Statement of
James L. Blum
Assistant Director
Budget Analysis
Congressional Budget Office

before the
Subcommittee on International Finance, Trade
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NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EST), Thursday, February 27, 1986

Mr. Chairman, I am pleased to have the opportunity to appear before this Subcommittee. My statement this morning will explain the Congressional Budget Office's (CBO's) budgetary treatment of the Administration's proposal to convert the direct loan program of the Export-Import Bank of the United States into a 100 percent guarantee with an interest rate buy-down. The gist of the matter is that whereas the Office of Management and Budget (OMB) credits this proposal with a reduction in 1987 outlays and the deficit of $0.2 billion, in our analysis of the President's budget, we estimated that the proposal would increase outlays $0.1 billion.

Underlying these numerical differences is a difference in interpretation of the proposal. CBO believes that the Administration's proposal entails no substantive programmatic changes. Accordingly, we have no basis for a change in budgetary scoring. The increase in outlays shown in our analysis reflects the increase in requested activity. OMB, in contrast with CBO and contrary to its previously expressed policies, has treated the nominal change from direct loans to 100 percent guaranteed loans combined with an interest subsidy as a decisive programmatic restructuring.

Under current policy, Eximbank originates loans to selected, foreign buyers of U.S. goods, at subsidized, OECD-agreed interest rates and finances those loans with borrowing from the Federal Financing Bank (FFB). The subsidy conveyed includes the difference in interest rates between the loan rate and the FFB rate plus the risk of default.

Under the proposed policy, the FFB would be bypassed as a source of financing. Funding would be obtained directly from commercial lenders who would assume no more risk than on U.S. Treasury securities but who would require additional compensation for the lower liquidity of Eximbank guaranteed notes. Eximbank would continue to provide an interest-rate subsidy, but would do so under this proposal through interest make-up payments to commercial lenders. Eximbank would continue to bear full liability for all default risk.

The proposal would not affect amounts loaned, borrowers served, the subsidy conveyed, or the government's liability. The intent, in fact, is to leave borrowers unaffected by the change. The only substantive effect, in our view, would be to increase the cost of financing to Eximbank and the government because commercial lenders would not be able to provide funds to the program as cheaply as the FFB and Treasury have been able to do.

The Eximbank proposal exposes a well-known deficiency in federal budget accounting. Direct loan disbursements by government during a fiscal year are treated as equivalent in budget cost to an equal dollar expenditure for grants or salaries and wages. This treatment is faulty because loan repayments are expected and these repayments reduce the real cost of the loan outlay. OMB estimates that the Eximbank direct loan program conveys a subsidy with a present value of only 6.4 cents per dollar obligated instead of a full dollar. The budgetary practice of scoring the dollar volume of

direct loan activity overstates the long-term savings obtained by reducing direct loan obligations in existing programs. For example, if a $1 billion direct loan program is terminated, this appears to save $1 billion even though the subsidy saved is only a fraction of this, $64 million in the case of Eximbank loans.

Budgetary accounting for loan guarantees is also inadequate. Loan guarantee commitments are not recorded in the unified budget until a default occurs. Thus, loan guarantees appear to be "free" of budget cost until government has to honor its commitment to pay someone else's debt.

These deficiencies in the budgetary treatment of federal credit assistance create incentives for program managers, seeking short-run budgetary savings, to convert direct loan programs to guarantees. This incentive is especially strong when the conversion can be to 100 percent guarantees with an interest buy-down, because this means the substance of the program is unchanged but that budget savings may be claimed. No meaningful programmatic difference exists between a direct loan made by government at a subsidized interest rate for which the government is fully liable for default and a loan originated by a private lender at the same rate for which government is liable for the interest subsidy and default.

OMB has previously recognized that a 100 percent guaranteed loan is essentially equivalent to a direct loan. In August 1984, OMB issued its

Circular A-70, Policy and Guidelines for Federal Credit Programs. One goal of this Circular was to prevent agencies from obtaining illusory budget savings by substituting 100 percent guarantees for equivalent direct loans. Accordingly, A-70 contained a general prohibition of new 100 percent guarantees and suggested that private lenders be required to assume at least 20 percent of the loss from default. In those cases where 100 percent guarantees must be used, A-70 indicates that these instruments ordinarily should be financed through the FFB; that is, they should be converted explicitly into direct loans. The source of disagreement between CBO and OMB over the Eximbank proposal is the inconsistency of this plan with the principles embodied in the Administration's credit policies.

Both CBO and OMB agree that the true cost to government of federal credit activity is its subsidy cost. Without great difficulty, the current proposal could be modified to permit the budget to reflect accurately its interest subsidy costs. This could be achieved by having Eximbank pay the interest subsidy in one, up-front sum using appropriated funds. Further, the plan could be made fully compatible with the policies outlined in the A-70 by reducing the guarantee to 80 percent.