

Statement of
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before the
Special Subcommittee on Control of Federal Credit
Committee on the Budget
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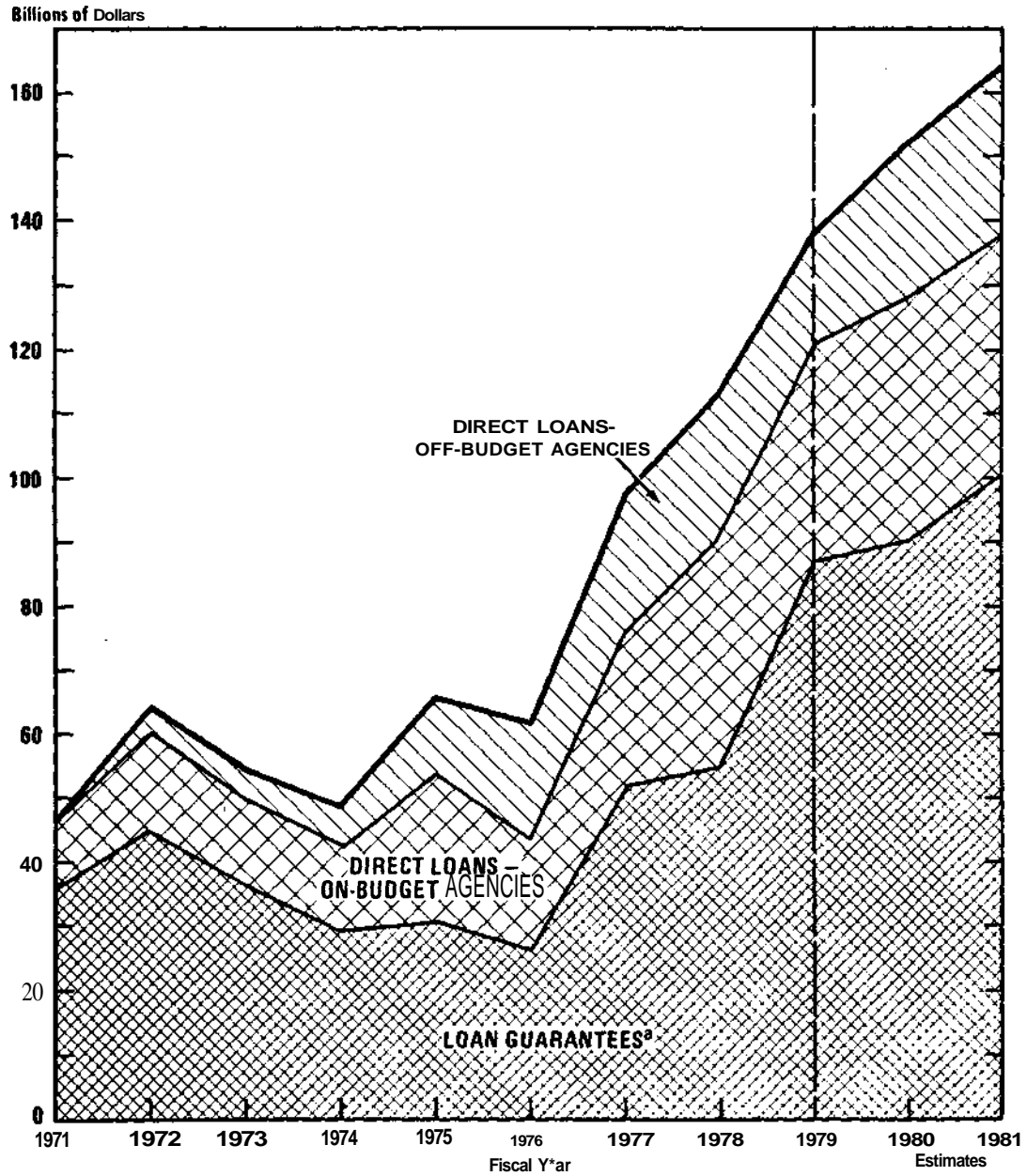
I am pleased to have the opportunity to discuss with this Subcommittee federal loans and loan guarantees and the budget process. As more attention has been focused on the growth of federal credit programs in recent years, it has become clear that current budget techniques, with their focus on direct spending and taxing, do not control credit program levels. The Administration's proposed credit budget and the aggregate targets for direct loans and loan guarantees contained in the First Concurrent Resolution on the Budget for Fiscal Year 1981 constitute, however, significant steps toward exercising greater and more systematic control over federal credit activities.

My statement this morning has three parts. First, it describes the growth of federal credit and the role that the budgetary treatment of credit programs may play in encouraging that growth. Second, it discusses the proposal to establish a credit budget within the Congressional budget process. Finally, it suggests what might be done to rationalize the budgetary treatment of the Federal Financing Bank (FFB) and the other off-budget credit programs.

Understanding the Growth of Federal Credit

Federal credit assistance, in the form of direct loans and loan guarantees or insurance, has grown rapidly in recent years. In fact, off-budget direct loans and loan guarantees by on- and **off-budget** agencies have grown more rapidly in recent years than have direct federal expenditures. In the four-year period from 1976 to 1979, expenditures increased by 35 percent. During that same period, new loans guaranteed increased 208 percent and new direct loans by **off-budget** entities posted an increase of 70 percent. Direct loans by on-budget agencies, on the other hand, increased only 31 percent. Figure 1 further illustrates the rapid growth of federal credit by showing the growth of total new commitments for direct loans and loan guarantees for the decade 1971-1981.

Figure 1.
Growth of Total New Commitments for Federal Credit, 1971-1981



SOURCE: Budget of the United States Government, Special Analysis on Credit, Fiscal Years 1973-1981.

^a Primary guarantees: excludes secondary guarantees and guaranteed loans acquired by on- and off-budget agencies.

One possible explanation for this growth of federal credit programs is their budgetary treatment. Since loan guarantees are excluded by statute from the definition of budget authority, they are effectively beyond the control of a budget process that focuses only on budget authority, outlays, and receipts. In addition, some direct loans are effectively hidden off budget because of two practices--sales of loan assets to the FFB and purchases by the FFB of guaranteed obligations.

Most of the growth in federal credit programs has occurred outside any Congressional control process or mechanism for allocating resources. This poses three problems. First, the year-to-year growth of most credit programs is largely uncontrolled. The programs are often authorized on an open-ended basis or have only a ceiling on total outstanding indebtedness that is set so high as to be no restraint at all on annual growth. As a result, the Congress has not attempted to ration loans or set priorities among the competing needs of borrowers seeking loans or loan guarantees from the federal government.

A second problem arising from the unrestrained growth of individual programs is that the Congress has not limited the total amount of credit extended by the federal government through loans and loan guarantees. In a period of restrained growth of the money supply, such as we have been through recently, growth in the total amount of credit provided through federal programs may well mean that borrowers not eligible for these programs who seek credit in the private market may not be able to obtain it, or may have to pay more for it through higher interest rates.

A third problem posed by the lack of a resource allocation process for credit programs is the potential for making inappropriate decisions. Loan guarantees, in particular, have been subject to inappropriate use. Because

they have no direct budget cost, they appear to be free. Several programs of capital development have been financed using loan guarantees. Three of these have encountered serious difficulties. Under the New Communities program, developers could seek guaranteed financing for site preparation of "new towns," and 13 guarantees were issued. All 13 projects proved unable to pay the debt servicing on their loans and had to be reorganized by the federal government, resulting in a \$90 million loss. Two transportation ventures--Amtrak and Washington's Metro--received guaranteed financing for capital construction. Neither has been able to meet the burden of servicing its debt, and during the last session the Congress had to consider bills to provide them with direct assistance so they could get out of financing difficulties.

Including Credit in the Budget Process

In August 1978, CBO issued Loan Guarantees: Current Concerns and Alternatives for Control, a background paper prepared at the request of the Senate Budget Committee. In that paper we described the use and growth of loan guarantee programs, concerns about the appropriateness of their use, and alternative methods for controlling them. After reviewing the alternatives, we recommended that the Congress include targets for direct loans and loan guarantees in its concurrent budget resolutions. We noted at the time that this was consistent with the outline of a proposed credit program control system included in the President's 1979 budget.

Subsequently, the notion of including federal credit programs within the outlines of the Congressional budget process, as established by the Congressional Budget Act of 1974, was further developed in both the Congress and the executive branch. The 1980 budget further discussed the

proposed credit program control system, whose development culminated in the credit budget included by the Administration in its 1981 budget. In the Congress, legislative proposals were developed that would amend the Congressional Budget Act of 1974 to expand the coverage of the concurrent budget resolutions and related procedures to federal loans and loan guarantees. These proposals--S. 2151, introduced by Senator Percy, and H.R. 5683 and H.R. 6021, introduced by Representatives Mineta, Giaimo, and others--are the subject of this Subcommittee's next hearing.

This spring the Budget Committees proposed, and the Congress adopted, aggregate targets for new direct loan obligations and new loan guarantee commitments. The Congress is thus experimenting with one aspect of a credit budget system: setting aggregate targets. As the Congress gains familiarity with, and experience in the analysis of, federal credit programs, the Budget Committees may wish to consider the extension of other aspects of the budget process to a credit budget. Among the procedures that could be made part of succeeding experiments are:

- o Setting aggregate ceilings in the second concurrent resolution, and enforcing these ceilings through the extension of the point-of-order provisions of Section 311 of the Budget Act;
- o Including functional targets for loans and guarantees in the first and second budget resolutions;
- o Applying a provision to "close the backdoor" on new loan and guarantee programs, such as Section 16 of the Senate's first resolution; and
- o Applying the May 15th deadline to bills authorizing loan or guarantee programs.

The experience gained by the Congress through experiments with these provisions would be invaluable if the Congress eventually decides on complete integration of a credit budget into the Congressional budget process.

While there are gaps in our knowledge about federal credit programs, we do not believe that these gaps pose insurmountable obstacles to the extension in the near future of the procedures of the Congressional Budget Act to federal credit programs. The Congressional Budget Office is ready to assist the Congress in achieving that goal. We have already taken steps to help close the gaps in our knowledge of federal credit programs. In addition to our 1978 study on loan guarantees, we issued in **January** 1979 a volume that contained four papers of a more technical nature. One paper compiled for the first time in one place the data on federal credit programs included in the special analyses on credit in the budgets from 1952 to 1979. Two other papers dealt with two complexities in the financing of federal credit programs: the budgetary treatment of loan asset sales and certificates of beneficial ownership, and the financial operations of the Federal Financing Bank. A final paper stemmed from concern about the impossibility of obtaining comparable and reliable data on defaults in loan guarantee and insurance programs. To assess the extent of this problem, we asked Peat, **Marwick**, Mitchell and Co. to survey the accounting and data collection practices of 22 major loan guarantee or insurance programs.

We have also taken steps to attempt to close the gaps in our knowledge of the economic **effects** of federal credit programs. This spring we conducted a two-day conference on the Economics of Federal Credit Activities. At the conference eight papers by prominent researchers were

presented to an audience of Congressional and executive branch staff people. While the conference was more helpful in defining exactly what we do not know than in breaking new ground, it has encouraged the academic community to begin studying in greater depth the entire federal credit universe.

CBO has also begun to include in its regular activities analyses of federal credit programs, and their impacts. This year, in addition to preparing our annual analysis of the **President's** budget, we prepared a separate analysis of the **President's** proposed credit budget. At present, we are making good progress in developing an automated system for tracking Congressional action on proposed limitations for loan and loan guarantee programs. We will soon present to the Budget Committees' staffs proposals for credit budget scorekeeping procedures and formats.

Rationalizing Off-Budget Credit Activities

In the final part of my statement this morning, I would like to urge that this Subcommittee, during its consideration of credit budgeting, take advantage of an opportunity to consider a related issue: the need to rationalize the budgetary treatment of **off-budget** credit activities.

The distinction between on- and off-budget credit activities is not one of substance. In fact, over 90 percent of the credit activity of off-budget entities is handled through the Federal Financing Bank (FFB) which, as I noted earlier, acts as an off-budget lender for on-budget agencies. By purchasing loans and certificates of beneficial ownership (pools of loans, called CBOs) from on-budget agencies, the FFB transfers on-budget loans off budget. The FFB also acts as a primary lender at the request of various on-budget federal agencies. If an agency guarantees the full repayment of

interest and principal in the event of default by a borrower, the FFB will make a direct loan to the borrower, at interest rates only marginally above the cost of Treasury borrowing.

The distinction between on- and off-budget credit programs is thus virtually **meaningless--except** with respect to the unified budget **deficit**. By using the FFB, agencies can initiate activities without having to pay for them out of their budgets. Although the Congress currently exercises no control over the timing or amounts of off-budget financing of direct loans by the FFB, it cannot escape the consequences of it. The ceilings on the public debt must be increased for each dollar of net lending by the FFB. Even with a balanced budget, the public debt ceiling will still have to be **increased--because of the FFB's off-budget lending**.

The Budget Committees have made a first step toward exercising greater control over the FFB and the other off-budget credit activities by including them in the aggregate totals and by proposing that limits be placed on them, as well as on all other credit programs. As a next step, the Committees may wish to consider legislation to rationalize the treatment of off-budget activities. Such legislation could have two parts. First, the treatment of transactions by **on-budget** agencies with the FFB could be changed to record in their budgets the direct loans made by the FFB on their behalf. This would effectively put all of the **FFB's** credit activities on budget in the respective agency budgets. This is preferable to simply putting the FFB itself on budget. If the FFB were put on budget as a separate item, the process of allocating resources by function could be distorted because the FFB serves no end purpose of its own. It simply finances agency activities. Efficiency in the allocation process requires that these activities be attributed to the proper functions. A second part of the legislation would be to put the remaining **off-budget** activities back into the budget, thereby making the unified budget comprehensive of all federal activities.

SUMMARY

In summary, the Congress, by adopting aggregate targets for direct loans and loan guarantees, has taken a significant step forward toward a credit budget and a credit program control system. The CBO is ready to assist the Budget Committees in extending the procedures of the Congressional Budget Act of 1974. In addition, we urge that the Committees take this opportunity to consider rationalizing the off-budget agency dilemma.

This concludes my prepared statement. I will be happy to answer questions from the Members of the Subcommittee.