STATEMENT OF

Alice M. Rivlin
Director
Congressional Budget Office

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Mr. Chairman, I am pleased to appear before this Committee to discuss the operations and the budgetary implications of the Federal Financing Bank (FFB). The FFB has met the objective for which it was created: reducing the interest costs of federal agencies that otherwise would have marketed their own debt. But the budgetary treatment of the FFB has created two problems not foreseen at the bank's inception: facilitation of the transfer of on-budget outlays to off-budget status--thereby understating unified budget deficits--and conversion of programs approved by the Congress as guaranteed loans into off-budget direct government loans. Hence, the budgetary treatment of the FFB potentially distorts fiscal policy and the allocation of resources among programs. This distortion is especially relevant as you consider legislation to increase the debt limit, since increases in federal debt result from both on- and off-budget deficits.

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. Congressman Gradison has introduced the Truth in Budgeting Act of 1983 (H.R. 2868), a comprehensive reform of the budgetary treatment of the FFB. This bill would correct the problems presented by the current budgetary treatment of the FFB in a single piece of legislation.

Problems caused by the budgetary treatment of the FFB are described in detail in a January 1982 Congressional Budget Office study, "The Federal Financing Bank and the Budgetary Treatment of Federal Credit Activities," which has been provided to the Committee as background information. My statement this morning briefly summarizes how the FFB functions, describes problems created by the budgetary treatment of some FFB transactions, and presents alternative solutions to those problems.

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 1982 and, assuming the continuation of current policy, would exceed $210 billion by 1988.

The FFB finances three categories 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 category is purchases 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 CBOs totaled $53.7 billion by the end of fiscal year 1982, 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 total holdings. 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, the FFB, in effect, 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 countries purchasing 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

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			
Agriculture 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

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

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 government's interest costs but not otherwise affecting the 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.

Loan Asset Sales Shift On-Budget Outlays Off Budget

Special provisions of law require sales of certificates of beneficial ownership by the Farmers Home Administration and the Rural Electrification Administration (REA) to 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 CBOs to the FFB, the net outlays for the Farmers Home Administration are zero in the unified budget. 1/

Before the FFB was established, when the Farmers Home Administration or REA sold a CBO to a nonfederal investor, the special provisions of law governing the treatment of CBO sales also removed the lending activity from the budget. The creation of the FFB, however, made the understatement of direct lending and of unified budget outlays a direct

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1. Sales of loan assets, other than CBOs, to the public by federal agencies convey ownership and servicing responsibility to the purchaser. When a CBO is sold to the FFB, however, the originating agency retains title and does the servicing. Thus the case can be made that the CBO form is simply a device to hide transactions.

result of federal activity. Instead of the outlays being incurred by a nonfederal investor, they are incurred by an off-budget entity of the federal government itself. In current budget documents, the lending activity is recorded as budget authority and outlays of "off-budget federal entities."

In 1982 the sale of CBOs to the FFB by the Farmers Home Administration reduced on-budget outlays by 70 percent for rural housing, 42 percent for agricultural credit, and 73 percent for rural development (see Table 2). The off-budget Rural Electric and Telephone Revolving Fund shifted all of its direct loans to the FFB. Its $500 million lending activity for 1982 does not appear in the unified budget.

The budgetary treatment of loan asset sales introduces a lack of uniformity into the budget's consideration. 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.

TABLE 2. FFB OUTLAYS COMPARED TO AGENCY OUTLAYS, FISCAL YEARS 1980-1982 (In billions of dollars and percents)

	1980	1981	1982
Rural Housing Insurance			
Dept. of Agriculture outlays	1.7	-0.1	1.2
FFB outlays	1.9	4.0	2.8
Total outlays	3.6	3.9	4.0
FFB as a percent of total	53	103	70
Agriculture Credit Insurance			
Dept. of Agriculture outlays	0.5	-0.2	1.4
FFB outlays	4.0	5.8	1.0
Total outlays	4.5	5.2	2.4
FFB as a percent of total	89	112	42
Rural Development Insurance			
Dept. of Agriculture outlays	0.2	0.3	0.4
FFB outlays	1.0	1.0	1.1
Total outlays	1.2	1.3	1.5
FFB as a percent of outlays	83	77	73
Rural Electrification Administration			
Dept. of Agriculture outlays	-a/	-a/	-a/
FFB outlays	0.7	0.7	0.5
Total outlays	0.7	0.7	0.5
FFB as a percent of total	100	100	100

a. Less than $50 million.

FFB Conversion of Guaranteed Loans to Direct Loans

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 sell the 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 Budget Act. 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.

If financing by the FFB makes it easier for a higher loan level to be attained, it affects the allocation of the federal resources. FFB financing

also increases direct federal borrowing requirements and the gap between the unified budget deficit and total federal borrowing.

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. Yet, it is the total borrowing requirements of the federal government that determine the government's impact on financial markets. Also, the debt ceiling must be increased to cover total borrowing requirements, which result from both on- and off-budget deficits. Unnecessary confusion is added to the budget debate by the fact that the unified deficit understates the government's borrowing requirements.

Most of the off-budget deficit is accounted for by the transactions of the FFB. (The off-budget deficit also includes the outlays of the U.S. Postal Service, the Rural Telephone Bank, and the Strategic Petroleum Reserve.) Table 3 shows how the off-budget accounts understate the total deficit from 1974 to 1988. Because of the FFB, the unified budget deficit understated total deficit spending by one-third in 1979. Since that year, the unified budget deficit has grown so rapidly that it has outpaced the off-budget deficit. It should be easier to bring all spending on-budget now that off-budget spending is a relatively small portion of the total deficit.

TABLE 3. UNDERSTATEMENT OF THE BUDGET DEFICIT, FISCAL YEARS 1974-1988 (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	194.0	14.7	2.9	211.6	91.7
1984	200.0	12.9	4.7	217.6	91.9
1985	210.0	13.3	2.3	225.6	93.1
1986	226.0	13.0	1.7	240.7	93.9
1987	248.0	13.5	3.7	265.2	93.5
1988	268.0	14.2	1.8	284.0	94.4

NOTE: 1983-1988 data are CBO revised baseline estimates.

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

Purchases of Agency Debt Fulfill FFB's Intended Role

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. In these cases, the agency's interest costs are lowered, 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 curb other FFB activities.

POSSIBLE SOLUTIONS

The budgetary problems raised by the FFB are attributable to the budgetary treatment of the transactions it finances: CBO sales and direct loans to guaranteed borrowers. These problems can be solved by changing the budgetary treatment either of those transactions or of the FFB itself.

A simple requirement to put 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 guaranteeing agencies understated and would not mandate the voting of budget authority for guaranteed loans that are converted into direct loans. Thus, unless the budgetary treatment of

loan asset sales and direct loans from the FFB is addressed, distortion in the budget will persist.

Truth in Budgeting Act

Congressman Gradison has introduced legislation to correct the problems presented by the budgetary treatment of the FFB by amending the Federal Financing Bank Act. The Truth in Budgeting Act of 1983 (H.R. 2868) 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 is financed by the FFB. In order to ensure that agencies could not bypass the FFB and return to the securities markets, the Truth in Budgeting Act would require that all federal agencies first offer their loans and securities to the FFB. This requirement would be limited to transactions ordinarily financed in investment securities markets, as defined by the Secretary of Treasury, and could be waived by the Secretary of Treasury if sales to the FFB would either entail too much risk or disrupt private financial markets.

The requirement for all agencies to sell their obligations to the FFB could create a problem. Programs such as the mortgage-backed securities program of the Government National Mortgage Association (GNMA) or the loan guarantees of the Export-Import Bank could be required to be financed through the FFB, thereby eliminating existing, and apparently viable, secondary markets. The authority to decide whether guaranteed loans should be converted to direct loans financed by the FFB would be granted to the Secretary of Treasury. Should the Secretary not waive the guarantee programs currently financed in securities markets, the conversion of guaranteed loans to direct loans would substantially increase combined on- and off-budget outlays. It is my understanding that the Committee staff has prepared technical amendments to H.R. 2868 that would avoid this problem.

CONCLUSION

The budgetary treatment of the Federal Financing Bank currently distorts the unified budget in several respects. Remedies are needed to make the unified budget more comprehensive and to improve the accountability of the budget by recording transactions in the appropriate places. Enactment of the Truth-in-Budgeting Act as amended would be a step in the right direction.

In closing Mr. Chairman, I would like to raise two related issues. First, although correcting the budgetary treatment of the FFB would improve the unified budget, that budget would still understate both direct federal loans (because it counts only net lending) and loan guarantees. To some extent, these shortcomings are addressed by the credit budget, which has been implemented on an experimental basis by the Budget Committees. Progress in further strengthening the enforcement of the credit budget will still be necessary even after the FFB is reformed.

Second, neither the unified budget nor the credit budget 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 its federal financing requirements, its impact in credit markets, or the amount of subsidy delivered. These complicated relationships need to be explored further and the relative costs defined before legislation is enacted that would change the basic concept of guarantees.