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THE WHITE HOUSE

WASHINGTON

November 20, 1975

MEMORANDUM FOR: JIM CANNON
FROM: PAUL LEACH *PL*
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.

SBA

1977 Presidential Review
Small Business Administration
Table of Contents

TAB A Summary tabulation of the 1977 Budget amounts requested and recommended.

TAB B Summary of the principal budget decisions reflected in the OMB recommendation.

TAB C Issue Papers

<u>Issue</u>	<u>Effect of issue on outlays (dollars in millions)</u>	
	<u>1977</u>	<u>1978</u>
1. Management Assistance and Portfolio Management	- 5	- 5
2. Lease and Surety Bond Guarantees	+ 2	+ 2

TAB A

Small Business Administration
1977 Budget
Summary Data

	(In Millions)		Employment, end-of-year	
	Budget authority	Outlays	Full-time Permanent	Total
1975 actual	446	618	4,127	4,698
1976 February budget	289	339	4,171	4,457
enacted	417	468	XXX	XXX
supplementals recommended	-	-	XXX	XXX
agency request	645	476	4,741	5,356
OMB recommendation	417	468	4,339	4,792
OMB employment ceiling	XXX	XXX	4,171	4,786
TQ February budget	11	41	XXX	XXX
enacted	9	86	XXX	XXX
supplementals recommended	-	-	XXX	XXX
agency request	11	89	XXX	XXX
OMB recommendation	9	86	XXX	XXX
1977 July planning target	450	500	XXX	XXX
October planning target	450	545	XXX	XXX
agency's initial request	848	693	5,011	5,341
agency's reduced request	544	400	5,011	5,341
OMB recommendation	536	400	4,434	4,764
1978 OMB estimate	678	539	4,434	4,764

TAB B

1977 Budget
Small Business Administration
Summary and Background Information

Agency Request

SBA initially requested large increases in its direct loan programs (+\$130 million), expansion of its loan guarantee programs (+\$805 million), and an additional 840 permanent positions (a 20% increase). To reach its reduced outlay target of \$400 million, SBA decreased its direct loan request by \$165 million. This reduces the direct loan level to \$375 million, which is \$35 million less than in 1976.

OMB Recommendation

The OMB recommendations are driven primarily by the desire to provide the incentives and pressures for SBA to put its programs on a more business-like basis. In particular, there is a need for SBA to revise its entire approach toward loan and guarantee programs, to bring under control the loss rates and costs on these programs.

The recommendations propose to accept SBA's reduced direct loan levels. OMB believes SBA has reduced these programs to about the minimum level that has any chance of being accepted by Congress. Also, these programs should be held down while SBA revises its loan approval procedures to limit the loans to those firms for which there is reasonable assurance of repayment.

OMB disagrees with SBA's proposals for guarantee programs in three areas:

- 7(a) guarantee: SBA requests an increase from the current budget level of \$1.2 billion to \$2.0 billion. OMB recommends \$1.5 billion to avoid a major expansion while this program is under study to determine how to bring it under control;
- Lease guarantee: OMB recommends suspending operation of this program until SBA is able to manage it effectively on a full cost recovery basis; and
- Surety bond guarantee: SBA proposed an increase of \$445 million in this program. OMB recommends reducing this program by \$100 million from the 1976 level of \$750 million to help push SBA to establish tighter acceptance criteria and reduce loss rates.

OMB also recommends an increase of 95 permanent positions, including 85 to permit SBA to increase its efforts to reduce losses on its loan portfolio.

Areas of Expected Disagreement With SBA

The Acting Administrator has made it clear that his highest priority is increased staffing and funds for loan portfolio management and management assistance (Issue #1). He is likely to appeal the proposed addition of only 85 positions (SBA requested an increase of 405 positions for these activities).

SBA also may appeal the proposed suspension of the lease guarantee program and may object to holding down the surety bond program (Issue #2).

1977 Budget
 Small Business Administration
 Summary of Recommended Program Reductions
 (\$ in millions)

	1976		TQ	1977		1978		
	0	FTP Employ.		0	FTP Employ.	0	Employ.	
Current base	468	4,339	86	410	423	4,434	562	4,434
Recommended level	<u>468</u>	<u>4,339</u>	<u>86</u>	<u>375</u>	<u>400</u>	<u>4,434</u>	<u>539</u>	<u>4,434</u>
Reduction	-	-	-	35	23	-	23	-

Program reductions:

Direct loans, reduce	-	-	-	35	23	-	23	-
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Actions required:

Reduce the budget request.

Program impact:

The agency proposed to reduce its direct loan programs by a total of \$35 million. This reflects estimates of reduced demand for nonphysical disaster loans. It also makes reductions in the lower priority regular 7(a) loan program (to \$100 million from \$113 million). These reductions will have no serious impact on small businesses.

TAB C

Small Business Administration (SBA)
1977 Budget
Issue #1: Management Assistance and Portfolio Management

Statement of Issue

Are additional personnel needed to allow SBA to properly service and manage its loan portfolio?

Background

SBA has experienced a large growth in direct loan losses and in guarantee loan defaults in the last several months. While part of this could be attributable to the recent downturn in the economy, other major contributing factors are SBA's problems in making sound credit decisions in the loan approval process, and its lack of staff to properly monitor and service non-delinquent loans and to effectively process and liquidate delinquent loans. We will be working with SBA in the coming year to improve the loan approval process and procedures so that loans are made only when there is a reasonable chance of repayment.

Since 1968, the size of SBA's loan servicing portfolio has increased from 111,000 loans and \$1.7 billion, to 240,000 loans with \$6.8 billion in outstanding value. Despite this growth in the loan portfolio, the number of personnel assigned to service and manage these outstanding loans has declined. The effect has been to increase the loan servicing workload per employee to the point that SBA is unable to properly monitor non-delinquent loan accounts and process or liquidate delinquent loan accounts. In recognizing this problem, SBA initiated a pilot project in 1976 which combined available management assistance and portfolio management personnel into 10 teams and provided emergency servicing to approximately 3,000 delinquent loan accounts in 20 cities.

Alternatives

- #1. Agency Request: Increase 1976 and 1977 employment levels by a total of 405 permanent positions. Provide \$3 million in 1976 and \$7 million in 1977 to support these positions and expand other management assistance programs.
- #2. OMB Recommendation: Continue to improve the team approach during 1976 to manage and service the loan portfolio. Provide an additional 85 positions and \$2 million in 1977 to allow SBA to improve its ability to handle the loan portfolio.

Analysis

<u>Budget Authority/Outlays</u> <u>(\$ in millions)</u>	<u>1975</u>	<u>1976</u>	<u>July 1 -</u> <u>Sept. 30, 1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
Agency Request	29	32	9	36	36	36	36	36
OMB Recommendation	29	29	7	31	31	31	31	31
Reduction From Agency Request		-3	-2	-5	-5			

Agency Request: SBA requests an increase of 405 permanent positions to provide more in-depth, long-term counseling to SBA delinquent and non-delinquent borrowers and to permit better management and servicing of the direct and guaranteed loan portfolio. SBA feels strongly that failure to provide it with the requested positions would result in a net dollar loss on SBA loans to small business and an increased number of failures of these firms. The agency states that this is its highest priority budget request.

OMB Recommendation: OMB recommends that SBA improve its coordination effort between management assistance and portfolio management prior to supplementing these functions with additional positions. Notwithstanding the desire to restrain Federal employment, the recommendation for an additional 85 positions and \$2 million in 1977 is considered to be necessary as an initial step to increase SBA's ability to properly service and manage its loan portfolio.

Small Business Administration (SBA)
1977 Budget
Issue #2: Lease and Surety Bond Guarantee Programs

Statement of Issue

What actions should be taken to control the costs of the Lease Guarantee and Surety Bond Guarantee programs?

Background

SBA's Lease Guarantee program assists small business persons to obtain leases of commercial and industrial space in desirable business locations. In participation with insurance companies, SBA guarantees the rental payment of a small business lessee. Although this program was legislated to be self-sustaining, a recent GAO report stated that the program was not operating on a self-sustaining basis and that SBA was not taking action to control the program. In 1975, about 100 businesses received assistance under this program.

SBA's Surety Bond Guarantee program assists small contractors to obtain the surety bonds necessary to permit them to bid on public and private procurement contracts. In participation with surety bond companies, SBA guarantees 90 percent of all losses which might be incurred by the participating surety company as a result of a small business default on a contract. A recent review of this program indicates that it has a rapidly growing loss rate, and SBA has not introduced controls to help reduce defaults. The program operated on a deficit basis of \$3 million in 1974 and \$14 million in 1975. The deficit in 1977 is expected to exceed \$20 million. In 1975 the program guaranteed 11,600 bonds with a contract value of \$760 million.

Alternatives

- #1. Agency Request: Continue the lease guarantee program at the 1976 level. Expand the Surety Bond Guarantee program from \$750 million in 1976 to \$1,195 million in 1977.
- #2. OMB Recommendation: Suspend the Lease Guarantee program indefinitely. Reduce the Surety Bond Guarantee program from \$750 million in 1976 to \$650 million in 1977.

Analysis

Guarantee Level/Outlays (\$ in millions)	1975		1976		July 1 - Sept. 30, 1976		1977		1978	
	GL	0	GL	0	GL	0	GL	0	GL	0
Lease										
Agency Req.	37	2	35	1	9	0	35	1	35	1
OMB Rec.	37	2	35	1	9	0	0	2	0	2
Surety										
Agency Req.	760	14	750	14	240	6	1,195	20	1,195	20
OMB Rec.	760	14	750	14	187	6	650	21	600	21

Agency Request: SBA's request for the Lease Guarantee program is based on an expected continued low demand for lease guarantees due to rising costs of leased spaced in choice locations. SBA proposes no changes in the program to make it self-sustaining.

SBA's request for the Surety Bond Guarantee program is based on a perceived tightening of the private surety industry which could preclude previously bondable small contractors from obtaining a surety bond in the private sector. SBA believes that expansion of this program is desirable because it would provide additional market opportunities for small businesses. The agency believes that the cost to the Government of the program is not excessive in view of the benefits to small businesses.

OMB Recommendation: The OMB recommendation for the Lease Guarantee program would suspend the program. The program has not provided for the type of lease guarantees originally contemplated by Congress and requires major modifications to assure that it operates on a self-sustaining basis. We believe that suspension of the program would not have a serious impact on small businesses. It is recommended that this program be suspended indefinitely unless SBA can establish a management system to make the program self-sustaining.

The OMB recommendation on the Surety Bond Guarantee program would require a \$100 million reduction in this program while SBA is working to correct the program deficiencies to reduce the defaults and costs. It is expected that the recommended reduction in this program would provide an incentive for SBA to establish the necessary controls on the program. Continuing the program at the \$650 million level will permit assistance to about 10,000 small firms, and emphasis can be given to assisting the socially and economically disadvantaged.

These recommendations do not reduce outlays in 1977, but will prevent major increases in costs in future years. These actions are part of a broader effort to put the SBA programs on a more business-like basis. The Agency is expected to oppose the suspension and reduction of these programs.