Statement of

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Mr. Chairman, I am pleased to appear before this Committee to discuss S. 1679, the Honest Budgeting Act of 1983. I strongly support the objectives of this bill.

The current budgetary treatment of the Federal Financing Bank (FFB) has created two problems not foreseen at the bank's inception: the transfer of on-budget outlays off budget as a result of the FFB's purchase of loan assets from on-budget agencies, and the conversion of loan guarantees into off-budget direct government loans. This potentially causes confusion about fiscal policy and may distort the allocation of resources among programs.

The Congressional Budget Office (CBO) believes that the budgetary treatment of the FFB should be revised to conform more closely to the original intent of the Congress. This could be accomplished by modifying the budgetary treatment either of programs financed by the FFB or of the FFB itself. The Honest Budgeting Act of 1983 introduced by Senator Trible takes the latter approach--it amends the budget treatment of the Federal Financing Bank itself.

My statement this morning will reiterate some of the background material presented to this Committee by Dr. Rivlin in the spring. I will also discuss how improving the budget treatment of the FFB relates to the broader concerns of the control of federal credit activities.

FEDERAL FINANCING BANK OPERATIONS

Since 1974 the FFB has become an important source of financing for loans directly issued or guaranteed by federal agencies. The FFB portfolio has grown rapidly and steadily since its inception. Its outstanding holdings totaled $124.3 billion in fiscal year 1982 and, if current policy is continued, would exceed $210 billion by 1988.

The FFB engages in three types of activities: purchasing loan assets (certificates of beneficial ownership--CBOs) from agencies, making direct loans to borrowers holding agency guarantees, and purchasing agency debt. The largest activity is purchase of loan assets, which accounted for 46 percent of the FFB's total holdings at the end of fiscal year 1982. The FFB has become the primary buyer of loan assets sold by federal agencies. In 1975, its first full year of operation, the FFB purchased 63.8 percent of all loan assets offered for sale by federal agencies. By 1982 the FFB's share had increased to 86 percent, or $12.6 billion of the $14.8 billion of assets offered for sale. The Farmers Home Administration (FmHA) has been the principal seller of loan assets to the FFB. As shown in Table 1, FFB holdings of Farmers Home Administration certificates at the end of fiscal year 1982 totaled $53.7 billion, or 94 percent of the bank's loan asset holdings.

The second largest category of FFB activity is direct loans to guaranteed borrowers, which represent 32 percent of the bank's assets.

TABLE 1. FFB OUTSTANDING HOLDINGS BY TYPE OF ACTIVITY, FISCAL YEARS 1980-1982 (In billions of dollars)

Type of Activity	1980	1981	1982
Loan Assets			
Agricultural Credit Insurance (FmHA)	37.9 a/	22.4	23.4
Rural Housing Insurance (FmHA)	---	21.1	23.9
Rural Development Insurance (FmHA)	---	5.3	6.4
Rural Electrification Administration	1.9	2.6	3.1
Other	0.6	0.4	0.4
Subtotal	40.4	51.8	57.2
Direct Loans to Guaranteed Borrowers			
Foreign Military Sales	7.2	9.1	11.4
Rural Electrification Administration	8.4	12.3	16.3
Student Loan Marketing Association	2.3	4.3	5.0
Low-Rent Public Housing	0.1	0.9	1.6
Rail programs	1.1	1.5	1.1
Small Business Administration	0.5	0.6	0.7
Seven States Energy Corporation	0.7	0.9	1.3
Other	1.2	1.5	1.9
Subtotal	21.5	31.1	39.3
Agency Debt			
Export-Import Bank	10.1	12.4	14.0
Tennessee Valley Authority	8.9	10.9	12.3
Postal Service	1.5	1.3	1.2
Other	0.6	0.3	0.3
Subtotal	21.1	24.9	27.8
Total	83.0	107.8	124.3

SOURCE: Budget of the U.S. Government, Fiscal Years 1982, 1983, and 1984, Special Analyses.

a. Includes activities of the Rural Development Insurance Fund and Rural Housing Insurance Fund.

Instead of raising funds in the securities market, a borrower with a guarantee from a federal agency may have the FFB purchase the entire security issue. Thus, in effect, the FFB makes a direct loan to that borrower. In terms of dollar volume, the two largest categories of borrowers have been rural electric cooperatives, under guarantees by the Rural Electrification Administration, and foreign purchasers of U.S.-made military equipment, under guarantees by the Department of Defense. These two categories accounted for $27.7 billion of the FFB direct loans outstanding at the end of 1982, or 70 percent of the total.

The remaining 22 percent of the FFB portfolio consists of holdings of agency debt. Since its inception in 1974, the FFB has been the sole financing agent for nearly all new issues of agency debt. At the close of fiscal year 1982, its holding of agency debt was $27.8 billion. The main debt issues held are those of the Export-Import Bank and the Tennessee Valley Authority. In recent years, the U.S. Railway Association and the Postal Service have both redeemed some of their debt held by the FFB.

BUDGETARY TREATMENT OF FFB FINANCING

The Federal Financing Bank was intended to be a neutral financial intermediary, lowering the agencies' interest costs but not otherwise

affecting the federal budget. The FFB authorization provided that the bank's activities should not affect the budgetary status of agencies selling obligations to the bank, and further provided that the receipts and disbursements of the bank should not be included in the unified budget. The on-budget activity levels of agencies were not expected to be affected by the establishment of the FFB. In fact, however, the budget treatment of loan asset sales and direct loans to guaranteed borrowers financed by the FFB has affected the unified budget. Under current practices, FFB operations contribute to a situation in which the unified budget deficit understates federal borrowing requirements and otherwise identical loans appear to have different budgetary costs.

Shifting of On-Budget Outlays Off Budget Through Loan Asset Sales

Special provisions of law require that sales of certificates of beneficial ownership by the Farmers Home Administration and the Rural Electrification Administration (REA) be treated as sales of assets rather than as borrowing by these agencies. The significance of these provisions is that asset sales are treated as negative outlays in the originating agency's budget accounts. Thus, when the Farmers Home Administration makes $1 million in loans and uses them as collateral for selling $1 million in certificates of beneficial ownership to the FFB, the net outlays for the Farmers Home

Administration are zero in the unified budget. 1/ The lending activity is recorded as budget authority and outlays of "off-budget federal entities."

In 1982 the sale of certificates of beneficial ownership to the FFB by the Farmers Home Administration reduced on-budget outlays by 70 percent for rural housing, 44 percent for agricultural credit, and 73 percent for rural development (see Table 2). Similarly, the off-budget Rural Electric and Telephone Revolving Fund shifted all of its direct loans to the FFB, understating its lending by $500 million for 1982.

The budgetary treatment of loan asset sales introduces inconsistency into the budget's consideration for different lending programs. The Farmers Home Administration budget, the Agriculture appropriation bill, and related budget functions are all understated in the unified budget. This understatement potentially affects the funding level for these programs.

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1. Sales of loan assets other than certificates of beneficial ownership to the public by federal agencies convey ownership and servicing responsibility to the purchaser. When a certificate is sold to the FFB, however, the originating agency retains risk of default and servicing. The case can be made that the certificate transaction is borrowing rather than an asset sale.

TABLE 2. COMPOSITION OF OUTLAYS FOR LOAN PROGRAMS FINANCED BY THE FFB, FISCAL YEAR 1982 (In billions of dollars)

	Agency Outlays	FFB Outlays	Total	FFB Outlays as Percent of Total
Shifting of On-Budget Outlays Off Budget Through Loan Asset Sales				
Farmers Home Administration				
Agricultural Credit Insurance	1.4	1.1	2.5	44
Rural Housing Insurance	1.2	2.8	4.0	70
Rural Development Insurance	0.4	1.1	1.5	73
Rural Electrification Admin.	0.5 a/	0.5	0.5	100
FFB Conversion of Guaranteed Loans to Direct Loans				
Rural Electrification Admin.	---	4.0	4.0	100
Foreign Military Sales	---	2.3	2.3	100
Tennessee Valley Authority	---	0.3	0.3	100
Small Business Administration	---	0.1	0.1	100
Student Loan Marketing Assn.	---	0.7	0.7	100
Alternative fuels production	---	0.3	0.3	100
Low-rent public housing	---	0.7	0.7	100
Other	---	0.2	0.2	100
Total	3.5	14.1	17.1	82

SOURCE: Budget of the United States Government, Fiscal Year 1984, Special Analyses.

a/ The authorization for the REA excludes it from the budget. It is in every other respect comparable to on-budget lending programs.

FFB Conversion of Guaranteed Loans to Direct Loans

In my view, almost all federally guaranteed loans should require private participation--either through shared risk or services to the borrower. In the absence of this partnership, guaranteed loans are virtually the same as direct federal loans. When financed by the FFB, guaranteed loans are converted to direct loans, both guaranteed and financed by the Treasury.

The FFB is authorized to lend directly to borrowers whose loan notes carry a full guarantee of repayment by a federal agency. The agencies make guarantee commitments to qualified borrowers and then arrange the sale of guaranteed notes to the FFB. The FFB disburses funds raised through the Treasury to the borrowers, thus converting loan guarantees authorized by the Congress into direct loans. The conversion of loan guarantees into direct loans bypasses the constraints established by the Congressional Budget Act of 1974. The Budget Act specifically excludes guaranteed loans from the definition of budget authority. Direct loans, in contrast, require budget authority and are included in the targets and ceilings enacted in the budget resolutions.

When guaranteed loans are converted to direct loans, agencies increase their direct lending without having to request additional budget authority. The largest programs are the Rural Electric and Telephone

Revolving Fund, which effectively increased its direct loans from the $1.1 billion authorized to $5.8 billion extended in 1982, and the foreign military sales credit program, which increased its direct loans from $0.4 billion to $3.5 billion in 1982. These direct loans are accounted for in the off-budget FFB, not in the on-budget agency of origination.

To the extent that financing by the FFB enables agencies to lend more money, it affects the allocation of federal resources. It also increases direct federal borrowing requirements and the gap between the unified budget deficit and total federal borrowing.

Purchases of Agency Debt

The final form of financial transaction engaged in by the FFB is its purchase of agency debt, such as notes issued by the Tennessee Valley Authority. When an agency sells notes to the FFB, it obtains favorable interest rates. The outlays that the agency makes are recorded in the agency's budget (not the FFB's), and the full impact on government borrowing needs is recorded in the unified budget. Since this activity of the FFB performs a useful service and causes no budget distortions, it should be allowed to continue even if reforms are undertaken to correct the accounting of other FFB activities.

WHY THE BUDGET DEFICIT UNDERSTATES TOTAL FEDERAL BORROWING

The unified budget deficit--the difference between revenues and on-budget outlays--is featured in the President's budget, the Congressional budget resolutions, and most discussions of fiscal policy. But the total borrowing requirements of the federal government, which determine the government's impact on financial markets, also include off-budget outlays. Moreover, the debt ceiling has to be raised to cover financing requirements that result from off-budget as well as on-budget deficits. Unnecessary confusion is added to the budget debate by the fact that the unified deficit understates the government's financing requirements.

Most of the off-budget deficit is accounted for by the transactions of the FFB. (The off-budget deficit also includes the net outlays of the U.S. Postal Service, the Rural Telephone Bank, and the Strategic Petroleum Reserve.) Table 3 shows the extent to which the off-budget accounts understated the total deficit from 1974 to 1983. Because of the FFB, the unified budget deficit understated total deficit spending by nearly one-third in 1979. Since that year, the unified budget deficit has grown so rapidly that it has outpaced the off-budget deficit.

TABLE 3. UNDERSTATEMENT OF THE BUDGET DEFICIT, FISCAL YEARS 1974-1983 (In billions of dollars)

Fiscal Year	Unified Budget Deficit	FFB Outlays	Other Off-Budget Outlays a/	Total Federal Deficit	Unified Budget Deficit as a Percent of Total Deficit
1974	4.7	0.1	1.3	6.1	77.0
1975	45.2	6.1	2.0	53.3	84.8
1976	66.4	6.1	1.2	73.7	90.0
TQ	13.0	2.6	-0.9	14.7	88.4
1977	44.9	8.1	0.6	53.6	83.7
1978	48.8	10.7	-0.3	59.2	82.4
1979	27.7	13.3	-0.8	40.2	68.9
1980	59.6	14.4	-0.2	73.8	80.8
1981	57.9	21.0	---	78.9	73.4
1982	110.6	14.2	3.1	127.9	86.5
1983	207.0	14.2	2.3	223.0	92.8

SOURCES: Fiscal years 1974-1982 data, Budget of the United States Government 1976-1982; fiscal year 1983 data, Congressional Budget Office, The Economic and Budget Outlook: An Update (August 1983).

a. Includes outlays of the U.S. Postal Service, Rural Telephone Bank, Regional Rail program, and the Strategic Petroleum Reserve.

POSSIBLE SOLUTIONS

There are several alternative approaches to correcting the budget presentation of the FFB. 2/ The budgetary problems raised by the FFB are

2. See Congressional Budget Office, The Federal Financing Bank and the Budgetary Treatment of Federal Credit Activities (January 1982).

attributable to the budgetary treatment of the transactions it finances: purchases of loan assets and the making of direct loans to guaranteed borrowers. The problems can be solved by changing the budgetary treatment either of those transactions or of the FFB itself.

Simply putting the FFB on budget would make the unified deficit a better indicator of federal financing needs. But it would still leave the activity levels in the lending and guaranteeing agencies understated. Thus, unless the budgetary treatment of FFB loan asset purchases and direct loans is addressed, distortion in the budget will persist.

Honest Budgeting Act of 1983

Senator Trible has introduced legislation to correct the problems presented by the budgetary treatment of the FFB by amending the Federal Financing Bank Act. The Honest Budgeting Act of 1983 (S. 1679) would require the transactions of the FFB to be reflected in the unified budget. The federal budget would, therefore, more accurately reflect the fiscal operations of the federal government. The bill would require the transactions of the FFB to be recorded in the originating agencies' budgets, thereby ensuring that all agency transactions would be taken into consideration as budget resources were allocated. Budget authority would have to be appropriated for any agency-guaranteed loan that was financed by the FFB.

In order to ensure that agencies could not bypass the FFB and return to the securities markets, the Honest Budgeting Act would require that all activities financed through the bank prior to the effective date would remain in the bank thereafter. Thus, when the new accounting provisions took effect, these activities would be fully and correctly recorded in the budget.

We understand that the intent of the bill is to freeze current practice with respect to programs now financed through the FFB and to correct their budget treatment. Thus, all guarantees currently financed as direct loans by the FFB would continue to be financed by the FFB but would be correctly recorded as direct loans. Additional guarantee programs could be financed by the FFB if they were appropriately recorded as direct loans of the originating agencies. Assuming this interpretation is correct, I believe that this is the right approach. As noted previously, I would prefer to see most guaranteed loans have significant private sector involvement, and as a result, they would not qualify for FFB financing.

Had the Honest Budgeting Act been in place for fiscal year 1982, total unified budget outlays would have increased by $14 billion, or 2 percent. Federal borrowing requirements would have been unchanged. Two budget functions would have been greatly increased: the energy function by 111 percent, and the commerce and housing function by 74 percent (see Table 4).

The budgets of individual agencies would have been increased even more dramatically. Farmers Home Administration outlays would have increased from $3 billion to $8 billion. Outlays for the foreign military sales program would have increased by 460 percent (see Table 5).

TABLE 4. IMPACT OF SHIFTING FFB OUTLAYS ON BUDGET, BY BUDGET FUNCTION, FISCAL YEAR 1982 (In billions of dollars)

Budget Function	On-Budget Outlays	FFB Outlays	Total	Percentage Increase From Shifting FFB Outlays On Budget
International Affairs	10.0	2.3	12.3	23
Energy	4.7	5.2	9.9	111
Agriculture	14.9	1.1	16.0	7
Commerce and Housing	3.9	2.9	6.8	74
Community and Regional Development	7.2	1.1	8.3	15
Other	687.7	1.5	689.2	0
Total	728.4	14.1	742.5	2

SOURCE: Budget of the United States Government, Fiscal Year 1984, Table 14.

To the individual agencies and borrowers that have benefited from the present budgetary treatment of the FFB, the Honest Budgeting Act no doubt presents some concerns. The budget authority and outlays they have previously shifted to the FFB would henceforth be shown in their budgets.

TABLE 5. IMPACT OF SHIFTING FFB OUTLAYS ON BUDGET, BY AGENCY AND PROGRAM, FISCAL YEAR 1982 (In billions of dollars)

Agency/Program	On-Budget Outlays	FFB Outlays	Total	Percentage Increase From Shifting FFB Outlays On Budget
Farmers Home Administration				
Agricultural Credit Insurance	1.4	1.1	2.5	79
Rural Housing Insurance	1.2	2.8	4.0	233
Rural Development Insurance	0.4	1.1	1.5	275
Rural Electrification Admin.	---	4.5	4.5	N/A
Foreign Military Sales	0.5	2.3	2.8	460
Tennessee Valley Authority	1.5	0.3	1.8	20
Small Business Administration	0.6	0.1	0.7	17
Other	11.1	1.9	13.0	17
Total	16.7	14.1	30.8	84

SOURCE: Budget of the United States Government, Fiscal Year 1984, Budget Accounts Listing.

But the effects should not be overstated. First, the standard budget convention is to adjust all historical data to reflect subsequent changes in budget structure. There would be no jump in year-to-year agency budget authority and outlays upon implementation of the Honest Budgeting Act. Second, the program levels of almost all of the large credit programs financed through the FFB are already controlled through the appropriations process. As part of the credit budget, the Appropriations Committees have

set limits on new direct loan obligations and loan guarantee commitments for all but three of the programs financed through the FFB (see Table 6).

CORRECTING FFB ACCOUNTING--A PARTIAL SOLUTION

Correcting the budgetary treatment of the FFB will improve the unified budget. It will make the unified budget more comprehensive and improve accountability by recording transactions in their appropriate places. The unified budget will become a better measure of the cash flow of the federal government, and of federal borrowing requirements. Improving the unified budget treatment of lending is, however, only a partial solution to the budget treatment of credit programs.

The unified budget is an inadequate device to control federal credit activities in several respects: first, it understates program levels; second, it overstates the long-term costs of credit programs since most loans will ultimately be repaid; and finally, it does not present clearly the long-run costs arising from subsidies and loan defaults.

The unified budget understates program levels for direct federal loans by counting only net lending--that is, new loans less repayments. The costs of guaranteed loans are recorded in the budget only when the borrowers default. To some extent, this shortcoming is addressed by the credit budget,

TABLE 6. SOURCE OF PROGRAM LEVELS FOR AGENCY LOAN PROGRAMS FINANCED THROUGH THE FFB (In millions of dollars)

	Authorizations		Appropriations a/	
	1982	1983	1982	1983
Direct Loan Obligations				
Farmers Home Administration				
Agricultural Credit Insurance	---	---	2,129	2,349
Rural Housing Insurance	---	---	3,725	3,314
Rural Development Insurance	---	---	505	730
Rural Electrification Admin.	---	---	1,425	1,425
Health Maintenance Organizations	---	---	76	24
Subtotal	---	---	7,860	7,842
Guaranteed Loan Commitments				
Foreign Military Sales	---	---	3,083	3,931
Rural Electrification Admin.	---	---	6,400	4,745
Rail programs	---	---	100	100
TVA Seven States b/	4,513	5,641	---	---
NASA satellite leases	146	205	---	---
Small Business Administration-Small Business Investment Corporations	215	510	---	---
Student Loan Marketing Assn.	700	---	---	---
Community development grants	---	---	225	225
Other	---	---	25	---
Subtotal	5,574	6,356	9,833	9,001

SOURCE: Congressional Budget Office, An Analysis of the President's Credit Budget for Fiscal Year 1984 (March 1983).

a/ All programs limited by appropriation also were authorized.

b/ The current budget treatment of the Tennessee Valley Authority guarantees overstates program levels because it records refinancing of short-term debt as new loans. The 1985 budget will remove refinancing from the totals. CBO estimates that new loans for 1983 will be $195 million in contrast to the $5.6 billion shown.

which the Budget Committee have implemented on an experimental basis by establishing nonbinding limits on new direct loan obligations and loan guarantee commitments. The credit budget will still be necessary even after the FFB is reformed. I believe that credit budget procedures should be fully incorporated into the Congressional Budget Act.

Neither the unified budget nor the credit budget, however, accurately describes the relative cost to the taxpayer of spending, lending, and guarantees. Direct federal spending for purchases, grants, or income transfers has a different cost from direct loans of federal funds, most of which will be repaid, and from federal guarantees of private transactions, which are contingent costs to taxpayers. A dollar of income transfers is not equal to a dollar of direct loans or a dollar of guaranteed private borrowing in the amount of income generated or in long-term federal financing requirements. Since these are important cost criteria for deciding how best to deliver a government service, the absence of a common metric for these different programs can--and probably has--distorted choice. CBO has a study in progress on the relationship between spending and lending.

In closing, I see three changes as needed to improve the budget treatment of credit programs: recording agency activities financed by the FFB in the originating agencies' budgets, implementation of a Congressional credit budget, and further study of the relationship between spending and lending programs. We look forward to working with you on these issues.