STATEMENT OF

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Mr. Chairman, I am pleased to appear before this Task Force as you review the revised 1982 and 1983 credit budgets. The Congressional Budget Office (CBO), at your request and that of the Senate Committee on the Budget, has prepared an overview of the President's 1983 credit budget. This report is being released today. My statement this morning will cover three major topics:

- o Review of the importance of a credit budget;
- o The President's revised 1982 and 1983 credit budgets; and
- o Alternative approaches the Congress could use to reduce federal credit.

BACKGROUND

The development of the credit budget was prompted by three concerns:

- o Federal credit grew rapidly during the 1970s.
- o Federal credit activities may have important economic consequences through their impact on credit markets.
- o The budgetary treatment of credit programs has traditionally been less rigorous than that of direct spending.

The credit budget, which records new direct loans and new loan guarantees for each fiscal year, also attempts to correct for the understatement of the size of federal credit activities in the unified budget. In 1981 the federal government obligated $57 billion in new direct loans and committed $76 billion in new loan guarantees. Yet net on-budget direct lending, the only portion of the credit budget included in the unified budget, amounted to only $5 billion. The unified budget understates the amount of new federal credit extended each year in three respects; the credit budget corrects for this understatement in each case, as follows:

- o Direct loans by off-budget agencies are excluded by law from unified budget totals. All direct loans are recorded in the credit budget.
- o Loan guarantees are excluded by law from the budget totals, except in the event of default. They are fully counted in the credit budget.
- o The unified budget records net loan disbursements. The credit budget records gross new credit activities.

The understatement in the unified budget has fostered the perception of federal credit as an almost costless form of federal assistance. The credit budget is designed to correct this perception by recording the total volume of new credit activities. Through the imposition of limitations on the authority of federal agencies to enter into new obligations for direct loans and new commitments for loan guarantees, the credit budget also enhances Congressional control of individual credit programs.

THE PRESIDENT'S REVISED 1982 AND 1983 CREDIT BUDGETS

The Administration's credit budget for 1983 continues the efforts initiated with its 1982 budget to reduce federal credit activities as a means of reducing federal presence in credit markets. Table 1 displays the credit budget aggregates for the 1981 actual direct loan obligations and loan guarantee commitments, the 1982 base, and the Administration's proposals for 1982 and 1983. The 1982 base figures are the estimates for the credit budget used by the 97th Congress in its first session.

TABLE 1. TOTAL CREDIT BUDGET (By fiscal year, in billions of dollars)

Credit Activity	1981 Actual	1982 Base a/	Administration Estimates 1982	Administration Estimates 1983
Direct Loan Obligations				
On-budget	40.9	42.7	39.9	31.8
Off-budget	31.5	31.3	29.6	25.5
Gross Direct Loan Obligations	72.4	73.9	69.5	57.3
Less FFB sales of loan assets	-15.2	-13.5	-13.2	-8.3
New Direct Loan Obligations	57.2	60.5	56.4	49.0
New Loan Guarantee Commitments	152.7	205.7	166.1	161.4
Less				
Secondary loan guarantees	-44.1	-68.8	-48.7	-38.4
Guaranteed loans held as direct loans				
FFB	-30.3	-30.0	-28.5	-24.7
GNMA	-1.8	-2.0	-1.9	---
New Primary Guarantees	76.5	104.9	87.1	98.4
Credit Budget Total	133.7	165.4	143.4	147.3

SOURCES: The Administration estimates are taken from the Budget of the U.S. Government, Fiscal Year 1983, Part 3, p. 3-24; 1982 base figures are taken from CBO's Credit Budget Scorekeeping System.

a/ Adjusted to reflect full principal for loan guarantees rather than contingent liability, an increase of $17.1 billion in primary guarantees.

Revised 1982 Credit Budget

Last September, the Administration announced its intention to reduce the credit budget to restrain federal credit demands and reduce interest rate pressures. In November, the Administration released details of $20.3 billion in cuts for 1982 loan guarantee programs. The Administration's revised 1982 request, included in the February budget, incorporates most of those cuts. It proposes reductions of $4.1 billion in direct loans, $17.8 billion in primary loan guarantees, and $20.1 billion in secondary loan guarantees.

Most of the reductions in the 1982 credit budget reflect the Administration's reestimates of program requirements. The largest direct loan cut involves the National Credit Union Administration's Central Liquidity Facility, for which the previous estimate was far in excess of program requirements. The actual demand for loans by credit unions is expected to be $330 million rather than $3.6 billion. The largest loan guarantee adjustments are in Federal Housing Administration (FHA) and Veterans Administration (VA) housing programs, both of which show significant reductions because of the economic conditions in the housing market and the resulting decline in demand from qualified borrowers. Together, these reductions amount to $17.1 billion. The elimination of all loan guarantees for the Synthetic Fuels Corporation is based on an Administration policy decision that all projects will be supported through price guarantees rather than credit assistance. Small Business Administration (SBA) surety bond guarantees are also eliminated, based on a change in definitions. The Administration no longer views surety bond guarantees, which are primarily used to guarantee the performance of construction contractors, as credit assistance. While the government does assume a contingent liability, surety bond guarantees are not guarantees of loans and do not directly involve the allocation of credit.

The only sizable increase in the Administration's revised 1982 credit budget is $2.5 billion for the guaranteed student loan program, raising its level to $9.5 billion.

The Administration has proposed new appropriations limitations whenever the 1982 revised credit total requests are lower than the currently authorized direct loan obligations and loan guarantee commitments--established either in appropriations limitations or in authorizations for the programs. The largest decrease is the proposed $20.2 billion cut in the appropriations limit for the Government National Mortgage Association (GNMA) mortgage-backed securities, a secondary guarantee program. Reductions in appropriated limits are also requested for both the direct loans and loan guarantees of the International Trade Administration, loan guarantees of the Rural Electrification Administration (REA), and aircraft purchase loan guarantees. The limitations proposed for the Economic Development Administration (EDA) and the SBA would restrict authorizations rather than revise previously enacted appropriations limitations.

1983 Credit Budget

The Administration's 1983 credit budget proposes $49.0 billion in new direct loan obligations, $98.4 billion in new primary loan guarantee commitments, and $38.4 billion in secondary loan guarantee commitments. The 1983 request for direct loans is 19 percent below the 1982 base level; for primary loan guarantees, 6 percent lower; and for secondary guarantees, 44 percent lower.

The 1983 proposals also represent further cuts from the revised 1982 budget in most budget functions. The major changes for direct loan programs are reductions in the Farmers Home Administration's (FmHA) rural housing and rural development programs and elimination of SBA direct loans to businesses. The Administration also eliminates direct loans for the Commodity Credit Corporation (CCC) programs of short- and medium-term export loans. (No CCC direct loans for exports were obligated in 1981 or 1982, but a $2 billion limitation was enacted for 1982.)

The Administration has requested no direct loan obligations or loan guarantee commitments for a number of other credit programs. For example, no obligations are proposed for the GNMA tandem plan program, a reduction of $2 billion, or for direct student loans, a reduction of $287 million. Total reductions from termination of funding amount to direct loan savings from the 1982 base of $1.4 billion in 1982 and $3.6 billion in 1983. The loan guarantee savings from the 1982 base are estimated to be $3.3 billion in 1982 and $4.4 billion in 1983.

The major increases in loan guarantee commitments are for VA and FHA mortgage guarantees and low-income public housing. The VA and FHA increases reflect anticipated higher demand for housing, rather than a policy change. The increase in low-income housing guarantees results from the assumed refinancing of existing short-term bonds and notes already outstanding to finance public housing projects. It does not reflect new federal investment in low-income public housing.

In developing the revised 1982 and 1983 credit budgets, the Budget Committees could adopt the Administration's reestimates for programs that are not limited by appropriations, as was done in 1981 and 1982. These unlimited programs are mainly entitlements or other mandatory programs or financing transactions such as the loan asset sales and guaranteed loans originated by the Federal Financing Bank. Direct loans disbursed to cover defaulted loan guarantees are also exempted from limitation. The reason for using the Administration's estimates for these activities is that they are not controlled by the Congress, but are either open ended (for example, VA mortgages) or subject only to administrative discretion.

The Administration's 1982 credit budget revisions also contain reestimates based on economic conditions for some programs that are limited by appropriations. The 1982 limitation for FHA mortgages, for example, was set at $40 billion. The current estimate for the program is $28 billion, a reduction of $12 billion, caused by the lack of qualified borrowers in the current housing market.

ALTERNATIVE APPROACHES

The large deficits projected for the unified budget during the next several years will put upward pressure on market interest rates. Although we are unable to estimate the magnitude of the effects of federal credit on interest rates, it is apparent that a higher level of federal credit activity adds to that pressure. The Congress may wish, therefore, to consider ways of reducing federal credit demands, especially if those cutbacks can be used to enhance the efficiency of remaining credit programs. I would suggest three strategies consistent with an efficient reduction in federal credit:

- Eliminate credit programs in which federal credit duplicates private credit.
- End interest subsidies entirely for some programs by raising interest rates to market levels. If the Congress desires to subsidize certain activities, it may prefer to do so with direct grants.

- o Restrict eligibility and loan terms to make the existing programs more cost-effective.

Credit Duplication

A number of current federal credit programs may duplicate private sector lending. For instance, FHA mortgage insurance was originally designed to correct a gap in private credit markets by extending credit in a form not supplied by private lenders. Until the recent rise in interest rates, the housing market had accepted the long-term, low downpayment mortgage that the FHA pioneered. If patterns of current interest rates do not continue into the future, this program may no longer be needed.

The Rural Electrification Administration (REA) was also designed to meet an earlier credit market gap that may no longer exist--the inability of rural utilities to raise capital to extend electricity to remote areas. Now that almost all homes and businesses have access to electricity, the capital needs of rural utilities may be similar to those of other utilities. Since REA lending is heavily subsidized, however, these utilities would face higher interest costs. Eliminating REA-guaranteed lending programs would reduce federal intervention in credit markets by $5.5 billion in 1983.

The Synthetic Fuels Corporation is an example of a fairly new program planned to override private financial market decisions. Under current policy, synfuel loan guarantees could be extended to oil companies that might not need subsidized credit. Moreover, the increased price of oil resulting from decontrol has improved the competitiveness of synfuels, providing incentives for energy companies to make synfuels investments without a subsidy. The Administration has proposed to shift from synfuel loan guarantees to price guarantees, a change that reduces the credit budget by $2 billion in 1982, but may result in substantial uncontrolled outlays in the future.

Eliminate or Reduce Interest Subsidies

The Office of Management and Budget (OMB) currently estimates that the present value of explicit interest subsidies to the borrowers from 1983 federal credit extensions will be $14 billion. The total subsidy amount is even higher since the government lends to riskier borrowers and projects than those financed by private markets. The Congress should consider whether such large subsidies are required. Reducing interest subsidies would not only lower direct spending but could also reduce demand for federal loans.

Some examples of current interest subsidies for federal credit programs are:

- The Economic Support Fund lends to foreign countries at an average interest rate of 2.8 percent and with an average term of 32 years;
- Direct loans for rural housing are made at an average rate of 3.6 percent for a 37-year term;
- Loans are made to rural electric cooperatives at an average rate of 4.7 percent for a 35-year term; and
- The Bonneville Power Administration is being charged 1.3 percent for a 19-year loan.

These and other examples appear in the following table.

Interest Subsidies for Federal Credit Programs

Program	Average Current Interest Rate (percents)	Average Term (years)	Present Value of Loans Extended in 1983 ($ in millions) a/
Economic Support Fund	2.8	32.2	651
Foreign Military Sales Credit	12.0	8.0	278
Agricultural Credit	9.0	7.0	1,822
Rural Housing	3.6	37.2	2,644
Rural Electric and Telephone	4.7	35.0	461
Bonneville Power Administration	1.3	19.5	42
Export-Import Bank	10.5	11.0	1,275
Guaranteed Student Loans	9.0	12.0	3,401

SOURCE: Office of Management and Budget.

a/ The interest subsidy is the difference between the interest payments at current rates and the payments that would be required at market rates, converted to a single discounted present value.

Revise Eligibility Criteria and Loan Terms

If the Congress wished to continue to provide subsidized credit for certain activities, it might choose to target assistance more narrowly. Stricter focusing of eligibility requirements and tightening of loan terms could make existing programs more cost-effective by directing subsidies to those in need of assistance without aiding potential borrowers who have an unduly high risk of default.

Tighter eligibility rules would lead to a smaller number of loans with little diminution in program effectiveness. For example, the government could limit the Aircraft Purchase Loan Guarantee Program to airlines serving small communities. By directing loan guarantees to commuter carriers that generally serve communities of less than 5,000 persons and through stipulations on appropriate aircraft size, the current $650 million ceiling on loan guarantees could be reduced. (The Administration has recommended eliminating this program.)

The Food for Peace (Public Law 480) credit sales could be limited to countries in which the United States has a strong foreign policy interest or which are experiencing food shortages. The present program frequently provides funds to countries that do not need the commodities urgently but purchase them because of the large subsidy. Similarly, loan terms for foreign military sales and economic support loans to middle-income countries could be revised. The loan terms for economic and military aid to U.S. allies are now designed to meet the needs of the poorest nations. But setting lower standards to help these countries also permits such lending to wealthier countries that could borrow at higher interest and shorter maturities.

CONCLUDING COMMENTS

CBO continues to support enactment of the Federal Lending Oversight and Control Act, introduced by the Chairman and ranking minority member of this Task Force. Pending enactment of this legislation, we would encourage the Committee and the Congress to consider enacting binding ceilings for the federal credit budget for 1983. CBO is prepared to scorekeep Congressional action on the credit budget.

We would also encourage the Committee to include language in its budget resolution similar to the "Levin Amendment" to the continuing resolution. As you know, that language established credit limitations as mandatory program levels except in programs lacking sufficient qualified borrowers. A provision is needed to ensure that Congressional intent, as established in its credit budget, is not circumvented. CBO is prepared to support the Budget Committees in implementing the credit budget.