional man-years likely to be appropriated by the Congress, there appear to be adequate resources in the 1977 base to address the one-time workload increase resulting from passage of the 1974 Act.


539.9
Original
Treasury
Request
NON-PERSONNEL COSTS
(Budget Authority; $Millions)
Revised Treasury Request
479.1
452.0
Treasury Approach
to Planning Target
3,750
WORK-YEARS
OMB
Recommendation
395.7
1976
BUDGET
393.9
OMB/Treasury Base
389.5



Original Treasury Request 32,002 (2.69% coverage)
Revised Treasury Request 30,017 (2.59% coverage)
(2.53% Coverage 28,100
1976 BUDGET
Treasury Base 27,940
OMB Base 27,547
27,089 OMB Recommendation (2.46% coverage)
AUDIT WORK-YEARS
25,984 (2.38% coverage) Treasury Approach to Planning Target
Original Treasury Request 28,293
Revised Treasury Request 27,121
26,623
OMB/Treasury Base 26,030
26.353 OMB Recommendation
DATA PROCESSING WORK-YEARS
Treasury Approach to Planning Target 21,896


COLLECTION WORK-YEARS
Original Treasury Request 13,558
Revised Treasury Request 12,896
12,604
Treasury Base 11,605
OMB Base 11,377
OMB Recommendation 11,157
Treasury Approach to Planning Target 11,158
Original Treasury Request 20,275
Revised Treasury Request 19,047
(Include pending Supplemental) 17,009
Treasury Base 16,822
OMB Base 16,632
OMB Recommendation 16,245
16,802 Treasury Approach to Planning Target
OTHER PERSONNEL WORK-YEARS

Iss aper
Department of the Treasury
1977 Budget
Issue #2: Level of U.S. Customs Service Activities

	1975 Actual	1976 Agency Request: Current Estimate	1976 Agency Request: Proposed Supplementals	1976 OMB Recom.	1977 Agency Request	Revised Agency Request	Agency Approach To Planning Target	1977 OMB Recom.: Base	1977 OMB Recom.: Program Changes	1977 OMB Recom.: Recom.
Budget Authority ($M)	292.4	310.0	14.5	310.0	381.2	351.2	320.9	311.6	-5.1	306.5
Outlays ($M)	298.5	329.0	14.1	329.0	375.7	346.5	316.2	309.3	-4.3	305.0
Work-years	13,076	13,255	313	13,255	14,358	14,068	13,359	12,928	+8	12,936

Customs seeks a 23% increase in resources above the 1976 appropriation to expand all of its programs. Special emphasis would be given to revenue producing and law enforcement programs, especially efforts to intercept air smugglers along the southwest border. The latter program, which Customs believes is now effective, would require additional jet planes and sophisticated radar to raise the risk to air smugglers. If the additional resources are not approved, Customs estimates that receipts from duties and excise taxes will decline by $180 million in 1977 and by $300 million in 1978. The requested resources are divided between a 1976 supplemental (+14 million) to enforce the Trade Act and Oil Proclamation, and the 1977 budget request (+$57 million) to expand all programs.

After examining Customs revenue loss estimates, OMB concludes that those estimates are invalid. Chart A shows that past receipts have not fluctuated with changes in staffing levels. Instead, staffing has increased by 8% per annum over the past five while receipts declined by 8% in real dollars.

The traditional drug arguments were not emphasized by Customs this year because: (1) 1975 drug seizures either equaled or declined from 1974 levels even though work-years increased by 10% during the same period; and (2) almost all Customs' seizures are soft drugs, primarily marihuana, which were assigned lower priority by the Domestic Council Drug Abuse Task Force in its White Paper on Drug Abuse.

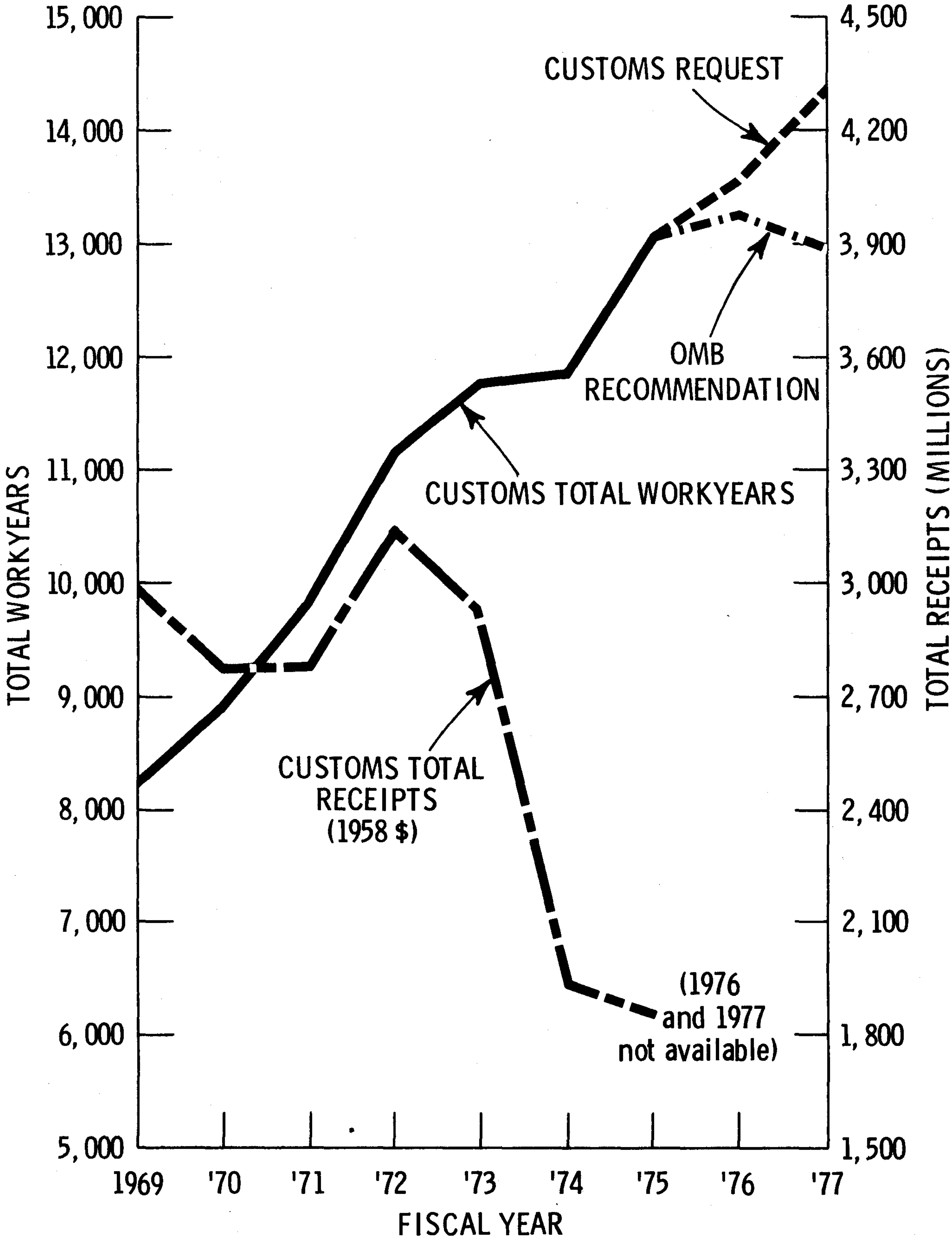
Because drug seizures and revenue receipts do not directly depend upon Customs' staffing levels, OMB continues to believe that Customs can anticipate productivity gains without jeopardizing either receipts or drug seizures. Customs has anticipated some increase in productivity but not enough to compensate for the substantial drop in productivity which occurred during 1975. This decline was due to an unanticipated decrease in workload and is reflected in Chart B. In order to bring productivity back to past levels, OMB recommends that the 1976 supplemental request be absorbed by Customs and that 1977 increases be disapproved. No increase in the program to intercept air smugglers is recommended because the program is targeted against lower priority drugs and its effectiveness remains questionable.

The OMB recommendation would disapprove the requested increases of 1,103 work-years and $71 million. Staffing in 1977 would be reduced by 319 work-years in order to return productivity to the rates achieved in prior years.

Chart A

CUSTOMS RECEIPTS DATA

(STAFFING LEVEL vs ADJUSTED RECEIPTS)



CUSTOMS PRODUCTIVITY DATA