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PARTICIPATION SALES ACT OF 1966

GOVERNMENT

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HEARINGS BEFORE THE COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

EIGHTY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 14544, and S. 3283

BILLS TO PROMOTE PRIVATE FINANCING OF CREDIT
NEEDS AND TO PROVIDE FOR AN EFFICIENT AND
ORDERLY METHOD OF LIQUIDATING FINANCIAL
ASSETS HELD BY FEDERAL CREDIT AGENCIES, AND
FOR OTHER PURPOSES

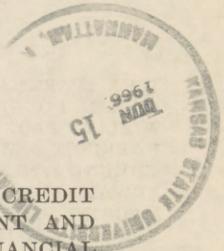
APRIL 26 AND 28, 1966

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PARTICIPATION SALES ACT OF 1966

TUESDAY, APRIL 26, 1966

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 5302, New Senate Office Building, Senator A. Willis Robertson presiding.

Present: Senators Robertson, Sparkman, Douglas, Proxmire, Muskie, and Bennett.

The CHAIRMAN. The committee will please come to order.

I called a meeting of the full committee this morning to hear testimony concerning a bill relating to the sale of participation certificates secured by agency loans reported by the House Banking and Currency Committee. It is pending on the House side, and the House is expected to act on the bill one day this week.

We have passed a bill which would authorize the Small Business Administration to sell these participation certificates, S. 2499, but the Administration would like to have that enlarged to include at least four other agencies, and that is in the House bill.

So, at the request of the White House, I have called this more or less emergency meeting of our committee. The Appropriations Committee had previously scheduled a number of hearings for this morning, other committees have hearings scheduled, and it is just impossible for Members of the Senate to be in two places at once.

So we couldn't get a full attendance here because members of the committee who had bills up that were actually pending thought that they would have plenty of time to reach these hearings after the House had sent the bill over to us and we had further hearings on it.

We are pleased to have with us this morning the Under Secretary of the Treasury, Mr. Barr. In fact he is now the Acting Secretary, because I understand that the Secretary is in some foreign country at the present time.

We also have the Director of the Budget.

So, gentlemen, you may proceed, each one of you taking such time as you see fit, and then we may be asking you some questions.

(A copy of the bill, H.R. 14544, as reported, follows:)

Union Calendar No. 629

89TH CONGRESS
2D SESSION**H. R. 14544**

[Report No. 1448]

IN THE HOUSE OF REPRESENTATIVES

APRIL 20, 1966

Mr. PATMAN introduced the following bill; which was referred to the Committee on Banking and Currency

APRIL 25, 1966

Reported with amendments, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

A BILL

To promote private financing of credit needs and to provide for an efficient and orderly method of liquidating financial assets held by Federal credit agencies, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 That this Act may be cited as the "Participation Sales Act
4 of 1966".

5 SEC. 2. (a) Section 302(c) of the Federal National
6 Mortgage Association Charter Act is amended—

I

2

1 (1) by inserting "(1)" immediately following
2 " (c) ";

3 (2) by inserting after "undertakings and activities"
4 a comma and "hereinafter in this subsection called
5 'trusts,'";

6 (3) by striking out the words "offered to it by
7 the Housing and Home Finance Agency or its Admin-
8 istrator, or by such Agency's constituent units or
9 agencies or the heads thereof, or any first mortgages in
10 which the United States or any agency" in the first
11 sentence thereof and by inserting "and other types of
12 securities, including any instrument commonly known
13 as a security, hereinafter in this subsection called 'obliga-
14 tions,' in which the United States or any executive
15 department, agency,";

16 (4) by striking out the third sentence thereof and
17 substituting therefor the following: "Participations or
18 other instruments issued by the Association pursuant
19 to this subsection shall to the same extent as securities
20 which are direct obligations of or obligations guaranteed
21 as to principal or interest by the United States be
22 deemed to be exempt securities within the meaning of
23 laws administered by the Securities and Exchange Com-
24 mission."; and

25 (5) by striking out the fourth sentence thereof.

3

1 (b) Section 302 (c) of such Act is further amended by
2 adding the following:

3 “(2) ~~Notwithstanding any other provision of law,~~
4 *Subject to the limitations provided in paragraph (4) of this*
5 *subsection, the head of any executive department, agency,*
6 *or instrumentality of the United States, hereinafter in this*
7 *subsection called the “trustor”, is authorized to set aside a*
8 *part or all of any obligations held by him and subject them to*
9 *a trust or trusts and, incident thereto, may shall guarantee*
10 *to the trustee timely payment thereof. The trust instru-*
11 *ment may provide for the issuance and sale of beneficial in-*
12 *terests or participations, by the trustee, in such obligations or*
13 *in the right to receive interest and principal collections there-*
14 *from; and may provide for the substitution or withdrawal of*
15 *such obligations; or for the substitution of cash for obliga-*
16 *tions. The trust or trusts shall be exempt from all taxation.*
17 *The trust instrument may also contain other appropriate pro-*
18 *visions in keeping with the purposes of this subsection. Not-*
19 ~~withstanding any other provision of law, the~~ *The Association*
20 *may be named and may act as trustee of any such trusts and,*
21 *for the purposes thereof, the title to such obligations shall*
22 *be deemed to have passed to the Association in trust: Pro-*
23 ~~vided, That the~~ *. The trust instrument shall provide that*
24 *custody, control, and administration of the obligations shall*
25 *remain in the trustor subjecting the obligations to the trust,*

4

1 subject to transfer to the trustee in event of default or prob-
2 able default, as determined by the trustee, in the payment of
3 principal and interest of the beneficial interests or participa-
4 tions. Collections from obligations subject to the trust shall
5 be dealt with as provided in the instrument creating the trust.
6 The trust instrument shall provide that the trustee will
7 promptly pay to the trustor the full net proceeds of any sale
8 of beneficial interests or participations to the extent they are
9 based upon such obligations or collections. Such proceeds
10 shall be dealt with as otherwise provided by law for sales or
11 repayment of such obligations. The effect of both past and
12 future sales of any issue of beneficial interests or participa-
13 tions shall be the same, to the extent of the principal of such
14 issue, as the direct sale of the obligations subject to the trust.
15 Any trustor creating a trust or trusts hereunder is authorized
16 to purchase, through the facilities of the trustee, outstanding
17 beneficial interests or participations to the extent of the
18 amount of his responsibility to the trustee on beneficial in-
19 terests or participations outstanding, and to pay his proper
20 share of the costs and expenses incurred by the Federal Na-
21 tional Mortgage Association as trustee pursuant to the trust
22 instrument, and for these purposes may use any appropriated
23 funds or other amounts available to him for the general pur-
24 poses or programs to which the obligations subjected to the
25 trust are related.

1 “(3) ~~If~~ *When* any trustor shall guarantee *guarantees*
2 to the trustee the timely payment of obligations he subjects
3 to a trust pursuant to this subsection, and it becomes neces-
4 sary for such trustor to meet his responsibilities under such
5 guaranty, he is authorized to fulfill such guaranty by using
6 any appropriated funds or other amounts available to him for
7 the general purposes or programs to which the obligations
8 subjected to the trust are related.

9 “(4) ~~The Association, as trustee, is authorized to issue~~
10 ~~and sell beneficial interests or participations under this sub-~~
11 ~~section, notwithstanding that aggregate receipts from obli-~~
12 ~~gations subject to the related trust are or may become insuf-~~
13 ~~ficient in amount to provide for the payment by the trustee~~
14 ~~(on a timely basis out of current receipts or otherwise) of~~
15 ~~all interest or principal on such interests or participations~~
16 ~~(after provision for all costs and expenses incurred by the~~
17 ~~trustee, fairly prorated among trustors): *Provided*, That no~~
18 ~~such beneficial interests or participations shall be issued in~~
19 ~~relation to any obligations unless the trustee determines there~~
20 ~~is a reasonable probability there will not be an insufficiency~~
21 ~~as aforesaid, or unless the amounts issued are within aggreg-~~
22 ~~ate principal amounts authorized in advance in appropri-~~
23 ~~ation Acts, and it shall be in order to include provisions~~
24 ~~authorizing such issuance in an appropriation Act. *When*~~

6

1 ever such an aggregate principal amount is so authorized,
2 there shall be established on the books of the Treasury as
3 indefinite appropriations such sums as may be necessary from
4 time to time to enable the trustor to pay the trustee such
5 insufficiency as the trustee may require on account of out-
6 standing beneficial interests or participations, and such trustor
7 shall make timely payments to the trustee from such appro-
8 priations, subject to and in accord with the trust instrument."

9 “(4) Beneficial interests or participations shall not be
10 issued for the account of any trustor in an aggregate
11 principal amount greater than is authorized with respect
12 to such trustor in an appropriation Act. Any such author-
13 ization shall remain available until used.

14 “(5) The Association, as trustee, is authorized to issue
15 and sell beneficial interests or participations under this sub-
16 section, notwithstanding that there may be an insufficiency
17 in aggregate receipts from obligations subject to the related
18 trust to provide for the payment by the trustee (on a timely
19 basis out of current receipts or otherwise) of all interest or
20 principal on such interests or participations (after pro-
21 vision for all costs and expenses incurred by the trustee,
22 fairly prorated among trustors). Whenever the issuance of
23 an aggregate principal amount is authorized pursuant to par-
24 agraph (4) of this subsection, such an authorization in an
25 appropriation act shall establish on the books of the Treasury

1 *as appropriations such sums as may be necessary from time*
2 *to time to enable the trustor to pay the trustee such insuffi-*
3 *ciency as the trustee may require on account of outstanding*
4 *beneficial interests or participations. Such trustor shall make*
5 *timely payments to the trustee from such appropriations,*
6 *subject to and in accord with the trust instrument."*

7 SEC. 3. (a) Section 305 (c) of the Federal National
8 Mortgage Association Charter Act is amended by deleting
9 "by \$450,000,000 on July 1, 1966,"

10 (b) Section 401 (d) of the Housing Act of 1950 is
11 amended by deleting "1968:" immediately preceding the
12 first proviso and by substituting therefor "1965, and 1967
13 and 1968:".

14 SEC. 4. (a) Section 303 (c) of title III of the Higher
15 Education Facilities Act of 1963 is amended by striking out
16 the first nine words in the second sentence and substituting
17 therefor the following: "For the purpose of making pay-
18 ments into the fund established under section 305".

19 (b) Title III of the Higher Education Facilities Act of
20 1963 is further amended by adding after section 304 the fol-
21 lowing new section:

22 "REVOLVING LOAN FUND

23 "SEC. 305. (a) There is hereby created within the
24 Treasury a separate fund for higher education academic facili-
25 ties loans (hereafter in this section called "the fund") which

1 shall be available to the Commissioner without fiscal year
2 limitation as a revolving fund for the purposes of this title.
3 The total of any loans made from the fund in any fiscal year
4 shall not exceed limitations specified in appropriation Acts.

5 “(b) (1) The Commissioner is authorized to transfer to
6 the fund available appropriations provided under section
7 303 (c) to provide capital for the fund. All amounts re-
8 ceived by the Commissioner as interest payments or repay-
9 ments of principal on loans, and any other moneys, property,
10 or assets derived by him from his operations in connection
11 with this title, including any moneys derived directly or in-
12 directly from the sale of assets, or beneficial interests or par-
13 ticipations in assets, of the fund, shall be deposited in the
14 fund.

15 “(2) All loans, expenses, and payments pursuant to
16 operations of the Commissioner under this title shall be paid
17 from the fund, including (but not limited to) expenses and
18 payments of the Commissioner in connection with sale,
19 under section 302 (c) of the Federal National Mortgage
20 Association Charter Act, of participations in obligations ac-
21 quired under this title. From time to time, and at least at
22 the close of each fiscal year, the Commissioner shall pay
23 from the fund into the Treasury as miscellaneous receipts
24 interest on the cumulative amount of appropriations paid out
25 for loans under this title or available as capital to the fund,

9

1 less the average undisbursed cash balance in the fund during
2 the year. The rate of such interest shall be determined by
3 the Secretary of the Treasury, taking into consideration the
4 average market yield during the month preceding each fiscal
5 year on outstanding Treasury obligations of maturity com-
6 parable to the average maturity of loans made from the fund.
7 Interest payments may be deferred with the approval of the
8 Secretary of the Treasury, but any interest payments so
9 deferred shall themselves bear interest. If at any time the
10 Commissioner determines that moneys in the fund exceed
11 the present and any reasonably prospective future require-
12 ments of the fund, such excess may be transferred to the
13 general fund of the Treasury.”

14 SEC. 5. Section 338 (c) of the Consolidated Farmers
15 Home Administration Act of 1961 is amended by striking
16 in the second sentence “and (8)” and inserting in lieu
17 thereof “(8) section 8 of the Watershed Protection and
18 Flood Prevention Act, as amended (16 U.S.C. 1006a);
19 (9) section 32 (e) of the Bankhead-Jones Farm Tenant
20 Act, as amended (7 U.S.C. 1011); and (10)”; and by
21 inserting in the fifth sentence after “title,” the following:
22 “section 8 of the Watershed Protection and Flood Prevention
23 Act, as amended, and section 32 (e) of the Bankhead-Jones
24 Farm Tenant Act, as amended,”.

25 SEC. 6. Nothing in this Act shall be construed to repeal

10

1 or modify the provisions of section 1820 (e) of title 38,
2 United States Code, respecting the authority of the Admin-
3 istrator of Veterans' Affairs.

4 *SEC. 7. Paragraph (7) of section 8 of the Federal*
5 *Credit Union Act (12 U.S.C. 1757) is amended to read:*

6 *“(7) to invest its funds (A) in loans exclusively to*
7 *members; (B) in obligations of the United States of*
8 *America, or securities fully guaranteed as to principal*
9 *and interest thereby; (C) in accordance with rules and*
10 *regulations prescribed by the Director, in loans to other*
11 *credit unions in the total amount not exceeding 25 per*
12 *centum of its paid-in and unimpaired capital and sur-*
13 *plus; (D) in shares or accounts of savings and loan*
14 *associations, the accounts of which are insured by the*
15 *Federal Savings and Loan Insurance Corporation; (E)*
16 *in obligations issued by banks for cooperatives, Federal*
17 *land banks, Federal intermediate credit banks, Federal*
18 *home loan banks, the Federal Home Loan Bank Board,*
19 *or any corporation designated in section 101 of the*
20 *Government Corporation Control Act as a wholly owned*
21 *Government corporation; or in obligations, participations,*
22 *or other instruments of or issued by, or fully guaranteed*
23 *as to principal and interest by, the Federal National*
24 *Mortgage Association; or (F) in participation certifi-*
25 *cates evidencing beneficial interests in obligations, or in*

1 *the right to receive interest and principal collections there-*
2 *from, which obligations have been subjected by one or*
3 *more Government agencies to a trust or trusts for which*
4 *any executive department, agency, or instrumentality of*
5 *the United States (or the head thereof) has been named*
6 *to act as trustee;”*

7 *SEC. 8. The Secretary of the Treasury, in consultation*
8 *with heads of agencies of the United States carrying on*
9 *direct loan programs, shall conduct a study, in such manner*
10 *as he shall determine, on the feasibility, advantages, and*
11 *disadvantages of direct loan programs compared to guaran-*
12 *teed or insured loan programs and shall report his findings*
13 *together with specific legislative proposals to the Congress*
14 *not later than six months after the effective date of this Act.*
15 *There are authorized to be appropriated such sums as*
16 *necessary for the purpose of this section.*

STATEMENT OF JOSEPH W. BARR, UNDER SECRETARY OF THE TREASURY

Mr. BARR. Mr. Chairman and members of the committee, I am very glad to appear before you this morning to support prompt passage of the Participation Sales Act of 1966. This bill would provide an efficient and orderly method for liquidating financial assets held by Federal credit agencies and would help to promote private financing of Federal credit programs.

This legislation would extend a technique that has been carefully tested and has proved its value to the Nation. There is nothing essentially new or unusual in what we are proposing.

Under authority provided in 1964, the Federal National Mortgage Association, as trustee, has already sold \$1.6 billion of certificates of participation in pools of assets set aside by the Veterans' Administration, and by FNMA itself under its special assistance and management and liquidating functions.

The Participation Sales Act of 1966 would simply broaden and make available on a governmentwide basis this same authority for the sale of participations in pools of financial assets owned by Federal credit agencies.

Our objective is to limit and to reduce the Government's portfolio of direct loans by substituting private for public credit.

We cannot justify immobilizing the dollars of the taxpayer by holding larger and larger amounts of loans when the private credit markets can and want to participate with us in our credit programs.

In 1961, our loan portfolio stood at \$25.1 billion. By June 30, 1965, it had increased to \$33.1 billion.

The program of asset sales in which we have engaged during fiscal year 1966 and the program that is proposed in the President's Budget Message for fiscal year 1967, will reduce this total to \$31.5 billion on June 30, 1967.

Without the fiscal year 1966 action and the program proposed in the budget, the portfolio total would approach \$39 billion on June 30, 1967. This kind of growth in neither desirable nor necessary.

It is undesirable because it is the essential business of Government to help stimulate and encourage worthwhile credit programs, but not to be the final lender holding an ever-rising portfolio.

It is unnecessary because the Participation Sales Act of 1966 offers an attractive alternative in the form of substituting private for public credit.

The substitution of private for public credit has been a continuing objective of the Congress and successive administrations for more than a decade.

It is a recurring theme in President Eisenhower's budget messages in 1954, 1955, 1956, and 1958.

Encouraging the flow of private credit was strongly supported in the 1961 Report of the Commission on Money and Credit and in the 1964 Report of President Kennedy's Committee on Federal Credit Programs.

Expansion of the asset sales program was urged in 1963 in a minority report of the House Ways and Means Committee on H.R. 6009 on providing temporary increases in the public debt limit, from which I quote the following passages, which I think are most interesting:

The administration also can always reduce its borrowing requirements by additional sales of marketable Government assets. * * *

For example, when the Secretary of the Treasury was before the committee on February 27, we suggested that it was incumbent upon the administration to show "good faith" before coming to the Congress for an additional increase in borrowing authority. We pointed out that the Government held about \$30 billion in loans, many of which were readily marketable. In fact, there was a very good market for many of these loans. Instead of increasing its offering of these loans to private lenders, the administration was then acting on the supposition that the Congress would automatically accede to a request for an increase in its borrowing authority.

By "its," I suppose they mean the Treasury's borrowing authority.

Our refusal to grant the administration's request last February produced "results." In the interim of less than 2 months the administration found that it could increase revenues from the sale of loans by an additional \$1 billion for fiscal 1963. Now, the administration estimates that it will realize \$2.082 billion—as contrasted with an original estimate of only \$0.929 billion less than 2 months ago.

Before I outline the procedures which would be followed under the bill, let me mention two amendments proposed by the House committee in which we concur.

First, the House committee proposed, and we agreed, that it would be desirable to amend the bill to provide that no sale of participation certificates on behalf of any agency could be undertaken without prior authorization in an appropriations act.

As originally drafted, the bill provided that prior authorization in an appropriations act for the sale of participation certificates would be required only if the assets pooled by the agency bore interest rates below the rate at which the participation certificates could be sold in the market.

It was our intention that the Appropriations Committees should consider any sale of participations where they would be need for appropriations to cover expenditures or interest deficiencies.

We were pleased to accede to this amendment—proposed by the minority side in the House committee—which will have the effect of strengthening congressional control over all of these credit programs.

Second, we agreed to a change which would require—rather than simply authorize—an agency to guarantee its pooled obligations to FNMA.

We believed that circumstances could arise, for example, in connection with insured FHA loans, in which a further guarantee to FNMA, as trustee, would not be necessary.

But we are glad to accept the amendment, since its intent is identical to our own, which is to protect FNMA, both in its trust and corporate character, and to place the first responsibility where it belongs—on the lending agency, and ultimately on an appropriation act of the Congress of the United States.

I would like to sketch for you the procedure which would be followed under this bill:

When authorized in appropriation acts, each lending agency could enter into a trust agreement with FNMA, under which it would set aside on its books certain of its loans and subject them to a trust. It would be required, for purposes of the trust, to guarantee the loans, including timely payment of principal and interest. The bill would permit the substitution of other loans in the event of default or likely default on any of the loans subjected to the trust agreement. In fulfilling its guarantee, the lending agency would be authorized to use any appropriated funds or other funds available for the general purposes of programs related to the entrusted obligations.

FNMA would then—up to the maximum amounts authorized for each agency—issue and sell participations based on the pooled obligations and on the right to receive principal and interest collections from those obligations. FNMA would also, in its corporate capacity, guarantee all payments due on the participation certificates sold. For the purpose of making timely debt service payments, FNMA would be authorized to borrow from the Treasury under the procedures provided in subsection (d) of section 306 of the Federal National Mortgage Association Charter Act.

Because of the right of substitution and the lending agency's guarantee, which in turn runs to an appropriations act of the Congress, it is not anticipated that either the FNMA guarantee or the Treasury borrowing authority would have to be used. These additional safeguards, however, would help to assure the most favorable market reception for the participation certificates and minimize the interest rates at which they could be sold.

Proceeds of the participation certificates sold would be paid over to the lending agency. They would become available for new loans only to the extent that repayments of the underlying obligations can be used for new loans under existing law and under present congressional controls.

I would like to emphasize that point. These payments can be used only for new loans under existing law and congressional controls.

If the loans pooled by the lending agency, pursuant to an authorization in an appropriation act, included obligations bearing submarket interest rates, an appropriation act would be authorized to enable the lending agency to pay FNMA the amount of any deficiency in the interest earned on the pooled obligations. The amount would be the difference between the interest paid by the borrowers and the interest payable on the participation certificates. If this payment was not made in timely fashion, FNMA, as part of its guarantee of timely payment on the participation certificates, would itself pay the amount of the deficiency—and would then be reimbursed by the agency with interest, when funds became available.

While title to the pooled loans would pass to FNMA in trust, the lending agency would maintain custody and service of the loans. Again let me stress a point: the lending agency would maintain complete administrative control over its programs.

Borrower payments on the pooled loans would be paid to the lending agency. The agency would turn the payments over to FNMA, to be applied toward payments becoming due on the participation certificates. Any collections in excess of the amounts needed for payments on the participation certificates would be returned to the lending agency, after deduction of FNMA's costs. Any additional expenses would be paid by the lending agency, using either appropriated funds or other amounts available for purposes of programs related to the entrusted obligations. An additional benefit of this proposal is that the sale of participation certificates through FNMA would assure the essential coordination of asset sales by different agencies. It would not make sense for agencies to market their assets in a way that interfered with similar efforts on the part of sister agencies. All would be marketing an essentially similar product—an obligation backed by the Federal Government.

Coordinated offerings through FNMA would mean that market offerings could be timed and adapted in other respects to minimize interest costs, maximize marketability, and, in general, gain the greatest benefit from this technique for drawing private investment funds into Federal credit programs.

The bill would also assure the most effective coordination of participation sales operations with the Treasury's debt management operations. The Treasury has long-established and excellent working rela-

tions with FNMA in coordinating market operations with overall debt management policy.

While similar arrangements have been and could be established with other agencies, the coordinating job grows in complexity as more agencies and larger sales are involved. Centralizing sales will avoid unnecessary staffing and other administrative costs.

Scheduling a large number of separate agency issues to avoid market congestion and to minimize the cost to the Government is both intricate and unnecessary.

Difficulties in timing and coordination are compounded during periods of rapidly changing market conditions, leading to possible disruptions of needed credit programs.

The participation sales technique—as compared with the outright sale of Federal loans—provides significant additional marketing flexibility. It thus assures that Federal agency assets will be more readily saleable and at lower interest rates.

The participation technique converts obligations of relatively narrow market acceptability into obligations of broad marketability which are attractive to a wide variety of purchasers: banks, insurance companies, pension funds, and other institutional investors.

For example, if the Government were to sell directly the home mortgages which it now holds, most of these mortgages would be bought by institutions (such as savings and loans and mutual savings banks) which normally supply a large part of the credit needs of the home mortgage market. The result would be to put this particular sector of the credit market under increased pressure.

However, if these mortgages are marketed via the participation route, the purchasers would include the whole spectrum of investors, including those which normally do not invest in home mortgages such as corporations, personal trusts, and State and local government pension funds.

Thus the sale of home mortgages in a pool of assets (as contrasted with the direct sale of mortgages) would tend to ease, rather than increase, pressures on the home mortgage market.

Since the FNMA participation instruments have already gained broad acceptance in the market, the Government should capitalize on this proven experience and avoid the startup costs that other agencies encounter if they approached the market individually.

This bill is a recognition of and response to the growing size and complexity of Federal credit program financing operations and the need for coordinating these operations with the overall financial activities of the Federal Government.

I fully endorse this legislation and urge its prompt enactment.

Mr. Chairman, this concludes my formal statement. Since this statement was printed there has been called to my attention another technical amendment which I would like to call to the committee's attention.

In the hearings before the House committee, Director Schultze and I, after deliberation with our colleagues, accepted an amendment proposed by Congressman Widnall which would place all sales of these direct loans, whether or not they are at submarket or at market rates, under the authority of the Appropriations Committees.

We were glad to accept this amendment, as I mentioned in my statement, because it followed the intent that we are trying to follow here, to place these programs under careful and close congressional scrutiny.

However, we have been informed that FNMA has an offering plan roughly as follows: about \$350 million on SBA loans and perhaps \$200 million in FAA and VA mortgages.

By accepting this amendment we have probably knocked out the \$200 million sale of FHA and VA mortgages. Therefore, we are proposing that this legislation not require Appropriation Committee action for these sales during fiscal 1966.

Acceptance of this technical amendment would enable the proposed sale, which is legal under existing law, to go forward as we had planned, but it does not lessen the urgency for prompt action on this bill.

If we are to proceed with the program to sell \$4.7 billion in assets next year, as the President has envisaged, it will be necessary, if this legislation is enacted, to go back to the Appropriations Committees and get their approval for the whole program. If this legislation is enacted promptly, we would move directly into the appropriation process and hopefully get the approval of the Appropriations Committee by July 1, so that the \$4.7 billion sale could be stretched over the entire 12 months of fiscal year 1967.

I would respectfully urge that you consider this technical amendment which we offer as a result of the acceptance of Congressman Widnall's amendment. However, I hope you will also consider the need for prompt action on the legislation before you.

Thank you.

(The proposed amendment and explanatory comments on the bill follow:)

SEC. 9. The Federal National Mortgage Association is authorized during fiscal year 1966 to sell (1) additional participations in the Government Mortgage Liquidation Trust, and (2) participations in a trust to be established by the Small Business Administration, each without regard to the provisions of paragraph (4) of section 302(c) of the Federal National Mortgage Association Charter Act, as added by this Act.

HOW THE PARTICIPATION SALES ACT WOULD WORK

The following two examples illustrate the procedures that would be followed in implementing the provisions of the Participation Sales Act of 1966. Example No. 1, covering SBA loans, outlines the procedures in the case of programs in which loans are made at market rates. Example No. 2, covering CFA college housing loans, sketches the procedures that would be followed in the case of a program with submarket rates.

EXAMPLE 1. SMALL BUSINESS ADMINISTRATION

The Small Business Administration, after receiving an authorization in an appropriations act, would enter into a trust agreement with FNMA under which SBA would set aside on its books certain of its business loans. These loans would be in such amounts and have such interest rates and maturities as to assure principal and interest collections sufficient to meet the payments due on the participation certificates.

These loans would be subjected to a trust and would be guaranteed by SBA. To fulfill its guarantee, SBA would be authorized to use any appropriated funds or other funds available to it for the direct loan program. Following past practices, SBA could also be expected to set aside a reserve equal to 10 percent of the principal amount of the loans subject to trust.

In addition, SBA would agree to substitute good loans in the event of default or likely default on any of the loans subjected to the trust agreement.

FNMA, as trustee, would issue and sell participations based on the pooled obligations and on the right to receive principal and interest collections from those obligations. FNMA, in its corporate capacity, would also guarantee timely payment of principal and interest due on the participation certificates. For this purpose FNMA, if necessary, would be able to borrow from Treasury any amounts needed under the procedures provided in subsection (d) of section 306 of the FNMA Charter Act.

Proceeds of the participations sold, after deduction of the costs of the transaction, would be paid over to SBA. They would become available for new loans only within the overall loan authorization provided by the Congress.

As Mr. Ross Davis, Acting Director of SBA, has testified, SBA would continue to count against its authorization to have loans outstanding the principal amount of all loans placed in trust. Consequently, SBA would not be enabled to increase its loans outstanding beyond the level authorized by the Congress and provided for in appropriations acts.

While title to the pooled SBA loans would pass to FNMA in trust, SBA would continue to maintain custody and service of the loans. Consequently, SBA would maintain complete administrative control over its programs.

In accordance with the trust agreement, SBA would pay over to FNMA periodically repayments of principal and interest on the pooled loans. Any collection receipts in excess of the amounts needed to assure the payments on the participation certificates would be returned to SBA after deduction of FNMA's costs, and any additional expenses would be paid by SBA from appropriated funds or other amounts available.

EXAMPLE 2. COLLEGE HOUSING LOANS, COMMUNITY FACILITIES ADMINISTRATION

The Community Facilities Administration of the Department of Housing and Urban Development would also in the normal appropriations process, request congressional approval to sell a certain amount of participations in the CFA loan portfolio. The Appropriations Committees would again be free to approve or reject the request or to change the amount, thus maintaining strict control over the amount of funds which would be made available to CFA for new college housing loans.

If the sale of \$820 million of participation certificates, the amount proposed for fiscal 1967, was approved by the Congress in an appropriation act, it is anticipated that the same act would establish on the books of the Treasury an indefinite appropriation which would enable CFA to pay FNMA the interest insufficiency arising from the difference between the rates of interest on loans and on participation certificates. The Congress would be provided with estimates of the amount of anticipated expenditures under this appropriation, which would be indefinite only to the extent that estimates would be required of the market rates of interest at which the participation certificates could be sold.

This indefinite appropriation would cover the payments throughout the life of the participation certificates sold under the authorization. It would not run to additional issues of participation certificates for which new authorizations would be required.

The Community Facilities Administration would then enter into a trust agreement with FNMA, under which CFA would set aside on its books certain of its loans, all of which presently bear interest rates significantly below current market rates of interest.

As in the SBA example, CFA would subject these loans to a trust, guarantee the loans, and undertake to substitute good loans for loans which default or were likely to default.

Similarly, FNMA would, as trustee, issue the participations and, in its corporate capacity, guarantee the timely payment of principal and interest on the participation certificates, again with the support of its borrowing authority from Treasury.

Proceeds of the participation certificates sold would be paid over to CFA and become available for new college housing loans.

As in the SBA case, CFA would maintain custody and service of the loans and exercise full administrative control over its program.

Since the pooled loans would bear interest below the rate at which the participation certificates could be sold in the market, from time to time CFA would

draw on the indefinite appropriation provided when the participation sale was authorized in order to make payments to FNMA for the amount of the interest insufficiency.

The CHAIRMAN. Thank you, Mr. Secretary.

Now I think we should hear from the Director of the Bureau of the Budget, and then we may ask questions of either or both.

STATEMENT OF CHARLES L. SCHULTZE, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. SCHULTZE. Thank you, Mr. Chairman and members of the committee.

I would like to discuss briefly today the background and some of the major features of the proposed "Participation Sales Act of 1966." This legislation was transmitted last week to the Congress by the President to provide the authority needed to carry out his earlier recommendations for a more extensive and effective substitution of private for public credit.

BACKGROUND

As the members of this committee are well aware, both the Congress, in authorizing—and successive administrations in administering—specific credit programs have, as a basic policy, relied primarily on the use of private credit institutions rather than direct Federal loans wherever such reliance could be expected to produce the desired results.

Historically, the major role of the Federal Government in the area of credit assistance has been to encourage a smooth, efficient flow of funds between private borrowers and lenders. This has been done in two major ways:

By chartering, regulating, and insuring the deposits in financial institutions—banks and savings and loan associations—which pool the savings of many savers and from these funds provide credit to borrowers.

By guaranteeing specific loans to facilitate the flow of credit to borrowers where risks are otherwise unattractive to private lenders.

At present, almost \$100 billion in Government-guaranteed or insured private loans are outstanding under programs long approved by the Congress, and each year the total steadily increases.

Despite such assistance there remain some types of borrowers who are not able to establish credit standing, who are remote from credit sources, or who, in the judgment of the Congress, require interest rates lower than can be obtained from private lenders even with a Federal guarantee. In such cases, the Federal Government makes direct loans. In meeting these special requirements, the Federal Government has over the years, built up a large portfolio of direct loans. The basic purpose of the Federal Government in such programs, however, is not to build up a portfolio of financial assets, but to assume some or all of the risks involved in order to make loan funds available to borrowers who need it.

The legislation now before this committee provides an effective means by which the Federal Government can continue its historic role of assuming part or all of the loan risk, while at the same time avoiding an unnecessary increase in Government-owned loan portfolios.

The Government, after all, is fulfilling the same basic role, whether it—

Makes direct loans, pools the loans, and sells participations to private lenders, as under the proposed legislation.

Insures a Federal Housing Administration loan made by a mortgage banker, who then sells it to a private investor.

Insures a ship mortgage under the Merchant Marine Act of 1936.

Insures deposits in savings and loan institutions, assuming some of the credit risk, and thereby facilitating the flow of credit from savers to home buyers.

Although the techniques differ in each case, the underlying principle of risk assumption is the same.

As one way of attracting private capital to public loan programs while minimizing the buildup in federally owned portfolios, lending agencies have found it possible from time to time to encourage private refinancing of such loans on an individual basis. Direct sales of individual assets have been the normal practice for the past decade or more by several major Federal lending programs. But there are limits to the volume of such loans that can be efficiently marketed in this way. Many loans are too small and too expensive to administer to be readily marketable. If the private lender has to select the assets on a retail basis and undertake their administration, he will often be unwilling to purchase them.

The process of pooling a number of such loans and selling participations in the pool serviced by the original lending agency, however, converts a loan instrument of very narrow acceptability into one with very wide attraction. In the relatively brief period since 1962 when the Export-Import Bank initiated its program and since 1964 when FNMA was authorized to sell participations in its own and VA assets, more than \$3.3 billion in such certificates have been successfully sold. And as the volume of participations in the market increases, the efficiency of the market grows too.

As compared with direct sales of Government loans, the participation technique enables more loans to be sold in total, and reduces the net cost of selling the loans, whether measured in terms of administrative and selling costs or in terms of the yields which have to be paid on the assets to make them salable.

Let me discuss briefly the last topic mentioned above, the yields necessary to sell participation certificates in the private market. On the one hand, as I have pointed out, this is the most inexpensive means of attracting private credit into these programs. On the other hand, it is true that the interest rate on participations is slightly higher than the rate on Treasury bonds. Experience in the past has indicated a premium of 25 to 35 basis points ($\frac{1}{4}$ to $\frac{3}{8}$ percent) and this premium should decline as a larger volume of participations are issued and a broader secondary market develops. Indeed on a "yield-after-tax" basis—which is a relevant way of comparing yields from the Treasury's standpoint—the yields on participations are only slightly greater than yields on Treasury securities. In recent weeks the after-tax yield differential has averaged only some 10 to 15 basis points.

Of course, Treasury borrowing is cheaper than any other form of financing. But this is hardly a reason to abandon the historic Federal role of assisting the flow of private credit to borrowers. Should we borrow through the Treasury and add to the public debt as a replacement for FHA and VA mortgages, or guaranteed small business loans? I do not believe that any administration or any Congress has ever operated on the premise that the U.S. Treasury should replace available private credit simply because the Treasury can borrow more cheaply than anyone else.

MAJOR FEATURES OF THE BILL

Let me turn, if I may, to several major features of the bill before the committee.

1. The proposed bill will make available on a Governmentwide basis the authority to pool financial assets and to sell through FNMA as trustee certificates of participations in such assets.

Under present law the FNMA as trustee can sell certificates of participation in any type of loans owned by the Department of Housing and Urban Development as well as first mortgage loans owned by other agencies. The language of the bill would permit any Federal department or agency with direct lending authority to place any of its loans in a pool and would authorize FNMA as trustee to sell certificates of participation in pools of such assets.

The President in his 1967 budget has explicitly proposed that this new authority be used by the following credit programs not now engaged in participation sales:

Department of Agriculture: Farmers Home Administration;
Department of Health, Education, and Welfare, Office of Education: Academic facility loans;

Department of Housing and Urban Development: College housing loans and public facility loans; and

Various loans of the Small Business Administration.

To facilitate sales by the Office of Education and the Farmers Home Administration, the legislation contains necessary modifications in existing laws governing the programs.

2. To facilitate sales of participations in pools of loans bearing interest rates below market levels, the proposed bill provides for supplemental payments adequate to cover any insufficiency of receipts from assets in the pool as necessary to meet the payments on the certificates. This provision is highly important because under present laws governing many direct loan programs in large share of the loans have been made at interest rates significantly below the levels prevailing in the private market, as well as below the cost of the Treasury of obtaining the funds. These supplementary payments, in and of themselves, do not add to Federal outlays, but merely recognize explicitly the present cost now incurred by the Federal Government in such loan programs, which are not specifically identified in the budget.

3. The bill proposed by the President provides for effective review and control in appropriation legislation of the sale through participation pools of any assets requiring such supplemental payments. It does this by requiring that the amounts of any such certificates issued

shall be within aggregate principal amounts authorized in advance in appropriation acts. If and when appropriation language is enacted specifically authorizing such certificates the appropriation authorization automatically makes funds available to cover the interest differential. The House committee is amending legislation submitted by the administration to provide that all participation sales covered by the bill would be subject to authorization in appropriation acts, whether or not funds are required to cover an interest differential. The administration concurs in that amendment. We believe it is a desirable change.

4. Finally, as Under Secretary Barr has already emphasized, under the proposed bill all future sales of participations by these agencies would be carried out under the experienced management of the Federal National Mortgage Association, assuring effective coordination of the various credit programs, as well as with Treasury debt management operations themselves.

SIZE OF PROGRAM

As outlined in this year's budget, the President's program for 1967 relies upon a considerable expansion in the sale of financial assets. Of the total 1967 sales estimate of \$4.7 billion, \$4.2 billion represents the sale of certificates of participation, and \$2,850 million of this requires the provision of new legislative authority.

In the absence of an offsetting sales program, the total loan portfolio of the Federal Government, now in excess of \$33 billion, will continue to grow year by year as it has over the past two decades. We believe there is no need for this portfolio growth. The Government can meet its program requirements without accumulating a large volume of loans and mortgages.

SUMMARY

The authority contained in this bill provides a most efficient method of allowing the Government to play its historic role in assisting credit through risk assumption without building up an unnecessarily huge portfolio of loans.

Our expanding economy will require increased capital outlays for many years to come in order to finance such important programs as education, health, transportation, and public facilities. Private financing, if obtainable, is clearly preferable and should, to the maximum extent possible, be utilized to meet these urgent needs.

The Federal Government can and should provide the necessary services such as smoothing the imperfections in the private credit system, in order to maximize the participation of the private financial sector. As I indicated earlier, this is a historical role for the Federal Government in the credit markets of our Nation. We need not and should not hold loans which the private sector can handle. Or, to put this another way, the purpose of the Federal loan programs is to assist the borrower to obtain funds on a reasonable basis, not to build up a large portfolio of federally owned loans.

For all of these reasons, I urge early enactment of this legislation. Thank you.

The CHAIRMAN. The Chair feels that this proposal, not only in volume but in procedure, is a big difference from the bill that has

passed with respect to small business. We did increase the lending power of small business in our bill. We raised it to \$2 billion, but we still put a limit on what it could lend. It would make its own loans and Congress, of course, would keep control or a measure of control by the Appropriations Committee appropriating the difference between what those business loans would pay in interest and what the Government would pay.

But that isn't a circumstance, let us say, to issue participating certificates against housing loans made at 3-percent interest. In the law we passed last year for college dormitories, classrooms, we authorized \$300 million of 3-percent money. Within 3 months we had over a billion dollars of requests. If the Small Business Administration refinances its paper, it does it for loans by the Small Business Administration, but I understand if FNMA takes the whole pool, they can take all of this paper that is now held by small business, which is close to a billion dollars, and refinance the whole thing.

They can take all of these other four agencies and I understand that if they should finance the total, it would be in the magnitude of \$7 or \$8 billion if they should use it all, and it would not then be limited to the loans to be made by the agency that had held the paper. Money would go into the Treasury for such use as the Treasury might see fit to make of it.

I had a letter from the executive vice president of the American Bankers Association, Charls E. Walker. He said at this time they didn't want to take a positive position either for or against the policy of this bill but he said he wanted to call attention to two possible objections to it.

I will ask permission that the letter may be printed in the record at this point and then I will quote from two paragraphs.

(The letter referred to follows:)

THE AMERICAN BANKERS ASSOCIATION,
New York, N.Y., April 26, 1966.

Hon. A. WILLIS ROBERTSON,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR SENATOR ROBERTSON: The American Bankers Association desires to take this opportunity to express its views on H.R. 14544, a bill to promote private financing of credit needs and to provide for an effective and orderly method of liquidating financial assets held by Federal credit agencies and for other purposes, which we understand will shortly be under consideration by your committee.

Inasmuch as H.R. 14544 has been introduced to carry out a definitive policy decision of the administration, we are not expressing any comments on such policy decision. Nevertheless, we are concerned about certain aspects of the legislation as outlined below.

H.R. 14544 provides a mechanism for financing the Treasury through the issuance of securities by the Federal National Mortgage Association representing beneficial interests or participations in certain loans made by various agencies of the Government. The Government agencies responsible for administering the loan programs which will be utilized as a basis for the issuance of participation securities will retain custody, control, and administration of the obligations securing the participation certificates. FNMA will promptly pay to the agencies whose obligations form the basis for the issuance of participations the full net proceeds of any sale of such beneficial interests or participations to the extent they are based upon such obligations or collections. Such proceeds will be dealt with as otherwise provided by law for sales or repayment

of such obligations. In most cases, this will make the proceeds available for new loans to the extent authorized under existing programs.

In my letter to you of February 28, 1966, with reference to S. 2499, a bill to amend the Small Business Act to authorize issuance and sale of participation interests based on certain pools of loans held by the Small Business Administration, we expressed our concern about certain implications of that bill which we believe also applies to H.R. 14544. We desire to restate such comments, in part, as follows:

(1) The type of transactions envisaged seem to us to be simply another type of deficit financing, rather than a genuine substitution of private for public credit, but at interest rates higher than is effected in the usual manner through sales of Treasury obligations. Although no serious objection could be made to this alternative type of financing of itself, the higher interest cost that is likely to be incurred should be of concern to both taxpayers and the Congress.

(2) Debt operations of the type authorized in H.R. 14544 bypass the public debt ceiling and the interest rate ceiling on new issues of Treasury securities with maturities beyond 5 years. Our purpose here is not to defend the arbitrary manner in which these limitations can impinge on budget spending and Treasury debt management. But we do believe strongly that the issue of our relaxation or elimination of these limitations should be confronted directly in the Congress and not bypassed through alternative methods of financing.

In addition, we are concerned with the impact of the implementation of the program contemplated under H.R. 14544 and the demands it will place on the money and capital markets at a time when private demands for funds are active and strong. From the standpoint of timing, such a program could be better implemented at a time when the banking system and long-term investors are actively seeking earning assets because of a limited availability of such in the private sector. The proposed Government agency financing may very well have a considerable rate impact in the market. So long as economic conditions continue expansive and private demands for funds are heavy, the agency financing will exert upward pressure on interest rates. This pressure could be felt in the market for direct Treasury obligations and rate adjustments could take place in that sector. The sheer magnitude of the administration's program—\$3.3 billion in this fiscal year and \$4.7 billion next year—raises the question as to whether all of the Government agency funds can be raised in this time interval.

The Government agencies that have been regular borrowers in the market for many years (such as Federal intermediate credit banks, Federal home loan banks, Federal land banks, FNMA, etc.) have increased their borrowing demands both in terms of magnitude and frequency of borrowing. This borrowing has already become more expensive in relation to direct Treasury obligations and the spread in rates has widened as a consequence. The rate spread could widen further as enlarged Government agency borrowing reaches the market, particularly if this increases the frequency of borrowing operations. On some recent occasions, it has appeared that the Government agencies were competing among themselves for funds and have had to pay a higher rate in the market because of this.

Section 2(b) of H.R. 14544 amends section 302(c) of the Federal National Mortgage Association Charter Act by giving FNMA authority to issue securities under the new program "notwithstanding any other provision of law." We believe it is essential that the authority of the Federal National Mortgage Association to issue securities as contemplated under H.R. 14544 be made subject to the approval of the Secretary of the Treasury in order that such transactions be handled with utmost care so as not to disturb market financial processes more than is absolutely necessary.

Very truly yours,

CHARLES E. WALKER.

The CHAIRMAN (reading):

(1) The type of transactions envisaged seem to us to be simply another type of deficit financing, rather than a genuine substitution of private for public credit, but at interest rates higher than is effected in the usual manner through sales of Treasury obligations. Although no serious objection could be made to this alternative type of financing of itself, the higher interest cost that is likely to be incurred should be of concern to both taxpayers and the Congress.

(2) Debt operations of the type authorized in H.R. 14544 bypass the public debt ceiling and the interest rate ceiling on new issues of Treasury securities with maturities beyond 5 years. Our purpose here is not to defend the arbitrary manner in which these limitations can impinge on budget spending and Treasury debt management. But we do believe strongly that the issue of our relaxation or elimination of these limitations should be confronted directly in the Congress and not bypassed through alternative methods of financing.

So that brings up several interesting points. From the standpoint of the taxpayer, which is going to be cheaper—increasing by a very substantial amount the interest that the Government will pay to those who buy participation certificates, or issuing long-term financing which of course would be on money that would appear in the budget and all the public would know that the deficit is a given amount. For instance, I checked last week with our Committee on Internal Revenue taxation and I said, What do you think our revenue for this year will be? He said about \$101 billion. I said, What do you think we will spend, about \$107 billion, a deficit, \$6 billion-plus?

It now appears that deficit was reduced by money a method of raising money by the sale of participation certificates, several billions of dollars, maybe 3, and so the deficit would appear to be only 3 billion or so.

Again, I said, What will be the revenue for next year? Well, he said, we think \$111 billion, maybe a little more, because this boom is really still going and apparently it is going to continue for some months. What will we spend? He said the budget is a little over \$112 billion, already the House has raised some items. I don't know how much more it will be, but some items like the milk program, school lunch program, impacted area aid for schools and things like that, but the impression was, as the distinguished Vice President said in New York, without a tax bill we can have next year both guns and butter and that we are only going to have a small deficit and we won't have serious inflation.

But we will be raising \$4 billion by selling participation certificates that will be spent and it will have the same inflationary effect or more, and it might cost us more in the long run than if we honestly face up to the fact that we are going to have a budget deficit of \$5 or \$6 billion next year. The Treasury is going to borrow the money, but it is going to borrow it on long-term bonds—on participation certificates—instead of the short-term paper that is all that can be sold now under the 4 $\frac{1}{4}$ -percent ceiling. We will have to look at whether or not, if we need to get this money, we should do something about limitation on 4 $\frac{1}{4}$ percent.

I say these are some problems that our committee has to consider. We want these agencies like the Small Business to have this money because credit has gotten so tight, that the average merchant, for instance, who needs a little money, he just can't get it.

I was talking the other day with the president of the fourth largest savings and loan association. He said we are selling good paper. We can't take care of some of our best customers. We just can't get any money.

Well, I understand that it is getting tight everywhere, that loans are hard to get. That is one of the reasons we acted promptly. We didn't think we had time to wait for supplemental money for small business.

Now, I don't know how many other agencies that lend money are in as acute a condition as the Small Business Administration, but we had to commingle business loans and disaster loans. We had a lot of disasters and it exhausted our funds. We were faced with an emergency and we rushed through a bill.

But, now it is proposed to commingle all of these debt obligations into a new agency, so to speak, not new, but it wasn't created for this purpose, FNMA we called it, and let them sell billions of dollars of certificates. It creates a problem in what is the most effective and the cheapest way to meet the obligations that confront us, and whether, if we take a good look at what we are doing, we want to spend what some people are planning to spend or to cut down, or will we just say, if we do this, we have to have more revenue and we will put on taxes.

Those are problems that have got to be met by our committee because after all, we carry a big responsibility and as far as we know how, we follow a program of sound business policy.

Senator SPARKMAN. Mr. Chairman, there are a few things I wanted to ask about. First, Mr. Schultze and Mr. Barr, has the committee reported H.R. 14554 yet?

Mr. BARR. Yes, sir.

The CHAIRMAN. Twenty-two to three.

Senator SPARKMAN. It is on the House calendar.

The CHAIRMAN. It hasn't been printed yet.

Senator SPARKMAN. Do you have the bill before you?

Mr. SCHULTZE. I have it before me but without several House amendments. Yes, sir; I do.

Mr. BARR. Yes, sir.

Senator SPARKMAN. Mr. Chairman, I ask that the bill as reported by the House committee be printed in the record.

The CHAIRMAN. Without objection, that will be done.

Senator SPARKMAN. Would you look at page 6, section 3, subsection b, I am a little puzzled on the amendment of the Housing Act. You delete 1968 and then you say "1965 and 1967 and 1968." Why do you leave out 1966?

First of all, I would like to ask why are you amending the Housing Act in this bill?

Mr. SCHULTZE. The effect of subsection (b) is to reduce the new borrowing authority for the college housing program by \$300 million, since the funds, that will be received from the sale of participations will resolve previous borrowing authority. In other words, the funds received from the sale of participations in college housing over and above those needed to finance the college housing program that year will be repaid to the Treasury, reduce the obligation of the college housing program to the Treasury, increase its borrowing authority, and thus restore it to the status quo. That is the reason for the subsection.

The reason for leaving out "1966" essentially is that we assume that this legislation is going into effect July 1, 1966, and you don't need it.

Senator SPARKMAN. What will happen to the \$300 million, was it, that was to be added July 1, 1966?

Mr. SCHULTZE. What I am saying, Senator, is that the budget program sales of \$820 million of participations in college housing

loans will be substantially larger than the funds needed in fiscal 1967 to make \$300 million worth of new loans. The extra money goes into the Treasury, increasing the borrowing authority available for college housing. This subsection simply removes a further increase in borrowing authority to leave the situation about where it was before.

Senator SPARKMAN. It doesn't change the borrowing authority, does it?

Mr. SCHULTZE. That is right.

Senator SPARKMAN. And the \$300 million which would have been added you anticipate being replaced by the sales.

Mr. SCHULTZE. Correct.

Senator SPARKMAN. In other words, there will be no loss to the college housing program.

Mr. SCHULTZE. That is correct, sir. There will be no loss. Actually, netted out, there will be a slight gain.

Senator SPARKMAN. Then why do you include 1967 and 1968? Why do you put the numerals there? Wouldn't the same thing hold true for these years? Or would they be sold out?

Mr. SCHULTZE. I am sorry that I am so slow in answering this. It is a technical point. We won't know until the budget for 1968 comes around exactly what the situation will be. This is the reason we didn't propose changes in the 1968 authority.

Senator SPARKMAN. It seems to be that the whole thing could be handled administratively without the requirement of being written in. I have no objection, as long as the fund is not impaired.

Mr. SCHULTZE. The fund will not be impaired, Senator.

Senator SPARKMAN. At any time.

Mr. SCHULTZE. At any time.

Senator SPARKMAN. All right. Now, Mr. Barr, you have quoted from the House Ways and Means Committee, minority report.

Mr. BARR. Yes, sir.

Senator SPARKMAN. That was last year?

Mr. BARR. It was 1963, Senator Sparkman.

Senator SPARKMAN. How many signed that?

Mr. BARR. Every member of the minority signed it, Senator, and I must say we took the advice of the minority. They said don't be coming up here asking us to increase the debt ceiling when you are sitting here, like a banking institution, holding a large portfolio of loans which can be sold. We did follow their advice and, as they point out in the report, we increased our sales, after this admonition from the minority, by slightly in excess of \$1 billion.

I quoted the report to show the feeling that seems to exist in the Congress that this Government is not a banking institution created to sit and hold very large portfolios of Government loans. These Government direct loans are not just borrowed money, they are taxpayers money.

It seems to have been a feeling of this minority, and widely reflected in Congress, that taxpayers and borrowed money should be used for the purpose of Government—but one of these purposes is not to build an enormous portfolio of loans. It was one of the clearest statements that was available of what the Congress seems to think about this practice.

Senator SPARKMAN. What about this varying interest rate? Will there be a loss to the Government? In other words, you will be paying on the participation certificates, in some instances, a higher interest rate than the paper calls for, won't you?

Mr. BARR. That is correct, Senator. In looking at the costs, I think that the cost is not the difference between the 3-percent loan and what it would sell for in the market, about 5.3 percent. I think the accurate way of looking at the cost, Senator Sparkman, is to compare what it would cost us to borrow in the Treasury—

Senator SPARKMAN. I was going to follow up with that; how does that compare with what you would have to pay?

Mr. BARR. At the moment, as Director Schultze has indicated, the difference between Treasury borrowing and this participation route runs between 25 and 35 basis points, or one-fourth to three-eighths of 1 percent. If you translate that, Senator, into fiscal year 1967, it would cost the United States, to take the participation route, between \$10 and \$14 million to raise this amount of money and to reduce the portfolio of loans by \$4.7 billion. That would be the cost.

Mr. SCHULTZE. Could I add one other point to that, Senator?

Senator SPARKMAN. Yes.

Mr. SCHULTZE. I think it is important to bear in mind, that it has always been cheaper for the Treasury to borrow money than any other entity or any other way of borrowing money. And yet, and I think wisely over the years, the Congress has operated on the principle that where you can get credit to borrowers by Federal insurance or guarantee and have private money come in, it ought to be done that way, even though it is slightly more costly than if you did it directly through the Treasury.

And as you know, we have many programs which do that, VA, FHA insurance, ship mortgage insurance, there are guaranteed small business loans, these kinds of things.

It turns out we do have a number of programs, however, that even with a guarantee, it is impossible to have a direct connection between the lender and borrower. So the Federal Government has to make that connection by making a direct loan. But we think there is a way of getting private money in, even though the Federal Government has to make a direct loan by having the Federal Government make the loan initially and then pool it, give you a better piece of paper and sell it out.

We think the sale of participations performs exactly the same function as the guarantee—bringing private capital in. Admittedly it is slightly more costly in terms of interest rates than if the Treasury itself did it, but if we use the argument that the Treasury ought to do everything because it is slightly cheaper, we would be doing everything that way.

Senator SPARKMAN. What is the estimated amount that you would sell during fiscal year 1967?

Mr. SCHULTZE. The amount that we would sell through participations now estimated in fiscal 1967 is \$4.2 billion. Of that \$4.2 billion, about \$1,350 million could have been done under existing legislation, this legislation therefore adds \$2,850 million.

Senator SPARKMAN. This would add \$2,800 million?

Mr. SCHULTZE. That is right.

Senator SPARKMAN. Then in succeeding years, would it climb about the same amount?

Mr. SCHULTZE. That is very difficult to say. There would still be two things: First, significant amounts of loans will be left in the portfolios, even after the sales, secondly, on going programs would continue to generate portfolios. I can't give you a number, but it would be significant. The exact amount I wouldn't really know, but \$2 to \$3 billion is not an impossible number.

Senator SPARKMAN. Mr. Schultze, the question we see raised every so often by economists and writers suggest a change in our bookkeeping system. Are you still giving, do you give consideration to that along the way so as to reflect the true condition, whereas the present system more or less lays aside the assets there are on hand?

Mr. SCHULTZE. This is something we have looked at. As a matter of fact, I have just been looking at a book published by the Brookings Institution. One of our staff members on leave wrote it on the capital budget. The budget which economists tend to look at in judging the impact of the budget on the economy is called national income accounts budget. This budget tends to treat loan transactions as part of the monetary sector and to exclude them from the Federal sector of the income accounts budget.

Essentially the impact of this bill, to the extent that it nets out receipts against payments, is to do the same thing. So that the practical effect of it is to make the administrative budget closer in concept to the national income accounts budget, which is precisely the one that most economists use in judging the impact of the budget on the economy.

So, in essence, therefore, the practical effect of this from an accounting standpoint is to make the administrative budget measure of the economic impact somewhat closer to the budget that the economists use.

Senator SPARKMAN. It does have the practical effect, as I see it, and as is brought out by Mr. Barr's statement, of reducing the terrific amount that is carried in our portfolio?

Mr. SCHULTZE. Some \$33 billion now; that is correct, sir.

Senator SPARKMAN. Thank you very much.

The CHAIRMAN. Would you tell us approximately how much money you figure will be raised in this program? If Congress grants it?

Mr. SCHULTZE. In fiscal 1967, the planned sales of participations by the Federal Government is estimated, we plan, \$4.2 billion. Of that \$4.2 billion, \$2,850 million is made possible by this bill. The remainder could be done under existing legislation.

The CHAIRMAN. How much for the existing fiscal year?

Mr. SCHULTZE. This bill in and of itself does not make possible any participation in sales we weren't planning on. This year, under existing legislation, plus under the small business participation bill, which the Senate passed recently, we would have something over \$2 billion of participation sales, in fiscal 1966, under existing legislation and SBA legislation.

The CHAIRMAN. So you do plan about \$2 billion for fiscal year 1966, the current year?

Mr. SCHULTZE. \$2,600 million of participation sales this year.

The CHAIRMAN. The Chair recognizes the Senator from Utah.

Senator MUSKIE. Would the Senator yield just to clarify that point?

You say 2 billion 6 is not required by this legislation; did you or did you not mean to say that?

Mr. SCHULTZE. About \$350 million of it assumes passage of the separate small business participation bill. The remainder, 2 billion 3, therefore, out of the 2 billion 6 would be possible under existing legislation.

Senator MUSKIE. Neither of those figures is dependent upon this legislation?

Mr. SCHULTZE. That is correct. However, let me make one point on that, if I may. The major reason we are urging prompt passage of this bill is that it takes a significant amount of time to go through the steps required under this legislation, including through the appropriations committees; that, to plan the sales, having done that, to make the announcement; having done that, to set a price; having done that, to get the receipts in, and we want to avoid having to cram this all up into a short portion of fiscal 1967. Therefore, even though we are still well before fiscal 1967, we think it is very necessary to have this authority soon so we can begin to take the necessary orderly steps in marketing in 1967.

Senator MUSKIE. This legislation is necessary for fiscal 1967 and not fiscal 1966.

The CHAIRMAN. I am glad the Senator brought that point out. I thought the thrust of this was for the current as well as the next fiscal year.

Mr. SCHULTZE. No, sir.

The CHAIRMAN. But you can raise 2 billion 3 under existing law, only 300 million under the Small Business Administration would be affected?

Mr. SCHULTZE. That is correct.

The CHAIRMAN. So the major impact of this bill is for the year that does not commence until July 1 next?

Mr. SCHULTZE. That is correct.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman.

Gentlemen, as I have listened to the discussion, I am coming to realize that in passing this bill we are making a very major and permanent change in the method of financing the operations of the Federal Government.

This is not an emergency bill to get us through 1966 and 1967. This is a bill which will put a new element in the Treasury's management of our cost of Government, and I think probably is going to require very definite change in our method of reporting the cost of Government to the American people.

I don't question the right of the Treasury to approach their problem in this way. Actually, as I have listened to the testimony, I realize that the problem has been sneaking up on us for a long time, ever since the Treasury or the Federal Government went into the business of direct loans.

We could have foreseen that the day would come when the total of those loans would be a burden and we would be tempted or advised to reduce that burden by selling the loans in some form or another back to the private sector.

It is interesting to observe that in 1959, when President Eisenhower used a variation of this process to get past the crisis, the resolution was offered, voted and approved in the Senate condemning this action and many of the members of the Banking Committee were the authors of that resolution and the present President of the United States spoke and voted for it, condemning this kind of an approach.

So we have grown up. We have learned a lot in 7 years.

Senator SPARKMAN. We have learned from our Republican brethren.

Senator MUSKIE. Excellent teachers.

Senator BENNETT. It is interesting that the Republican minority suggests an improvement.

Mr. BARR. Senator Bennett, if I may—

Senator MUSKIE. You are not going to run out on us now that we have joined you?

Senator BENNETT. I am going to point out ways by which you can save yourselves from further criticism.

Mr. BARR. The present Under Secretary of the Treasury should be included in that last group. I spoke in the Congress in precisely the same vein, sir.

Senator BENNETT. Well, my father used to have a phrase, "It is a condition, not a theory." Now we realize that this is a condition, those of us who opposed it as a theory a few years ago have changed their position.

Comment has already been made and questions have been asked indicating that when this new form of financing comes into general use it is going to leave many questions in the minds of people affecting (a) the budget deficit, because we are going to have one for a year or two, and (b) the debt ceiling.

It is the opinion of this Senator that unless the budget reporting is set up in such a way that income from this type of borrowing is shown separately and clearly and shown as a reduction in the regular budget deficit, the administration is going to lay itself open to a charge of deceit.

This could become a political issue and the so-called credibility gap and management of news charges can be illustrated or demonstrated by this procedure unless it is properly handled.

I wonder if we haven't reached the point, Mr. Schultze, where the method of reporting the budget should include at least a reporting of the total amount of private loans made by the Government to the private individuals at the beginning of a term, the increase in that amount during the term, and the decrease created by the sale of these participations, because this will have a very definite effect on the deficit as reported, and unless it is understood and carefully spelled out, it can be the basis of accusation, maybe unfair, that this device is used to conceal budget deficits.

Now it seems to me those three facts become important.

We are going to embark upon a permanent program of the sale of participations. This bill has no expiration date. It is a new perma-

ment program, part of the Treasury's business. So, I think unless the budget shows it not included in some other total, but plainly spelled out and unless the budget reporting shows the deficit that exists in terms of tax revenues and expenses, and then shows separately the impact of the borrowing, both through the selling of Treasury obligations and the selling of participations, we are really going to confuse the people.

Even though it may be said that this brings the administrative budget more nearly into line with the national income accounts budget, the ordinary individual doesn't know what that budget is. He just looks at the figure given by the President and says, we are going to have a budget deficit this year of so much, and I think he is entitled to know that the deficit has either been increased or decreased by transactions in this field of borrowing.

Do you agree with me?

Mr. SCHULTZE. Well, I don't know whether I can simply say yes or no to that, Senator. If I may have a moment or so—in the first place, in 13 pages of detail, with appropriate summaries, we do publish and have published for several years in the budget a special analysis of our credit programs which, among other things, shows program by program and in total exactly how much we are planning to sell of these assets, either directly or through participations.

As I say, it gives it in total, by individual program, and by type of sale, so that anyone who wishes can see this. Not only that, in addition to the special analysis there is a special section in the President's budget message—by that I mean the part that the President himself signs—calling attention to this. That is point No. 1. All of the facts are laid out and are by no means concealed. We have gone to great pains to spell it out in great detail.

The second point on this is that it is indeed a very complex matter to decide what ought and ought not to go into the "deficit." Let me give you an example. Until last year the rate on college housing loans was higher than 3 percent. It was reduced to 3 percent. Under the earlier set of circumstances—when rates were higher—the short maturities in the public issues generally were taken up by the private market and sometimes all of a public issue was taken up by the private market. That never appeared in the budget. I don't think anyone ever thought it should show in the budget, even though it was in a sense part of a general program to help colleges build housing.

Now, by a change of a very small amount, a few eighths of a percentage point in the interest rate, short-term as well as long-term public issues are being bought by the Federal Government. Under this technique that we are proposing those loans would be pooled and sold out again. The net result, really, in terms of the taxpayer is to put you back exactly where we were before, where nobody really claims they should have showed up in the budget deficit.

The only difference is a very slight difference in the interest subsidy which will be shown and counted in the budget.

So, what I am really saying is—and this is the whole thrust of this program—is not to disguise the deficit in some sense, but to recognize the fact that the purpose of the Federal Government in these programs is to assume some of the credit risk and get funds to borrowers in.

In some other cases you can do it through a direct guarantee. In this case the loan has to be made initially by the Federal Government and pooled and sold out.

It seems to me it is perfectly in keeping with the traditional treatment of these programs to show it the way we are showing it.

Senator BENNETT. On the other hand, the so-called man in the street doesn't go back to all of these supporting documents and all of this technical data. He is led to believe that the final figure which is announced as the budget deficit actually represents a difference between the income from taxes and the operating expenses of the Federal Government.

The fact that in the coming fiscal year the President projects a very small budget deficit, but brings into that rather substantial amounts that have not been in previous years, destroys the comparability, and I think we have got to preserve the comparability and I believe that if you don't—and this is just a warning from a man on the other side of the political fence—if you don't, you are going to be charged with deception, and this is pretty good political fodder.

Now, I don't like to see the Treasury of the United States charged with deception and I believe that if this is going to be a permanent program, as it seems, and if we are going to embark now on a program of borrowing through the sale of participation certificates; that the impact of these borrowing transactions on the budget deficit should be so clearly recorded that it can't be missed.

While \$2 or \$3 billion may not be large in respect to the hundreds of billions of dollars that come in from other sources, I think this is important.

I have talked too long about that.

To what extent is it fair to say that in practice these participations are backed by the full faith and credit of the U.S. Government? Do they, in effect, have as much backing as a Government bond?

Mr. BARR. In practice, Senator Bennett, that is true. The legal definition, however, is different.

Senator BENNETT. I understand that.

Mr. BARR. This legal distinction will give the States the right to tax these securities. If it is a debt instrument bearing the full faith and credit of the United States, then it becomes a Treasury issue and cannot be taxed by the States. This is the reason for the slight distinction.

Senator BENNETT. But you can't conceive of a situation in which an owner of a participation certificate would find that it would be in default?

Mr. BARR. No, sir; I couldn't.

Under this proposal, Senator Bennett, I quite agree with you. The last thing we want is to destroy credibility. That is the reason we are providing for the appropriating process.

These securities, Senator Bennett, will be backed, by FNMA, but also by an agency that goes to the Appropriations Committee, gets an act, and the act is passed by the Congress. So this is about as much the full faith and credit of the United States as you can get.

In the final analysis, full faith and credit of the United States is the authority granted by the Congress, and that will be granted explicitly every year for every issue covered by this legislation, Senator.

Senator BENNETT. As new leading programs come into being—and we create them quite frequently—will they be subject to the same situation and subject to being used as the background for participation?

Mr. BARR. That is correct, sir.

Mr. SCHULTZE. Yes, sir.

Senator BENNETT. So that this program could continue to increase substantially.

I have been trying since this bill came over here to get a list of the leading programs that are now available. I get told, "Well, here are the main ones, the others are inconsequential."

Can you supply for the committee a list of all of the existing lending programs which would be subject to this legislation?

Mr. SCHULTZE. Yes, sir.

Mr. BARR. Yes, sir.

(The list follows:)

Outstanding direct loans, and guaranteed and insured loans for Federal credit programs classified by agency or program

[In millions of dollars]

Agency or program	1965 actual	
	Direct loans	Guaranteed and insured loans
A. MAJOR AGENCIES OR PROGRAMS		
Office of Economic Opportunity.....	17	-----
Department of Agriculture:		
Commodity Credit Corporation.....	2,115	419
Rural Electrification Administration.....	4,072	-----
Farmers Home Administration.....	1,990	727
Department of Commerce:		
Economic Development Administration.....	126	-----
Maritime Administration.....	109	419
Department of Defense: Military assistance credits.....	79	-----
Department of Health, Education, and Welfare:		
Office of Education.....	538	-----
Public Health Service.....	13	-----
Department of Housing and Urban Development:		
Federal National Mortgage Association.....	2,121	300
Federal Housing Administration.....	527	49,042
Public housing program.....	60	5,033
College housing program.....	1,927	-----
Urban renewal program.....	196	1,382
Other major programs.....	342	-----
Department of the Interior: Reclamation loans.....	90	-----
Department of State: Agency for International Development.....	8,997	144
Treasury Department:		
Loans to District of Columbia.....	139	-----
Foreign loans.....	3,763	-----
Veterans' Administration.....	1,649	30,951
Export-Import Bank of Washington.....	2,490	2,617
Small Business Administration.....	1,147	104
Total, major agencies or programs.....	32,507	91,138
B. OTHER AGENCIES OR PROGRAMS		
Department of Agriculture: Soil Conservation Service.....	15	-----
Department of Commerce: Aircraft loan guarantees.....	-----	9
Department of Defense:		
Loans for construction of Ryukyu power system.....	9	-----
Defense production loans and guarantees.....	14	49
Department of Health, Education, and Welfare:		
Community facility loans.....	(1)	-----
Hospital construction activities.....	4	-----
Assistance to refugees in the United States.....	6	-----
Department of Housing and Urban Development:		
Urban mass transportation loans.....	2	-----
Liquidating programs (Community Facilities Administration).....	13	-----
Community disposal program.....	4	-----

See footnote at end of table.

Outstanding direct loans, and guaranteed and insured loans for Federal credit programs classified by agency or program—Continued

Agency or program	1965 actual	
	Direct loans	Guaranteed or insured loans
B. OTHER AGENCIES OR PROGRAMS—continued		
Department of the Interior:		
Alaska public works (repayable investment).....	16	
Bureau of Indian Affairs.....	24	
Defense Production Act loans.....	8	
Fisheries loans.....	6	
Ship mortgage insurance.....		5
Guam rehabilitation program.....	2	
Minerals exploration program.....	1	
Department of Labor: Manpower development and training loans.....	(1)	
Department of State:		
Repatriation loans.....	3	
Loans to the United Nations.....	107	
Treasury Department:		
Defense Production Act loans (liquidating).....	4	
Reconstruction Finance Corporation (liquidating).....	5	
Civil defense loans.....	(1)	
Federal Home Loan Bank Board: Federal Savings and Loan Insurance Corporation fund.....	131	
General Services Administration:		
Public Works Administration bonds (liquidating).....	58	
Surplus property sales credit.....	100	
Interstate Commerce Commission: Guaranteed railroad loans.....		214
National Capital Planning Commission: Advances to the District of Columbia and Maryland.....	(1)	
Veterans' Administration:		
Service disabled veterans fund.....	4	
Vocational rehabilitation fund.....	(1)	
Veterans special term insurance fund.....	5	
Veterans insurance and indemnities fund.....	1	
Veterans reopened insurance fund.....	(1)	
Total, other agencies or programs.....	547	276
All agencies.....	33,054	91,414

¹ Less than \$1,000,000 outstanding.

NOTE.—Figures may not add due to rounding.

Senator BENNETT. Can you explain to us how the sale of these participations will be coordinated with the activities of the monetary authorities?

Mr. BARR. Yes, sir. It will be coordinated through the Treasury. As you know, we have a close relationship with the Federal Reserve Board. The Chairman of the Federal Reserve Board lunches with us every Monday and we are in constant communication with him.

The Under Secretary of the Treasury for Monetary Affairs is a member of the Board of FNMA, so the coordination with monetary authorities will be through the Treasury, Senator Bennett, and I think this coordination will be improved.

If I may refer to a letter that Senator Robertson put in the record from the American Bankers Association, sir, they mention that nearly everyone who has ever looked at this whole area of Federal credit program has urged us, where possible, to substitute private for Federal credit. They have urged us to sell assets that they will buy.

In this area of coordination, however, there are two problems: If you sell the assets directly, each one of these agencies is attempting to get into the market at given times. The coordination process, Senator

Bennett, is almost impossible. You can compare it to several people trying to get through the door at the same time.

We believe that through the coordination that we can achieve through FNMA, we can bring some sense into this whole area and the coordination will move from FNMA through the Treasury to the Federal Reserve Board. This, in our opinion, is a vast improvement over the present situation.

Senator BENNETT. That leads up to this question: FNMA was originally created to provide a secondary market for housing mortgages. It was expected they would move in and out as the private market made it possible. It is a part of the Department of Housing and Urban Development now.

If this is going to become Government-wide in its scope, why shouldn't the process and the control of the coordination be moved into the Treasury leaving FNMA to carry out its original function? If it has to be coordinated with the monetary authorities, and if this is going to be a permanent part of Treasury's programs for financing, why shouldn't an amendment be offered to the bill which moves this into the Treasury?

Mr. BARR. Senator, we looked at this approach and it is an approach. Reasonable men can differ over this. It seemed to us that FNMA was established. It had its relationships with the market. We had a long record of cooperative arrangements and coordination with FNMA and from the Treasury, as I mentioned before, back to the Federal Reserve System.

We decided that instead of creating another agency, we should use what we had. It worked well in the past, and we thought it would continue to work well in the future.

Senator BENNETT. I can't think of any agency that has a closer relationship with the market than the Treasury. You are in the market much more frequently than FNMA.

Mr. BARR. That is correct.

Senator BENNETT. It would seem to me if it is just a question of experienced personnel, maybe they can be moved out of HUD into the Treasury, but I predict that if this becomes a permanent part of our financing program, that the day will come when it will move into the Treasury because as more and more agencies begin to lend money, the spectrum will just be so broad that the Department of Housing and Urban Development will no longer appear the proper department to handle this kind of a problem.

Mr. SCHULTZE. There was one advantage with FNMA in that this does involve the pooling of a number of individual loans and relationships with other agencies and keeping the books on this and everything else. It turns out, unlike Treasury, this particular one, FNMA, does have experience, and I mean specifically they have already done this over the last year and a half, so there was some advantage in taking advantage of that expertise.

Senator BENNETT. There was a time when it was assumed that FNMA would possibly become a privately operated, privately capitalized operation. In other words, that the need for the Government to supply a secondary mortgage market would disappear because the private industry would supply the secondary mortgage market. This of course would completely eliminate that thought.

Mr. SCHULTZE. No; the FNMA secondary market function is treated separately. The sale of participations doesn't go through their secondary market function. That is separate, as it has been, ever since 1954 when it was established as a separate function.

Senator BENNETT. I think it should be left with that market and I hope the committee will consider whether or not this thing as a permanent program hasn't become important enough to move into the Treasury.

Then there is another thought that occurs to me about this program. You have made abundantly clear that there are times when it is difficult for a private individual or a company, or an operation, to get credit and so the Federal Government through its various agencies supplies that need. And now you turn around and sell participation certificates.

Are you creating a psychological situation in which the banker will say, "Why should I take the risk? Why shouldn't I send my borrowers to the Federal Government and then buy the participation back? I supply the credit, but I supply it without risk."

Is it not possible and perhaps likely that to make this practice Government-wide is going to increase the penetration of the Government into the business of supplying credit to industry and while it is true that the sale of participations brings private money back into the situation, that money or the credit created by that money is Government managed and aren't we by this process increasing the extent to which Government will manage private credit?

You become a broker between the borrower and lender and you eliminate the risk and take full control.

Mr. SCHULTZE. Senator, let me point out that over the last 2 years really, as we have been moving into this participations area, we have also moved along the lines you have dictated, where it is feasible with the cooperation of the Congress, to take programs which were originally Federal and move them out and make them almost purely private. Let me give you two examples of legislation passed and one now pending.

The first case is the Farmers Home Administration direct loan program for rural housing. The administration proposed, this committee agreed, and the Congress passed legislation translating that direct loan program into an insured loan program. Last year, in attempting to get more credit flowing into student loans, again the administration proposed and the Congress agreed on a program of lending from individual banks guaranteed by the Federal Government with an interest subsidy, so there is a direct relationship here. Finally, we proposed the same kind of thing this year, a little more complicated, for national defense education loans.

What I am trying to get at is that we have quite consciously moved in the direction wherever feasible not merely going the participation route, but going further than that, where it is feasible, and putting the whole program back out into the private market with just a straight guarantee.

Now, the reasons we can't do it with these other programs varies depending on the nature of the program, but we are continually surveying and evaluating programs with this in mind. What I did want

to assure you is that use of the participation method in and of itself does not ignore the possibility of trying to get private credit in more directly than if it is brought in through participation.

Mr. BARR. Senator Bennett, my I mention that we accepted a House amendment to this bill that instructed the Secretary of the Treasury to make a study and come back to the Congress in 6 months, with a report on all Federal credit programs and the possibility of substituting guarantees for direct loans.

Senator BENNETT. I think that is important, because I think the risk of getting deeper and deeper into the market increases with the passage of this bill unless there is something to offset it.

You have been very patient with me and I probably used more than my share of the time and I can only defend that by saying that today I am the captain and the crew and the whole minority. Earlier you had a discussion with Senator Robertson about the additional cost. Somewhere in these papers here, is a page from the Congressional Record containing a statement put in by Senator Williams quoting from the Wall Street Journal, which showed that the first sale under the Small Business Act represented an increase in cost of six-tenths of 1 percent, rather than the 25 to 35 basis points you have suggested.

Can you tell me why that happened?

Mr. BARR. Senator Bennett, this is a perfect illustration of why we want to go the participation route. As I mentioned to you, representatives of nearly every part of the financial community have recommended that we get rid of the assets we hold by direct sales or by guarantees.

Now we tried the direct sale route with the SBA loans, these were SBIC debentures. We sold them directly into the private market. We had to take a discount of 9 percent. In other words, SBIC bonds that were issued to yield 5 percent on par of 100 had to be sold at 91 so as to yield an effective rate of 5.75 percent.

At almost precisely the same time, Senator Bennett, FNMA was in the market. It got a rate of 5.38 percent. The difference between the two rates is almost 40 basis points, or 0.4 percent, so you can make the point that it cost close to a half million dollars to go the direct sale route rather than participation route. That was the cost to the Government in this operation.

If we are going to get rid of assets, we are faced with the question of whether we should sell them directly in the market or sell them via the participation route. If we sold mortgages, Senator Bennett, they would be bought, as I mentioned, by the very people making mortgages, thereby increasing the pressure on the homeowner who is trying to borrow money.

The participation route takes us through the whole spectrum, Senator.

Senator BENNETT. The paragraph I was quoting from page 169 of the March 22 Congressional Record says:

It is interesting to note, that the following day after the enactment of the bill, the Federal National Mortgage Association sold \$410 million worth of participation certificates. The interest rate they paid was 0.6 percent higher than the interest rates for corresponding Government issues.

Mr. BARR. I'm sorry, I misunderstood you. There has been a churning in the market in January, February, and March, and Di-

rector Schultze and I have referred to the spread of 25 to 35 basis points—one-fourth to three-eighths of 1 percent.

We are referring to the experience we have had over the past 2 or 3 years. The market has been churning in the last 3 months. Sometimes there has been a wide spread between the rate on participations and Treasury securities and at other times, in the same maturity schedules, the cost of participation sales comes very close to that on Treasury issues. It varies on different days.

Senator BENNETT. Let me ask you a question now. Does the buyer know the actual instruments behind his certificate?

Mr. BARR. If he reads his prospectus, he will know what assets are in this pool. That will be clearly set forth.

Senator BENNETT. That is fine. Now one other comment. And this question was handed to me.

Does this device really substitute private for public credit? Isn't it rather a means of using public credit to provide private credit?

Mr. BARR. I would describe it, Senator, as an attempt to enable borrowers who can't get to the market to use the facilities of the U.S. Government to get to the market. In effect the Government—I will use the term you used—would act almost as a broker, and we admit that there is a cost in this thing.

The alternative is having the Treasury do all of the borrowing. As you have pointed out, these direct loans have grown and grown and grown, so that the Government is beginning to look more like a bank than a Government—clearly an unacceptable position.

Senator BENNETT. In the last analysis, the Government gets its money from the public in any of its activities.

Mr. BARR. That is correct, sir.

Senator BENNETT. So it depends on private credit, whether by this device, the device of selling bonds, but this is a device by which the Government becomes a kind of broker.

Mr. BARR. It is the only feasible way we can see—

Senator BENNETT. Mr. Schultze wags his head at that.

Mr. SCHULTZE. I hate to let it go by without adding a comment if I might, Senator.

These programs are established in law and the Government now is not only the broker, but is the holder. So admittedly it is true, the Government becomes a broker, but actually shift from being the whole banker to becoming a broker. I think this is backing off rather than moving further into banking operations.

Senator BENNETT. Although the Government does take on a brokerage function in its sales of participations, it doesn't seem to me that it is backing off. It still makes the loans and retains title to them. It has just used them as collateral to borrow from the private market.

Thank you. You have been very patient with me and I thank you.

The CHAIRMAN. The Senator from Utah has developed some interesting points. For example, suppose a man wants to build a house, and we say, "Get a mortgage on the house, take it to the bank; we will guarantee 90 percent of it." And that is private credit.

Now the Secretary of the Treasury said while the Government does not guarantee these certificates of participation, the agency guarantees them, but the Congress is going to honor that obligation, so as far

as the borrower is concerned, he can rely on it just as much as if he were buying a Government bond.

What we want to know is, in what way then, if he is buying what is equivalent to a Government bond, we are using private credit any more than if he bought a Government bond?

You can think about that, and if you want to put that in the record later, you can do it. I just at the moment don't see the distinction.

The next thing he brought up is the question of the ceiling on the debt. The present ceiling is \$328 billion. The present debt is \$320 billion. On July 30 the ceiling goes back to \$285 billion. Whether we act on this bill or not, you have got to act on the ceiling, isn't that true?

Mr. BARR. Yes, sir. While it is true that the very same types of private investors might buy the FNMA participation certificates as would buy U.S. Government bonds, there is nonetheless a difference in the degree of linkage between the final investor and the final borrower under various Federal credit programs. In the case of the participation certificate in a pool of assets, the investor obtains a beneficial interest in a specific pool of credit related to a specific credit program. It is a significant step along the path toward a fuller degree of private participation in the Federal credit programs, which would include direct contact between the investor and the ultimate borrower, servicing of the loan by the private sector, and a bearing of some part of the risk by the private investor. In contrast, the investor who holds a U.S. Government bond has an asset that is completely general in scope—it could be associated just as well, for example, with the purchase of an Atlas missile as with the holding of an SBA loan.

The CHAIRMAN. But if we go through with this bill, the ceiling could be, presumably, about 2 billion less in this current fiscal year, and the next fiscal year might be a full billion less, because the money that you raise under these certificates will not appear in the debt ceiling.

Mr. BARR. That is basically correct, sir.

The CHAIRMAN. The Chair recognizes the Senator from Illinois.

Senator DOUGLAS. I apologize for not having been present when the testimony began. I take it that what you are doing essentially, is to sell off assets in order to meet current expenditures?

Mr. BARR. No, sir. We could meet current expenditures, Senator Douglas, by borrowing through the Treasury or we could meet current expenditures by raising taxes.

The objective of this legislation is to reduce the Government's ever-mounting portfolio of direct debt.

Senator DOUGLAS. And with those amounts, you meet your current deficits, isn't that right?

Mr. BARR. Yes, sir; if you want to look at it that way.

Senator DOUGLAS. Now is this a new practice or has this been put into effect before?

Mr. BARR. It is quite an old practice, Senator. There is nothing new or novel about it.

Senator DOUGLAS. I wonder if we could have a little history? You know after having sat 18 years on this committee, one's memory of details becomes a little hazy, but I have the vague recollection that,

around 1958, the Secretary of the Treasury, or at least the Under Secretary, appeared and asked that this same authority be given in connection with FNMA. Is that true?

Mr. BARR. That is correct. Mr. Schultze has some figures here he would like to insert.

Mr. SCHULTZE. I am a little at a loss to know exactly how to introduce this, because I am not trying to make invidious comparisons.

Senator DOUGLAS. I am not making invidious comparisons. It is just that my memory is not perfect. I have the vague recollection that the Under Secretary of the Treasury or perhaps the Secretary at that time appeared and asked that this be done so far as FNMA was concerned. Am I right or wrong?

Mr. SCHULTZE. Correct.

Senator DOUGLAS. How much was sold off?

Mr. SCHULTZE. What I was going to give you was kind of a summary of 8 years of the Eisenhower administration in this area of assets.

Senator DOUGLAS. It began before 1958?

Mr. SCHULTZE. Correct, sir.

The total amount of Federal portfolio sold over those 8 years was \$2½ billion, approximately—

Senator DOUGLAS. Two and one-half billion?

Mr. SCHULTZE. We may have missed a few small sales, but as far as we can figure, 2½ billion.

Senator DOUGLAS. This was to help reduce the deficit which would otherwise have existed?

Mr. SCHULTZE. Right.

Senator DOUGLAS. So you are merely walking in the familiar paths first trod by the Eisenhower administration?

Mr. SCHULTZE. We did not go back to the Truman administration, I suspect we would have found some sales of assets there. We did not go back.

Senator DOUGLAS. This applies to sales of securities and not sales of commodities?

Mr. SCHULTZE. That is right, financial assets, loans, mortgages, and the like.

Senator DOUGLAS. How much did the Eisenhower administration lose in its sales of its assets?

Mr. SCHULTZE. I'm sorry, sir, I would have no idea of what that was.

Senator DOUGLAS. I think it would be very interesting to find out.

Mr. SCHULTZE. I can make one point on it, Senator, that in general, although not always, given the kind of assets in the Federal Government's portfolio, it will cost more, as a general rule, to sell them individually, than if they are pooled and sold. This is because of the risk pooling involved, quite apart from the guarantees.

Even a guaranteed mortgage is going to cost more to sell it individually than if you pool a number of mortgages.

Senator DOUGLAS. You are the Inspector General for the Government, and your agency keeps a very close watch on all public bodies. Haven't you ever figured out what the loss was on the sale by the Eisenhower administration of these securities and mortgages, or are you drawing a silken curtain of secrecy over these?

Mr. SCHULTZE. No, sir. I think the only way one can, I think, legitimately calculate a loss is to look at the difference between what it would cost to continue to carry the securities by having Treasury debt outstanding and what it costs to get rid of them.

Senator DOUGLAS. That is what H. J. Davenport used to call "opportunity costs," but I don't recognize that. I would only like to know the difference between the amounts which the Government originally paid for these assets and the amounts which they secured when they sold them off. What was the loss?

Mr. SCHULTZE. That would be a different and possibly larger number.

Senator DOUGLAS. Yes, indeed; and do you mean to say that the very efficient Bureau of the Budget has not computed these losses?

Mr. SCHULTZE. I'm sorry to say, sir, we have not.

Senator DOUGLAS. This is a grave delinquency and I am surprised. If this had been some poor Government administrator, you would know how much he was losing. But you have never gone into this?

Mr. SCHULTZE. It may have been gone into—

Senator DOUGLAS. I am going to ask you to go into it and to produce for the record the amounts lost between the periods 1953 and 1961, and the amounts lost since 1961. Also, we should have the amounts sold, and the amounts which were originally paid. But not so-called opportunity costs. You see, the Government buys these things, but never likes to admit that it loses anything.

Mr. SCHULTZE. Two points, Senator. We will try, to the best of our ability.

(The information will be supplied later for the committee's use.)

Senator DOUGLAS. You have such an able group of men, you certainly should be able to do this. You have the cream of the intellect of Washington. This is a modest task. I am not asking a heculean task, but this is a modest task considering the intellectual assets you have.

Mr. SCHULTZE. There are, of course, as you know, hundreds of individual transactions stretching over this.

Senator DOUGLAS. Don't you have computers?

Mr. SCHULTZE. Yes, sir.

Senator DOUGLAS. On my basis of computation, how much are you going to sell off and how much do you expect to lose?

Mr. SCHULTZE. Senator, two points. First, the total amount of sales of participation in fiscal 1967 is planned at \$4.2 billion. Now, Senator, I would in all respects still insist that when the Federal Government makes a loan at 3 percent, whether it sells that loan out or not, it has taken the loss.

Now it takes the loss as a stream of income.

Senator DOUGLAS. Then you divide your loss into two groups, the loss occasioned by the low interest rate, and then, second, the loss occasioned by the sale to private parties?

Mr. SCHULTZE. The "loss" occasioned by the sale to private parties would presumably be the opportunity costs, which is the difference between carrying it continually at the Treasury rate and what it costs to sell participation. That, I can give you. That depends on the market.

Senator DOUGLAS. How much do you estimate that to be, on the sale of \$4.2 billion?

Mr. SCHULTZE. Two points on that. First, our past experience with a much smaller volume of participations outstanding, we already have some participations sold in the past, is about 25 to 35 basis points or a quarter to three-eighths of a percent. But, one of the reasons why that spread is what it is is because the secondary market for these participations, since only \$1.6 billion is outstanding, is rather thin. As more get outstanding, the market will be broader and deeper and hence that spread should narrow.

The spread also, obviously, varies from time to time and day to day, but from past experience, it was one-quarter to three-eighths.

Senator DOUGLAS. Now, Mr. Schultze, you also mentioned that of course the Government would take losses on the sale of loans at 3 percent. But FNMA loans have not been at 3 percent?

Mr. SCHULTZE. No, sir; that is correct.

Senator DOUGLAS. Now I have always suspected that FNMA was a happy dumping ground for a lot of sour stuff, and for 17 years I have been trying to probe FNMA. And I always come up against this assertion, "Oh, they are just as good as any other types of mortgages."

Now their losses are not occasioned by any 3 percent. What proportion of the \$4½ billion would be FNMA holdings?

Mr. SCHULTZE. In our 1967 estimate of \$4.2 billion, the following kinds of sales would be made:

FNMA, \$520 million worth, from portfolios in FNMA. In turn, that is composed of two kinds of items, the management and liquidation portfolio and the special assistance portfolio.

College housing loans, \$820 million.

Senator DOUGLAS. Those are low.

Mr. SCHULTZE. Public facility loans, \$80 million; that is 3¾ to 3¾ percent.

Senator DOUGLAS. You have \$2.8 billion to go.

Mr. SCHULTZE. Veterans' Administration direct loan portfolio, \$154 million.

Loan guarantee revolving fund—vendee loans—\$106 million.

Senator DOUGLAS. You are up to \$1.7 billion, if my arithmetic is correct.

Mr. SCHULTZE. Export-Import Bank, \$975 million.

Senator DOUGLAS. That is the biggest figure yet, Export-Import.

Mr. SCHULTZE. Rounded to a billion.

Small Business Administration, \$850 million.

Farmers Home Administration, \$600 million.

And the Office of Education, \$100 million; these would be academic facility loans.

Senator DOUGLAS. Now how much of this is in low interest loans? The Export-Import Bank loans are not low interest?

Mr. SCHULTZE. Five and one-half, generally.

I will give you the range of interest rates involved. For example, in the Farmers Home Administration, the bulk of them are in the 4- to 5-percent range.

In the case of the Office of Education, these range between 3 and 3⅝ percent.

Senator DOUGLAS. Export-Import?

Mr. SCHULTZE. Those are generally 5½-percent loans.

Senator DOUGLAS. Those have not been subsidized loans?

Mr. SCHULTZE. Those are not essentially carried in this bill, in the sense—

Senator DOUGLAS. Do you expect losses on the sale of these?

Mr. SCHULTZE. Of the Export-Import, no, sir. So far they have been able to do this pretty well, they have taken no losses.

Senator DOUGLAS. I have always been concerned whether the Government was having dumped upon it a lot of sour loans and mortgages. Now we made a conscious choice, which I supported, and I am still supporting, to have loans for college housing and other features. But many of these activities, such as FNMA's, have been at the request of the real estate market. The Export-Import Bank has made its loan at the request of those supporting it.

Have you ever surveyed the quality of these loans?

Mr. SCHULTZE. Not as a broad across-the-board survey, no, sir.

Senator DOUGLAS. But you mentioned the volume of all of these loans in the amount of \$33 billion.

Mr. SCHULTZE. That is correct.

Senator DOUGLAS. Do you mean you haven't assayed \$33 billion worth of alleged assets?

Mr. SCHULTZE. No, sir. What I mean, we do know where the \$33 billion is, we do know what the interest rates involved are, we have a good idea of the general nature and quality of the loans.

Senator DOUGLAS. How about the assets which lie behind? The Government owns metals; it owns foodstuffs; it owns securities.

Mr. SCHULTZE. That is right.

For example, we do have some figures, I don't have them with me, but agency by agency, in most cases, you can get a figure on the loss experience, for example, of the agency.

Senator DOUGLAS. You haven't done that?

Mr. SCHULTZE. Yes, sir.

Senator DOUGLAS. Would you make those results available to this committee?

Mr. SCHULTZE. To the extent that we can get the figure, yes, sir.

Senator DOUGLAS. Can't you get the figures?

Mr. SCHULTZE. In general, yes, sir. I don't want to promise what I can't deliver. In general we do.

Senator DOUGLAS. What are they holding in metals? How much does this amount to?

Mr. SCHULTZE. The market value of the raw materials stockpiles totaled \$7.3 billion on April 1.

Senator DOUGLAS. That doesn't include food and fibers?

Mr. SCHULTZE. Metals, raw materials.

Senator DOUGLAS. And food and fibers?

Mr. SCHULTZE. The commodity inventory, excluding loans, amounts to about \$2.8 billion on April 15.

Senator DOUGLAS. So you roughly have \$43 billion in all of these?

Mr. SCHULTZE. Or more; that is correct.

Senator DOUGLAS. Now, a good many of these commodities, whether hard goods or soft goods, were purchased in order to prevent prices from falling, not for a war reserve?

Mr. SCHULTZE. Are you talking about the metals?

Senator DOUGLAS. Yes.

Mr. SCHULTZE. A large part of them were purchased under contracts made during the early part of the Korean war, which essentially had a price support feature in them, so that is correct.

Senator DOUGLAS. I was against most of these measures to purchase metals in order to support prices and I know something of the forces which were at work. Those forces wanted to prevent the prices of these metals from falling.

Mr. SCHULTZE. I say, they were under contracts which essentially said the Government would take it off the market if the price goes below a certain amount.

Senator DOUGLAS. I wish you would get these figures. If not, we will ask the Comptroller General to make a survey.

Mr. SCHULTZE. I don't know whether that is a threat or a promise.

Senator DOUGLAS. It is an alternative to see just what these assets are worth, because these are tremendous figures.

This is one of those situations in which people claim to be strongly opposed to Government intervention, but they are pretty strong for Government intervention when it bails out private industry. Without indulging in mock heroics, I believe we should stick to the principle and let the chips fall where they may. I was somewhat critical of this practice under the Eisenhower administration.

Mr. SCHULTZE. Can I defend one point on this, Senator?

Senator DOUGLAS. On the Eisenhower administration?

Mr. SCHULTZE. No, sir; the other way around. I think there is one significant difference that Mr. Barr has already alluded to, that almost all of the sales made up until about 4 years ago were direct sales of individual mortgages, primarily.

When you make sales of individual mortgages, these are bought directly by mortgage lenders and have a very specific impact on the mortgage market.

Senator DOUGLAS. Also on losses, isn't that true, if you sold for less than you paid?

Mr. SCHULTZE. Correct.

Senator DOUGLAS. And that has never been computed?

Mr. SCHULTZE. Not to the best of my knowledge.

Senator DOUGLAS. You have all of these high-powered, high-speed computers, which can give you instantaneous results and you feed in thousands of separate items, and you have never done that?

Mr. SCHULTZE. No, sir.

Senator DOUGLAS. Has the truth been too terrible to contemplate?

Mr. SCHULTZE. No, sir.

The point I did want to make, Senator, is that when you go the participation route, instead of putting these mortgages directly into a narrow segment of the market, namely the mortgage market, and having a particular impact on that market, you are selling a much more neutral instrument which is attractive to a much larger and much broader market, and not just the mortgage market. You don't have that specific impact on the mortgage market.

Senator DOUGLAS. Do you want me to ask the Comptroller General to make a survey of the losses on these items?

Mr. SCHULTZE. Could you let me see what is available? I'm not sure what is available, if you are going all the way back to 1953, that is my only point.

Senator DOUGLAS. If the task is too heavy for you and the resources which you have available are too scanty, I will be very happy to write to the Comptroller General and his overburdened staff can perhaps do the job.

Mr. SCHULTZE. We will take a look at our resources.

Senator DOUGLAS. How long will that look continue?

Mr. SCHULTZE. I can give you an answer as to whether our resources can do it very quickly.

Senator DOUGLAS. How quickly is very quickly?

Mr. SCHULTZE. Within a week.

Senator DOUGLAS. Excuse me, Mr. Chairman.

Senator SPARKMAN (presiding). Senator Proxmire?

Senator PROXMIRE. Mr. Schultze, what are the built-in authorization restrictions here? You have made a good case on page 7. I think you indicated that the Appropriations Committee has to provide specific approval before these assets can be sold, any of these assets. So you have shut the back door, but if we pass this bill, how much of the, what is it, \$39 billion of assets then can be sold, assuming that the appropriation is passed?

Mr. SCHULTZE. Two parts to your question, I think, Senator. One is, What are the authorization controls? There are two kinds of controls on it in that sense. First, in program after program, the authorization bills have placed limits on the total volume of loans outstanding, for example Small Business Administration.

Senator PROXMIRE. I understand that very well, but my question is, that you have these loans outstanding now.

Mr. SCHULTZE. Correct.

Senator PROXMIRE. You have them in your portfolio, and you have, as I understand in 1965, something like \$33 billion. You would have, if you didn't sell any of these participation, somewhere between 32 and 39.

My question is, How much of that can you sell without additional authorization, assuming the Appropriations Committee goes along?

Mr. SCHULTZE. Without additional substantive authorization?

Senator PROXMIRE. Sell the whole thing?

Mr. SCHULTZE. Most of it. We have looked at the assets that we think are appropriate to include in such pools, under present circumstances.

Senator PROXMIRE. Is that your conclusion that this committee, the authorizing committee, we are out of the act, having passed this?

Mr. SCHULTZE. That is correct.

Senator BENNETT. Will the Senator yield?

Senator PROXMIRE. Yes, sir.

Senator BENNETT. It should probably be pointed out that even after they sell the participations, they still have \$33 billion worth of loans in their portfolio. All they have done is issued a new form of security with that as backing. They are not selling the loans.

Senator PROXMIRE. That was my next question, and I think that is a very interesting question; that is, you don't diminish the federally owned assets at all; what you do is put them up as collateral.

Mr. SCHULTZE. In a sense, yes.

Senator PROXMIRE. And then you sell participations; is that correct?

Mr. SCHULTZE. Correct.

What we have done is bring into this—through the pooling device, private credit, but granted, the pool itself holds the assets—you are quite correct. But you have brought in the private credit to offset that.

This is where, I indicated to Senator Bennett earlier, where feasible, we have proposed legislation to change some of these programs to insured programs, under which, in no sense, do we hold the assets. In some cases that is feasible and in some cases it hasn't been feasible.

Senator MUSKIE. Will the Senator yield on that point?

Senator PROXMIRE. Yes, sir.

Senator MUSKIE. As a matter of fact, with respect to direct sales, unless they are without recourse they are still obligations of the Government and in the Government's portfolio.

Mr. SCHULTZE. Correct.

Senator MUSKIE. To what extent do we sell directly without recourse? Any at all?

Mr. SCHULTZE. There are some sales. For example Export-Import Bank makes some sales without recourse, they are small in volume; but they make some sales.

Senator MUSKIE. So for all practical purposes, both in connection with direct sales, as well as participation sales, the basic obligation is still an obligation, a contingent liability.

Mr. SCHULTZE. That is correct.

Senator PROXMIRE. Now, just today, Senator Sparkman raised the point on page 6, lines 9 to 12, and you have this limitation which you explained as providing a restriction really on college housing loans, so they wouldn't exceed \$300 million?

Mr. SCHULTZE. You wouldn't be basically increasing the borrowing authority, significantly.

Senator PROXMIRE. Last Tuesday we had a very good presentation from Dr. Mullins, president of the University of Arkansas, on behalf of seven outstanding, the outstanding higher educational organizations in the country. He made a very, very strong appeal to this committee that we should do just what this part of the bill would prevent us from doing.

He said:

The President's proposal to sell off college housing bonds through a pool arrangement is in effect comparable to receiving early repayment on those bonds. The college housing legislation, as we have already noted, provides for the relending of such repayments in order to provide additional college housing. In view of the critical and increasing demand for additional student spaces, we have no choice but to urge strongly that any proceeds realized from the sale of college housing bonds in fiscal 1967 be made available in that fiscal year for additional college housing loans.

Now I understand the administration, of course, has to make some painful and tough choices in all these areas, but I want to make sure I know what we are doing.

This would mean that we would not be able to reloan the proceeds from sales on this basis?

Mr. SCHULTZE. The key point is, we would reloan no more than the amount the substantive committee, again roughly, has already provided in authorizing legislation. In other words, what we are doing is really replacing new borrowing authority by sale of participations. We are at the status quo, roughly with respect to the amount the college housing program is authorized to borrow from the Treasury.

Senator PROXMIRE. Would this place any new restraint in the way—

Mr. SCHULTZE. No, sir.

Senator PROXMIRE. If Congress decides they should go ahead with college housing?

Mr. SCHULTZE. No, sir, in other words the whole point of this bill is to keep the status quo, and the authorizing committee then can work its will as it may on the program itself.

Senator PROXMIRE. One of the arguments, it is true, there are two sides, one of the arguments in favor of this kind of procedure, both for SBA and the legislation before us, is that it means that Congress can act more rapidly. At least I thought that was it, because we didn't have to wait on appropriation acts. In view of the House amendment which brings everything under appropriations authorization, we lose that, don't we? In other words, the back door is shut. The House amendment provides that in all cases the Appropriations Committee has to give specific authorizations; isn't that correct?

Mr. SCHULTZE. For the total amount of participation sales.

Senator PROXMIRE. Not only where you have 3 or 3.5 percent subsidized loans but for all, not export-import, that is taken care of separately, but all of the other legislation?

Mr. SCHULTZE. That is correct.

Senator PROXMIRE. Well, that is a loss as well as a gain.

Senator DOUGLAS. The loss exceeds the gain.

Senator PROXMIRE. I think perhaps it does.

Senator SPARKMAN. Will the Senator yield while he is on that subject?

Senator PROXMIRE. Yes, sir.

Senator SPARKMAN. Going back to this cutting out of 1966 provision, how long is it going to take, assuming that Congress passes this bill, it goes into effect July 1, how soon will funds be available for sale or participation of college loans in order to replenish the supply?

Mr. SCHULTZE. I don't know exactly, Senator. It would depend on how long it takes to arrange the sale, and then determine the appropriate time to sell, in terms of scheduling it for the market.

But I see no reason why it could not be very early in the fiscal year, if necessary. Whether it could be July 1 or not is another question, but it could be very early in the fiscal year. I think Secretary Barr could speak better to this point.

Mr. BARR. The more promptly this legislation is considered, and hopefully passed, the more promptly we can get into the market. That is one reason for the urgency of this legislation. If it is passed, as I have already indicated, we would go immediately to the Appropriations Committee for the authority to transfer these assets to FNMA and move ahead right into the market as early as it is practicable.

Mr. SCHULTZE. May I point out, Senator, that as far as college housing is concerned, there is plenty of carryover in the college housing fund, even without new borrowing authority, so that the agency does not depend on the sale of assets early in fiscal 1967 in order to continue the program.

Senator SPARKMAN. You know, there are some of these programs that can be badly hurt by delay, and college housing is one of them.

They are trying to meet a deadline in construction to take care of the students in the fall. Small Business has been hurt for the last 6, 7, 8, and 9 months, by not having funds available for it.

I am just afraid of those lapses.

Mr. SCHULTZE. As I say, in the college housing program, there are plenty of funds to carry over into fiscal 1967, so there is no problem as far as that program is concerned with respect to this.

Senator SPARKMAN. Thank you, Senator Proxmire.

Mr. BARR. Mr. Chairman, may I correct the record at this point? Mr. Schultze and I have been informed by counsel that we have made an error, and as these proceedings are going to be watched by all bond counsels in the country, I would like the record to be corrected, if I may, sir.

In answer to Senator Bennett's question, and Senator Proxmire's question, we made the statement that these loans were just collateral in the FNMA account. Actually, title legally does pass from the agency to FNMA as trustee, so they are not merely collateral, FNMA holds title to these direct loans.

Senator PROXMIRE. The point that Senator Bennett and I were making would still be correct, in other words, this would still be in the hands of a Government agency, the Federal Government would still hold title and, therefore, in a sense it is collateral.

Mr. BARR. The reason I am correcting the record is that I don't want the lawyers to be confused as to precisely what happens.

Thank you.

Senator PROXMIRE. You have, Mr. Barr, an attachment here in which you give two examples. One example is SBA.

Mr. BARR. Yes, sir.

Senator PROXMIRE. I want to be sure I understand correctly, we passed the SBA participations bill.

Mr. BARR. Yes.

Senator PROXMIRE. That bill is separate and distinct. That bill, as I understand it, was approved by the House committee and is now pending, and I hope it will be acted on favorably by the House soon and be enacted into law; is that correct?

Mr. BARR. That is correct.

Senator PROXMIRE. That is separate and distinct from this, and that would permit sales of participations by Small Business.

You are giving this as an example, not meaning that the possibility of having participations for SBA is contingent on passage of this bill?

Mr. BARR. No, sir.

Senator PROXMIRE. That is all, Mr. Chairman.

Senator SPARKMAN. Senator Bennett, any further questions?

Senator BENNETT. I just had one more question. Are these participations eligible for the banks to use as reserves?

Mr. BARR. Senator, they would not be eligible by a bank for use as a reserve. It is a question as to whether or not the Federal Reserve Board will have to pass on the eligibility of this paper for rediscount use and the Comptroller of the Currency will have to pass on the eligibility of this paper as legal investments for national banks. But they are not available for reserves.

Reserves of the national banks and members of the Federal Reserve System are held in cash in the Federal Reserve bank.

Senator BENNETT. I have just one other thing. There was a discussion, of which I was not a part, as to whether or not the Export-Import Bank had suffered any loss in the sale of its assets. There is some information here in our hearings on October 7, 1965, where they set up original pool, in which Mr. Schultze said, with respect to the audit of the Export-Import Bank for fiscal year 1962, that in that year they had a direct loss of \$3.9 million in the sale. That loss occurred in the difference between what the Government would have received if they had been held until maturity and when they were sold.

Mr. SCHULTZE. All right, in terms of the rate on participation versus the rate on the loan, the interest they were getting, there was no loss.

Senator BENNETT. This loss was because of their premature or early disposition.

Thank you, Mr. Chairman.

Senator PROXMIRE. May I just ask, is there in your judgment any economic effect, any economic difference between a direct Treasury borrowing on the one hand and participations on the other?

Mr. SCHULTZE. I would say there is very little.

Senator PROXMIRE. From an economic standpoint, of course the administrative budget has all kinds of weaknesses. But from the effect on the economy it makes no difference if you handle it with a \$1.8 billion deficit or don't pass the bill and have a deficit of \$6.5 billion, or whatever it is—

Mr. SCHULTZE. In this context, you are quite right.

Senator PROXMIRE. Except that it is a happier situation for us to have \$1.8 billion deficit.

Mr. SCHULTZE. Right.

Senator PROXMIRE. Thank you.

Senator SPARKMAN. Thank you very much, gentlemen.

Senator BENNETT. Thank you.

Senator SPARKMAN. Have you had a citizens advisory group to work with you on that?

Mr. BARR. It is an Advisory Committee on Financial Assets.

(The committee membership was later supplied, as follows:)

Chairman of the Committee is Sidney Weinberg, partner in Goldman Sachs, New York City. Other members are: Robert McKinney (Vice Chairman) publisher, Santa Fe, N. Mex.; Jamar Adeock, Monroe, La.; Howard Bowen, president, University of Iowa, Iowa City, Iowa; Morris D. Crawford, Jr., president, Bowery Savings Banks, New York City; Thad Holt, Birmingham, Ala.; George Jenkins, vice president, Metropolitan Life Insurance Co., New York City; David M. Kennedy, chairman, Continental Illinois National Bank & Trust Co., Chicago, Ill.; Cameron McElroy, Marshall, Tex.; James O'Leary, Life Insurance Association of America, New York City; Emil J. Pattberg, chairman of the board, the First Boston Corp., New York City; and Rudolph A. Peterson, president, Bank of America, San Francisco, Calif.

Senator SPARKMAN. These are bankers?

Mr. BARR. A combination of bankers, investment bankers, mutual savings bankers, savings and loan people, and educators. This is very technical legislation and it took a month and a half to really make sure that we had not made any technical mistakes. As you can see, we made one in accepting the last amendment.

Senator SPARKMAN. Was the committee or group or whatever you called it in favor of this legislation?

Mr. BARR. We consulted them about the financial and technical aspects of the bill. The committee made several suggestions which we adopted. They agreed that the legislation was well conceived from a financial and technical standpoint.

Senator SPARKMAN. Did they go along with you?

Mr. BARR. Yes, sir; from a technical standpoint. They were technical advisers, and we did not specifically ask them for an overall endorsement.

Senator PROXMIRE. Let me ask, Does that House amendment giving the Appropriations Committee the authority over all of this participation action, apply to the SBA? It wouldn't apply to export-import, would it?

Mr. SCHULTZE. Anything that goes through FNMA.

Senator PROXMIRE. Small Business goes through FNMA, but we have this separate legislation, which stands on its own feet.

Mr. BARR. We will give you an answer to that.

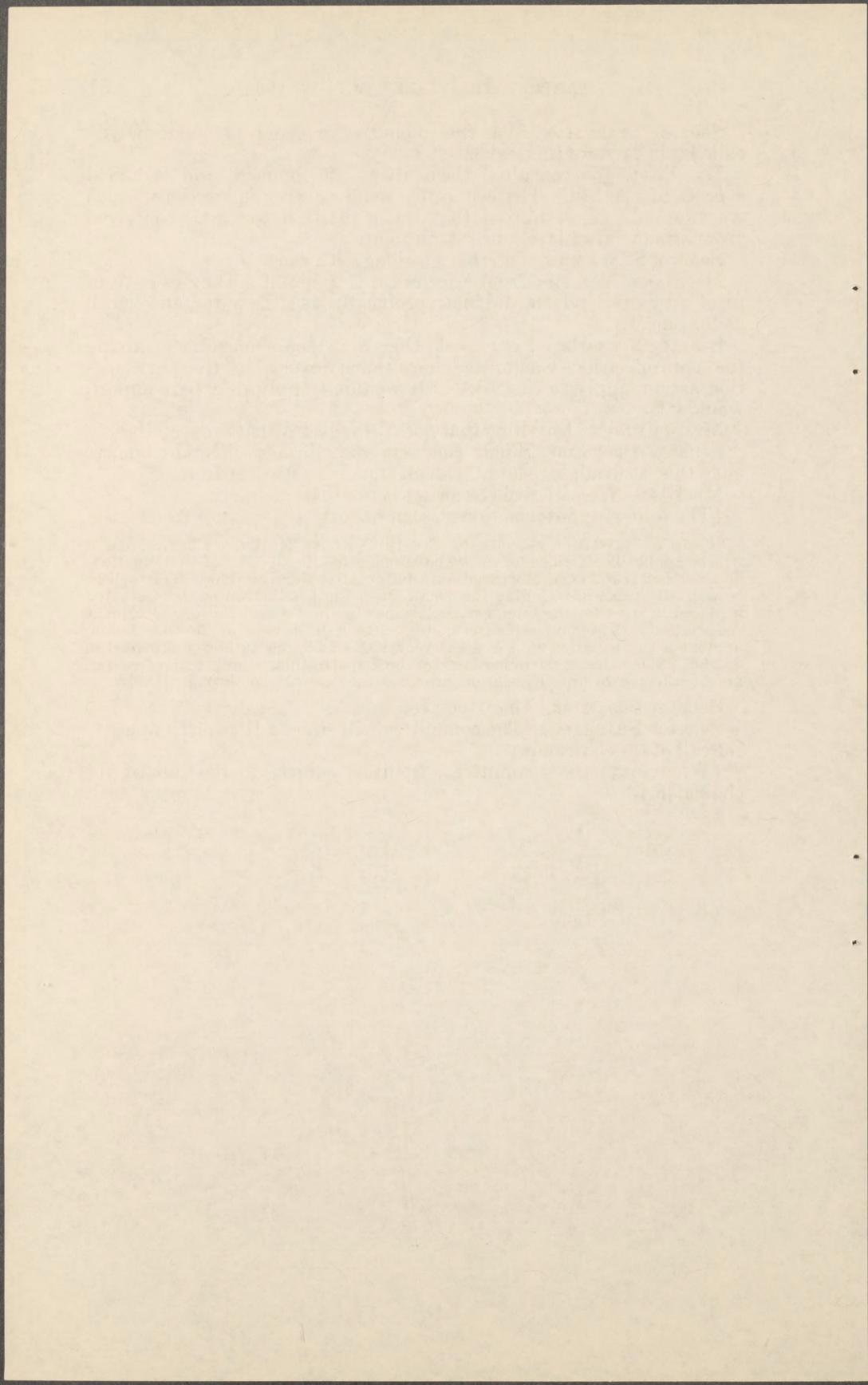
(The following information was supplied.)

Since this legislation amends the Federal National Mortgage Charter Act, it will be applicable, if amended as we have requested, to all sales of participations by the Federal National Mortgage Association after June 30, 1966. This will be true of all agencies, including the Small Business Administration, whose paper is placed in trust for the sale of participations by the Federal National Mortgage Association. It is planned, however, that SBA will, in view of the time factor, arrange a participation sale in fiscal year 1966 under the authority provided in S. 2499. The sales of participations by the Export-Import Bank will, of course, not be affected by this legislation provided they do not go through FNMA.

Senator PROXMIRE. Thank you very much.

Senator SPARKMAN. The committee will stand adjourned subject to the call of the chairman.

(Whereupon the committee adjourned subject to the call of the chairman.)



PARTICIPATION SALES ACT OF 1966

THURSDAY, APRIL 28, 1966

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D.C.

The committee met, pursuant to notice, at 10:07 a.m., in room 5302, New Senate Office Building, Senator A. Willis Robertson, presiding.

Present: Senators Robertson, Sparkman, Douglas, Proxmire, Muskie, McIntyre, Mondale, Bennett, and Tower.

The CHAIRMAN. The committee will please come to order.

We regret that we had to call a meeting of this committee for the further consideration of a proposal to issue participating certificates, because the money market is getting very tight, I am sure everybody knows. It was in the paper this morning that the Treasury was forced to sell at a discount an 18-month note that would bear almost 5 percent interest.

Everybody knows that on bonds we have a limit of 4.5 percent.

Everybody knows that money is tight in the banks and savings and loan and mutual banks and that the Small Business Administration urgently needs some money to make loans. Other agencies need the money.

We know, of course, that if the Federal Government right now should up the 4.5 percent interest rate, which it will have to do if we don't give them any opportunity to get money without doing it, that could touch off a very harmful situation.

Recognizing that fact, I wish to first read into the record at this point a telegram that I have just received from Dr. Charles E. Walker, executive vice president, American Bankers Association:

Supplementing and clarifying my letter to you of April 26 the American Bankers Association believes that H.R. 14544 with proposed amendments offers adequate congressional safeguards for use of the authority, and we therefore interpose no objection to the passage of the bill.

We will, of course, indicate in the record at an appropriate time the amendments to which that telegram refers.

The letter to which he refers appears in Tuesday's proceedings.

At this point, without objection, I will place in the record Senator Muskie's bill, S. 3283.

(The bill follows.)

89TH CONGRESS
2^D SESSION

S. 3283

IN THE SENATE OF THE UNITED STATES

APRIL 27, 1966

Mr. MUSKIE introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To promote private financing of credit needs and to provide for an efficient and orderly method of liquidating financial assets held by Federal credit agencies, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Participation Sales Act
4 of 1966".

5 SEC. 2. (a) Section 302 (c) of the Federal National
6 Mortgage Association Charter Act is amended—

7 (1) by inserting "(1)" immediately following
8 "(c)";

9 (2) by inserting after "undertakings and activities"

2

1 a comma and "hereinafter in this subsection called
2 'trusts,'";

3 (3) by striking out the words "offered to it by the
4 Housing and Home Finance Agency or its Adminis-
5 trator, or by such Agency's constituent units or agencies
6 or the heads thereof, or any first mortgages in which
7 the United States or any agency" in the first sentence
8 thereof and by inserting "and other types of securities,
9 including any instrument commonly known as a secu-
10 rity, hereinafter in this subsection called 'obligations,'
11 in which the United States or any executive department,
12 agency,";

13 (4) by striking out the third sentence thereof and
14 substituting therefor the following: "Participations or
15 other instruments issued by the Association pursuant to
16 this subsection shall to the same extent as securities
17 which are direct obligations of or obligations guaranteed
18 as to principal or interest by the United States be deemed
19 to be exempt securities within the meaning of laws
20 administered by the Securities and Exchange Commis-
21 sion.;" and

22 (5) by striking out the fourth sentence thereof.

23 (b) Section 302 (c) of such Act is further amended by
24 adding the following:

25 "(2) Subject to the limitations provided in paragraph

1 (4) of this subsection, the head of any executive depart-
2 ment, agency, or instrumentality of the United States, here-
3 inafter in this subsection called the "trustor", is authorized
4 to set aside a part or all of any obligations held by him and
5 subject them to a trust or trusts and, incident thereto, shall
6 guarantee to the trustee timely payment thereof. The trust
7 instrument may provide for the issuance and sale of bene-
8 ficial interests or participations, by the trustee, in such obli-
9 gations or in the right to receive interest and principal col-
10 lections therefrom; and may provide for the substitution or
11 withdrawal of such obligations, or for the substitution of cash
12 for obligations. The trust or trusts shall be exempt from all
13 taxation. The trust instrument may also contain other appro-
14 priate provisions in keeping with the purposes of this subsec-
15 tion. The Association may be named and may act as trustee
16 of any such trusts and, for the purposes thereof, the title to
17 such obligations shall be deemed to have passed to the
18 Association in trust: *Provided*, That the trust instrument
19 shall provide that custody, control, and administration of
20 the obligations shall remain in the trustor subjecting the
21 obligations to the trust, subject to transfer to the trustee
22 in event of default or probable default, as determined by
23 the trustee, in the payment of principal and interest of the
24 beneficial interests or participations. Collections from obli-
25 gations subject to the trust shall be dealt with as provided

4

1 in the instrument creating the trust. The trust instrument
2 shall provide that the trustee will promptly pay to the
3 trustor the full net proceeds of any sale of beneficial interests
4 or participations to the extent they are based upon such
5 obligations or collections. Such proceeds shall be dealt
6 with as otherwise provided by law for sales or repayment of
7 such obligations. The effect of both past and future sales
8 of any issue of beneficial interests or participations shall be
9 the same, to the extent of the principal of such issue, as
10 the direct sale of the obligations subject to the trust. Any
11 trustor creating a trust or trusts hereunder is authorized to
12 purchase, through the facilities of the trustee, outstanding
13 beneficial interests or participations to the extent of the
14 amount of his responsibility to the trustee on beneficial
15 interests or participations outstanding, and to pay his proper
16 share of the costs and expenses incurred by the Associa-
17 tion as trustee pursuant to the trust instrument, and for
18 these purposes may use any appropriated funds or other
19 amounts available to him for the general purposes or pro-
20 grams to which the obligations subjected to the trust are
21 related.

22 “(3) When any trustor guarantees to the trustee the
23 timely payment of obligations he subjects to a trust pur-
24 suant to this subsection, and it becomes necessary for such
25 trustor to meet his responsibilities under such guaranty, he

5

1 is authorized to fulfill such guaranty by using any appro-
2 priated funds or other amounts available to him for the
3 general purposes or programs to which the obligations sub-
4 jected to the trust are related.

5 “(4) Beneficial interests or participations shall not be
6 issued for the account of any trustor in an aggregate princi-
7 pal amount greater than is authorized with respect to such
8 trustor in an appropriation Act. Any such authorization
9 shall remain available until used.

10 “(5) The Association, as trustee, is authorized to issue
11 and sell beneficial interests or participations under this sub-
12 section, notwithstanding that there may be an insufficiency
13 in aggregate receipts from obligations subject to the related
14 trust to provide for the payment by the trustee (on a timely
15 basis out of current receipts or otherwise) of all interest or
16 principal on such interests or participations (after provision
17 for all costs and expenses incurred by the trustee, fairly
18 prorated among trustors). Whenever the issuance of an
19 aggregate principal amount is authorized pursuant to para-
20 graph (4) of this subsection, such an authorization in an
21 appropriation Act shall establish on the books of the Treas-
22 ury as appropriations such sums as may be necessary from
23 time to time to enable the trustor to pay the trustee such
24 insufficiency as the trustee may require on account of out-

6

1 standing beneficial interests or participations. Such trustor
2 shall make timely payments to the trustee from such appro-
3 priations, subject to and in accord with the trust instrument.”

4 SEC. 3. (a) Section 305 (c) of the Federal National
5 Mortgage Association Charter Act is amended by deleting
6 “by \$450,000,000 on July 1, 1966,”.

7 (b) Section 401 (d) of the Housing Act of 1950 is
8 amended by deleting “1968:” immediately preceding the
9 first proviso and by substituting therefor “1965, and 1967
10 and 1968:”.

11 SEC. 4. (a) Section 303 (c) of title III of the Higher
12 Education Facilities Act of 1963 is amended by striking out
13 the first nine words in the second sentence and substituting
14 therefor the following: “For the purpose of making pay-
15 ments into the fund established under section 305”.

16 (b) Title III of the Higher Education Facilities Act
17 of 1963 is further amended by adding after section 304 the
18 following new section:

19 “REVOLVING LOAN FUND

20 “SEC. 305. (a) There is hereby created within the
21 Treasury a separate fund for higher education academic
22 facilities loans (hereafter in this section called “the fund”)
23 which shall be available to the Commissioner without fiscal-
24 year limitation as a revolving fund for the purposes of this
25 title. The total of any loans made from the fund in any

1 fiscal year shall not exceed limitations specified in appropria-
2 tion Acts.

3 “(b) (1) The Commissioner is authorized to transfer
4 to the fund available appropriations provided under section
5 303 (c) to provide capital for the fund. All amounts
6 received by the Commissioner as interest payments or
7 repayments of principal on loans, and any other moneys,
8 property, or assets derived by him from his operations in
9 connection with this title, including any moneys derived
10 directly or indirectly from the sale of assets, or beneficial
11 interests or participations in assets, of the fund, shall be
12 deposited in the fund.

13 “(2) All loans, expenses, and payments pursuant to
14 operations of the Commissioner under this title shall be paid
15 from the fund, including (but not limited to) expenses and
16 payments of the Commissioner in connection with the sale,
17 under section 302 (c) of the Federal National Mortgage
18 Association Charter Act, of participations in obligations
19 acquired under this title. From time to time and at least
20 at the close of each fiscal year, the Commissioner shall pay
21 from the fund into the Treasury as miscellaneous receipts in-
22 terest on the cumulative amount of appropriations paid out
23 for loans under this title or available as capital to the fund,
24 less the average undisbursed cash balance in the fund during
25 the year. The rate of such interest shall be determined

1 by the Secretary of the Treasury, taking into consideration
2 the average market yield during the month preceding such
3 fiscal year on outstanding Treasury obligations of maturity
4 comparable to the average maturity of loans made from the
5 fund. Interest payments may be deferred with the approval
6 of the Secretary of the Treasury, but any interest payments
7 so deferred shall themselves bear interest. If at any time
8 the Commissioner determines that moneys in the fund exceed
9 the present and any reasonably prospective future require-
10 ments of the fund, such excess may be transferred to the
11 general fund of the Treasury.”

12 SEC. 5. Section 338 (c) of the Consolidated Farmers
13 Home Administration Act of 1961 is amended by striking in
14 the second sentence “and (8)” and inserting in lieu thereof
15 “(8) section 8 of the Watershed Protection and Flood Pre-
16 vention Act, as amended (16 U.S.C. 1006a); (9) section
17 32 (e) of the Bankhead-Jones Farm Tenant Act, as amended
18 (7 U.S.C. 1011); and (10)”; and by inserting in the fifth
19 sentence after “title,” the following: “section 8 of the Water-
20 shed Protection and Flood Prevention Act, as amended, and
21 section 32 (e) of the Bankhead-Jones Farm Tenant Act, as
22 amended.”

23 SEC. 6. Nothing in this Act shall be construed to repeal
24 or modify the provisions of section 1820 (e) of title 38,

9

1 United States Code, respecting the authority of the Adminis-
2 trator of Veterans' Affairs.

3 SEC. 7. Paragraph (7) of section 8 of the Federal
4 Credit Union Act (12 U.S.C. 1757) is amended to read:

5 " (7) to invest its funds (A) in loans exclusively to
6 members; (B) in obligations of the United States of
7 America, or securities fully guaranteed as to principal
8 and interest thereby; (C) in accordance with rules and
9 regulations prescribed by the Director, in loans to other
10 credit unions in the total amount not exceeding 25 per
11 centum of its paid-in and unimpaired capital and sur-
12 plus; (D) in shares or accounts of savings and loan
13 associations, the accounts of which are insured by the
14 Federal Savings and Loan Insurance Corporation; (E)
15 in obligations issued by banks for cooperatives, Federal
16 land banks, Federal intermediate credit banks, Federal
17 home loan banks, the Federal Home Loan Bank Board,
18 or any corporation designated in section 101 of the
19 Government Corporation Control Act as a wholly owned
20 Government corporation; or in obligations, participa-
21 tions, or other instruments of or issued by, or fully
22 guaranteed as to principal and interest by, the Federal
23 National Mortgage Association; or (F) in participation
24 certificates evidencing beneficial interests in obligations,

10

1 or in the right to receive interest and principal collections
2 therefrom, which obligations have been subjected by one
3 or more Government agencies to a trust or trusts for
4 which any executive department, agency, or instrumen-
5 tality of the United States (or the head thereof) has
6 been named to act as trustee;”

7 SEC. 8. The Secretary of the Treasury, in consultation
8 with heads of agencies of the United States carrying on
9 direct loan programs, shall conduct a study, in such manner
10 as he shall determine, on the feasibility, advantages, and
11 disadvantages of direct loan programs compared to guaran-
12 teed or insured loan programs and shall report his findings
13 together with specific legislative proposals to the Congress
14 not later than six months after the effective date of this
15 Act. There are authorized to be appropriated such sums
16 as necessary for the purpose of this section.

17 SEC. 9. The Federal National Mortgage Association is
18 authorized during fiscal year 1966 to sell (1) additional
19 participations in the Government Mortgage Liquidation
20 Trust, and (2) participations in a trust to be established by
21 the Small Business Administration, each without regard
22 to the provisions of paragraph (4) of section 302 (c) of
23 the Federal National Mortgage Association Charter Act,
24 as added by this Act.

The CHAIRMAN. I will ask permission to put in the record endorsement of the American Legion through Commander James.

Also a letter addressed to Mr. Patman from the national commander of the Disabled American Veterans.

Also endorsement from the Amvets, National Headquarters.
(The material referred to follows:)

THE AMERICAN LEGION,
Washington, D.C., April 27, 1966.

HON. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. PATMAN: As national commander of the American Legion, I have been asked to comment on H.R. 14544, the Participation Sales Act of 1966.

I am advised that this bill would authorize Federal agencies administering credit programs to enter into agreements with the Federal National Mortgage Association, whereby that Association would sell to private investors interest-earning shares, known as participation certificates, based upon a pooling of Government loan certificates. I am told that this plan, in effect, would serve to substitute private for public credit.

The Veterans' Administration has, since 1964, used this technique to sell a substantial number of its veterans' housing mortgages, under a similar authorization contained in Public Law 88-560. H.R. 14544 would encompass this authorization and extend it to include certain other Federal agencies.

The impact of the proposed legislation upon present VA operations in the primary concern of the American Legion. It is our understanding that the sale of participation certificates under the provisions of this bill would not give the purchasers any control over the programs under which the loans were made. The veteran would continue to deal directly with the Veterans' Administration, the agency which administers his housing loan program.

We have been assured by the Veterans' Administration that the provisions of this bill will favorably affect the operations of the VA. Accordingly, the American Legion favors the enactment of H.R. 14544.

Sincerely yours.

L. ELDON JAMES, *National Commander.*

DISABLED AMERICAN VETERANS,
Washington, D.C., April 20, 1966.

HON. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency, House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: The Participation Sales Act of 1966 will encourage greater use of this country's private capital assets in financing education and the general welfare through loan programs. One of the major lending programs is that authorized by veterans legislation.

The Disabled American Veterans (DAV) supports only that legislation which is designed for the benefit of the disabled veteran. Recognizing that adequate financing is a foundation of any continuing program, a review of this act shows that it warrants our endorsement.

The provisions of this act have been tested and proved by a Veterans' Administration lending program in which numerous members of the DAV have participated. This includes guaranteed loans and direct loans to disabled veterans, and the special program for partial Federal financing of special homes for certain disabled veterans. There are part of one of Government's largest lending programs, administered by the VA, which has sold almost \$1 billion loans to private capital. The Participation Sales Act of 1966 would extend the same privilege of "pooling" loans to other Federal agencies.

We find that the new act in no way changes the veterans' program administration, and that the VA will continue to deal directly with the veteran. It provides selling of mortgage loans through the Federal National Mortgage Association, which acts as marketing agent for the loans to private capital. This, in turn, permits use of the capital from sales of the loans. The VA experience has shown that this practice has allowed loans to thousands of additional veterans.

The DAV support of the President's policy of defending freedom against communism in Vietnam is unwavering, as is the support of necessary expenditures to

fight the war. As veterans who have suffered at the hands of enemies who would deny our freedom, we best understand that the primary responsibility of Government is security of our country.

Since the provisions of this act strengthen the method of financing by our Government, and encourages private enterprise participation in the loan programs, it is consonant with the aims of the DAV.

The goals of the DAV remain consistent: benefits for those who gave so much in service to their country. Adequate financing of those benefits is essential. Therefore, I urge you to support this legislation and its passage by Congress.

Sincerely,

CLAUDE L. CALLEGARY,
National Commander.

AMVETS NATIONAL HEADQUARTERS,
Washington, D.C., April 22, 1966.

HON. WRIGHT PATMAN,
*Committee on Banking and Currency,
House of Representatives, Washington, D.C.*

DEAR MR. PATMAN: The President of the United States has called for passage of the Participation Sales Act of 1966, which, if enacted into law, will permit greater use of private capital assets in financing education and general welfare through loan programs.

One of the major Government lending programs is authorized by the loan provisions of veterans' legislation. The validity of the principle embraced in this proposed law has already been tested and proved by this veterans' lending program. Since 1964, nearly \$1 billion in these loans have been "pooled" and marketed to private financial institutions through the Federal National Mortgage Association (FNMA). This has permitted thousands of extra loans to veterans without extra Treasury borrowing.

The act would permit the same practice by other Federal agencies, in permitting "pooling" to market Government-backed loans to private capital. The officers of AMVETS have reviewed the proposed legislation and find that its passage will bring absolutely no change in the management of the VA guaranteed or direct loans to veterans on homes and businesses. The VA will continue to be the administering agency, and the veteran, as always, will deal with the VA.

We also find that, under the proposed law, Congress will retain full control of appropriations, and in many areas congressional control will be strengthened. No veterans benefits funds can be diverted elsewhere.

The members of this organization fully recognize that fighting a godless enemy in Vietnam is costly, but necessary. Its cost is nothing compared to the human suffering if freedom is lost. This organization is on record strongly supporting the necessary expenditures for the Vietnam conflict and the President's policy of resisting the Communist conspiracy that has threatened to bury us. As veterans, we recognize that a primary responsibility of government is security of our country.

We also stand firmly on the long-established principle that the veterans of this country are fully entitled to the benefits provided under present laws, and more. For without those who respond to the call to colors, there would be no freedom, no United States as we know it.

This organization is seeking liberalized expenditures in compensation for those who suffered wounds in wars, bigger pensions for those veterans who are in need, and greater aid to the widows and children of those who served. We further seek strengthening of veterans preference in Government jobs, another benefit granted veterans by the latest GI bill and previous veterans legislation.

Recognizing the need for adequately financing veterans benefits, including those rightfully extended to millions of veterans under the new GI bill passed by this Congress, and the need for financing other programs improving the general welfare, the AMVETS endorses the principles embodied in the Participation Sales Act of 1966.

The act obviously enhances and improves Government's method of financing, encouraging a greater partnership of private enterprise and Government. This improvement and this partnership is compatible with the goals of this organization, and we strongly urge its passage.

Sincerely,

RALPH E. HALL, *National Commander.*

The CHAIRMAN. We gave as much notice as the time would permit to everybody that we anticipated would want to appear either for or against this proposal, and we are glad that we have with us today representatives of the Farmers Union, which wants to testify, and the Federal National Mortgage Association. We will be glad to hear them.

If anybody else has since come in, we will be glad to hear them.

Mr. Clerk, please call the first witness.

Mr. HALE. Mr. McDonald from the National Farmers Union is the first witness.

The CHAIRMAN. Mr. McDonald, we are pleased to have you. You represent a fine lodge and a fine organization. We are always pleased to hear its views on matters affecting the farmers. I assume that you speak primarily for farmers, do you not?

**STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH,
NATIONAL FARMERS UNION**

Mr. McDONALD. That is correct, Mr. Chairman.

Let me begin by stating my name—Angus McDonald, director of research, National Farmers Union.

I have been with the organization 18 years. I have a rather extensive farm background. I grew up on a farm in eastern Oklahoma. I farmed as early as the 1920's during the agricultural depression.

I have owned farms in New York State, in Maryland, and in Oklahoma. I finally liquidated my agricultural assets in 1958, we felt perhaps wrongly, Mr. Chairman, because of some of the events and policies in Washington. Perhaps we were incorrect.

But I wanted to indicate that I have had some experience and knowledge of agriculture.

I was in the Soil Conversation Service for 7 years, 1935 to 1942.

I was a free-lance writer for some years, writing primarily on agricultural matters. I was farm editor for the New Republic magazine for the years 1946 to 1948, when I left and went to work for the Farmers Union in February of 1948, and I have been in this position with this fine organization ever since.

First, Mr. Chairman, I would like to ask permission to put this document into the record. I am not going to read it. I had some copies distributed. It is a brief memorandum on the Participation Act of 1966.

The CHAIRMAN. Without objection, it may be incorporated.

(The memorandum referred to follows:)

**FARMERS UNION MEMORANDUM ON H.R. 14544, THE PARTICIPATION SALES ACT
OF 1966**

1. The purpose of this legislation is to get the Federal Government out of the lending business. According to Budget Director Schultze, the Federal Government should not act as a bank; all Federal lending programs and assets should be taken out of the Federal Government and turned over to private business.

2. The Federal National Mortgage Association Charter Act is amended and the Association is given authority to issue "participations" which shall be guaranteed as to principal and interest by agencies of the United States.

3. The head of any executive department, agency, or instrumentality of the United States is authorized to set aside a part or all of any obligations held by him. The agency "shall guarantee" to the trustee timely payments thereof.

4. The "trustee" which would issue the "participations" is the Federal National Mortgage Association which gets investment bankers to handle the paper and sell the participations on the public money market. The bill indicates that all of the funds raised by the sale of the participations shall be turned over to the agency or trustor. The trustee is the mortgage association commonly referred to as "Fannie Mae." These are the principal provisions of the bill.

5. Here is what will happen: The loan agency which might be Farmers Home, Housing, or Small Business, or any one of the lending agencies, must, we believe issue these participations if the administration so desires. The language says specifically of the agency "he is authorized to set aside all or part of any obligations held by him." We believe the effect of this language will be mandatory.

6. First, the lending agency will turn over the loan papers to "Fannie Mae" and as a result participations will be issued. The New York banks and others will underwrite them, "Fannie Mae" having decided that they are sellable and worth their face value. Interest rates or effective yields, we assume, will be agreed on by "Fannie Mae" and the bank and other underwriters.

7. Example: The agency and Fannie Mae decide to lump together papers held by farmers homes, small business, and housing agencies, totaling, say \$1,500,000, the participations are then sold on the public market for 6 percent plus a servicing fee. We do not believe that the rate will be much lower, since 90-day Treasury bills now stand at 4.7 percent, and prime securities are around 5 to 5½ percent. Suppose that the loan paper held by the agency on which the participations are based, average 4 percent. It is evident that the Treasury will have to make up the difference. In other words, there will be a subsidy of 2 percent.

8. Aside from costing the Federal Government additional money which the banks will pocket, the issuance of guaranteed paper will have an adverse effect on the home mortgage institutions. A banker would be loath to lend money for housing, tractors, etc., if all he had to do was pick up the phone and buy a participation at 5½ percent which was guaranteed and which could be sold or held at his discretion.

9. Savings and loan associations under the law are not allowed to share in these participations; however, to compete with this new money market they will have to raise their interest rates or else go out of business and the general effect will be, of course, together with the other operations mentioned, to raise interest rates all along the line.

10. A final point should be made. Hometown bankers and even relatively large banks are having a tough time because of the policies of the Federal Reserve Board. They are having to pay a 4½-percent discount rate and are in competition with institutional money lenders who, under the ruling of the Board, may get 5½ percent on time deposits. Another factor is the fact that reserves in the banks have reached a minus figure. The Federal Reserve Board has been selling securities on the open market thus decreasing liquid reserves of the banks. The result has been to bring about a very tight, high interest situation.

The CHAIRMAN. Go right ahead in your own way.

Mr. McDONALD. I also, Mr. Chairman, would like to have a letter dated April 21 of this year to the President of the United States over the signature of our newly elected national president, Tony Dechant, put into the record.

The CHAIRMAN. Without objection.
(The letter referred to follows:)

FARMERS UNION,
Washington, D.C., April 21, 1966.

HON. LYNDON B. JOHNSON,
The President of the United States,
The White House, Washington, D.C.

DEAR MR. PRESIDENT: We are very much concerned about H.R. 14544 which would increase interest rates to farmers already overburdened by excessive interest charges. The Federal Government should lead the way toward decreasing interest rates, not increasing them.

We recognize that you are seeking to avoid a tax increase but feel that a small increase in the Federal deficit or an increase in taxes is preferable to adding one-half of a percent to interest charges which are at an all-time high.

All interest rates will be affected by this proposal to turn over all Government-sponsored programs to private moneylenders. Over the years the cumulative effect of H.R. 14544 will add millions of dollars to the amount consumers of credit will pay. It will result in increased costs for all consumers since interest charges must be added to the cost of doing business and in turn passed on to the consumer. It will result in decreased farm income since the farmer cannot pass on his costs to those who purchase food and fiber.

We respectfully urge that you seek other ways to solve your budgetary problem. We must regretfully oppose this inflationary interest proposal in every way possible.

Respectfully,

TONY T. DECHANT, *President.*

Mr. McDONALD. I have a few comments on this legislation.

I would like to indicate first, partly in response to a comment of the Senator from Utah, Mr. Bennett, in regard to the organizations affected by this legislation.

Mr. Chairman, I call your attention to a list of organizations who would be affected on page 113 of the hearings before a subcommittee of the Committee on Banking and Currency, U.S. Senate, on S. 249. The date of these hearings was October 7 to 11, 1965.

It appears, Senator Bennett, that Senator Tower from Texas requested that this material be inserted into the record in a letter addressed to the staff director of this committee.

Senator BENNETT. Yes, I have a copy of it, and I know of the list. What I was trying to get yesterday was an official list.

I was trying to get an official statement of the Treasury of all the agencies that might be affected. I am not sure this is all. There may be others.

Mr. McDONALD. I was going to comment on that.

Now, I notice in this list, Senator, that the Commodity Credit Corporation is not included, and that certainly is an agency I believe in my interpretation of this bill that could be affected. So it obviously is not a complete list.

Senator BENNETT. Yes.

Mr. McDONALD. I would like to direct my remarks primarily to the agricultural agencies that would be affected, naturally, representing a farm organization.

We find in this list here which I referred to, Farmers Home Administration, REA, Crop Insurance, Bank for Co-Ops, Intermediate Credit Banks, Farm Credit Administration, Federal Land Banks, Bureau of Reclamation, and, as I indicated—

The CHAIRMAN. Now, with all due deference, you appear before us as an expert in farm matters, and you are appearing to object. Now, will you qualify as an expert in all financial matters, or are you still going to testify just about the farmers?

I just want to know what scope you plan to occupy here today.

You said you had been 18 years with the Farmers Union, and you grew up in Oklahoma. Very fine. You came to appear because you thought this would not be good for the loans made to farmers. Are you going to confine yourself to the farmers, or are you going to qualify as an expert on all these agencies that handle \$7 billion of loans?

Mr. McDONALD. No, sir; I am not going to qualify as an expert, really, Senator, on anything.

The CHAIRMAN. Well, thank you very much.

Mr. McDONALD. With my limited understanding I am going to make some comments on what I think this bill might do.

Now, first of all, it seems clear to me that on page 3, line 1, of the House bill, that all these agencies are affected. That seems very clear—that all of the executive departments, agencies, or instrumentalities of the United States come under this bill.

I would like to begin by commenting on the Farmers Home Administration, which we think is a very fine agency, and in regard to what happens, what is happening and has been over the years, in this agency in regard to farm loans.

Now, this is an insured loan program, and the farmer will get approval of a loan from FHA and the bank will insure it. So it is very beneficial to the farmer, very beneficial to the bank. It is a local community matter in many instances. I understand that the FHA deals with 4,000 country banks.

Furthermore, the relationship between the farm and the local bank is such that the banker often will make additional loans which are not insured in regard to getting the farmer through a rough year, in regard to buying a tractor, in regard to the general operation of his farm.

This FHA guaranteed loan is a kind of a bulwark for the local bank which also establishes credit for the farmer. And often it is a family matter, because the banker, with a relationship with one farmer in credit, perhaps his relatives, his friends, his neighbors, develops a good community relationship there.

Under my interpretation of this bill I think that the country bank would be short circuited. I think that the farmer would request FHA, go to the Farmers Home Administration for a loan, and the local FHA man would look into the character of the farmer, his assets, his probability of being able to repay the loan, and he will say, "Well, for all practical purposes you are good for a loan."

Then, instead of going to the country bank, the FHA would check with the National Mortgage Association, the Federal Mortgage Association, called "Fannie May," and say, "Well, I have got a bunch of people here who have good credit, and I think they are good people who need some money. Can you arrange some participation so we can get the money out here?"

And Fannie May will look the situation over, and the underwriter, or whoever is working with Fannie May, such as the First Boston Corp. of New York, which is involved, I believe, and numerous other large banks, and, of course, these loans of FHA will be lumped together with many other loans from many other agencies so the identity of the original borrower is lost.

It would remove, it seems to us, one step by this legislation. It would take it out of the community and be adverse to the interest of the local community and the country banker.

Furthermore, it takes, it seems to me, Mr. Chairman, the power of decision to some extent out of the Farmers Home Administration, because the ultimate decision on whether this money would be available or not would be in the Fannie May Corporation.

So they might very well reach a point where they felt like they had sold all the participations that they wanted to sell about that time,

and they might very well say, when these agencies came up with groups of loans, well, we can't do it now because of certain situations in the national market.

As you know, of course, you can't dump a lot of things on the market all at once. You have to deal with these matters from day to day and adjust your financial operations to the market.

Now, that is my second point, Mr. Chairman. Another point which I would like to refer to is that under this bill subsidies would be increased.

Now, I am referring primarily to the agricultural subsidies.

I have in my hand a document, "Budget Estimates for the U.S. Department of Agriculture, Fiscal Year Ending June 30, 1967." On page 177 and page 178 we find the amounts of money, Mr. Chairman, which are loaned, and they are itemized.

For example, on page 178 you will find \$122,892,000 in building loans. You will find \$1.7 million in building loans for the elderly. You will find other categories. The interest rate is 3 percent.

On the previous page there is another list there.

My point is that there is a wide variation in the ceilings. That is indicated in this document here that I have in my hand, "Special Analysis, Bureau of the Budget of the United States, Fiscal Year 1967." And on page 62 of this document there is quite an extensive list of the interest rates and maturities for major active credit programs classified by agency or program, December 1965.

You find listed under "Agriculture" that the interest rates vary from 2 percent to 6 percent.

You will find, for example:

Commodity Credit Corporation interest rates vary from 3.5 to 4 percent. Rural Electrification is 2 percent.

And so on. There are others too numerous to read.

Mr. Chairman, I am trying to bring out the point that there is a wide variation. And I suggest that any increase in interest rates on these programs, these subsidized programs—of course, we are heartily for and have testified many times for subsidy for relief for slum housing and various programs which burden the taxpayers, and we think that the taxpayers are perfectly willing, as evidenced by legislation passed by the United States, to support these programs and to take money from the taxpayers and to give it to help the poverty program which the President is pushing, and so forth and so on.

The CHAIRMAN. Well, may I interrupt to ask you a question so that we can get on to the nub of your opposition? Aren't you opposing this program because you believe it will result in increasing the interest rate to farmers?

Mr. McDONALD. Primarily.

The CHAIRMAN. All right. That is the decision of your president.

Mr. McDONALD. My—

The CHAIRMAN. Let me read your president's statement to that effect. I have just gotten it:

We recognize that you are seeking to avoid a tax increase but feel that a small increase in the Federal deficit or an increase in taxes is preferable to adding one-half of 1 percent to interest charges which are at an all-time high.

All interest rates will be affected by this proposal to turn over all Government-sponsored programs to private money lenders.

Well, the whole letter will be in the record.

Now, let me ask you this: Do you want to get the \$477 million for direct loans for the Federal Farm Home Administration or not? Are you in favor of that or not?

Mr. McDONALD. Yes, sir.

The CHAIRMAN. All right. You favor it?

Mr. McDONALD. Insured loans.

The CHAIRMAN. Did you read in the paper this morning that even on an 18-month note it had to be sold at a discount that yielded 4.9-some percent rate of interest?

Mr. McDONALD. I did not read that. No, sir.

The CHAIRMAN. Well, that was in there.

Do you know how you can get any bank or any private institution or any individual to lend you money for 20, 25, or 30 years at 4.5 percent?

Mr. McDONALD. I don't know.

The CHAIRMAN. All right. Do you know that the law authorizes these loans at from 3 to 5 percent for the direct loans and at 2¾ to 5¾ for the guaranteed loans? Do you know that?

Mr. McDONALD. I believe that is in this table.

The CHAIRMAN. All right. The administration tells us that it won't have the money to let you have \$477 million for these loans unless we permit them to sell some of the \$1.6 billion of these loans that have already been made and pay the difference between what those certificates—those mortgages bear, which as I say will range from 3 to 5 percent, or whatever is necessary to get the money to make new loans.

That is the problem that confronts us.

You want to help the farmer. You want him to have low interest rates. So do we. There are plenty of people in the city that would like to see cattle drop back to 21 cents a pound like it was in 1964. They don't like the idea of \$1.09 for bacon and \$1.35 for steak. Don't you see?

Why are they up there? You know why they are up there. There is the demand for them, isn't there? And still the farmer does not get parity. He is only getting but 85 percent now. Isn't that right?

Mr. McDONALD. That is correct.

The CHAIRMAN. He has not gotten through the years what is coming to him. So we are trying to help him. And we have been making him loans through the years at very low interest rates.

Now, the same pressure that has put up his hogs and his cattle and others in less proportion is putting up the price of money. You just cannot get it. Isn't that right, Doctor? You taught economics.

Senator DOUGLAS. Well, I will deal with that later.

The CHAIRMAN. All right. But that is what the administration says. We can't get this 3-percent money anymore. We can't even get it at 4.5 percent for a long time.

So that is one reason I think that the American Bankers Association sent me this telegram. They realize that we are in a bind. And they say, "With the proposed amendments it offers congressional safeguards, and we interpose no objection."

Now, if you will confine yourself to the farmers and tell us how you think we can get 4.5-percent money for them on the longtime market, we will be glad to hear you.

Mr. McDONALD. I think my answer to that, Mr. Chairman, is we prefer a deficit of \$6 billion, I believe it is for fiscal year 1967, to the Government selling off at sort of a bankrupt sale these securities, this loan paper, next year.

We would also prefer, as indicated by our president's letter, that perhaps taxation, selective taxation, would be preferable for paying for the cost of this Vietnam war in which the people involved are making huge profits. Of course, we are for the profit system, but we think they are making tremendous profits. Perhaps we should have a readjustment in regard to taxation.

If these boys are giving their lives for the country, it seems to me, with the corporations having now, according to Economic Indicators, \$26 billion worth of undistributed profits, some of those undistributed profits, which are causing the inflation incidentally, should be tapped by the Government to make up for the cost of the Vietnam war which is ruining to some extent President Johnson's Great Society program.

But I did not want to—I am trying to stick to my promise to state agricultural matters. And I would hope that the cost of these subsidized agricultural programs would not be increased as they would be under this bill.

We would prefer that the subsidies come out of the Treasury. Let me illustrate.

If you have a subsidy program which is 4 percent, 3 percent, and the cost is 4.6, according to April Economic Indicators, when Treasury bills stood at 4.618, I think it would be preferable to finance these subsidies at this figure than at the figure of 5.4 or 5.5 or whatever it is that these securities would sell for, or 6 percent, on the competitive money market. Because in the last analysis—

The CHAIRMAN. May I interrupt you? Considering the fact we have other witnesses and we cannot be here all the day, would you mind yielding to let Senator Douglas ask you a question or two that he wants to have some information on, and then yield to the Senator from Utah?

Senator DOUGLAS. Mr. McDonald, is it not true that the Farmers Home Administration has been virtually the only farm agency that has helped the so-called poor farmer or small farmer? Is it not true that the price-support programs have primarily helped those who have had larger commercial crops and, therefore, have helped them, but that the poor farmer, the subsistence farmer, the farmer with small crops, has not obtained very much advantage from them? Moreover, isn't it true that the Farmers Home Administration by helping tenants to purchase this land and to obtain loans for livestock, for seed and for machinery, and so forth, has been the most constructive agency for the small farmers that we have had in the last 30 years? Is that correct?

Mr. McDONALD. I would agree completely, Senator Douglas, with both your questions in regard to Farmers Home Administration and in regard to the benefits of the price-support programs.

The Farmers Union is the only general farm organization which has been for a cutoff which would prevent these millionaires, some of them foreign investors, from benefiting to the extent of millions of dollars out of the Federal Treasury because of price support.

We think—

Senator DOUGLAS. Now, you were the strongest force behind the passage of the original Farmers Home Administration Act, were you not?

Mr. McDONALD. We fought many years. Senator Douglas. I was here at that time for Farm Security.

Senator DOUGLAS. Yes.

Mr. McDONALD. We tried to save Farm Security, which was the parent of the present Farmers Home Administration.

Senator DOUGLAS. That is right. And this program was under very heavy attack in the Congress and from the more affluent farm organizations. Is that not true?

Mr. McDONALD. That is correct.

Senator DOUGLAS. Now, you have supported the proposal which has been advanced that no subsidy be paid in excess of \$25,000 to any one farmer?

Mr. McDONALD. That was a figure, Senator, we put forward several years ago. I would imagine that, due to recent economic changes and so forth, that that would probably be doubled today if our—

Senator DOUGLAS. You would only check those receiving over \$50,000?

Mr. McDONALD. That would be gross.

Senator DOUGLAS. Oh. Gross? I see.

Mr. McDONALD. Now, I am really talking—

Senator DOUGLAS. I see. Not net?

Mr. McDONALD (continuing). Without any authority on this point, because we do not have any figures in our resolution.

Senator DOUGLAS. You remember Senator Brewster's amendment of last year which started at \$25,000. That was voted down. Then \$50,000, and that was voted down. I do not know whether or not he put in a resolution not to pay subsidies over \$100,000.

But the figures published for cotton and wheat, as I recall, showed large numbers of farmers getting more than \$25,000 a year in cash subsidies.

The CHAIRMAN. Will the Senator from Illinois yield there?

Senator DOUGLAS. Surely.

The CHAIRMAN. Would you mind saying that the chairman of this committee supported every one of those amendments and has consistently done so?

Senator DOUGLAS. Mr. Chairman, this one of the few occasions where you and I agrée. That is right.

And the figures for corn, I believe, were never published.

I have talked with Senator Brewster. He intends to renew his amendment or family of amendments this year.

I would appreciate it if you would help us on these, and we welcome the aid of our chairman in this matter.

The CHAIRMAN. And I have always supported these loans to the farmers. Make no mistake about that.

Senator DOUGLAS. Very good.

And it is your belief that if we could restrict the amounts going to the extremely rich and affluent farmers, in some cases corporation farmers, that we would probably have money enough with which to subsidize loans to the poorer farmers? Is that your position?

Mr. McDONALD. I agree with that.

Let me point out, Senator, that I was speaking of gross sales when I mentioned the figure, so that would mean——

Senator DOUGLAS. Yes; the Brewster amendment was directed to the amount of the subsidy, that the subsidy should not be more——

Mr. McDONALD. That is entirely different.

Senator DOUGLAS. Yes.

Mr. McDONALD. As you know, farm costs have skyrocketed, so that even a farmer making \$25,000 would have maybe \$5,000 left after he met his expenses.

Senator DOUGLAS. Yes.

Well, I have always been in favor of fixing an upper limit. In fact, my upper limits on subsidies are somewhat more rigorous than those which Senator Brewster proposed.

But the \$25,000 limit did not pass. The \$50,000 limit did not pass. And, while I cannot remember whether the \$100,000 limit was proposed or not, if it was proposed, it did not pass.

The difficulty is that we are faced with a situation in which apparently the Congress will place no ceiling on the subsidies paid to the extremely wealthy farmers, who in my judgment do not need them. And yet the costs of the Vietnamese war go on.

I think the administration feels that unless it can sell off these assets the pressure of the conservative forces in Congress and the country will force it to curtail the programs for the relief of poverty and to provide economic and educational opportunity.

And so, with torn heartstrings, they have made this very difficult choice. And there we are.

I want to congratulate the Farmers Union for the part they have played in fostering not only the Farm Security Administration and the Farmers Home Administration but also other constructive measures to help the average American throughout the years.

And I want to thank you, Mr. McDonald, for your unselfish work through the years.

Mr. McDONALD. Thank you.

The CHAIRMAN. I wish to make this comment. I think it must have been 10 years ago we first had a proposal to limit this support program to what we call the family farm. And then with the overall expenses we had a limit of \$25,000. I have supported it all the time, and we have never had a chance in the world to put it through. We have no chance in the world to put it through now.

While it might be a fine theory that if we put this through we could save enough on price supports to finance loans to farmers, we cannot put it through. It is just that simple.

I recognize Senator Bennett of Utah.

Senator BENNETT. Mr. Chairman, I am not going to question the witness at length. Both his statement and the letter of his president indicate that there is some feeling that the Government is going to sell these securities. The Government will continue to hold the securities. The Government will collect the interest. And the Government will sell a new piece of paper with the securities as collateral, which it calls a participation.

Do you understand that?

Mr. McDONALD. I understand that, Senator. What I object to is the increased interest rate. Nobody knows for sure what it will be. But everyone agrees there will be an increase which will go into the pockets, we feel, of the big bankers ultimately.

Now, we have nothing against the banking industry, of course, and particularly the local industry as I mentioned. We think it is important to economic growth in agriculture to have these country banks serving the farmer.

But, as I pointed out, they will be sidetracked in this.

Senator BENNETT. The reason I raise the question is that in the first paragraph of your statement you say that the Government should not act as a bank, that all Federal lending programs and assets should be taken out of the Federal Government and turned over to private business, according to Budget Director Schultze.

Mr. McDONALD. That is what he said.

Senator BENNETT. That is not the effect of this bill. If this bill is passed, the Government will still own the obligations. It will still collect them. And if the man who makes the loan goes into default, the Government will still attempt to force payment.

There is one other point in the last paragraph of your statement before us which has just been called to my attention by our staff economist. It says:

The Federal Reserve Board has been selling securities on the open market thus decreasing liquid reserves of the banks.

He tells me that the reserves have increased by over \$1 billion and the Federal Reserve Board has bought over \$3.5 billion of securities net.

Senator DOUGLAS. Since when?

Senator BENNETT. Since last year according to Mr. Thomas.

Senator DOUGLAS. What have they been doing in the last few months?

Mr. THOMAS. Increasing.

Senator DOUGLAS. Increasing purchases or increasing sales?

Mr. THOMAS. Increasing purchases.

Senator DOUGLAS. I would like to see the figures on that.

Mr. McDONALD. Mr. Chairman, in that connection I have an article from the Wall Street Journal, a clipping dated April 22, 1966. I do not know if you want to insert it in the record or not. But it seems to refute that statement your adviser just made. They are in a minus position now, Senator.

Senator BENNETT. Unless there is some objection the article will be placed at the end of your statement.

Mr. McDONALD. They have no reserves. They are all gone.

Senator BENNETT. But they have moved from a minus position to a plus position and back to a minus position as a matter of policy. This is playing what I call the "numbers game." It depends on the date which you use for your comparison.

Senator DOUGLAS. That is right.

Mr. McDONALD. It has generally been minus, Senator, the last few weeks.

Senator BENNETT. Well, the Government over the last year, and I am sure Mr. Thomas is right, has bought more than \$3.5 billion worth of securities. I mean the Federal Reserve has.

Now, in its operating day to day it may have been selling some of these, selling more than it bought recently. But, on balance, it still bought \$3.5 billion.

Mr. McDONALD. Senator, if you sell \$3.5 billion and buy \$3.5 billion you are just standing still.

Senator BENNETT. That is not my point.

Senator DOUGLAS. Mr. Chairman, I think we ought to get at the facts on this. I would like to have Mr. Thomas, or whoever you designate, prepare a table to be entered into the record showing the net monthly purchases or sales during the last 18 months, with subtotals by each 6 months, and subtotals for the year and a half.

The CHAIRMAN. That will be helpful. That will be done. Our staff economist will get those figures, and we will publish them in this record.

(The table referred to, with comments, follows:)

*Transactions in Federal Reserve System open market account, by months,
February 1965 to February 1966*

[In millions of dollars]

	Outright transactions			Repurchase agreements		Net in-crease in holdings
	Gross purchases	Gross sales	Redemptions	Gross purchases	Gross sales	
1965—February.....	865	198	464	983	1,019	166
March.....	642	-----	7	482	434	684
April.....	466	290	126	1,831	1,717	163
May.....	984	26	-----	1,207	1,233	932
June.....	755	115	224	1,894	1,895	415
July.....	206	284	-----	2,734	2,549	106
August.....	758	398	114	1,552	1,955	-157
September.....	1,692	770	198	450	450	725
October.....	652	671	98	352	352	-117
November.....	1,666	598	150	24	24	918
December.....	816	615	297	1,661	1,372	193
1966—January.....	894	919	228	1,595	1,545	-203
February.....	1,114	979	171	272	611	-376
Total for 12 months ending February 1966.....	10,645	5,656	1,613	14,054	14,197	3,283

NOTE.—Sales, redemptions, and negative figures reduce System holdings; all other figures increase such holdings.

Source: Federal Reserve Bulletin.

COMMENTS AS TO FEDERAL RESERVE OPERATIONS

Federal Reserve operations in U.S. Government securities during 1965 and the first 4 months of 1966 have had the effect of assuring a substantial and fairly steady increase in the volume of reserves available to banks. Purchases and sales have varied in the course of the year to offset the effect of seasonal and other temporary variations in various factors affecting the supply of reserves. These variations through February are reflected in the table.

On balance, daily average reserves of member banks increased by nearly \$1.2 billion from the last week of April 1965 to the last week of April 1966.

Funds to supply reserves, as well as to meet a loss in the country's gold stocks of nearly \$800 million and an increase of over \$2 billion in currency in circulation (other than that supplied by Treasury issues of coins), were provided by the increase in Federal Reserve holdings of Government securities, amounting to \$3.1 billion, by additional member banks borrowing at the Federal Reserve banks of nearly \$300 million, and by other factors of less importance.

The additional reserves and currency thus made available provided the basis for a large expansion of bank credit that resulted in an increase of the country's

money supply—demand deposits and currency—of over \$9 billion, or about 5 percent, and an increase in time deposits at banks of nearly \$20 billion, or 15 percent. This expansion in money and credit has been fairly continuous throughout the past year, after allowance for usual seasonal variations.

The CHAIRMAN. I don't like to hurry this, but—

Senator BENNETT. All right. No further questions.

Senator PROXMIRE. I will be brief.

I am shocked at the conclusion here. Are you concluding that the farmers would have to pay higher interest rates because of this Participation Sales Act?

Mr. McDONALD. Yes, sir.

Senator PROXMIRE. This shocks me. We went into great detail with the Small Business Administration on this provision. Nobody argued that any small businessman would have to pay more than 5.5 percent or on distress loans more than 3 percent. And I am very puzzled as to how you conclude that.

It seems to me this could not possibly affect the interest rate that the original borrower has to pay, unless there is further congressional action. I do not see how the Participation Sales Act by itself would have any effect on the amount that the person who borrows from the Government has to pay.

Mr. McDONALD. I think, Senator Proxmire, it might work something like this. You were not here when I described what is happening, what has happened, in regard to FHA loans and what might happen under this bill.

I think the local banker would be sidetracked, and FHA would not go to him at all, nor the farmers to the local bank. It would be handled by FHA and Fannie Mae.

Now, the local banker is put in a very bad position. He no longer has this bulwark of the guaranteed insured loan, this paper, which enables him to make other loans, small loans, to keep his customers, to lend money for a tractor.

I think the local banker would feel that because of the general increase in interest rates along the line he would have to get more interest and more and more in any loan that he made to the farmer.

Of course, my point on the subsidized program was that nobody seems to know and the Director of the Budget yesterday didn't know in response to Senator Douglas' question, how much this was going to cost, a half a percent increase, a quarter of a percent increase, or what.

Senator PROXMIRE. The increase is not paid by the borrower, by the farm borrower.

Mr. McDONALD. That ultimately—

Senator PROXMIRE. Our complaint is it is paid by the taxpayer.

Mr. McDONALD. The subsidized programs are paid by the taxpayers.

The CHAIRMAN. If the gentleman will yield, nobody denies that this is going to cost more.

Senator PROXMIRE. Yes.

The CHAIRMAN. But a good illustration is the bill we passed which was for 3-percent loans. We put \$300 million in it. It was all taken up the first month. And we got over \$700 million applications pend-

ing. Three-percent money. They could not get it anywhere else. A whole lot wanted it.

There is nothing in this law that raises that 3 percent. But the agency that lends the 3 percent has not got any more money. So we are going to subsidize the 3-percent certificate based upon the 3-percent loan at whatever it is, 5.5, but we do not raise it any higher to the colleges. But the taxpayer pays the difference.

So now we are down to this. You cannot get any more 3-percent money. You cannot get any more 4-percent money. You either do not put the money out, or you are going to pay more interest for it.

The administration says it is going to cost you some, but Congress can have control, because you can't put out any more of these subsidized certificates than the Appropriations Committee will authorize. But we do not have to go in and officially raise that 4.5 percent.

Senator PROXMIRE. Thank you.

The CHAIRMAN. The Senator from Maine.

Senator MUSKIE. No questions.

The CHAIRMAN. Do you have something more, Mr. McDonald?

Mr. McDONALD. I do have one or two remarks. I think this will have a bad effect on home mortgages as indicated. I think it will have a bad effect on the farmer getting loans from the local banker.

Why should the local banker, when he can pick up the phone and buy a participation guaranteed for 5.5 percent, loan money to me, a farmer, who is not too good a risk? Why should the local banker tie up his funds in a house or a building or a tractor which he cannot get rid of if the loanee does not make good?

So it will just squeeze the credit in the local areas.

Senator DOUGLAS. Are you more afraid of the indirect effects than of the direct effects?

Mr. McDONALD. Yes, sir. I believe that is correct, Senator. There is a general trend, as we all know, toward higher interest rates, and we feel that it is partly because of the Federal Reserve Board. I think the President feels the same way as represented by his December statement.

And we know that the Federal Reserve Board could have done this thing in several other ways besides giving the time depositors up to 5.5 percent. That has been perhaps one of the worst effects of this action.

I have one final comment.

I was going to express my appreciation for this committee allowing me to come here today. I believe it wasn't in the original plan. And the Farmers Union is very grateful for the opportunity to come here.

Senator DOUGLAS. A soft answer which turneth away wrath.

Mr. McDONALD. And this is really a wonderful committee. Nothing I have said is any indirect criticism of the members of this committee. We have always been your admirers. We feel, however——

Senator DOUGLAS. Let me say Mr. McDonald is a Scotchman, and Scotchmen are proverbially tough and persistent.

The CHAIRMAN. We understand each other.

Senator DOUGLAS. He fights for what he believes. I have found him through the years to be very tough, and I honor him for it.

Mr. McDONALD. Mr. Chairman, if I may be permitted an off-the-record remark.

(Remark off the record.)

Mr. McDONALD. Thank you very much.

The CHAIRMAN. You are welcome, sir.

(The Wall Street Journal article and the Federal Reserve statistics follow.)

[From the Wall Street Journal, Apr. 22, 1966]

RESERVE SYSTEM U.S. SECURITY HOLDINGS SLASHED—IT MADE LARGEST 1-WEEK CUT IN 18 YEARS; TREASURY TAX FUND REDEPOSITS FELL—BANK LOAN PRESURE GROWS

(By a Wall Street Journal staff reporter)

NEW YORK.—The Federal Reserve System reduced its holdings of U.S. Government securities in the week ended Wednesday by the largest week-to-week amount in 18 years and thus bore down further on the capacity of the Nation's banks to lend and invest.

This was disclosed in data released yesterday by the New York Federal Reserve Bank. The weekly reduction in the system's holdings of Government obligations was \$1,084 million, the biggest drop since the week ended February 4, 1948.

Still further pressure on the Nation's commercial banking system last week came when the Treasury didn't redeposit with the banks certain funds it collected on the April 15 tax payment date. Banks had been counting on the usual redeposit of 50 percent of larger checks drawn on them by corporate taxpayers. But the Treasury's own short cash position prevented it from redepositing the funds.

The reserve position of the Federal Reserve member banks across the country—a rough indicator of monetary policy—showed that on an average day in the latest statement week the banks had "net borrowed," or minus, reserves of \$231 million. This was the largest amount since March 2, 1960, when the minus reserve figure stood at \$352 million.

The previous week's initial estimate of \$287 million in minus reserves was also the highest since March 1960, but this week the estimate was reduced to \$231 million. Net borrowed reserves had exceeded the \$200 million mark only four times all last year, when a moderately restrictive Federal Reserve policy prevailed.

TUGGING AT CREDIT REINS

In the past 2 months the reserve system has been tugging harder at the credit reins in an apparent effort to moderate the rate of expansion in the economy. This new policy became noticeable 7 weeks ago when the net borrowed reserve figure hit \$237 million.

Also indicating the increased tightening in the statement week was a further increase in total borrowing by member banks from Federal Reserve banks. Such borrowings in the week ended Wednesday averaged \$685 million a day, up from an already high level of \$603 million a week earlier and a substantial increase from an average level of about \$500 million a day in most weeks last year.

Some indication of the unusual pressure on reserves can also be seen in a Wednesday-to-Wednesday rise of \$701 million in borrowings by the 13 reporting New York City Federal Reserve banks. This was the highest weekly rise since December 1952. The \$701 million rise brought the borrowings at the New York banks to \$706 million last Wednesday.

Commercial bank members of the Federal Reserve System are required to set aside certain percentages of their deposits at Federal Reserve banks or as cash in their own vaults; these deposits frequently represent loans credited to the borrowers' deposit accounts. On any day, some banks will have reserves that exceed their requirements, while others will have to borrow from the Federal Reserve to meet their needs.

When total borrowings are greater than aggregate excess reserves as at present, the difference—a minus amount—constitutes net borrowed reserves. When excess reserves total more than the borrowings, this constitutes free reserves or uncommitted funds the banks can lend and invest.

HUGE REDUCTION

The main factor contributing to the further tightening of reserves was, of course, the huge reduction in the system's holdings of U.S. Government securities. Although the Federal Reserve System's daily average holdings of Government securities fell \$1,084 million on a Wednesday-to-Wednesday basis the system's daily average holdings were down \$520 million in the statement week. The total decrease occurred in securities due to mature in a year or less.

When the Federal Reserve disposes of Government securities in the open market, it takes money out of the banking system or "sops up" reserves as the securities dealers draw on their banking accounts to pay for the securities.

Some indication of the effect of the Treasury's failure to redeposit its tax funds can be seen in figures on U.S. Government deposits with the New York City banks. These deposits rose \$16 million on a Wednesday-to-Wednesday basis in the latest statement week. In the statement week that included the March 15 tax payment date the Wednesday-to-Wednesday rise of U.S. Government deposits at the New York banks was \$334 million.

The tightening factors in the statement week more than offset expansionary factors in the week. One was a \$307 million daily average rise in the "float" of checks delayed in collection for which Federal Reserve banks automatically get credit. Another was a \$301 million daily average rise in vault cash counted as part of reserve.

NEW YORK LOANS DROPPED

The New York Federal Reserve Bank reported also that commercial and industrial loans at leading New York City banks fell \$42 million in the week ended Wednesday. This drop followed a \$72 million rise in the previous statement week. Bankers said the drop in New York loans in the latest week was surprising because corporations were expected to make large borrowings for the April 15 tax payment date.

The \$42 million drop in the latest statement week brought the total of business loans on the books of the 13 reporting New York banks to \$17,831 million, a net rise of \$558 million since the start of the year. A year ago such loans showed a Wednesday-to-Wednesday rise of \$14 million but were up \$888 million since the start of the year.

Other figures released by the New York Federal Reserve Bank showed that major New York bank loans to sales finance and business credit companies rose \$176 million in the statement week to \$1,993 million. In the previous week the loans had fallen \$63 million. The total outstanding loans of New York banks to sales finance and business credit companies on Wednesday was down \$23 million from the end of 1965. In the year earlier week, such loans rose \$80 million and were up \$59 million from the end of 1964.

In another development, the New York Reserve Bank reported that the total of negotiable certificates of deposit at major New York City banks rose \$40 million to a record \$7,352 million, marking the fifth consecutive weekly increase. In the previous week the rise was \$45 million. The continuing rise was attributed mainly to the higher rates that the banks have been paying for the CD's to replace other certificates that have fallen due and haven't been renewed.

SAVINGS DEPOSITS DROP

As the commercial banks gained funds through CD's, they continued to lose regular savings deposits on which they are barred from paying more than 4 percent. The latest statement week registered a drop of \$53 million and followed a drop of \$66 million the previous week. The drop in regular savings deposits so far this year is \$359 million, in contrast to a rise of \$238 million in the like 1965 period. Bankers attributed the fall this week mainly to withdrawals of funds to meet the April 15 tax payment.

Commercial and industrial loans of leading Chicago banks fell by \$11 million in the latest statement week, bringing their gain since the start of 1966 to \$40 million. In the 1965 week such loans fell \$25 million and were up \$175 million since the start of that year.

The New York Reserve Bank also reported that the U.S. monetary gold stock was unchanged in the week. There was a drop of \$100 million in the stock 4 weeks ago. That drop was the first U.S. gold loss this year, putting the monetary gold hoard at \$13,634 million, the lowest level since September 1938. In 1965

the loss from the U.S. monetary gold reserve totaled \$1,654 million, the largest since 1960, when the total outflow was \$1,703 million.

FEDERAL RESERVE REPORT

Assets and liabilities of 13 weekly reporting member banks in New York City

[In millions of dollars]

	Apr. 20 1966	Apr. 13 1966	Apr. 21 1965
ASSETS			
Total loans and investments.....	42,483	41,765	38,822
Loans and investments adjustment (r).....	42,118	40,989	37,736
Loans adjusted (r).....	31,765	31,067	27,225
Commercial and industrial loans.....	17,831	17,873	14,747
Agricultural loans.....	21	22	29
Loans to brokers and dealers for.....			
U.S. Government obligations.....	696	421	450
Other securities.....	2,293	2,015	2,427
Other loans for purchase or carry:			
U.S. Government obligations.....	15	17	12
Other securities.....	640	640	518
Sales, personal finance, etc.....	1,993	1,817	1,575
Other.....	1,222	1,246	945
Loans to foreign banks.....	792	810	843
Real estate loans.....	3,019	3,006	2,400
Other.....	4,010	3,996	3,899
Loans to domestic commercial banks.....	365	776	1,092
U.S. Government securities, total.....	4,386	4,236	4,555
Treasury bills.....	1,214	1,061	870
Treasury certificates of indebtedness.....	125	124	0
Treasury notes and bonds maturing.....			
Within 1 year.....	586	591	673
1 to 5 years.....	1,320	1,317	1,699
After 5 years.....	1,121	1,143	1,313
Other securities.....	5,967	5,656	5,950
Reserve with Federal Reserve bank.....	3,898	3,826	3,368
Currency and coin.....	303	313	286
Balances with domestic banks.....	153	149	141
Other assets, net.....	2,891	2,893	2,609
Total assets, liabilities.....	56,016	54,999	50,607
LIABILITIES			
Demand deposits:			
Adjusted.....	17,276	16,085	15,995
Total (e).....	27,018	26,186	25,842
Individual partnerships and corporations.....	18,756	18,121	17,218
States and political subdivisions.....	264	283	305
U.S. Government.....	131	115	1,141
Domestic interbank:			
Commercial.....	3,323	3,333	3,385
Mutual savings.....	312	357	320
Foreign:			
Official institutions.....	654	552	546
Commercial banks.....	946	991	875
Time and savings deposits, total (v).....	18,077	18,067	15,374
Individuals, partnerships, and corporations:			
Savings deposits.....	4,922	4,975	4,880
Other time deposits (z).....	8,846	8,940	6,468
States and political subdivisions.....	666	630	528
Domestic interbank.....	486	481	372
Foreign:			
Official institutions.....	2,935	2,822	2,910
Commercial banks.....	139	139	135
Borrowings:			
From Federal Reserve banks.....	706	5	0
From others.....	1,688	2,170	1,902
Other liabilities.....	3,581	3,622	3,148
CAPITAL ACCOUNTS			
Capital accounts.....	4,946	4,949	4,341

r—Exclusive of loans to domestic commercial banks and after deduction of valuation reserves; individual loan items are shown gross. e—Includes certified and officers checks not shown separately. v—Includes time deposits of U.S. Government and postal savings not shown separately. z—Includes Christmas savings and similar accounts which amounted to \$45 million for the current week. s—Not available.

Member bank reserves and borrowings of Central Reserve New York City Banks

[In millions of dollars]

	Change since—	
	Apr. 20, 1966	Apr. 13, 1966
Reserves with Federal Reserve bank.....	4,351	+90
Required reserves (partly estimated).....	4,270	+63
Excess reserves.....	81	+27
Daily averages for week:		
Estimated excess reserves.....	12	-26
Borrowings at Federal Reserve bank.....	160	+132
Free reserves.....	-148	-158

Member bank reserve changes

[Changes in weekly averages of member bank reserves and related items during the week and year ended Apr. 20, 1966]

[In millions of dollars]

	Change from week ended—		
	Apr. 20, 1966	Apr. 13, 1966	Apr. 21, 1965
RESERVE BANK CREDIT			
U.S. Government securities:			
Bought outright—system account.....	40,301	-486	+2,815
Held under repurchase agreement.....		-34	-108
Acceptances—bought outright.....	77		+24
Held under repurchase agreement.....	34	-6	-4
Loans, discounts and advances:			
Member bank borrowings.....	685	+82	+113
Other.....	21	+1	+4
Float.....	2,176	+307	+220
Total Reserve bank credit.....	43,293	-138	+3,063
Gold stock.....	13,632	-1	-780
Treasury currency outstanding.....	5,776	+16	+368
Total.....	62,702	-122	+2,651
Money in circulation.....	41,768	-96	+2,710
Treasury cash holdings.....	951	+18	+190
Treasury deposits with Federal Reserve banks.....	268	+130	-613
Foreign deposits with Federal Reserve banks.....	146	-12	-32
Other deposits with Federal Reserve banks.....	406	+11	+178
Other Federal Reserve accounts (net).....	448	-110	-272
Total.....	43,988	-58	+2,162
Members bank reserves:			
With Federal Reserve banks.....	18,713	-65	+489
Cash allowed as reserve (estimate).....	3,927	+301	+429
Total reserves held (estimate).....	22,640	+236	+918
Required reserves (estimate).....	22,236	+204	+988
Excess reserves (estimate).....	404	+32	-70
Wednesday to Wednesday			
Member bank reserves:			
With Federal Reserve banks.....	18,488	+136	
Currency and coin (estimate).....	4,337	+140	
Total reserves held (estimate).....	22,825	+276	
Required reserves.....	22,307	+162	
Excess reserves.....	518	+114	
Borrowings at Federal Reserve banks.....	1,587	+1,290	

12 Federal Reserve banks' position

[In millions of dollars]

	Apr. 20, 1966	Apr. 13, 1966	Apr. 21, 1965
ASSETS			
Total gold certificate reserves.....	13,180	13,185	14,128
U.S. Government securities:			
Bought outright:			
Bonds.....	6,571	6,571	4,928
Certificates.....	12	12	
Notes.....	24,926	24,926	25,691
Bills.....	8,434	9,278	6,806
Total bought outright.....	39,943	40,787	37,425
Held under repurchase agreement.....	0	240	77
Total U.S. Government securities.....	39,943	41,027	37,502
Total assets.....	64,059	62,913	60,096
LIABILITIES			
Federal Reserve notes.....	36,653	36,857	34,188
Total deposits.....	18,555	18,115	18,750
Ratio of gold certificate reserves to Federal Reserve notes (percent).....	(35)	(34.9)	(40.6)
GOLD RESERVES			
Gold reserves.....	13,634	13,634	14,413

Next witness, Mr. Clerk.

Mr. HALE. Mr. Northup of the Mortgage Bankers Association asked for an opportunity to speak.

The CHAIRMAN. Without objection, this witness may have printed in the record his full prepared statement.

I hope you will try to summarize it within the rules under which we normally operate, that a witness will summarize in 10 minutes his views but print as much as he wants in the record within limitations.

STATEMENT OF GRAHAM T. NORTHUP, DIRECTOR OF GOVERNMENTAL RELATIONS, MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. NORTHRUP. My name is Graham Northrup, director of government relations for the Mortgage Bankers Association of America.

We have no printed statement in view of the fact that we were only advised of the hearing at 9:15 this morning, sir. But I will try to be brief and enter some material in writing in order that you will have the benefit of the thinking that we have.

We appreciate the opportunity to be here and to speak to this committee on this very important piece of legislation.

We do wish that it would be possible for us to have had more advance notice or another opportunity to appear with a written statement, which we believe would be more valuable to you.

I represent an organization of mortgage bankers and investors who are involved principally in the financing of real estate mortgages. We do a large volume in home mortgages, farm mortgages, commercial and industrial properties, and our organization represents mortgage bankers and investors both.

We have a large number of insurance companies, savings banks, and pension funds in our membership, as well as the bankers who originate and service these mortgages for these national investors.

We are presently servicing about \$50 billion worth of residential, industrial, and commercial mortgages, and we originate each year in the neighborhood of \$9 billion worth of residential mortgages.

We have, as a result of this, a great interest in this piece of legislation and in most items of legislation that come before the Congress which affect the national money market in one way or another.

Those items of legislation that have a tendency to increase or decrease the shortage of money available in the market for any purpose have an effect ultimately on the mortgage market with which we are so much involved.

To answer Senator Robertson's questions about our area of interest, we are not an authority, and I personally am not an authority, on all phases of finance. However, because of our association with this national money market, we do have an interest in this legislation, and I will try to restrict my remarks to the parts that are really germane.

As I said, we do not have a written statement with respect to this particular piece of legislation in view of the shortness of the time.

However, on February 24, 1966, we did address a letter to Senator Robertson with respect to S. 2499, the bill which was before you at that time, with respect to the participation pools for the Small Business Administration.

With your permission, Mr. Chairman, I would like to have entered in the record a copy of that letter which does get into the principal arguments which we have against this legislation.

I would like to summarize these four by saying:

First, we are concerned, at a time when we are trying to reduce our domestic spending and maintain a sound budgetary approach to things, that we should be undertaking a program which everybody seems to admit will be more costly than direct Treasury financing of the obligations which are in the hands of the agencies at the present time.

The General Accounting Office did do a study prior to your hearings on S. 2499 which indicated the additional costs of participation pools that had been put out prior to those hearings. Using those figures from the GAO report and converting them to percentages and then applying those percentages to the approximately \$8 billion worth of participation pool certificates that you plan to sell in this and the next fiscal year, we estimate this will have an additional cost to the U.S. taxpayers of \$381 million. And we do not see why this is necessary.

Secondly, we do feel that this legislation circumvents the prohibition against the 4 $\frac{1}{4}$ percent Treasury financing—I mean the 4 $\frac{1}{4}$ percent limit on Treasury borrowing. It gets around this very neatly by going to Fannie Mae and letting Fannie Mae sell participations. In the last issue they sold I believe they went for yields as high as 5.75 percent.

We in our association do not believe the Treasury should be limited to 4 $\frac{1}{4}$ percent in its borrowings. We believe it should be able to borrow at market rates. But so long as the Congress keeps this limit on

the Treasury we feel this device is simply a means of circumventing your imposed control.

There is some loss in the degree of congressional control over program operations under the participation pool program.

The letter which I am submitting for the record speaks to S. 2499, and I would like to call to your attention we agree the draft you are now considering does have more congressional control. This argument has been offset somewhat by the requirements that the agencies come in for appropriation to make up the difference between the yield on the securities in the pool and the cost of these participation certificates to Fannie Mae.

However, I still feel—and I will admit that I have been too busy this week to review the amendments on the House bill that you now have before you, but it is my understanding that there still would be a possibility for some of these funds to go back into a revolving fund and be used.

My understanding of the Farmers Home Administration's revolving fund, for instance, is that you have no legal limit on the number of dollars of loans that they can make out of this revolving fund at all. There is a limit in there, I believe, of \$100 million that they can have outstanding in loans, at any one time, out of that revolving fund. I would stand to be corrected.

I know, Senator Sparkman, that you are an authority on this particular piece of legislation.

But I do think it is something we should examine. And if we do have revolving funds that have not got some precise limit to govern program activity, we should think about this and impose such controls.

Fourth, we do not consider this measure—and I think this is the principal argument that I would like to make before you this morning—we do not consider this participation pool program an effective means of stimulating private investment in the kinds of lending that are involved in these participation pools.

This measure has been proposed to you on the basis that this is a substitution of private credit for public credit and that it is consistent with the recommendations of the various committees that have studied the problems of credit, consistent with their recommendations that Government programs should stimulate and not supplant private credit.

I would like to quote for you, if I may, a couple of the recommendations that have been referred to by the proponents of this legislation.

The report of the Committee on Federal Credit Programs to the President of the United States was made to President Kennedy, I believe, and sent out, by him, to the various agencies. It says, on page 7:

Basic principles: In our society there is a presumption that the allocation of credit for essentially private purposes should be a function of private markets. Accordingly, the committee believes that Federal credit programs should in the main, and whenever consistent with essential program goals, encourage and supplement rather than displace private credit. This is more than a matter of basic economic philosophy. It also recognizes the fact that the private market will continue to account for the great bulk of all credit extensions. More can be gained in the end, therefore, if Federal credit programs, by working through the private market, help to make it stronger and more competitive than if they unnecessarily preempt the function that the private parties can potentially perform effectively.

They go on in this paragraph. And I would like to skip over to another paragraph here on page 8. I will give you this reference. It says:

The ultimate objective should be to reduce or eliminate the Government involvement if and as private imperfections disappear.

Now, let me cite for you what this bill does. This bill does not bring the private market closer to the problem areas of financing that you are trying to deal with in your various programs. It contemplates that the Government agency will make the loan and service the loan. The notes will be put in trust with Fannie Mae. The mortgages will be serviced continuously by the agencies who originated these loans.

Now, the FHA and VA mortgages in these pools I exempt from this particular discussion because they do operate differently, but the FHA mortgage is the best example of the difference. Here you have a loan which is originated through a local mortgage institution, be it by member or a commercial banker or a savings and loan or a savings bank. Whoever it is, it is a local institution.

This institution originates this loan and services this loan. If it sells that loan to Fannie Mae and the loan is ultimately put into the private market through a participation program, the servicing still remains at the local level.

There is a familiarity with this particular borrower and this particular borrower's type of problem. This is not inherent in what you are proposing under this participation pool program.

Take Farmers Home Administration as an example. Farmers Home Administration makes the loan. Farmers Home Administration services the loan. They sell the note to Fannie Mae. Fannie Mae sells a piece of paper that represents a participation to the extent of maybe 1 brick in 100 different houses to an investor somewhere.

Now, that investor never becomes familiar with the kind of lending that is involved, and there is no local lending company.

The CHAIRMAN. May I interrupt just a moment?

Mr. NORTHRUP. Yes, sir.

The CHAIRMAN. I realize you did not have notice enough to comply with our regulation to have a statement for every member of the committee. You have no prepared statement?

Mr. NORTHRUP. No, sir. I do not.

The CHAIRMAN. Tell me this: Are you for or against this bill?

Mr. NORTHRUP. We are very much opposed to this bill, Senator.

The CHAIRMAN. Can you tell us in simple words why you are opposed to it?

Mr. NORTHRUP. Yes sir; I am trying to do that.

The CHAIRMAN. I know, but I just want you to please try to summarize your objections 1, 2, 3, that it does this, it does the other, that you are against it.

Mr. NORTHRUP. No. 1, it is more costly than direct Treasury financing.

No. 2, it circumvents the legal prohibition against Treasury borrowing in excess of 4½ percent interest.

No. 3, there is a loss or reduction at least of congressional control over programs.

No. 4, it does not effectively stimulate private investment. It substitutes for it.

I would only like to add one additional point here, sir, and that is that we agree with the comments made by the previous speaker that this will have an adverse effect on home mortgage interest rates.

We believe that the injection of this additional \$4.7 billion into the market at this time will aggravate the current shortage of funds and tend not only, because it permits borrowing at higher than 4¼ percent, raise the entire level of interest rates in the market, but create an additional shortage of funds which will aggravate the residential and commercial mortgage business.

Thank you, sir.

The CHAIRMAN. Thank you.

Are there any questions?

Senator SPARKMAN. May I ask this question: Do you think it would aggravate the market more than the Government issuing a similar amount of bonds?

Mr. NORTHUP. No, sir. I don't.

Senator SPARKMAN. Which it would have to do to take care of the same amount of indebtedness or to take care of any deficit.

Mr. NORTHUP. Senator Sparkman, I am only asked to comment on this particular bill. But to answer that question I have to say that our philosophy is that we ought to have a little less butter and reduce the domestic spending that is not absolutely essential to avoid this problem.

The CHAIRMAN. If Senator Sparkman will permit—

Senator DOUGLAS. What items would you cut down? War in Vietnam?

Mr. NORTHUP. I refer to nonessential domestic spending Senator Douglas. Obviously we are in favor of support of Vietnam.

The CHAIRMAN. We might hear from the Senators from Wisconsin and Minnesota. Those are butter States.

I just want to say this: If we issue the bonds, the banks cannot buy them. They cannot even make loans to their best customers right now. Who would buy them? The agency that can issue a dollar against every bond that they buy. And what happens when a Federal Reserve bank buys? It sets up \$6 of new credit for every dollar it buys. So think of the inflationary effect if we have to force all of this deficit financing into the Federal Reserve System. How do they pay for it? They issue the money. We have authorized them to do it.

Senator DOUGLAS. The chairman is quite correct in saying that if the banks create the monetary purchasing power which the bonds support, it is an expansion sixfold.

The CHAIRMAN. For the Federal Reserve bank, not the commercial banks.

Senator DOUGLAS. Well, they increase the reserves.

Senator BENNETT. We are running downhill so fast that everybody is out of breath. [Laughter.]

But I would like to add my thanks. I think it is important that somebody should come and present the other point of view on this very important bill, particularly since the charge has been made that on the other side of the Capitol no opportunity was given for any opposition witness.

I appreciate the fact that you had to come here under the worst possible circumstances, with no time to think the thing through.

I realize, Mr. Chairman, that he was talking as fast as he was because you were anxious to have him finish and get through.

As far as I am concerned, I would like to thank him for the excellent job he did.

Mr. NORTHUP. Thank you. I would like to say that I talked so fast because I was wanting to get through this.

The CHAIRMAN. Yes; we appreciate that. Thank you very much.

(The Mortgage Bankers Association of America later supplied the following material:)

MORTGAGE BANKERS ASSOCIATION OF AMERICA,
Washington, D.C., February 24, 1966.

Senator A. WILLIS ROBERTSON,
Chairman, Senate Banking and Currency Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR ROBERTSON: On behalf of the Mortgage Bankers Association of America may I express appreciation for this opportunity to express the views of the association on S. 2499. The bill relates only to the authority of the Small Business Administration to pool loans and sell participations therein, either directly or through a trust agreement with the Federal National Mortgage Association. However, as you are aware, the proposal is symbolic of a trend in Federal fiscal management, and it therefore, must be considered in a broader light.

From statements made by the Director of the Bureau of the Budget in his testimony before Senator Proxmire's subcommittee, and from information in the President's economic message, we judge that it will be an administration policy to liquidate an increasing variety of debt instruments through this device. Just how broad this effort will be is not yet clear, but Senator Tower's letter of October 14, 1965, to Mr. Matthew Hale (p. 113 of the hearings on S. 2499) contains an impressive list of the types of collateral held in various Government agencies and which it would be possible to include in this type of financing.

The major justification usually advanced for financing through the participation pool is that it makes the budget for the year in which the sales occur look better. However, this appearance is deceptive, and while it may be understood by the Congress, it almost certainly deceives the taxpayer.

We find four principal objections to the kind of financing proposed in S. 2499:

- (1) It is more costly than direct Treasury financing.
- (2) It circumvents the legal prohibition against Treasury long-term borrowing at more than $4\frac{1}{4}$ percent interest.
- (3) There is a loss, or at least a reduction, of congressional control over program activity.
- (4) We do not consider it an effective means of substituting private investment for Government investment.

As to cost

During fiscal year 1966 it is proposed to sell \$3.3 billion of participations, most of which have in fact already been sold. During fiscal 1967 it is proposed to sell \$4.7 billion.

Government Accounting Office figures shown on page 49 of the hearing report on S. 2499 indicates the excess costs associated with this type of financing. Converting these figures to percentages and applying those percentages to the \$8 billion of participations proposed to be sold in fiscal 1966 and 1967, we estimate a total additional cost to the Government of over \$381 million (computation on attached sheet).

The proceeds of sales in any given year are handled as an offset against spending, however, the costs are cumulative. Conceivably, a point will be reached where sales in any one year will net nothing after deducting the costs.

As to the $4\frac{1}{4}$ percent interest rate ceiling

The rates currently being paid on participation certificates, many of which are in reality long-term obligations, are considerably in excess of the $4\frac{1}{4}$ -percent maximum which the Treasury can pay for long-term obligations. While there may be valid questions raised about the advisability of limiting the Treasury by

law to this rate, or any other rate, the fact remains that this legal requirement does presently prevail. The effect of taking these obligations out of the Treasury and transferring them to FNMA and the participation pool is to circumvent this legal maximum. In addition, these obligations in participations are not considered as a part of the national debt, therefore, they are not subject to the debt ceiling established by Congress. In fact, they reduce the debt as Treasury obligations are retired, making it more difficult than ever to make objective judgments of the Federal financial position.

As to loss of congressional control

Perhaps more serious from the congressional viewpoint is the fact that use of participation pools in conjunction with the concept of revolving funds makes it practically impossible for the Congress to exercise any control over the lending activities of the agency. In some existing programs, the proceeds of the sales of participations replenish revolving funds from which the agency makes loans. Presumably, this will be true in the future extensions of this concept.

In the case of SBA there is a definite dollar limit on the loans which can be made. In other instances, activity is limited only by a maximum dollar amount per year, or a maximum dollar amount outstanding and unsold at any one time (see sec. 517, National Housing Act, governing activity of the Farmers Home Administration). The ability of an agency to make loans under this latter type control is limited only by its ability to sell loans quickly.

Some agencies are limited in their activity by expiration dates on their programs, but these are generally renewable by legislative committees rather than appropriations committees. Hence, the difficulty arises of coordinating the agency's program lending activity with financial policy as enunciated by the Congress.

Additionally, we are advised that there is no statutory limit on the amount which the FNMA can borrow from the Treasury to make up the difference between rates received on securities in the pool and rates paid on participation certificates. While there is such a proliferation of different laws involved here that we find ourselves less than certain about this point, we understand that FNMA can borrow funds without limit from the Treasury to make up deficiencies in the receipts from payments on obligations in the pool which occur because of the fact that lower interest rates prevail on the loans than on the certificates sold in the private market. This cost can reach significant proportions. For example, if this interest rate spread were as little as one-half of 1 percent, it would amount to \$40 million per year on \$8 billion of participation certificates. Although this has not been a problem on participation certificates sold to date, it probably will be in the future. Authority exists, for example, for the Department of Housing and Urban Development and the Farmers Home Administration to make loans at rates as low as 3 to 4 percent, while at the present time investors are seeking yields as high as 4.65 percent on long-term Treasuries.

These are not additional costs for these programs, for Congress has authorized the subsidy involved in these "below market" programs. However, the extent to which such programs are utilized, and the total amount of subsidy the Treasury will be called upon to provide, will be largely beyond congressional control under the circumstances outlined above.

As to recommendations of the Committee on Federal Credit Programs

This program does not, in our opinion, comply with the basic principle of the report of the Committee on Federal Credit Programs cited on page 11 of the hearings on S. 2499. Contrast, for example, operations of the Federal Housing Administration with those of the Farmers Home Administration. Under the Federal Housing's mortgage insurance programs, loan applications are processed by privately owned lending institutions which make loans with the funds of private investors. Through this insurance function, private investment is truly encouraged. Even when loans are sold to FNMA and that agency pools the resulting loans, selling participations therein, servicing of the loans remains in private hands. Under these circumstances private lenders gain increasing familiarity with borrowers and as opportunities for profitable investment arise private funds move directly into these markets.

Under the Farmers Home Administration program a Government agency handles all origination and servicing functions precluding any contact between a borrower and a private lender. No opportunity exists for increasing the private lender's knowledge of the market. The sale of loan participation in

pools of these loans does not give investors any firsthand familiarity with this market.

SBA loans, and loans of other agencies proposed for participation pools, would include some loans falling in each of the above categories, but the participation pool has no benefit in stimulating further private investment in these markets.

We request the committee to take note of our real concern on this point. Mortgage bankers have engaged in a successful 30-year effort utilizing FHA insurance to bring an ever-increasing number and variety of investors into the housing finance field. We know from experience that private investment can truly be stimulated by such a program. FHA standards constitute a benchmark which not only governs lending on an insured basis, but guides lenders in the conventional field as well.

Conversely, we know from experience that direct Government loans, either at market rates or submarket rates, drive private lenders out of the market for such loans. This is particularly true where submarket interest rates are involved. To suggest that the subsequent sale of these securities (or participations in a pool of them) on the basis of an absolute guarantee, ideal liquidity, and yields above those paid on Treasury obligations, constitutes a stimulation of private investment, is to demonstrate a complete lack of understanding of the financial markets.

As to the effect on mortgages

So far as the mortgage market is specifically concerned, we can only conclude that the action contemplated by S. 2499 and current Federal budget proposals will add impetus to the upward push on interest costs. So long as the current Treasury obligations are outstanding at their lower interest rates the amounts which investors can pay for savings must of necessity remain lower. As they are refunded through the participation pools, lower interest obligations will be substituted in loan portfolios by the higher yielding participation certificates, and the ability to pay more for savings will be increased with the consequent upward pressure on the general level of interest rates, including mortgages. At least at the present time we consider such action to be highly undesirable. Current rates of mortgage interest are approaching the legal maximum in many States. They are so far above the presently established maximum FHA and VA rate as to make money for these programs very scarce. In addition, so long as Government guaranteed obligations, such as the participation certificates, are available at high yields there will be little incentive for investors to assume the problems associated with mortgage finance, thus it will be increasingly difficult for the private mortgage market to carry on its normal responsibility. The ultimate result, obviously, will be increased reliance on the Federal Government.

We can only conclude that this legislation would increase costs to the Government and have adverse long-term effects upon private credit facilities.

We recommend against the favorable consideration of S. 2499.

Sincerely,

SAMUEL E. NEEL,
Executive Vice President.

ESTIMATE OF ADDITIONAL COSTS TO GOVERNMENT OF FUNDING THROUGH PARTICIPATIONS

Total estimated additional cost of participation sales during year of sale of \$2,185,000, or 0.624 of principal amount.¹

Recurring annual expense for 15-year estimated maturity of participation certificates is \$2,185,000 (less underwriter's expense of \$1,155,000) or \$1,030,000, which equals 0.294 percent of principal amount.¹

Fiscal 1966 sales of \$3 billion times 0.00624 equals \$20,592,000.

Fiscal 1967 sales of \$4 billion times 0.00624 equals \$29,571,360.

Recurring annual expense for both equals \$8 billion times 0.00294 percent times 14 equals \$331,173,360. Total for 15 years: \$331,336,720.

We believe there is a reasonable expectation that the difference between Treasury borrowing costs and rates on participation certificates will widen from the 0.25 used in this example as the quality of loans in the pool declines—actually, or in the investor's opinion.

¹ Using figures from Government Accounting Office report.

The CHAIRMAN. We will go into executive session. All those not entitled to the floor will please retire.

(Whereupon, at 11:10 a.m., the committee continued in executive session.)

(The following material was submitted for inclusion in the record:)

[Excerpts from the Presidential Message entitled "Private Financing of Credit"]

LETTER OF TRANSMITTAL

THE WHITE HOUSE,
Washington, April 20, 1966.

HON. HUBERT H. HUMPHREY,
President of the Senate,
Washington, D.C.

DEAR MR. SPEAKER: I have the honor to transmit the "Participation Sales Act of 1966." This important legislation is designed to forward our objective of substituting private for public credit.

For many years the Federal Government has carried on lending programs to finance essential activities which would not otherwise receive adequate financial support. Under these programs direct loans are made to help the farmer, the businessman, the home buyer, the veteran, the student, our colleges, and our schools. As of June 30, 1965, the volume of these Federal loans exceeded \$33 billion.

Desirable as these activities are, Federal lending neither can, nor should, shoulder the entire job.

Under our system of free enterprise it is far better for the Government to mobilize private capital to these ends; and it is far better for the Government to stimulate and supplement private lending rather than to substitute for it.

To do this, we sell Federal loans directly, or in some cases, sell "participations" in pools of loans, to private investors. The Government acts as both middleman and underwriter for the loans, assuring adequate and economical financing for desirable projects while at the same time attracting the maximum participation of private investors.

This substitution of private for public credit provides sound financing for worthwhile projects with a minimum of Federal participation.

In encouraging private participation in Federal credit programs, I am building on the outstanding work begun and carried forward by:

President Eisenhower's administration.

The 1958 Commission on Money and Credit, chaired by Frazar B. Wilde and of which Secretary of the Treasury Fowler and many other distinguished citizens were members.

President Kennedy's 1962 Committee on Federal Credit Programs, under the chairmanship of former Secretary of the Treasury Dillon.

The substitution of private for public credit has many advantages:

It makes more effective use of the taxpayers' dollar.

It offers the private investor an opportunity for sound investment and a fair return.

It benefits business and those of our citizens who are helped by the vital programs made possible both by Federal and private investment.

In the fiscal year we expect to replace a total of \$3.3 billion in public credit with private credit. In fiscal 1967, with the help of legislation such as the proposal I am submitting today, we believe that private credit can be substituted for public credit, advantageously to all concerned, in the amount of approximately \$4.7 billion.

As private credit is introduced on an increasing scale, the need to coordinate the sales of Federal loans also increases. It would defeat the purpose of improving the operation of the credit market if loans offered under particular programs interfered with each other or with the orderly financing of the public debt through the sale of Treasury securities.

The Participation Sales Act of 1966 will help solve this problem in two important respects:

First, instead of the Government making a number of relatively small and uncoordinated offerings of loans in the market, the act provides for pooling

many loans together together and selling participations in the pool. The pooling of mortgages and loans and the sale of participations in the income and repayments from loans in the pool is not new. It has been used to advantage over the past several years by the Export-Import Bank, the Veterans' Administration, and the Federal National Mortgage Association.

Second, this legislation would extend the pool participation technique to other lending programs, including:

- Farmers Home Administration.
- Office of Education.
- College housing.
- Public facilities loans.
- Small Business Administration.

The pool technique adopted by this legislation has a number of advantages:

It assures the Government the best possible return on the sales of financial assets.

It provides the investor with a widely accepted and highly desired asset.

It provides a means for attracting private participation in loans made with relatively low-interest rates for special purposes.

It reaches sources of capital which would not be available for loans or mortgages offered individually, thus widening the reservoir of credit for vital projects.

The proposed legislation has two other major provisions.

1. Rather than have each of the agencies concerned conduct their own separate sales programs, the sale of participations would be centralized in a single agency—the Federal National Mortgage Association. This agency has already built up extensive experience with this technique in its mortgage pooling operations.

Individual agencies would continue to administer their credit programs, but the pooling of credits and sales of participations in the pools would be handled by the Federal National Mortgage Association. This centralization will greatly increase the efficiency of the sales operation and help coordinate this program with the Treasury's debt management operations.

2. In many cases the Congress has established Federal credit programs in which the interest rate charged to the borrower is below the market rate. The difference represents a net charge to the taxpayer. The act provides that, in all such cases, the Appropriations Committees of both Houses must authorize, in advance, the amounts of participations which could be sold against these assets. In this way, the safeguards of the annual appropriations process can be applied to this aspect of the program.

The Participation Sales Act of 1966 will permit us to conserve our budget resources by substituting private for public credit while still meeting urgent credit needs in the most efficient and economical manner possible.

It will enable us to make the credit market stronger, more competitive, and better able to serve the needs of our growing economy.

But, above all, the legislation will benefit millions of taxpayers and the many vital programs supported by Federal credit. The act will help us move this Nation forward and bring a better life to all the people.

I am enclosing a joint memorandum from the Secretary of the Treasury and the Director of the Bureau of the Budget which discusses in detail the major features of this legislation.

I urge speedy enactment of this legislation.

Sincerely,

LYNDON B. JOHNSON.

* * * * *

APRIL 19, 1966.

MEMORANDUM FOR THE PRESIDENT

This memorandum was prepared to provide you with background concerning the "Participation Sales Act of 1966." We recommend that you transmit the legislation to the Congress.

The proposed legislation is designed to implement your recommendation in the budget message relating to the substitution of private for public financing in various Federal credit programs. Specifically, the draft bill would provide for a coordinated program, through the Federal National Mortgage Association, of sales of participations in pools of financial assets held by various Federal agencies.

The basic purpose of the proposed legislation, as indicated, is to encourage the substitution of private for public credit in various major Federal credit programs. Given the desirability of drawing in greater private participation in the Federal credit programs, the sale of interests in pools of assets is the most satisfactory and economical means that has been devised to meet this end. The program of asset sales also facilitates the efficient use of budgetary funds.

The technique now proposed for sales of assets have evolved gradually during the past three administrations, stretching back in time to the mid-1960's. Both the Commission on Money and Credit, which produced its distinguished report in 1961, and President Kennedy's Committee on Federal Credit Programs, which was chaired by Secretary Dillon, recommended that vigorous efforts should be made to encourage private participation in Federal credit programs. A similar point was made in a minority report of the House Ways and Means Committee in 1963, which urged an expansion of the Federal Government's asset sales.

A guiding principle of these programs is that Federal credit should supplement or stimulate private lending rather than substitute for it. This is a matter of basic economic philosophy, as well as a recognition of the fact that the private market should, and will, continue to account for the bulk of all credit extensions.

Federal credit programs, working through the private market, help to make the market stronger, more competitive, and better able to serve the economy's needs over the long term, than if the Federal credit programs unnecessarily preempted functions that private lenders could perform effectively. In addition, use of private market facilities frequently can ease the problem of administering Government programs and make Government aid, where appropriate, more available to potential borrowers.

Carrying through these principles and recommendations, increased emphasis has been placed in recent years on greater use of Government guarantees of private credit and on direct sales of individual Government loans to private lenders. More recently, sales of individual loans have been supplemented by pooling large numbers of loans and selling certificates of participation in such pools.

But the use of this efficient technique, the Export-Import Bank of Washington has been able, since 1962, to sell about \$1.7 billion of its direct loans which otherwise might not have been marketable. The Federal National Mortgage Association, acting as trustee under authority granted by the Housing Act of 1964, has been able to sell \$1.6 billion of participation certificates (including their current offering) in pools of housing mortgage loans set aside by its management and liquidation and special assistance functions and by the Veterans' Administration.

Even with these major efforts to draw on private credit, the volume of direct Federal loans outstanding has increased in recent years. It was \$25.1 billion on June 30, 1961, and \$33.1 billion on June 30, 1965. The estimated level for June 30, 1966, is \$33.3 billion assuming completion of the sales indicated in the latest budget document. Under the proposed program of asset sales, the volume of direct Federal loans outstanding would decline to \$31.5 billion on June 30, 1967.

The increase in asset sales largely arises from broadening the program, as proposed in your 1967 budget, to include sales of participation in assets of the Farmers Home Administration, the Office of Education, the college housing program, the public facility loan program, and the Small Business Administration.

The centralization of the participation sales activity in FNMA, by building on an already successful body of market experience, will help to assure the orderly and most economical sale of this paper. It will also assure the effective coordination of these offerings, not only with one another but also with the Treasury's own debt management operations. The alternative of having each of the agencies involved conduct its own sales operation would greatly complicate the coordination problem, would produce a wasteful duplication of efforts, and would result in a less effective and more costly operation for the Federal Government. Under the guidance of FNMA, the asset sales undertaken for newer programs, less well known to the market, would gain the benefit of seasoning and experience that has been built up already through the FNMA operations.

Another advantage of the pool arrangements goes back to the fact that a number of sound Federal loans carry interest rates significantly below levels at which private lenders would be willing to invest their funds in the present mar-

ket. These rates, in many cases, have been written into the legislation setting up the programs. While the relatively low rates do not make the loans any less sound, these rates do mean that such loans could be sold directly to private investors only at substantial discounts.

The proposed legislation would make it possible to include such loans in marketable pools by providing, in effect, means for the agency owning the loans to make supplementary payments to the trustee of the pool to cover the interest insufficiency. The supplementary payments would be subject to the effective approval of the Appropriations Committees since these committees would authorize the amounts of any issues of participations on which supplementary payments are likely to be required. Section 2(b)(4) of the bill specifically provides that the amount of any such participation issues be within aggregate principal amounts authorized in advance in appropriation acts.

A further advantage of the pool arrangements is in their ability to draw into the financing of public credit programs practically all sectors of the capital markets. Many segments of the market cannot deal in individual mortgages. Other sectors are not able to purchase individual business or college housing loans. But almost all segments of the market are potential investors in pool certificates. Two consequences flow from this: first, the market for a number of particular types of credit instruments is substantially broadened; and, second, sales of participations do not disrupt particular segments of the capital markets, as might be the case if the mortgages or loans were sold individually.

It has been pointed out on some occasions that the sale of Federal credit program financial assets, whether through participation certificates or other means, is more expensive than financing through the direct issue of Treasury obligations. This is true, although the cost difference has proved to be relatively minor. For example, FNMA participation certificates have been sold at rates roughly one-fourth of 1 percent above Treasury issues of comparable maturity; and it is entirely possible that the margin may diminish as the market gains experience with these high-quality credits.

Moreover, carried to its logical conclusion, this argument would have the Treasury financing directly all of the Federal insurance and guarantee programs, since it can obviously do this more cheaply than the private market. Other types of credit, now handled entirely in the private market, could also be financed more "cheaply" by the U.S. Treasury. We certainly wish to retain, however, the principle that the allocation of credit for essentially private purposes should be a function of the private market. That was the philosophy of the Commission on Money and Credit and of the President's Committee on Federal Credit Programs. It is a sound philosophy, and I believe we should continue our efforts to strengthen the private market as a means for achieving program objectives with a minimum of Government interference.

For the reasons stated above, we recommended that you transmit the attached bill to the Congress and urge its speedy passage.

HENRY H. FOWLER,
Secretary of the Treasury.
CHARLES L. SCHULTZE,
Director, Bureau of the Budget.

SECTION-BY-SECTION SUMMARY OF THE PARTICIPATION SALES ACT OF 1966

General

The bill would broaden and make available on a governmentwide basis authority for the sale of participations in pools of financial assets now owned by Federal credit agencies. This would be accomplished by revising the authority provided in 1964 under which the Federal National Mortgage Association as trustee sells certificates of participation in pools of assets set aside by the Veterans' Administration and by the special assistance functions and the management and liquidating program of FNMA, and by making related changes in statutes of other agencies to permit such agencies to make use of participation sales methods.

Section 1. Short title

The bill would be cited as the "Participation Sales Act of 1966."

Section 2. Amendments to section 302(c) of the Federal National Mortgage Association Charter Act

Subsection (a) would amend existing section 302(c) of the Federal National Mortgage Association Charter Act to accommodate the provisions of new paragraphs (2), (3), and (4). The first and second amendments are technical. The purpose of the third amendment is to qualify for inclusion in participation trusts, securities held by various Government agencies even though they may not be within the technical definition of obligations. The fourth amendment would exempt participation certificates issued pursuant to this act from all regulation by the Securities and Exchange Commission. The fifth amendment would repeal the existing authority for appropriations to offset differentials arising from the issuance of participations based on below-market interest rate mortgages insured under section 221(d) (3) of the National Housing Act; this repeal is appropriate because of substitute arrangements provided in subsection (b) of section 2 of the bill.

Subsection (b) would add new paragraphs (2), (3), and (4), to section 302 (c) of the FNMA Charter Act. New paragraph (2) would authorize the head of any executive department, agency, or instrumentality of the United States to set aside a part or all of any financial assets held by him, subject them to a trust or trusts, and to guarantee to the trustee the timely payment of principal and interest on the assets so set aside. Under the trust instrument FNMA would act as trustee, and title to the obligations so set aside would be deemed to have passed to FNMA in trust. The custody, control, and administration of the obligations, however, would remain in the trustor, subject to transfer in event of default in the payment of principal and interest of the related participation certificates issued by the trustee. The trust instrument would require the trustee to pay promptly to the trustor the full net proceeds of any sale of participations, and require the trustor to treat the proceeds as otherwise provided by the law for direct sales or repayments of such obligations. To facilitate liquidation of assets because of prepayments or defaults and to release assets for direct sale, any trustor would be authorized, through the facilities of the trustee, to acquire outstanding participation to the extent of his responsibility to the trustee. Any trustor would also be authorized to pay his proper share of the costs and expenses incurred by the trustee.

New paragraph (2) would also specifically exempt any such trusts from all taxation. This, in effect, would categorize the trust as a corporation and exempt its income from tax. Since the trust is a corporation, the income received by the participation holders would be taxable dividends, even if part of the income earned by the corporation would have been tax exempt if owned directly by an investor.

New paragraph (3) would authorize any trustor to fulfill his guarantee of the timely payment of obligations subjected to a trust by using any appropriated funds or other amounts available to him for the general purposes of programs to which the obligations subjected to the trust are related.

New paragraph (4) would expressly authorize FNMA, as trustee, to issue and sell participations even if the aggregate receipts from obligations subject to the related trust are insufficient to permit the payment by the trustee of all interest or principal on the participations. However, the trustee cannot issue participations unless it determines there is a reasonable probability that the aggregate receipts from the obligations will not be insufficient, or unless the amounts of participations issued are within aggregate principal amounts authorized in advance in appropriation acts. Authority is given to include provisions authorizing the issuance of such participations in an appropriation act.

When the amounts of participations to be issued are authorized in an appropriation act or acts, indefinite appropriations would be established on the books of the Treasury in the amounts necessary to enable the trustor to effect timely payment to the trustee of any insufficiencies on account of outstanding participation. The trustor would be required to make timely payments to the trustees from such appropriations. Thus, purchasers of participations would be assured of timely payments of principal and interest without further action by the Congress.

Section 3. Reductions in new obligational authority

Subsection (a) amends section 305(c) of the FNMA Charter Act by reducing by \$450 million the aggregate potential authority of FNMA to purchase mortgages under its special assistance functions.

Subsection (b) would amend section 401(d) of the Housing Act of 1950 by reducing by \$300 million the borrowing authority of the college housing loan program. Both reductions are made possible by increased sales of participation certificates in existing loans.

Section 4. Office of Education revolving loan fund provisions

Subsection (a) of this section would amend section 303(c) of the Higher Education Facilities Act of 1963 to provide that appropriations for making academic facility loans would now be payable into the fund to be established by subsection (b) of this section.

Subsection (b) would add a new section 305 to the Higher Education Facilities Act of 1963 establishing a separate revolving fund for higher education academic facilities loans, available without fiscal year limitations. The total of new loans made from the fund in any fiscal year would be subject to limitations specified in appropriation acts. All appropriations available for academic facilities loans and all receipts from operations and from participation sales would be deposited in the fund. All loans, expenses, and payments would be paid from the fund, including expenses and payments to the Federal National Mortgage Association in connection with the sale of participations. The Commissioner would be required to pay from the fund into the Treasury interest on the net amount of appropriations used by the fund.

Section 5. Farmers Home Administration direct loan account provisions

Section 5 would amend section 338(c) of the Consolidated Farmers Home Administration Act of 1961 to transfer to the direct loan account watershed protection and flood prevention loans, rural renewal loans, and resource conservation and development loans not now financed through revolving funds. The intent is to include among the loans eligible for pooling under section 2 all loans made by the Farmers Home Administration (including not only those in the direct loan account, but also those in the emergency credit revolving fund, rural housing direct loan account, agricultural credit insurance fund, and the rural housing insurance fund).

Section 6. Preservation of existing Veterans' Administration authority

Section 6 would make it clear that nothing contained in this bill should be construed to repeal or modify the existing authority of the Administrator of Veterans' Affairs to enter into trust arrangements comparable to those contemplated by this bill. The intent of this section would be to authorize the Administrator of Veterans' Affairs to enter into trust arrangements either under the provisions of this bill, or under the provisions of section 1820(e) of title 38, United States Code.

BUREAU OF THE BUDGET,
Washington, D.C., April 29, 1966.

HON. A. WILLIS ROBERTSON,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: You have inquired whether there is any intention on the part of the Administration to seek the congressional authorization which would be required to include any rural electrification or telephone loans in participation pools established under the provisions of the Participation Sales Act of 1966.

As you know, the President has proposed legislation to establish Federal banks for rural electrification and telephone systems in order to provide supplementary financing for the Rural Electrification Administration program. We believe that favorable congressional action on this proposed legislation will assure a fully adequate supply of credit to meet the needs of rural electric and telephone cooperatives.

I can assure you that in no event under the legislation now before your committee will any participations be sold in any REA loans.

Sincerely yours,

CHARLES L. SCHULTZE,
Director, Bureau of the Budget.

*Export-Import Bank of Washington sales of bank paper, fiscal year 1961
through fiscal year 1965*

[In millions]

	Fiscal year 1961	Fiscal year 1962	Fiscal year 1963	Fiscal year 1964	Fiscal year 1965
Without recourse:					
For cash.....	14.1	38.8	80.8	63.3	87.5
Assignment of undisbursed obligations ¹	(²)	(²)	31.9	34.8	40.8
With recourse:					
Participation certificates (portfolio fund).....	0	300.0	250.0	372.5	450.0
Sales of specific maturities.....	0	0	5.0	0	36.4
Total.....	14.1	338.8	367.7	470.6	614.7

¹ Assumed by participants prior to disbursement by Eximbank.

² Not available.

Source: Office of the Controller, Apr. 29, 1966.

APRIL 29, 1966.

HON. A. WILLIS ROBERTSON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR ROBERTSON: The attached statement and proposed amendment to the Participation Sales Act to make its provisions inapplicable to the loan program operations under the Rural Electrification Act of 1936, as amended, is furnished at the request of Mr. Earl Shiflet, executive manager, Virginia Association of Electric Co-ops.

Sincerely,

IRA SNESSER,
Legislative Research Coordinator.

EXCLUSION FROM THE PARTICIPATION SALES ACT OF 1966 OF OBLIGATIONS
ISSUED PURSUANT TO THE RURAL ELECTRIFICATION ACT OF 1936 AS NOW
OR HEREAFTER AMENDED

The rural electrification program was established by Executive order in 1935 to provide financial assistance in bringing central station electric service to the unserved rural areas of the United States.

From its inception, the rural electrification program was set up to serve—and does serve—a social as well as an economic purpose by raising the working and living standards of the people of rural America. In 1936, Congress enacted the Rural Electrification Act giving statutory authority to this program. The present 2-percent interest rate charged for REA loans was written into the law in 1944. The rural electric cooperative systems established by farmers and other rural residents of the United States have utilized the financing made available under the Rural Electrification Act, to provide modern, efficient electric supply systems in their rural areas.

This job has been carried on amidst great difficulties and continues to be a challenge to the dedicated men and women of the rural electrification program. Today these systems serve the less densely populated areas of the country and require a high plant investment on which there is a very low monetary return.

The Federal Government holds approximately \$3.5 billion of obligations from rural electrification borrowers, and about \$700 million of obligations of rural telephone borrowers. These obligations all carry a 2-percent interest rate. To include these low-interest-earning holdings in the proposed Participation Sales Act would require an extremely large annual appropriation by the Congress to make up the interest deficiency which would arise from the sale of participations at the current market interest rates, which are now at a level of between 5¼ and 5½ percent. Interest rates have been at a high level for a number of

years, and in all likelihood may continue to remain so for a substantial period of time.

In addition, there has been proposed legislation submitted by the administration to amend the Rural Electrification Act to establish Federal Banks for rural electric and telephone systems to provide supplementary sources of capital for REA borrowers. This legislation is patterned after operations of the existing farm credit system and follows proposals which have been endorsed by the rural electric cooperatives. Under the proposal submitted by the administration, the proposed banks would have authority to issue up to \$10½ billion of debentures. Similar legislation introduced in the House by Representative Poage, of Texas, H.R. 14000, would authorize Federal electric and telephone banks to issue up to \$12½ billion of debentures for program purposes. The obligations proposed to be issued under this legislation will not be direct obligations of the Government, would not be expressly guaranteed by the Government, and would not be counted as part of the public debt or included in the Federal administrative budget. Further, it is the intention that the banks to be established under this proposed legislation would eventually become institutions wholly owned and operated by their borrowers. Any possible construction of language of the Participation Sales Act which would suggest that obligations of these banks be subject to its provisions could jeopardize the operations of these banks.

I am proposing to amend the Participation Sales Act by adding a new section, specifically excluding from the provisions of this bill any obligations issued to the United States pursuant to the provisions of the Rural Electrification Act of 1936, as amended. The text of this amendment follows:

"SEC. 9. This Act shall not apply to any obligations issued to the Rural Electrification Administration, its Administrator, or to any other officer, agency or instrumentality of the United States, pursuant to the Rural Electrification Act as now or hereafter amended."

UNITED STATES SAVINGS & LOAN LEAGUE,
April 29, 1966.

Hon. A. WILLIS ROBERTSON,
Chairman, Senate Banking and Currency Committee,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: We have noted that the Senate Banking and Currency Committee yesterday approved the administration's proposal with respect to the sale of participations in certain Government-held loans. It is our understanding that such participations will be sold to institutional investors and other large savers. We believe that some minimum size, such as \$25,000 or \$50,000, should be established.

We are anxious that these participations not compete in any way for the ordinary savings which now go into savings and loan associations and other financial institutions. As you know, savings competition is at an alltime high and many savings institutions are suffering their worst losses in savings. Certainly, we would not want the new program to add further to the turmoil.

We would hope that either the Committee report or your statement on the Senate floor would emphasize that only large blocks of participations will be sold and that there will be no competition with the typical passbook type savings.

Sincerely,

STEPHEN SLIPHER,
Legislative Director.

