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CONTROL OF FEDERAL CREDIT

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HEARINGS

BEFORE THE

SPECIAL SUBCOMMITTEE ON
CONTROL OF FEDERAL CREDIT

OF THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

JUNE 19, 23, AND JULY 1, 1980

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CONTROL OF FEDERAL CREDIT

THURSDAY, JUNE 19, 1980

U.S. SENATE,
SPECIAL SUBCOMMITTEE ON THE CONTROL
OF FEDERAL CREDIT,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The special subcommittee met, pursuant to notice, at 9 a.m., in room 357, Russell Senate Office Building, Hon. Howard Metzenbaum (chairman of the special subcommittee) presiding.

Present: Senators Metzenbaum, Bellmon, and Boschwitz.

Staff present: Lizabeth Tankersley, counsel; and Ann Hadley, analyst, full committee. Claudia Farris, legislative aide to Senator Metzenbaum. William L. Stringer, counsel to the minority, full committee.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. The Special Subcommittee on Control of Federal Credit will come to order. And I am pleased today to welcome our witnesses to the first hearing of the Special Subcommittee on the Control of Federal Credit.

I think it is about time the Congress got down to the serious business of dealing with the excessive use of Federal loan and loan guarantee programs. Although in most cases these credit programs serve a useful purpose, in recent years, in my opinion, they have gotten out of hand. They have come to be used as a backdoor method of funding which permits billions of dollars to be spent outside the scrutiny of the budget process.

In some cases, the off-budget loan or loan guarantee is simply a substitute for the more visible direct spending program.

Congress set up the budget process in order to control excessive Federal spending. But it seems the more control we have gotten over direct spending, the more everyone wants new credit programs. By the end of 1981 Federal loan guarantees will have expanded by 230 percent, just since the start of the congressional budget process.

In addition to the expansion of traditional forms of Federal credit activity, Congress has increasingly turned to credit financing for large, single-purpose projects like Lockheed, New York City, Chrysler, and, now, the very, very large and substantial synfuels program.

The presence of the Federal Government in credit markets at all levels has become pervasive. Even the possibility of default by Third World countries on their World Bank loans, which are guar-

anted, in part, by the United States, could have a direct impact upon the Federal budget.

MOST CREDIT PROGRAMS OPERATED THROUGH OFF-BUDGET AGENCIES

The amazing thing about all of this is that a lot of these credit programs are operated through so-called off-budget agencies. What that means is we are laying the U.S. Government on the line for billions of dollars which the budget does not even reflect. Frankly, can we afford to continue creating these kinds of programs? What are their real costs? Does not the public have the right to know the full extent of its Government's commitments?

SIZABLE OFF-BUDGET DEFICIT CREATED BY OPERATIONS OF FFB

The time has come to really take a close look at these credit programs. For instance, how many people know that there is an agency called the Federal Financing Bank? How many people know that this off-budget agency is costing the taxpayers over \$15 billion a year? I am not at all certain that the 535 members of Congress would be in a position to take an examination as to what the Federal Financing Bank is, how it is operated, what it does, and what its impact is.

Just what does this agency do? Can we justify to our constituents that this enormous amount of spending does not even show up in the budget? Why do we even need a Federal Financing Bank? And do we not have nearly enough information—and we do not have nearly enough information about loan guarantees. What is the total amount of outstanding Federal liability under these loan guarantee programs? What if suddenly there were massive defaults? How would the Federal Government be able to meet its commitments to repay the makers of these loans? What effect would that have on our economy?

And at this time in our Nation's history, when we are talking about are we in a recession, how deep will the recession be, how long will it last, the possibility of massive defaults on those loan guarantees is more than just a possibility.

I hope that this subcommittee will begin to answer these and other questions today. Through this subcommittee, we hope to lay the groundwork for establishing greater control and accountability in these loan programs.

IMPACT OF FEDERAL BORROWING ON INDIVIDUAL CREDIT FINANCING

There is another issue I want to raise. And that is the question of the impact of Federal borrowing on the ability of the private individual or the private business to obtain credit financing.

Now, we have heard a lot in recent months about the need for "supply side" incentives to help American industry improve its flagging productivity. But the massive growing presence of the Federal Government in the credit market has placed substantial pressure on the capital that business needs to make productive investments. That pressure makes capital harder to raise, particularly for small- and medium-sized companies.

We need to figure out a way to strike a balance between the public and private needs for capital. This is an issue which we will

raise in the hearing today, and then deal with in greater depth at a later date. Because of our need to make recommendations for the second budget resolution rather quickly, we will focus in this first set of hearings on the question of how best to establish budgetary control over Federal credit programs.

We have already taken some first steps. Aggregate targets for loans and loan guarantees were set in the first budget resolution for 1981. Legislation is pending before the House and the Senate to expand this system.

Our first panel of witnesses, Roger Altman of the Treasury Department, Mr. Bowman Cutter of the Office of Management and Budget, and Mr. Lyle Gramley of the Federal Reserve System, will discuss the accomplishments we can expect to achieve through this system. They will also address themselves to additional steps that can be taken to better coordinate Federal credit policies with direct Government spending and with the monetary policy of the Federal Reserve.

Later this morning, a panel of private sector experts will appear to discuss the effectiveness of Federal credit programs in achieving their objectives, the impact of Federal credit programs and capital markets, and the appropriate criteria for choosing between credit programs and direct Federal spending to achieve particular program objectives.

Senator Bellmon, do you have a statement?

Senator BELLMON. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR BELLMON

Mr. Chairman, this special subcommittee of the Budget Committee has been asked to explore the economic and budgetary consequences of credit extended under Federal auspices. It is a difficult charge. Nevertheless, the \$350 billion of Federal direct and guaranteed loans outstanding and their skyrocketing growth over the last 5 years demands that this committee act quickly to increase understanding, improve budgetary treatment and bring Federal credit programs under more comprehensive management. Between 1976 and 1979, direct lending by on-budget agencies increased 31 percent, direct lending by off-budget agencies increased 70 percent, and loan guarantees increased 90 percent.

As you know, the first budget resolution for fiscal year 1981 for the first time contains fiscal year 1981 guidelines for new Federal direct loans of \$63.9 billion, new loan guarantees of \$79.6 billion, and a sense of Congress resolution limiting off-budget lending to \$25.8 billion. In conference, however, conferees were unable to agree upon an appropriate enforcement mechanism and it is even uncertain whether the 1974 Budget Act provides for such a procedure. In fact, the Budget Act specifically provides that loan guarantees cannot be scored as budget authority. The full committee looks, in part, to this subcommittee for enlightenment on these issues and questions.

Perhaps the appropriate mechanism for control is a limitation provision such as that contained in the bill offered by Senator Percy. I understand that this subcommittee will investigate the ramifications of his bill and report to the full committee.

It would also be difficult to approach the subject of Federal credit without considering the whole area of off-budget agencies, the relationship of off-budget and the Federal Finance Bank, the netting of outlays in loan revolving funds and budgetary accounting of implicit subsidies tendered by below-market interest charges. Of course, these are far reaching and complex topics and will require inputs from all of Congress, the Office of Management and Budget, the Treasury and countless other agencies, bureaus and interested parties. The committee has already asked many of these groups for their views and I look forward to their responses.

ASSESSING THE NEED FOR BETTER MANAGEMENT OF FEDERAL CREDIT PROGRAMS

In my 5 years on the Budget Committee I have been concerned with the need for better management of Federal credit programs, yet some reluctance to treat credit as though it were an outlay. Payments, where they are made for prudent purposes and have high probability of repayment, are often a less expensive means of accomplishing valid objectives than direct payments. Identical treatment for both loans and payments, would, therefore, not be fair or accurate.

The Commodity Credit Corporation, for example, grants direct loans for basic commodities with the commodity held as collateral. Budget authority is restored 2 years after the loan is made. Because the loan is backed by the security of the commodity and because farmers understand and depend upon the program, its default rate is low and interest payments tend to offset the cost of the program. As another example, Senator Kennedy and I have proposed a direct student loan program which, when fully activated, would substantially reduce Government costs. Because the first few years require an infusion of initial capital front year costs look large. However, over the years cost savings compared to the existing guarantee program are substantial. The point is, whatever system of credit control is devised, it must be reflective of total real cost and allow priorities and policy choices to be made in a rational way.

ECONOMIC IMPACT OF THE GROWTH OF FEDERAL CREDIT

Experts are only beginning to recognize the profound impacts that the growth of Federal credit has had on overall economic activity and interest rates in particular. We have always recognized the impact of default. However, large, single recipient loans such as New York City and Chrysler Corp. guarantees, have certainly raised the probability of Federal payouts and their subsequent detrimental impacts on financial markets.

We are also beginning to recognize that the volume of guarantees and the selection of recipients is eliminating low quality debt without reducing risk of default and thus generally increasing the overall level of interest rates. It must always be remembered that a guarantee reduces risk to the investor but not to the economic endeavor.

Even the concept of default seems to be an ill-defined and obscure concept. Defaults do appear as outlays. But, while some

agencies readily score defaults, others count them as slow loans and withhold budgeting the loans as defaults. Other agencies, HUD is one example, may devise means of offsetting defaults of other payments. Uniformity of treatment is key to any accounting system and the Federal credit budgetary system as it exists is a hodge-podge of ad hoc accounting procedures. It would be a large step forward if this subcommittee were to start in motion some eventual agreement on a default criteria.

Mr. Chairman, I have outlined only a few of the areas of inquiry—it is an almost monumental assignment. Yet it is an area in which Congress and this committee has remained inactive for too long. I appreciate the efforts the members of this subcommittee have already made and look forward to carefully reviewing the information you gather. I am pleased to welcome the two panels of experts before us today and anticipate that they can shed some light on the issues I have listed.

Senator METZENBAUM. Thank you, Senator. We will now begin with Mr. Gramley. We are very happy to welcome you, sir, and we will hear from Mr. Cutter after he arrives.

Nice to have you with us this morning, we look forward to hearing from you.

I will ask the witnesses—and I think the staff has asked the witnesses—to try to summarize their statements so that they not be much more than 10 minutes. That will give us an opportunity for a number of questions since we have six witnesses this morning. Thank you.

STATEMENT OF LYLE GRAMLEY, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE BOARD

Mr. GRAMLEY. Mr. Chairman and members of this Special Subcommittee on Federal Credit, I am pleased to be here today to discuss measures to improve control over federally assisted credit programs.

The need for more adequate budget treatment and control of these activities has long been recognized. Both the 1963 Report of the President's Committee on Federal Credit Programs and the 1967 Report of the President's Commission on Budget Concepts called for reforms in the budgetary treatment of Federal credit. Until recently, however, little progress was evident. In particular, the Congressional Budget Act of 1974 specifically exempted loan guarantees from the budget process and did not develop a comprehensive framework for evaluating these activities. It was therefore especially heartening that the administration recommended a new budgetary framework for controlling Federal credit programs in its 1981 budget, and that the Congress has incorporated a new Federal credit budget into its first concurrent resolution.

As you know, Federal credit programs have expanded enormously, both in amount and in scope. Direct loans and loan guarantees outstanding, for example, are projected to total over \$425 billion in the fiscal year ending September 30. This is nearly triple the \$164 billion level reached just 10 years ago. In addition, loans held by

Government-sponsored agencies now are projected to be \$176 billion at the end of fiscal year 1980, up \$17 billion from the year before and more than four times the level of 10 years earlier. Federal credit activities, moreover, are projected to continue growing rapidly in the years ahead. The administration forecasts that net credit advanced under Federal auspices—direct, guaranteed, and sponsored—will increase by more than \$70 billion during fiscal year 1981. If total credit flows in the coming year turn out to be roughly the same as in the past year, funds raised under Federal credit assistance will account for over one-sixth of the total net funds raised in financial markets.

The widening in the range of economic activities sponsored by guaranteed loans has been particularly notable. In the late 1950's, the home mortgage guarantee programs of the Federal Housing Administration and the Veterans' Administration accounted for 90 percent of the total volume of guaranteed and insured loans outstanding. This proportion has since trended down, reaching 68 percent last year, mainly because of an expansion of loan guarantees into new areas—such as military sales, rural electrification, and student loans.

The provision of Federal credit assistance through direct loans and loan guarantees to achieve particular social and economic objectives has been widely recognized as a legitimate and valuable activity. Many credit programs originally were established to correct imperfections in capital markets that denied credit to some groups or made its cost prohibitive. For example, the FHA-insured loan programs were devised during the Great Depression to reduce the risks perceived by lenders. By pooling risks across a large number of loans issued in a standardized fashion, the Government program encouraged private lenders to advance credit at a lower cost to borrowers and on less restrictive terms than would otherwise have been possible. As a result, private individuals were able to finance the purchase of homes on terms involving more reasonable interest charges, more liberal loan-to-value ratios and longer maturities than before. Over time, these more liberal terms gained general acceptance among all types of private lenders.

Many other Federal credit assistance programs have been introduced over the years to foster social objectives. Increasingly, these programs have involved substantial interest subsidies. According to OMB estimates, the present value of the interest subsidy on new direct loan obligations and commitments to guarantee loans in fiscal 1981 will amount to almost \$30 billion. In contrast to the home mortgage area, moreover, the default rate in some of these programs—such as student loans and assistance for low-income housing—has been comparatively high. Thus, the Government has had to absorb sizable default losses in addition to providing a very large interest rate subsidy to borrowers. In the past few years, the Federal Government has also guaranteed sizable loans to single borrowers that carry a large potential for default.

PURPOSES OF CONTROLS OVER FEDERAL CREDIT PROGRAMS

Improvement in the budgetary treatment of Federal credit programs should seek to achieve several interrelated purposes.

First, it should encourage recognition by the Congress and the public that resources used in programs financed by Federal credit activities may have been shifted away from more productive uses. In setting annual credit targets, the Congress must not lose sight of the long-run consequences resulting from such a shift in resource use.

Second, it should identify where possible the costs entailed in Federal credit activities. These costs include not only the interest subsidies, the administrative expenses, and the default losses but also the loss in public welfare that occurs when Federal credit programs are expanded beyond socially desirable and efficient levels.

Third, it should focus attention on the macroeconomic effects of Federal credit activities—on employment and output, on prices, and on developments in credit markets. Information that helps to assess these effects is, of course, especially important to the Federal Reserve in its formulation of monetary policy.

IMPACT OF FEDERAL BORROWING ON PRIVATE BORROWERS

It has long been recognized that Federal borrowing can “crowd-out” private borrowers—and thereby transfer command over resources from the private to the public sector. The degree of such displacement depends on the extent to which the economy’s real resources are being utilized and on conditions in credit markets. During recessionary periods, when credit supplies are readily available, credit assistance programs may help promote a more intensive use of resources and an expansion in the level of economic activity. In this instance, the principal effect of the increase in expenditures made possible by the Federal credit activity is likely to be an increase in aggregate demand rather than a redistribution of resource use. On the other hand, when little excess capacity exists in the economy and credit supplies are tight, there is a much stronger tendency for credit extended under Federal auspices to raise interest rates and to divert loanable funds, and hence real resources, away from private producers. Moreover, when such programs create additional demands on limited resources, they also add to pressures on prices.

It would, however, be potentially misleading in a discussion of the crowding-out problem to focus simply on the cyclical condition of the economy. The long-run potential for the diversion of resources from private to public uses stemming from Federal credit programs is a serious problem.

FEDERAL CREDIT PROGRAMS AND THE ECONOMY

In recent years, the performance of productivity in our economy has been dismal. We do not know all the reasons why, and that will limit our ability to deal effectively with the problem. We do know, however, that a substantial increase in the share of national output will have to be devoted to capital formation if we are to have much hope of increasing the rate of productivity advance. Since the need for additional capital to deal with our Nation’s energy and environmental problems will also be large, it will be critical to adopt tax and expenditure policies that free up re-

sources—real resources as well as financial resources—to make that possible.

The need for a higher rate of business capital formation is critical to the long-run health of our economy. Holding down the share GNP devoted to Federal expenditures will contribute importantly to that effort. So also will the orientation of future tax cuts toward business investment incentives. But these efforts may go for naught if we do not control carefully the share of national resources absorbed by Federal credit programs.

One of the problems that has impeded the development of better budgetary treatment of Federal credit programs is the lack of a good analytic framework in which to assess the economic effects of these programs. Some Federal credit programs affect the economy much like direct Federal expenditures. Loan guarantees for low-income housing and foreign military assistance are the most obvious examples. Others provide only marginally lower interest rates, or marginally better nonprice credit terms, to borrowers whose credit needs would otherwise probably have been met by the private financial market. These differing effects, moreover, do not bear any necessary relation to whether credit is supplied through direct loans or loan guarantees.

Since research in the area of Federal credit programs has barely begun, what appears extremely complex today may appear more simply tomorrow. I suspect, however, that the problems we face in this regard stem from the diverse nature of these credit programs. If so, we will have to be satisfied with statistical measures and budgetary solutions for dealing with Federal credit programs that are inherently less than fully satisfactory. For example, the proportion of total borrowing in financial markets that is federally assisted can be used as an indicator of credit resources whose direction is governed by Federal lending programs. Similarly, the share of GNP accounted for by the total of Federal expenditures plus credit activities is a rough measure of the proportion of real resources whose use is directed by the Federal Government.

Summary measures such as these have inherent weaknesses because they add up things that are really very different. But they are better than nothing.

Your committee is rightly concerned about the potential problems that Federal credit programs may create for monetary policy. It is sometimes argued that expansion in Federal credit programs during periods of monetary restraint might frustrate the achievement of the objectives of monetary policy by insulating some borrower groups from the discipline of the market place. For most Federal credit programs, however, interest charges vary with market rates of interest; moreover, increases in the quantity of credit available from Federal sources seldom are large enough to offset completely the declines in the quantity available from private sources. It is true, nonetheless, that assuring larger numbers of borrowers ready access to credit requires higher interest rates to achieve a given degree of monetary restraint. This is one more reason for putting limits on how fast Federal credit programs can expand.

SUGGESTIONS FOR IMPROVEMENT IN THE BUDGETARY TREATMENT OF
CREDIT PROGRAMS

Let me turn now to a few suggestions on ways to sharpen the focus on the effects of Federal credit programs.

First, procedures should be developed that would permit policy-makers to determine the tradeoffs between accomplishing social objectives through direct outlays, on the one hand, and through Federal credit programs on the other. Similar criteria need to be developed to provide guidance for choosing between giving credit assistance through direct loans or loan guarantees.

Second, further consideration might be given to ways of controlling net as well as gross lending. The present credit limits apply to gross loans; that is, I believe, the appropriate place to begin. Gross lending and guarantee activities reflect the current scope of various programs, thus indicating the overall support being given to a sector by the Federal Government. On the other hand, the net change in such programs determines the current impact of Federal credit activities on economic and financial market conditions. So perhaps we ought to seek to limit the net, as well as the gross, increase in Federal credit extensions.

Third, the budgetary treatment of nonrecourse loans—such as those made by the Commodity Credit Corporation to farmers—should be studied in greater detail. Since nonrecourse loans need not be repaid, it is not clear whether these transactions should be treated as outlays or as loans at the time when the funds are disbursed.

Fourth, the accounting treatment of loans made through the Federal Financing Bank could be further improved. FFB activities in the past have reduced the accountability of Federal credit programs, because lending activities typically have been attributed only to the FFB rather than to the agency originating the transaction. The new budget rectifies a large part of this difficulty by attributing FFB outlays to the originating agencies—within the FFB account—and by establishing limitations on the absolute amount of credit—direct and guaranteed—that can be financed by an agency in a given year. The attribution process, however, is not yet complete because the combined total of outlays and direct and guaranteed loans never appears in a consolidated statement by function and agency. If this final step were taken, the unified budget accounts would provide a more complete picture of the Federal Government's support for particular programs and activities.

Finally, if the control system established by the Congress is to be successful, it must be accompanied by a detailed scorekeeping system. To satisfy this requirement the Congress should consider establishing a Credit Control Office within the Congressional Budget Office in order to provide the Congress with detailed technical data on the costs and benefits of Federal credit programs, and with up-to-date reports on Federal credit activities. These reports also would include a credit information system that encompasses total Federal lending activity by budget function and by economic sector. Ideally, such a system would provide information that highlights the Federal Government's total involvement in, and assist-

ance to, sectors in the form of direct outlays, direct loans, and loan guarantees.

To sum up, the Board of Governors welcomes the progress that has been made in establishing a credit budget. It will improve our ability to evaluate and control Federal credit activities, and enhance the long-run prospects for increased private capital formation. We will be happy to provide you whatever assistance we can in refining further the procedures for dealing with Federal credit programs in the budget.

Senator METZENBAUM. Mr. Gramley, there is a vote on the floor. I think that, rather than to start asking you questions and then stopping in the middle, I am going to go over and get my vote out of the way and then come back. I do not think I will have to stay there for any reason.

Senator BOSCHWITZ, did you have any opening statement you would care to make?

Senator BOSCHWITZ. No.

Senator METZENBAUM. There are other members of the committee who may have opening statements, and if they do they will be included in the record immediately following the chairman's comments.

Mr. Gramley, one of the key elements—first, let me thank you for an excellent statement indicating your views. I gather, are you speaking in this instance reflecting the views of the Federal Reserve Board?

Mr. GRAMLEY. My statement was circulated to other Board members. There was no formal Board approval of it, but the members had a chance to comment on it.

RELATING FEDERAL CREDIT POLICIES TO MONETARY POLICIES

Senator METZENBAUM. Thank you. One of the key elements of the administration's inflation control program was credit control, yet the Federal Government will add over \$60 billion to credit demand in 1981. How do Federal credit policies relate to monetary policies? And how can these policies be better coordinated?

Mr. GRAMLEY. As I indicated in my statement, Federal credit programs can either divert resources from one use to another, or add to resource use. At the present time, we are in an economy that is weakening. With interest rates falling, the major effect of an increase in the Federal credit program would be to add to aggregate demand rather than to divert resources from one use to another.

I think if one looks at these programs over the longer term—say the next 10 years or 15 years—the major effect is not to change the level of aggregate demand, but to divert resources. And so the implications of these programs, in terms of the ability of our country to deal with inflation, have to do with this longer run resource diverting effect.

I am greatly concerned about the fact that if our country is going to be successful in increasing the rate of private business capital formation, we are going to have to use every weapon at our command to make sure that real and financial resources are available to accomplish this objective. This will require that we hold down the growth of direct Federal spending, reduce the share of Federal

spending in GNP, provide for additions to the total of national saving to make the financial resources available for more investment, and add to business investment incentives through the changes in the tax structure. Also, and very importantly, we must hold down the long-term growth of Federal credit programs.

Turning more specifically to your comment about monetary policy, what the Federal Reserve needs most of all is information on the activities of these programs so that the Board can coordinate its own actions with those of the Federal credit programs. From our standpoint, it also will be very helpful to have these Federal programs under the control of a credit budget, so that congressional intentions and administration plans are relayed to us in a timely manner.

This does not mean that these programs, if they are set up at a given funded level for a year, should be fixed at a given level. Federal credit activities, of course, will change with economic conditions. Probably the most important changes will take place in the credit programs that deal with housing.

As you may know, Mr. Chairman, there is an Inter-Agency Housing Finance Task Force in which the Federal Reserve does participate. And there is a great deal of exchange of information back and forth about the activities and plans of Federal credit programs. Thus, I believe that mechanisms have been established and put in place handle the coordination problem.

Senator METZENBAUM. Now, in relationship to a balanced budget, what impact do you see in the extra \$60 billion of credit guarantees being included in the national economy in contradistinction to an extra \$60 billion of direct Federal spending?

Mr. GRAMLEY. I think the two are not at all the same. As I tried to point out in my testimony, the effects of Federal credit programs differ greatly from one program to another. Some Federal credit programs are almost like direct Federal expenditures in terms of their impact on the economy; whereas others probably provide a minor degree of subsidization to a private borrower who would otherwise have received the funds from private financial markets.

So a dollar's worth of economic activity that is directed by Federal credit programs is not necessarily the same as a dollar's worth of activity generated by Federal expenditures. But the general direction is clear; that is, the greater the extent to which we let Federal credit programs expand, the less credit and real resources there will be available for other uses.

Senator METZENBAUM. Perhaps you are not in a position to answer this, but on a scale of zero to a hundred, assuming that a hundred is the impact that an unbalanced budget has, or an extra \$60 billion in the Federal budget would have on spending, or being out of balance, and an extra \$60 billion of credit guarantees, using the mix that presently exists in our Federal loan guarantee program, on a scale of zero to a hundred, what would be the impact of that extra \$60 billion of Federal loan guarantees?

Mr. GRAMLEY. Mr. Chairman, I think that question is, in principle, answerable, as I think research can be done——

Senator METZENBAUM. Is answerable?

Mr. GRAMLEY. It is answerable, in principle, but no one has done the research to answer it yet. I also have no idea of whether the

number is 50 or 25 or 75. Moreover, I do not think it would be helpful for me to hazard an off-the-top-of-the-head guess when so little information exists on this subject.

CROWDING OUT VARIES WITH TYPE OF PROGRAM

Senator METZENBAUM. Do you think the amount of crowding out in capital markets varies with the type of Federal credit programs; student loan programs, SBA programs, agricultural programs, housing programs, various others?

Mr. GRAMLEY. Yes, I do think it varies by type of program, but more importantly, it also varies by economic conditions. In terms of thinking about this crowding out effect, however, I would encourage you to focus not on what happens with one program as opposed to another, or at one point in time as opposed to another, but on the overall thrust of these programs over the longer term. This is because Federal credit programs can direct resources from one purpose to another, and thereby reduce the amount of financial resources that are available for private use and for business capital formation.

REGULATION OF PRIVATE CREDIT AN ALTERNATIVE

Senator METZENBAUM. Is regulation of private credit an alternative to Federal loans and loan guarantees?

Mr. GRAMLEY. I doubt that one can accomplish all of the purposes that we are trying to achieve with Federal credit programs through private credit regulations. In most cases, Federal credit programs are used where, for one reason or another, there are imperfections in private credit markets or we wish to provide a degree of subsidy to the borrower. I believe that if Congress wishes to resolve these problems it is most appropriate to do it with Federal credit programs, rather than trying to force private lenders to do it through regulation.

Senator METZENBAUM. Senator Boschwitz, do you have a question?

IMPACT OF FEDERAL LOAN PROGRAMS

Senator BOSCHWITZ. I would like you to expand, Mr. Gramley, if you would, the effect on rerouting of the funds due to these guarantees. What effect do you perceive it has on the market place? The chairman asked about crowding out, and you touched on it briefly. But that is the principal impact of these programs. Some, as you say, perhaps should be considered in the same light as a direct Federal expenditure, others are, in a sense, a subsidy—and those that are a subsidy also have a crowdingout effect, as does all government borrowing. But I wonder if you would expand a little bit on what you perceive the crowding impact of these Federal loan and loan guarantee programs are, and to what extent they will be in use this year in view of the recession. And then I will follow it up with another question. The approximation this year is \$80 billion, is that correct?

Mr. GRAMLEY. I believe the figure is something like \$70 billion for the total—

Senator BOSCHWITZ. The chairman did say \$60 billion in his question, but it seems to me I read \$80 billion.

Mr. GRAMLEY. Mr. Cutter, perhaps, would have a better, more precise answer to that question than I could give you.

Senator METZENBAUM. It is only a difference of \$10 or \$20 billion between friends. [Laughter.]

GENERAL EFFECT OF CROWDING OUT

Senator BOSCHWITZ. I have read so many figures. Well, perhaps, that is the original. What is the effect of the rerouting of these funds, what is the impact of the crowding out, in general?

Mr. GRAMLEY. I would encourage you to look at this question from a long-range standpoint. The way we have tried to run monetary and fiscal policies over the postwar period is to provide for an economy that is fairly close to full employment, fairly close to full capacity utilization, during most periods of time. Over the long run, therefore, there will be forces which will tend to make our economy operate at a fairly high level of economic activity.

If one adds a very large amount of Federal credit programs on to governmental expenditures, you then will be utilizing resources which otherwise would have been available to the private sector. Now, in some cases, like the provision of loans under FHA or VA insurance, you are not really redirecting resources to any significant extent. But under many of the other programs, you are redirecting resources—not just credit resources, but real resources—which would be available for private consumption and private investment.

Given our need to increase capital formation, to raise productivity and to meet our energy and environmental requirements, it is extremely important not to let our efforts to hold down the growth of government spending and to provide more business tax investment incentives be frittered away by lack of control over the growth of Federal credit programs.

INSURE CREDIT PROGRAM FLEXIBILITY

Senator BOSCHWITZ. You said in your testimony that during the recessionary period when credit supplies are readily available, credit assistance programs may help to promote a more intensive use of resources and expansion on the level of economy activity. Credit supplies are more readily available in recent months. Are you suggesting that, somehow, we can fine tune some of these programs?

Mr. GRAMLEY. No, I am not. What I am suggesting is that you must avoid setting rigid targets which do not allow for any change in the level of Federal credit assistance, irrespective of what is happening in the economy.

Senator BOSCHWITZ. But you do not see a need or desirability of restructuring the programs to be, in effect, more—

Mr. GRAMLEY. No, I do not.

Senator BOSCHWITZ. At one point or another?

Mr. GRAMLEY. I think many of the programs will tend to respond automatically to changes in economic and financial conditions.

TOTAL CREDIT SPONSORED BY FEDERAL AGENCIES

Senator BOSCHWITZ. In this year, or this calendar year—I am not quite sure how some of these things are measured, calendar or fiscal—but what percentage of the credit demand will be through the Government?

Mr. GRAMLEY. It is awfully difficult to give you a precise figure, Senator Boschwitz, but if you assume that total funds raised in financial markets during fiscal 1981 will be roughly the same as they were in the previous year, and if you take the total of net lending, both direct and guaranteed and federally sponsored, then that would be roughly a sixth of the total, roughly a sixth.

Senator BOSCHWITZ. Continuing on at that level?

Mr. GRAMLEY. Right. And that is a large amount, about 15 to 20 percent of total funds raised being directed, in effect, by Federal credit programs. You are in effect taking and redirecting a substantial amount of credit and real resources.

Senator BOSCHWITZ. Is that just Federal programs or credit programs, or is that also the debt?

Mr. GRAMLEY. That is just the increase in credit sponsored and guaranteed by Government agencies—on-budget or off-budget agencies—relative to the increase in total private credit. It is a flow concept, not a stock of outstanding debt.

IMPACT OF EXPANSION OF FEDERAL CREDIT ACTIVITIES ON
PRODUCTIVITY

Senator BOSCHWITZ. Also in your testimony you talked about productivity which has been dismal. We do not know all the reasons why, and that will limit our ability to deal effectively with the problem. I wonder if you can expand on that sentence. Do you have any sense of what the impact of the Federal loan financing programs debt is on productivity as a whole?

Mr. GRAMLEY. I do not have any information on that. I would not regard the expansion of Federal credit activities as being a major source of the weakness in productivity recently. It is clear that our capital stock has not grown as rapidly relative to the supply of labor in the past 5 or 6 years as it had through the first two decades of the postwar period. I am sure, enlarged Federal credit programs have been a small contribution to this problem. But I do not think they are the major reason.

TOTAL CREDIT TAKEN BY FEDERAL SECTOR

Senator BOSCHWITZ. At one point, the Federal borrowing from all sources constituted a much higher percentage than a sixth. I think it was even upward of half, was it not, a few years ago.

Mr. GRAMLEY. I do not recall that it has ever been that high. Certainly, in a period like the recession of 1974-75, if you add a Federal deficit that amounted to \$66 billion to the demands of Federal credit agencies and then scale this total by a depressed level of private credit demands, the resulting fraction would have risen. That fraction, of course, will vary cyclically; that is it will vary with the state of the economy.

Senator BOSCHWITZ. In 1936 it was 39 percent.

Mr. GRAMLEY. That is, again, a situation of a very depressed economy.

Senator BOSCHWITZ. So that we can expect that to be repeated to some degree in 1980, 1981?

Mr. GRAMLEY. There will be some tendency, yes, for private credit demands to decline, and for Federal credit demands in some areas to grow. The share of total credit taken and directed the Federal sector, therefore, can be expected to increase. I see nothing wrong in principle with a rise in the fraction. I think what Congress ought to look at is how these ratios behave over the longer term.

Senator BOSCHWITZ. Over the longer term, it seems to be a little higher than a sixth, from the figures that I recall.

Mr. GRAMLEY. I believe that is correct.

MONITOR COSTS AND BENEFITS OF FEDERAL CREDIT PROGRAMS

Senator BOSCHWITZ. You also said that to satisfy the requirement there should be a credit control office within the Congressional Budget Office in order to provide to Congress the detailed technical data on the costs and benefits of Federal credit programs. Are you aware of any such office or any such control or any such central clearinghouse of information on credit programs at the present time?

Mr. GRAMLEY. Not at the present time. The Congressional Budget Office and the Office of Management and Budget have been doing studies on Federal credit programs. The Federal Reserve also watches these programs. But if Congress is going to have a credit budget and control these programs carefully, then it will need to pay much more careful attention to these programs than we have up to the present.

Senator BOSCHWITZ. Well, to some degree, I guess that is why we have the committee, because of the absence of that.

Senator METZENBAUM. Thank you very much, Senator Boschwitz and Mr. Gramley.

I think what we will do now is we will hear statements of Mr. Cutter and Mr. Altman. And, Mr. Cutter, we will be happy to hear from you at this point.

I had asked the witnesses to hold their statements to about 10 minutes so that we might have time for questions.

STATEMENT OF W. BOWMAN CUTTER, EXECUTIVE ASSOCIATE DIRECTOR FOR BUDGET, OFFICE OF MANAGEMENT AND BUDGET

Mr. CUTTER. Thank you very much. It is a pleasure to be here. And this is a topic that has concerned the administration in OMB and me, personally, for 3½ years. And I am appreciative, we are all appreciative, of the degree to which this committee of the Budget Committee and the subcommittee have taken to seize the topic. It is an important one. And we look forward, I have looked forward to this testimony, and we look forward to interaction that will continue over the years.

CONTROLLING FEDERAL CREDIT PROGRAMS

As you know, the 1981 budget proposed for the first time a system to restrain the growth of Federal credit activities. The system provides, where appropriate, specific annual appropriation bill limitations on new obligations for direct loans and new commitments for loan guarantees.

The reason for establishing the control system stems from our concern that the scope and scale of Federal credit programs should result from a systematic decisionmaking process. For over a decade, concern has grown over the effects of the Government's demands over the Nation's credit markets, both its direct demands and those created through various forms of assistance.

The total amount of funds advanced under Federal auspices has risen by 300 percent in the last decade, reaching \$73.3 billion in 1979. However, because of the equally rapid rate of increase in private lending over the same period, the funds advanced under Federal auspices has been a fairly constant share of the amount of funds advanced in domestic credit markets.

This share has ranged between 10 and 18 percent. The 1981 estimate for direct loan obligations increased by 3.1 percent over estimates for 1980, compared with a 19.1 percent increase in the previous year. Loan guarantee commitments, on the other hand, increased 11.5 percent in 1981, after increasing 3.8 percent in 1980.

The total estimated increase for direct loan and loan guarantees together is 8.1 percent in 1981. The increases in direct loan obligations between 1980 and 1981 are due largely to the changes in the Tennessee Valley Authority, Export-Import Bank, and the Rural Electrification Administration.

The increase in loan guarantees between 1980 and 1981 arises from housing programs in the Veterans' Administration and the Department of Housing and Urban Development, public housing, FHA, and the Ginny Mae mortgage-backed securities program, and the Farmers Home Administration.

ADMINISTRATION EFFORTS

The administration announced its intention to establish a system to control Federal credit in the 1980 budget. In the 1981 budget we carried out that goal by introducing a comprehensive and systematic review of both on- and off-budget programs within the budget document, including for 1981 recommended annual appropriation limits for a wide range of programs.

In March 1980 the President revised the 1981 budget. At that time, the administration proposed that the limitations amounts for loan guarantees and direct loans be reduced somewhat, and that their application be extended to major programs previously exempt. The action increased the amount of loan guarantee commitments subject to appropriation bill limits from \$29 billion to \$63 billion, or from 38 percent of total commitments to 82 percent.

Direct loans were largely unchanged. We are now in the process of sending initial guidance to the agencies on tentative credit limitations for the 1982 budget. The limitations on each kind of program, either direct or guaranteed, are set much the same way budget authority is now set. We review gross lending activity by

each program in much the same way that aggregate budget outlays are reviewed.

CONGRESSIONAL ACTIONS

We are pleased, as I opened by saying, to see efforts in both the Senate and the House, particularly by the Budget Committees, that support the administration's commitment to control credit program growth. The budget resolution proposed by the Senate Budget Committee included limits largely consistent with our own estimates on Federal credit activities. We are encouraged to see that the Budget Committee asked the other committees of the Senate for their estimates of new credit programs as a part of the March 15 reports. And we support the credit limits in the budget resolution. It is now up to the Appropriations Committee to respond.

We also need to work together in refining the mechanics of the credit budget process, and in addressing some of the broad economic questions that arise from Federal intervention in the private credit markets.

In summary, we are trying to develop an effective control system that will require policymakers to devote serious attention to reviewing credit aggregates and to allocating that total among individual programs. We think this control system can be achieved through administrative action and the appropriations process.

We are at the beginning of this process. Many of the questions we have about how credit affects the economy are ones we cannot now answer. Many of the credit program issues remain to be analyzed. But while we have much to learn, we consider our approach both practical and achievable. The gains from the control system can be substantial, we believe.

Mr. Chairman, that concludes my prepared remarks. You asked a series of questions in the letter that you sent to OMB. We have prepared answers to them which—as you ask some of those I will be happy to provide both now and also we can provide you written versions of the answers. Of course, I am prepared to answer any other questions.

Senator METZENBAUM. Thank you Mr. Cutter.

[The following was received for the record:]

OFFICE OF MANAGEMENT AND BUDGET WRITTEN RESPONSES TO QUESTIONS POSED IN A LETTER OF JUNE 12, 1980 BY SENATOR HOWARD METZENBAUM

Question 1. The Subcommittee would appreciate your overview of the scope, major characteristics and recent growth of Federal credit activities, including direct loans, loan guarantees and other activities in private credit markets.

Answer. Scope.—Federal credit programs play a significant role in the functioning of the economy. Credit programs—much like Federal expenditures on goods and services, tax expenditures, other characteristics of the tax structure, or transfer payments—can be used to change the allocation of resources and the distribution of income. In this regard, they can be used to overcome market imperfections, to provide additional liquidity for investors, and to furnish funds to maintain stability in a particular sector of the economy during business cycle fluctuations or provide a subsidy to a group or groups. Credit programs are thus used to provide credit to certain classes of borrowers, or on special terms or conditions, or for special activities.

Major characteristics.—Federal credit programs may be classified into five types as follows:

Lending: Direct loans; loan participations and purchases; and credit sales and other revenue deferrals.

Loans guarantees and insurance: Loan guarantees; and loan insurance.

Lending is an action that provides for a borrower to have the use of money for a period of time, with a reasonable expectation that the money will be recouped by the lender. Lending usually, but not necessarily, requires the payment of interest.¹

Direct loans are usually disbursements of cash by a Government agency—on- or off-budget—to a borrower (not in exchange for goods and services) that the borrower promises to repay. They may be in exchange for a bond, a debenture, a promissory note; sometimes the loan takes the form of the purchase of preferred, non-voting stock. Examples of direct loans are:

Loans made by the Veterans Administration to veterans in rural areas and in small municipalities where private credit may be unavailable;

Loans by the Small Business Administration to small firms for rehabilitation of property damaged by natural disasters; and

Loans by the off-budget REA to rural electric cooperatives.

Claim payments under most guarantee and insurance programs are also scored initially as direct loans until the loan is written off. That is, in cases of default, the Federal Government usually purchases the guaranteed loan and subsequently liquidates the loan on the most favorable terms possible.

Loan participations and purchases are disbursements by a Federal agency to a financial institution or other lender in order to acquire part or all of a loan owed to the institution or lender. An example is purchases of existing mortgages by the Government National Mortgage Association.

Credit sales and other revenue deferrals are transactions in which a Federal agency accepts a promissory note or other evidence of indebtedness in lieu of cash owed for goods services, or other benefits that have been provided. They represent non-cash extensions of credit. Examples are:

Sales of military equipment to other nations on long-term credit arrangements by the Department of Defense;

Sales of agricultural commodities to other nations on long-term notes by the Department of Agriculture; and

The deferral of interest (adding it to the principal) on debt due to the United States Railway Association.

Also, several agencies use credit sales (including "purchase money mortgages") to dispose of collateral acquired through defaulted loans or payment of guarantee claims.

Loan guarantees and insurance are created when the guaranteeing or insuring agency agrees to indemnify a lender against part or all of any defaults by those responsible for the repayment of loans. In practice, the terms guarantee and insured loans are used interchangeably.

Loan guarantees are pledges in which a Government agency enters into an agreement to use Government funds as necessary to secure a lender against default on the part of the borrower. The protection provided may cover principal, or interest, or both. The undertaking may be to "make good" the amount due and unpaid, or it may be to purchase the unsatisfied portion of the loan and the accrued interest upon the failure of a borrower to make a timely payment. Many guarantee programs involve the charging of a guarantee fee, and usually such fees are available as a first source of financing to pay administrative expenses, as well as to make payments required by the terms of the guarantee.

Loan insurance refers to transactions in which a Government agency operates a program of pooled risks, in each case pledging the use of insurance premiums to secure a lender² against default on the part of a borrower.³ The insurance usually runs to both principal and interest. The pledge is to "make good" the amount due and unpaid, or to purchase the unsatisfied portion of the loan and accrued interest when a delinquency occurs. An insurance program may have access to general resources of the Government in cases of shortfall in reserves, as a temporary measure pending the establishment of new premium rates or restructuring of the risks; or liability may simply be limited to existing reserves. Examples of loan insurance programs are mortgage insurance activities conducted under the auspices of the Department of Housing and Urban Development.

Mixed cases.—In a number of cases, two or more types of programs are found in combination. Also, one type of credit activity is sometimes incidental to another: a

¹ In the absence of interest, or when below-market interest rates are charged, the original principal disbursement may be considered to be part grant and part loan.

² Excluded from the concept of Federal credit programs are insurance activities not pertaining to loans—notably deposit insurance, flood insurance, and life insurance.

³ The title assigned to a program may not disclose its contents fully and accurately; for example, the Farmers Home Administration, Department of Agriculture, operates several programs labeled insurance that are not based on the risk-sharing principle of insurance, and thus are really guarantees.

loan purchase may be incidental to a guarantee program, or an interest deferral may be incidental to a direct loan program. A direct loan may subsequently be sold with a guarantee. Sometimes two agencies guarantee the same loan or portion thereof.

There are also a number of examples of the Government guaranteeing itself against loans—that is, of one Federal agency owning loans entered into by private borrowers, with guarantee. Sometimes two agencies guarantee the same loan or portion thereof.

There are also a number of examples of the Government guaranteeing itself against loans—that is, of one Federal agency owning loans entered into by private borrowers, with another Federal agency acting as the guarantor. Such cases constitute direct Federal lending, but result in double-counting of guarantees. Sometimes two Federal agencies guarantee the same loan. In at least two cases a single agency double-guarantees another: they guarantee the loans made and then guarantee the borrowing that provides the money to make the loans.

Recent growth of Federal credit activities.—The total amount of funds advanced under Federal auspices has risen threefold in the last decade, reaching \$73.3 billion in 1979. However, because of the equally rapid rate of increase in private lending over this same period, funds advanced under Federal auspices have been a fairly constant share of the amount of funds advanced in domestic credit markets. This share has generally ranged between 13 and 16 percent. (See the following table for growth over the past decade.)

Certain credit programs are particularly volatile in responding to changes in economic conditions. The Federal Home Loan Banks (a set of Government-sponsored enterprises), for example, make large loans to savings institutions during periods of tight monetary conditions in order to avert undue hardship in the mortgage market and the associated construction and housing industries. As monetary conditions ease, they make fewer loans and experience high repayment flows. Similar patterns occur in other programs related to housing finance, such as those of the FNMA. Such fluctuations have, however, proven difficult to forecast.

TABLE F-1.—FEDERAL PARTICIPATION IN DOMESTIC CREDIT MARKETS

(Dollars in billions)

	Actual										Estimates		
	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978	1979	1980	1981
Total funds advanced in U.S. markets ¹ (includes equities)	\$93.6	\$125.7	\$163.5	\$207.7	\$193.4	\$181.3	\$251.8	\$66.1	\$314.4	\$385.3	\$410.7	(²)	(²)
Advanced under Federal auspices.....	16.1	16.5	22.9	27.2	25.5	27.0	26.8	6.7	37.2	58.7	73.3	\$71.3	\$71.2
Direct loans:													
On-budget	3.0	2.0	2.7	0.3	1.9	4.3	3.3	0.9	2.5	8.4	6.0	6.1	-0.6
Off-budget			0.2	0.7	2.2	8.5	7.6	2.9	9.0	11.4	13.6	16.6	16.6
Guaranteed loans.....	8.0	16.1	19.8	17.7	10.5	8.7	11.2	-0.1	14.0	13.9	26.1	33.4	41.4
Government-sponsored enterprise loans	5.2	-1.7	0.1	8.5	11.0	5.5	4.7	3.1	11.6	25.0	27.5	15.1	13.8
Federal participation rate including Government sponsored enterprises (percent)	17.2	13.1	14.0	13.1	13.2	14.9	10.6	10.1	11.8	15.2	17.8		
Total funds raised in U.S. credit markets ¹	\$93.6	\$125.7	\$163.5	\$207.7	\$193.4	\$181.3	\$251.8	\$66.1	\$314.4	\$385.3	\$410.7		
Raised under Federal auspices	17.9	32.5	39.5	45.5	24.2	64.8	98.2	19.3	79.5	94.2	81.2	91.9	86.4
Federal borrowing from public	5.4	19.4	19.4	19.3	3.0	50.9	83.4	18.0	53.5	59.1	33.6	44.3	33.1
Borrowing for guaranteed loans	8.0	16.1	19.8	17.7	10.5	8.7	11.2	-0.1	14.0	13.9	26.1	33.4	41.4
Government-sponsored enterprise borrowing	4.5	3.1	0.2	8.5	10.8	5.3	3.6	1.4	11.9	21.2	21.4	14.2	11.9
Federal participation rate (percent)	19.1	25.9	24.2	21.9	12.5	35.7	39.0	29.2	25.3	24.4	19.8		

¹ Nonfinancial sectors. Source: Federal Reserve Board Flow of Funds Accounts.² Not estimated.

Note.—Outlay figures may change slightly due to March revisions of estimates for loan obligations and loan guarantee commitments.

Question 2. Have there been major changes in the nature of Federal credit activities in recent years? If so, why?

Answer. The largest change in the nature of Federal credit activities has been in the scale and growth of individual programs. Most growth has been in three forms of credit activity: off-budget loans, Government-sponsored enterprise loans, and loan guarantees. On-budget direct loans outstanding have changed very little. These growth trends are discussed in answer No. 1.

The range of activities and functions served by Federal credit assistance has expanded progressively over the years. Housing activities were the first and main use for many years, followed by agricultural and rural development activities. Today, credit programs can be found to serve almost every budget function—including aids to State and local governments, education, energy, and business. Most new initiatives are for promotion of energy resource development.

Question 3. Are there major new needs toward which Federal credit activities should be refocused?

Answer. Perhaps the greatest new need is in energy. Here credit assistance can play an important role in providing incentives to the private sector to accomplish important national policy goals. The Administration has proposed the establishment of the Energy Security Corporation (ESC) to promote synthetic fuel production. In order to obtain private sector involvement with a synthetic fuels industry, it is proposed that the ESC make direct loans and enter into loan, price, and purchase guarantees to absorb some of the risks inherent in the new industry.

Question 4. We would like your explanation of the programs you perceive to be associated with uncontrolled growth of Federal activities in credit markets and how these are addressed by the President's credit budget proposal.

Answer. Most direct Federal outlays re covered within the budget totals and have been subjected to periodic review in both the executive and the congressional budget processes. In this way, outlays for credit programs have not grown totally uncontrolled. However, several direct lending programs are excluded from the budget outlay totals under provision of law; and all loan guarantees are excluded, by their very nature, except for payments of claims on defaults, certain repurchases, interest subsidies, and other installment payments. The budget therefore understates the extent of Government involvement in credit markets. As a result, inadequate attention is paid to these programs in the course of policy review.

I would not like to point to any particular program that has simply grown uncontrollably, since the main purpose of the credit control system is to develop a more rational credit policy by establishing a comprehensive review process. It is primarily because Federal credit programs have not been subjected to systematic central policy review that individual programs have been allowed to grow rapidly.

Question 5. The subcommittee is particularly interested in the desirable coverage of Federal credit budget controls. The congressional credit budget contained in the tentative Conference agreement on the First Budget Resolution, H. Con. Res. 307 is more comprehensive than the President's proposal. We would appreciate hearing your views on the coverage of the credit budget proposed in the First Budget Resolution. Would you also comment, please, on the additional proposal in the Senate-reported resolution (S. Con. Res. 86) that all new authority for loans and loan guarantees be subject to appropriations limitations.

Answer. We are very pleased to see efforts in both the Senate and the House that support the Administration's commitment to control credit program growth. We recognize—as I think you do—that it will take time and experience to develop an effective credit control system. We believe that the credit budget contained in the tentative Conference agreement on the First Budget Resolution, H. Con. Res. 307 is an excellent start. We also support the budget resolution proposed by the Senate Budget Committee that included limits, largely consistent with our own estimates. We would like to note, however, that the suggestion in the Senate resolution that limitations on credit activity include those of the Federal Financing Bank, is contrary to Administration policy, since the FFB is a mechanism for financing loans. In our view the point of control should be the originating agency. FFB is not in a position to ration the credit it supplies to others.

Question 6. We would also appreciate your comments on other aspects of the design of budgetary control mechanisms for Federal credit activities. First, what are the arguments for a separate credit budget rather than a single budget aggregate for direct spending and credit activities such as direct loans and loan guarantees?

Answer. In designing the Federal credit control system, we attempted to integrate the Federal credit system into the budget process. We have not argued for a separate credit budget, nor would we like to advance arguments for one at this time. As you know, the proposed credit control system is based on two different forms of control. First, most programs are controlled by both authorizing legislation and

appropriations limitations. Second, the remaining programs are controlled by authorizations and not appropriations. The activity in all these programs is estimated and reviewed in the main budget. The budget appendix also includes estimates of the lending activity by program. By reviewing credit information along with outlays, we have attempted to give a more complete picture of all Federal activity in each functional area. In addition, we have information, but not control, on a range of federally assisted credit that should not be directly controlled. This permits a review of the total universe of the Federal and federally assisted credit enforcing control over only those aspects that are actually Federal, not private.

Question 7. In a period of budget stringency, is it to be expected that there will be pressures to use credit activities such as loans or loan guarantees as a substitute for direct spending?

Answer. This expectation may well be correct. It is an important reason for establishing a credit control system, so that credit is not looked upon as a "free good." Whether or not this pressure intensifies, credit should be viewed as a scarce economic resource, and as such merits review and allocation according to Federal policy priorities in the budget process.

Question 8. What criteria, if any, would you suggest for determining whether direct spending or loans, loan guarantees, and other credit activities should be used to achieve Federal objectives, and for determining whether a particular Federal activity should be scored as direct spending or as a credit activity?

Answer. This question is the subject of concern within the Administration and we have attempted to devise methods for discerning when it is most efficient to achieve Federal objectives through credit assistance rather than through some other form of assistance. At this time, our efforts are very preliminary, and a more reliable understanding of the true effects of credit programs is needed before we can satisfactorily answer these concerns. Our rules for scoring direct spending and credit activities are drawn largely from the Report of the President's Commission on Budget Concepts in 1967. Although there are possible improvements on the Commission's recommendations, and on our own variants of them, we are not now prepared to substantially revise our budget accounting concepts.

Question 9. In the process of designing a mechanism for control of Federal credit activities, should the on-budget or off-budget status of various Federal loan, loan guarantee and other credit activities be changed?

Answer. We are not tying changes in the budgetary status of off-budget Federal entities to the credit control system at this time. An effective system of control is our first priority. We do not want to divert our efforts in an attempt to bring individual programs on-budget in order to control their activities, especially since the primary objective of putting them on-budget—to control them—will be achieved under our proposed system.

Question 10. In view of the large contingent liabilities of the Federal Government associated with the recent growth of loan guarantees, are there any improvements that should be made in budget scorekeeping associated with loan guarantees? How should the existence of this contingent liability be reflected in the debt limit?

Answer. Loan guarantees are treated as contingent liabilities in the President's budget. That is, the amount that the Government would become liable to pay in the event a borrower defaults is not usually reflected in the budget totals. This stems from the definition of budget authority found in section 3(a)(2) of the Congressional Budget Act. The definition does not contain any reference to contingencies. In fact, it is reasonable to assume that guaranteed loans are good loans and will be repaid. If experience with a program permits us to forecast a default rate, we will in fact estimate the budgetary resources needed to pay default claims.

Debt is an actual liability, guarantees are only contingent, and from past experience most will not become actual liabilities. Thus they are appropriately controlled in different ways.

Question 11. Are there any generalized problems that you have identified in managing credit programs?

Answer. The diversity of credit programs creates some management problems. Also, credit extensions and repayments are more volatile than most forms of direct spending, and estimating the demand for and impact of Federal credit is often difficult. However, we are continually seeking to improve our management of all programs. Toward this end, we recently established a debt collection project on the management side of the Office of Management and Budget to assess agency performance in credit program management.

Question 12. Are there other aspects of the design of a control mechanism that should be prominent in the considerations of the subcommittee?

Answer. The range and depth of your questions cover most of our current concerns. In particular, I believe we need to work together in refining the mechanics of

the credit budget process, and in addressing some of the broad economic questions which arise from Federal intervention in the private credit markets.

Senator METZENBAUM. I think we will hear Mr. Altman next and then we will have questions.

Mr. Altman?

STATEMENT OF ROGER C. ALTMAN, ASSISTANT SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. ALTMAN. I also am pleased to be here to discuss this topic because I have had, as Mr. Cutter has, considerable involvement in this during the 3½ years of this administration. I feel strongly about it and have testified on this type many times.

IMPROVE CONTROL OVER FEDERAL CREDIT

I will not review the administration's proposal because Mr. Cutter has done that well. But I would like to make a few comments on the importance of a new system to control Federal credit, the aspects of how to do it, and why we have proposed what we have.

Senator METZENBAUM. Mr. Altman, while you are doing that, you both are talking about the new emphasis on controlling credit, and as I am sitting here, I am thinking of at least one major new program that very much will expand the whole credit undertaking, and that is the synfuels program. And the second one is some major changes in the matter of student loan programs and education programs, generally. And would you address yourself, just as you are going along, to those as well as any other new programs that have developed within the last few years, since this administration has been in.

Mr. ALTMAN. I think what I would like to do, Mr. Chairman, is to make a series of remarks on some of the concepts involved here, and then, if you would like, try to answer any specific questions on synfuels or on Sally Mae or other aspects of student loans, subsequently.

Mr. Chairman, I think the need for control, for a system of improved control over Federal credit is well illustrated in a table attached to my testimony¹ which points out that the increase in Federal and federally assisted borrowing from the public was estimated in March at \$54.8 billion in fiscal 1981, and the total of such debt outstanding at the end of fiscal 1981 was estimated at \$1,154 billion.

Now, we have, at any given moment, a limited supply of credit available in the economy. And that means, of course, that these increased demands—

Senator BOSCHWITZ. Pardon me, Mr. Altman. You did not submit your testimony in advance. Now I cannot follow. Where are you?

Senator METZENBAUM. On page 3.

Mr. ALTMAN. Well, I am excerpting from my testimony, but I have a table. I am afraid that only a few copies have arrived here, however, and a large bulk of them are in transit. I do have a table, Senator Boschwitz, which totals the amounts of loan guarantees, federally sponsored borrowing and direct Federal borrowing.

Senator BOSCHWITZ. Thank you.

¹See p. 32.

IMPACT OF INCREASED DEMAND OF FEDERAL CREDIT PROGRAMS

Mr. ALTMAN. In any event, this means, of course, that these increased demands of Federal credit programs are adding to pressures on interest rates and are raising interests costs for all borrowers, including the Federal Government.

I think, as Mr. Gramley pointed out so well, Federal credit programs change the allocation of total credit in the economy at any one time by increasing the availability or lowering the cost of credit to preferred borrowers. Now, that is, of course, their purpose, and they reflect determinations by Congress that the credit markets, as they function normally, are not providing the right mix of credit.

But the aggregate of growth has been so great that major distortions are occurring.

In terms of how to control or better control Federal credit, of course, we feel that the administration's proposal which subjects Federal credit programs to an appropriations-type process makes sense, and we are pleased by the actions of the Congress represented in the first budget resolution since they essentially accomplish the same thing. Of course, the appropriations committees will have to act, as well.

But I want to emphasize that in order for credit limitations to be effective controls, they have to relate to the agencies which provide credit. To be specific, the Treasury Department lends to several agencies to provide funds for direct loans to the public or to back-stop guarantees of borrowings by private borrowers.

But we are in a passive role. It is like a check writing function. The funds which we provide are actually controlled by other program agencies of the Government which have been authorized by specific statutes to draw on the Treasury. We, however, have no ability to affect the totals of such funds.

ROLE OF THE FEDERAL FINANCING BANK

Now, the Chairman, in his opening remarks, made a series of comments about the Federal Financing Bank. And I would like to address myself to those.

Of all the issues that I have had a chance to work on since I have been here, no other issue has caused greater confusion and misunderstanding than has the Federal Financing Bank. Mr. Chairman, the Federal Financing Bank is nothing more than a financing conduit and a debt management tool. It merely buys obligations of agencies which are fully guaranteed by the U.S. Government. It does not decide on which obligations to buy or not buy, because it is authorized to buy any Government-guaranteed obligation. But the central point—

Senator METZENBAUM. I am so confused about this. The Federal Treasury, which is the United States, buys obligations which are fully guaranteed by the same United States. That concept really gets me.

Mr. ALTMAN. Well, let me endanger myself by saying that I think that it is fairly simple. Before the Federal Financing Bank

Act of 1973, Government-guaranteed securities were sold by the guarantor agencies into the markets, often through underwritten public offerings, or through other means. But they were sold to the general public.

Now, I am sure you realize that, from the general public's point of view and the financial community's point of view, the Government-guaranteed security is the same from a credit standpoint as the Treasury security. If I am an investor——

Senator METZENBAUM. I understand.

Mr. ALTMAN [continuing]. As a bond buyer, all I need to know, as long as I have checked it out and found that it is true, is that it is Government guaranteed, because then I will not care about what type of function is being guaranteed, whether it is a Department of Energy geothermal drilling program or a HUD public housing related guarantee, since my investment is backed up by the U.S. Government.

So the Federal Financing Bank Act was passed by the Congress in 1973. All that this act did was to say that these securities which had previously been sold into the markets and to the public were costing the taxpayer too much, and they were complicating Federal debt management because some weeks you would have six or seven different offerings of Government-guaranteed securities of varying sizes and representing six or seven different programs, and some of these offerings would be financed at a rate slightly above the Treasury's own borrowing cost, while others, because of the small size of the issue or the fact that the particular program being guaranteed had never been heard of before by the financial community, were requiring large premiums over the Treasury borrowing rate.

Let me emphasize what it is that the Federal Financing Bank did in 1973, and has done since then. It simply redirects the financing of those securities. Instead of having them financed in the public markets, they are now financed through the Treasury and, in effect, added to the totals which the Treasury itself borrows through its normal process of auctions of Treasury bills, notes, and bonds.

GROWTH OF FEDERAL GUARANTEES UNAFFECTED BY FFB

It is the original statutes which provide the agencies with the guarantee authority which determines the total amounts of the guarantees outstanding. This is really the point. The Federal Financing Bank has absolutely no effect, Mr. Chairman, on the total amounts of guarantees that are outstanding. If the Federal Financing Bank self-destructed tomorrow, the total amounts of guarantees outstanding and the amounts of projected growth would be the same, because those guarantees, instead of being financed through the Treasury, would be financed in the public markets. There would be no difference on the totals. Yet, there is this widespread misconception that, if you could get rid of the Federal Financing Bank, you could limit the growth of Federal guarantees. This is absolutely wrong.

BRINGING OFF-BUDGET CREDIT ACTIVITIES ON-BUDGET

Senator METZENBAUM. Well, as a matter of fact, does not the Congress and the administration, back in 1973 before the FFB was created—would it not make much difference if the Federal Treasury just went out and borrowed the money without any Federal Financing Bank, and then provided \$200 million, or whatever—\$2 billion to the particular agency involved. Only, in that instance, it would be on-budget instead of off-budget, would it not?

Mr. ALTMAN. Well, I think the right answer to your question is that, in part, that is what is being done now, because the way that these guarantees are being financed is as I just described, through the Treasury's own borrowing program, which is the cheapest way to finance them. That is one of the biggest reasons why we have the Federal Financing Bank. It is much cheaper for the taxpayer to have the Treasury borrow the money.

ACCOMPLISH CREDIT DEMANDS THROUGH OUTLAY BUDGET

Senator METZENBAUM. My question is not the price—I understand it is cheap. I understand that concept. But what do we need something called a Federal Financing Bank for? Why do we not just say to the SBA or to the Agricultural Department, or whoever it is that comes to the FFB for the money, why do we not just say, "Well, we will go out and borrow \$200 million more, \$2 billion more, and make the money available to you"? And in that instance it would be on-budget.

Mr. ALTMAN. Well, Mr. Chairman, the decision as to whether a particular piece of Federal credit, or what is now a function accomplished by the provision of Federal credit, should be instead accomplished through an equivalent amount of budget outlays, that is a decision which the administration and Congress make each year with every budget. If you are saying that we should not have any Federal credit which is not in such an outlay budget, then that is a decision for the administration and the Congress to make.

And just to pick a particular example, if you would rather see—

Senator METZENBAUM. It is still an outlay, but it is just an off-budget outlay, is it not, by going through the FFB?

Mr. ALTMAN. No, the FFB does not affect the budget treatment of the credit which it buys. It has no effect on that budget treatment. The budget treatment is determined ultimately by the Congress in the specific statutes which govern the agencies which get Federal credit.

Let us take HUD. If certain amounts of off-budget HUD public housing notes were to be on the budget—if you want take those and put them on the budget—you would have to amend the statute which provides HUD with the authority to issue guarantees and say that such functions will be carried out only through conventional budget outlays. But you would have to get at it through that statute. You cannot do it through the Federal Financing Bank. We have no effect on the budget treatment. If the Congress already has given HUD or any other agency—I do not want to single out housing—guarantee authority through a particular statute, and the agency has already taken that action, then the simple choice is, should those guarantees be financed in the public markets, as they

used to be at higher costs and in a way that complicates Federal debt management, or should they be financed by the Treasury through the Federal Financing Bank.

Senator METZENBAUM. Well, Mr. Altman, as you understand, we are not here to question whether or not you have been complying with the law. I mean, we do not raise that issue. What we are really trying to do is to say—is to evaluate some policies issues, and whether or not what we are doing at the present time is right or wrong, from a policy standpoint. And it is in that arena that I am more interested in Treasury's comments than I am in trying to say whether you are doing something wrong or right. There is no suggestion at all of doing anything wrong.

Mr. ALTMAN. I understand that. But because your opening remarks reflect what, I think, is a widespread view held in the Congress that a lot of problems, which we agree are problems—most centrally, the fact that the rate of growth of Federal credit has been too large and is projected to continue to be too large—can be solved by changing the nature of or by eliminating the Federal Financing Bank. I am being emphatic, because that is not right. None of the problems, at least, that I think relate to the basic subject of today's hearings, would be solved that way.

LOAN GUARANTEE PROGRAMS

Mr. Chairman, I would like to conclude my remarks by emphasizing two other areas of concern. First of all, I think the greatest area of concern that we have with regard to growth in Federal credit and the need to curb it is loan guarantees. Of course, the sharp growth of loan guarantees in recent years have been the focus of a number of congressional committees interested in credit program control.

That same table attached to my statement indicates an estimated \$422 billion in guaranteed loans outstanding at the end of fiscal 1981, an increase of about \$57 billion over fiscal 1980.

Senator METZENBAUM. Thank you, Mr. Altman.

PREPARED STATEMENT OF ROGER C. ALTMAN, ASSISTANT SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

THE ADMINISTRATION'S SYSTEM FOR CONTROL OF FEDERAL CREDIT PROGRAMS

I welcome this opportunity to discuss the Administration's system to control Federal credit programs, which President Carter initially proposed in his January 1979 Budget Message. The new system will improve legislative and executive controls over credit programs and will make more clear the overall financing requirements involved and their effects on credit markets.

The Administration proposed that annual limits or new lending under direct and guaranteed loan programs be established in the regular budget and appropriations process. Legally binding limitations for loans and loan guarantees would be set in regular annual appropriation acts.

To implement the system, the Office of Management and Budget required Federal credit program agencies to include in their fiscal year 1981 appropriation requests limits on new obligations for direct loans and new commitments for guaranteed loans. The President also requested Congress to include Federal credit limitations in the concurrent budget resolutions. The Senate and House Budget Committees have responded to this request by including aggregate targets for Federal credit activity in the first Congressional budget resolutions for fiscal 1981. Pending legislative proposals which we support, such as S. 2151, would reinforce these efforts by requiring Congress to include targets and ceilings on direct and guaranteed loan programs in the Congressional budget resolutions.

LOAN GUARANTEE PROGRAMS

The major impact of the new system will be on loan guarantee programs. Opportunity exists for review and control of direct loans in the regular budget and appropriations process, since most direct loan programs are included in the budget totals. Loan guarantee programs, however, largely escape the budget process because budget authority is not requested for loan guarantees, except to cover defaults or subsidy payments.

The new control system does not apply to Government-sponsored enterprises such as the Federal National Mortgage Association, the Farm Credit System, and the Federal Home Loan Bank System. These agencies are entirely privately-owned and are largely self-supporting. Thus, they differ significantly from Federal loan guarantee programs which are administered by Federal agencies and are effectively backed by the credit of the U.S. Treasury. However, even though the Government-sponsored enterprises would be excluded from the new control system, their activities should be taken into account in determining the overall Federal impact on total credit demands and on the allocation of credit to particular sectors of the economy.

THE NEED FOR CONTROL OF CREDIT PROGRAMS

Mr. Chairman, let me turn now to the need for control of Federal credit programs.

The total volume of credit in our economy at any time is limited by a number of constraints, including the flow of savings and investment and the constraints of monetary policy and the level of interest rates. Federal credit programs change the allocation of this volume by increasing the availability or lowering the cost of credit to preferred borrowers. Indeed, that is their purpose. These programs reflect determinations by Congress that the credit markets in their normal functioning do not provide the right mix of credit since they do not supply adequate credit to the class of borrowers covered by the programs.

The limited supply of credit available in the economy means that the increased demands of Federal credit programs add to pressures on interest rates and tend to raise interest costs for all borrowers, including the Federal Government. It is difficult to measure their effects, but total Federal and Federally-assisted borrowings clearly have substantial impacts. As indicated in the attached table,¹ in March of this year Federal and Federally-assisted borrowing from the public was estimated at \$54.8 billion in fiscal year 1981, and the total of such debt outstanding at the end of fiscal 1981 was estimated at \$1,154 billion.

SETTING TARGETS AND CEILINGS FOR CREDIT PROGRAMS

I also think that we should discuss factors to be considered in setting targets and ceilings on the aggregate levels of Federal credit programs. First, in setting these targets and ceilings, Federal credit programs should not be considered in isolation, but must be viewed in the context of total Federal demands on financial markets, including direct Treasury borrowings and those of Federally-sponsored credit agencies. As you know, these borrowings vary substantially from year to year as economic conditions vary.

We also advise against adopting as a target or ceiling any fixed percentage of the supply of credit estimated to be available in the economy. On the one hand, during times of economic slack, the share of credit taken by Federal and Federally-assisted borrowings may rise without putting undue pressure on interest rates, as private demands for credit fall. Also, Federal borrowing may rise in these periods if budget deficits increase due to reduced tax receipts and increased unemployment-related expenditures. Moreover, some credit programs can be operated in a counter-cyclical fashion, and it may be appropriate to set higher targets for these programs during times of economic slack. On the other hand, during periods of high economic activity, Federal demands on the credit markets should be reduced, to avoid putting upward pressure on interest rates and to make room for higher private credit demands.

INSURE EFFECTIVENESS OF CREDIT CONTROLS

For a credit limitation to be effective, it should control the agency which provides credit aids to the public, rather than control inter-agency lending. For example, the Treasury Department lends to several agencies to provide funds for direct loans to the public or to backstop guarantees of borrowings by private borrowers. Thus the Treasury is in a relative passive role, as in its check-writing function, of providing

¹See p. 32.

funds which are actually controlled by other program agencies of the Government. Similarly, the Federal Financing Bank lends to other Federal agencies and purchases guaranteed obligations from them, but the FFB cannot provide funds for any purposes other than programs for which Congress has already authorized the required financing.

The FFB was established by the Federal Financing Bank Act of 1973 to consolidate and reduce the costs of the various market borrowing activities of Federal agencies. Without the FFB, these agencies would finance their programs directly in the securities market at substantially greater costs. Borrowing costs on Federally-backed credit other than Treasury obligations, that is, agency securities and Federally-guaranteed private issues, are higher because of the small size of issues, maturity and cash flow constraints, problems in developing markets for new issues, investor portfolio restrictions, underwriting costs, and market congestion resulting from crowding of competing issues in the financing calendar. Additional costs are incurred because agencies that sell securities directly in the market must develop their own financing staffs to cope with complex debt management and regulatory problems that divert resources away from principal program functions.

The FFB was created to provide a more efficient means of financing obligations issued, sold, or guaranteed by other Federal agencies. The FFB does not affect the budget status of the programs financed by it. Budget agencies borrowing from the FFB, such as TVA and Eximbank, are not removed from the budget by FFB financing. Furthermore, most of the FFB's financing activities relate to financing loan guarantee programs, which are not included in the budget in the first place. Placing restrictions on the use of the FFB would simply cause these agencies to return to the financing practices which they followed before the Bank's inception in 1973. In other words, the agencies would bypass the FFB and finance their programs directly in the securities markets. The same amounts would be financed as with the FFB, but the interest rates incurred in the credit markets would be higher. Thus, for controls to be effective, they must be placed on the activities of the guaranteeing agencies, not on the FFB.

GROWTH IN FEDERAL LOAN GUARANTEES

The sharp growth of loan guarantees in recent years has been the principal focus of the Congressional committees interested in credit program controls. The table attached to my statement shows an estimated \$422 billion of guaranteed loans outstanding at the end of fiscal year 1981, an increase of \$56.6 billion over the 1980 level. Thus, the net demands on financial markets in fiscal year 1981 from Government loan guarantee programs will total \$56.6 billion. These demands have increased rapidly in recent years, from \$16.3 billion in fiscal year 1976 to \$21.1 billion in fiscal year 1977, \$24.7 billion in fiscal year 1978, \$39.3 billion in fiscal year 1979, and an estimated \$50.3 billion in fiscal year 1980. By comparison, the net demands on financial markets to finance the Federal budget deficit during this period have been declining.

A major reason for the proliferation of guarantees is the common misconception that they are cheaper and less risky to the Federal Government than direct loans. There is, however, no inherent difference, from the Federal viewpoint, between the costs and financial market effects of these two forms of credit.

The argument favoring guarantees relies primarily on experience with the largest and best known guarantee program—the FHA's single family mortgage insurance program. This successful program, enacted during the great depression of the 1930's, assured private lenders that they could safely make long term, low down payment mortgage loans at reasonable interest rates, thus filling an important credit gap. Today, the FHA program's objectives are being achieved increasingly by private financial institutions without the need for Government intervention.

Unfortunately, FHA insurance has been the exception. A review of the programs covered in Special Analysis F of the Budget belies the argument that most guaranteed loan programs pose significantly less cost to the Federal Government than do direct loans. Indeed, most involve substantial subsidies to borrowers and direct costs to the Treasury and, ultimately, the taxpayer through subsidies of principal and interest and through default costs.

A final comparison between direct loans and guaranteed loans suggests that differences between them are more apparent than real. All loans involve three basic functions—assuming risk, supplying funds, and processing the loan.

Some argue that guarantees involve the Government only in risk assumption, and that the private sector supplies the funds and handles the paperwork. Yet another examination of the types of guarantees outstanding indicates that certain agencies issuing guarantees perform all three of these functions.

Specifically, several agencies, including HUD, HEW, and Agriculture, make direct loans but then covert them into guarantees. In making the direct loans, they assume the risk, supply the funds and handle the processing. They then can sell the loans to private parties, however, and guarantee the loans.

Another misconception is that guaranteed loans are still largely financed by local lending institutions, with minimal Government involvement, and thus have little net impact on the securities markets. In fact, the \$56.6 billion net financing requirements for loan guarantees in fiscal year 1981 will be largely financed directly in the securities markets: An estimated \$16.9 billion will be financed through the Federal Financing Bank, and thus by the Treasury; \$18.9 billion will be financed by GNMA mortgage-backed securities; \$2.0 billion by public housing bonds and notes; and additional amounts of securities market financing will be required for certain other guarantee programs such as the SBA, Farmers Home Administration, and the Maritime Administration.

IMPROVED STANDARDS FOR FEDERAL CREDIT PROGRAMS

Better control over Federal credit programs, also can be achieved by improving the standards under which credit assistance authority is provided by Congress in the first place.

Program agencies should be given more specific guidelines on the circumstances under which credit assistance is to be provided and the related terms and conditions of them. Giving these agencies broad assistance authority and then expecting them to resist the inevitable demands for assistance unavoidably leads to serious problems of control over credit assistance totals and general misallocation of our limited credit resources.

I have testified on several occasions at some length on the importance of program design as a means of achieving program control. Let me summarize the basic circumstances in which credit assistance is issued and make some suggestions for tightened lending standards and how they would help with the broader problem of controlling credit programs.

Credit need test.—Most credit programs are intended to facilitate the flow of credit to borrowers who are unable to obtain credit in the private market. To achieve this purpose more effectively, and to provide a built-in control over program growth, enabling legislation should require the credit program agency to certify that borrowers would be unable to obtain credit on reasonable terms and conditions.

Coinurance.—To avoid excessive demand for guarantees, we favor a much greater use of partial, rather than 100 percent guarantees. With partial guarantees private lenders would charge higher rates of interest commensurate with credit risk and with the rates charged on unguaranteed loans. Such risk-sharing, or coinurance, by private lenders would contribute to the development of more normal borrower-lender relationships, would prompt lenders to exercise greater surveillance over the loans, and would stimulate increased conventional lending for the economic activities involved.

Guarantees of tax-exempt bonds.—The Administration opposes Federal guarantees of tax-exempt municipal bonds. They create a class of securities which is stronger than the Federal Government's own securities. Like treasury securities, they would be backed by the full Federal credit but, unlike Treasury's, they would be exempt from Federal taxes. Also, tax-exempt guarantees are an ineffective means of delivering Federal aid to State and local governments, since much of the benefit goes to high income investors and since the financing of Federal programs in the municipal market competes directly with other State and local bond issues for essential local public facilities and increases the cost of financing the facilities. For these reasons, we believe that municipal bonds should only be guaranteed if they are taxable securities.

Fixed interest rates.—Another example of poor program structure, which leads to program control problems, involves loan programs where borrowers pay a fixed interest rate, and the Federal agency pays the difference between that rate and the market rate. Thus, as interest rates rise, there is an automatic increase in the Federal subsidy and in the demands on the Federal budget. The benefit to the assisted borrower are thus determined by fluctuations in the market rather than by changes in the borrower's real needs. This problem could be avoided by permitting the interest rate charged new borrowers to vary as market rates of interest vary.

Excessive financing costs.—Also to be avoided are guarantee programs which are financed directly in the securities markets at disproportionately high costs because of the small size or poor timing of the issue, the lack of investor familiarity with the program, or other special marketing factors. Many of these problems have been cured by financing such guaranteed obligations through the Federal Financing Bank.

Equity participation.—Many credit programs involve circumstances where borrowers could take equity positions in the projects being financed, and these programs should encourage them to do so. Requiring borrowers to have such a stake would help avoid excessive demands for credit, help assure more efficient projects, and help protect the interests of the Federal Government as lender or guarantor.

Other loan terms and conditions.—Demands for credit assistance will also be excessive if the authorizing legislation does not contain specific restrictions on such terms and conditions as maximum maturities, guarantee fees, reasonable assurance of repayment, and default procedures.

This is not to say that Federal credit assistance programs should not contain subsidies—indeed, that is their purpose—but the legislation should be carefully drafted so that the subsidies provided are by design, not chance, and are directed at specific needs.

In short, I believe that more effective Congressional control over Federal credit programs can be accomplished by adopting standards which build that control into the structure of each program. I recognize that this is not an easy task, particularly since there are more than 100 different credit programs which fall under the jurisdiction of many different subcommittees of the Congress.

In the Executive Branch, the Office of Management and Budget and the Treasury Department strive to assure a uniform application of standards in the process of reviewing proposed credit assistance legislation. Within Congress, however, it may be unrealistic for each interested subcommittee to develop the intense focus on credit program standards which is essential to this improved control. Accordingly, it may be worthwhile for such a responsibility to be lodged in one committee of the Congress. Alternatively, the Congress could take the approach taken in the Federal Financing Bank Act or the Government Corporation Control Act and enact omnibus legislation to establish credit program standards.

I would be happy to answer any questions.

NET INCREASE IN FEDERAL AND FEDERALLY ASSISTED BORROWING FROM THE PUBLIC

(In billions of dollars)

Fiscal year:	Federal borrowing from the public			Federally assisted borrowing from the public				Total Federal and federally assisted borrowing from the public
	Budget deficit	Off-budget deficit ¹	Other means of financing ²	Total ^{3,6}	Guaranteed obligations	Sponsored agency obligations ⁴	Deduct to avoid double counting ⁵		Total
1970.....	2.8	.....	2.6	5.4	8.6	10.7	6.8	12.5
1971.....	23.0	.....	-3.6	19.4	16.3	1.5	4.8	13.0
1972.....	23.4	.....	-3.9	19.4	19.8	5.0	4.7	20.1
1973.....	14.8	.....	4.4	19.3	16.3	8.8	-1.1	26.2
1974.....	4.7	1.1	-3.1	3.0	10.3	14.9	4.0	21.2
1975.....	45.2	8.1	-2.4	50.9	16.5	11.9	14.5	64.8
1976.....	66.4	7.3	9.2	82.9	16.3	5.3	6.3	98.2
Transition quarter.....	13.0	1.8	3.3	18.0	2.8	1.7	3.2	13.3
1977.....	45.0	8.7	-1.1	53.5	21.1	7.0	2.1	26.0
1978.....	48.8	10.3	-1	59.1	24.7	24.1	13.7	35.1
1979.....	27.7	12.4	-6.5	33.6	39.3	25.7	17.4	47.6
1980e.....	36.5	15.0	-12.2	39.3	50.3	16.2	18.9	47.6
1981e.....	-16.5	18.7	-7	1.5	56.6	16.7	20.0	53.3
1981e.....	334.8	83.8	-13.1	405.3	298.9	149.5	115.3	333.1
Net change 1970-81.....	.....	.....	.....	685.4	421.8	174.9	127.7	469.0
Outstanding Sept. 30, 1981.....	.....	.....	.....	.....	.....	.....	.....	1154.4

¹ Deficit of off-budget Federal entities. Consists largely of Federal Financing Bank borrowings to finance off-budget programs.

² Consists largely of changes in Treasury cash balances.

³ Consists of borrowing by Treasury and minor amounts by other Federal agencies.

⁴ Consists largely of Federal National Mortgage Association and the Federal Home Loan Bank and farm credit systems.

⁵ Largely Federal and sponsored agency purchases of guaranteed obligations.

⁶ 1976 figure excludes retroactive reclassification of \$471 million of Export-Import Bank asset sales to debt.

Source: Special Analysis E of the Fiscal Year 1981 Budget.

Senator METZENBAUM. While you are looking at that table, would you explain to me how you projected a \$16.5 billion surplus for 1981? I am impressed.

Mr. ALTMAN. Am I permitted to turn that to Mr. Cutter? You are talking about the basic budget surplus?

Senator METZENBAUM. Well, you have got here, I noticed, it is—well, you have got the amounts of deficits, budget deficits, and then you have a minus \$16.5 billion which, as I understand it, indicates there will be a surplus, if I am reading it correctly. Is that what you are saying?

Mr. ALTMAN. Well, this merely reflects—

Mr. CUTTER. It was the budget as revised in March.

Mr. ALTMAN. That is right.

Mr. CUTTER. That was the budget as revised in March, yes, sir.

Senator METZENBAUM. Do you think there will be a \$16.5 billion surplus?

Mr. CUTTER. That depends on what receipts are and—

Senator METZENBAUM. Pardon?

Mr. CUTTER. That depends on how the economy performs.

Senator BOSCHWITZ. We never projected a \$16.5 billion surplus.

Mr. CUTTER. Excuse me, sir?

Senator BOSCHWITZ. We never projected, the Budget Committee, a \$16.5 billion surplus.

Mr. CUTTER. The budget, as the administration revised it in March, there was a \$16.5 billion—

IMPACT OF OIL IMPORT FEE ON BUDGET SURPLUS

Senator METZENBAUM. How much of that was oil imports, oil import fee?

Mr. CUTTER. \$9.6 billion.

Senator METZENBAUM. This is a June 16, 1980, figure you are giving us. Congress has effectively killed the oil import fee. Do you not think it is time for you to take that \$9.6 billion out? I thought the figure was \$12 billion, but whether it is \$9.6 billion—

Mr. CUTTER. Well, I think that, if I can break down those numbers, of the \$16.5 billion surplus that is projected there—I think the number is \$9.6 billion. I think it grew to—it would have grown to \$12 billion over a year or a couple of years—but let us say roughly somewhere between \$9 and \$10 billion was the fee, another \$3.5 billion, or so—I may be wrong on this—was the taxes on the—was the withholding of dividends and interest.

Senator METZENBAUM. On the what?

Mr. CUTTER. Was the withholding of dividends and interest. And the way we presented it in March, in an effort to be as explicit as possible, was to say that, while we wanted both of those proposals, and, indeed, felt extremely strongly, as you well know, about the fee, that we did not want to depend on balance for those; and that without those there was a balance of about half a billion, as I remember. And we argued that we should not depend on those added receipts for the balance.

Obviously, therefore, if one takes the fee out and looks at a different enactment date for the withholding of dividends and interest, then one has different numbers. We do not do a kind of

constant rolling reestimate of the budget. We will reestimate as of the middle of July, by law.

Mr. CUTTER. You were right, the estimate for the oil import fee was \$12.6 billion and not \$9.6 billion.

Senator METZENBAUM. Well, I guess we—I do not want to make a big point of it. But it seems to me that when you come to a committee of the Senate with a document dated June 16, 1980, and the Congress has effectively, as it possibly could, killed the oil import fee, that it is only appropriate that you revise your figures and then, also, the withholding figure on dividends, interest, that was \$3.4 billion, that is, obviously, at this moment, not moving very rapidly. And I think that, realistically speaking, that it is—I would just suggest that you not come—when some portion of your figures lose credibility, it effects the balance of your presentation. And, certainly, \$12.6 billion does not belong in there. And, therefore, that figure should have been altered, in my opinion. But that is really not the subject of this hearing, and I do not mean to belabor the point.

Senator BOSCHWITZ. Let me make a similar comment about the deficit projected for fiscal year 1980. I hope it is only \$36.5 billion, but I believe you are off at least \$10 or \$12 billion there, too.

Mr. CUTTER. Well, I think you have raised two separate points. We revise the budget and revise our estimates officially at three different times. We revise in July—well, I will do it in order. We revise our estimates with our publication of a January budget, we revise the estimate in March, normally, and then we revise them in July. Those are instances that we take the time to pull everything together and to present the entire budget in detail as it exists at that point. If there are new economic assumptions, we then use those. If we were to revise the budget with every change in the economy or in congressional action, we would be shooting at a constantly moving target.

The number that was used in the table is not an attempt by Mr. Altman to suggest that what has occurred in the Congress has not occurred. It is a table as it existed in March, and it will change in July.

FEDERAL LIABILITY UNDER OUTSTANDING LOAN GUARANTEES

Senator METZENBAUM. All right. I am not going to belabor the point. I guess I still cannot—I can understand change in economic assumptions. You are not sure what the unemployment will be, you are not sure what the rate of inflation will be, I can understand that you cannot do that on a constant, moving basis.

But when you know the \$12.6 billion that you anticipated in the budget absolutely is not going to come—and that is a simple—it takes one stroke of the pen, and then I think you can do it. But let us not waste our time on that.

Mr. Cutter, let me ask you, what is the magnitude of the Federal liability under outstanding loan guarantees?

Mr. CUTTER. Let me check. I do not have the answer committed to memory.

Mr. ALTMAN. Mr. Chairman, as I was saying, we estimate that there will be an estimated \$422 billion in guaranteed loans out-

standing at the end of fiscal 1981. And so, theoretically, the liability of the United States, under all loan guarantees, is that amount.

Of course, the default experience has been relatively favorable. But that is the theoretical amount of the U.S. liability, \$422 billion.

Mr. CUTTER. Guaranteed liability, \$422 billion.

Senator METZENBAUM. What do you mean by theoretical?

MOST GUARANTEED LOANS SECURED BY REAL ASSETS

Mr. ALTMAN. Well, in other words, if the United States had to make good on the entire amount of obligations which it has guaranteed, its eventual outlays for that purpose would be \$422 billion. The reason why I call this amount the "theoretical" liability is that, numerous programs provide guarantees for less than 100 percent of the principal amount of the loan, and unguaranteed principal amounts in the \$422 billion of net loan guarantees are estimated to be \$70 billion. So the Government's net liability is actually \$352 billion.

But, more important than that, under many guarantee programs, Mr. Chairman, the guaranteeing agency is required to find reasonable assurance of repayment of the loan, in the first place. Also, most guaranteed loans are secured by mortgages on homes, and other real assets. And so the net cost to the Government of a default must take into consideration the prospective proceeds which we would realize from disposition of the collateral, and the fact that with so many guaranteed loans secured by mortgages on homes, first of all, the default rate in that area is very low, and, second of all, as I said, ultimately, we would be likely to realize a full return of our outlay through disposition of the collateral, by selling it.

So that our real exposure, Mr. Chairman, is much, much lower.

PROJECTED COST OF DEFAULTED GUARANTEED LOANS

Senator METZENBAUM. What is the cost to the Federal Treasury in the past year, and what do you expect it will be in the next year, with respect to defaulted loans?

Mr. ALTMAN. I do not have that exact figure with me.

Mr. CUTTER. We can get it for you for the record.

Mr. ALTMAN. We can get it for you for the record.¹

Senator METZENBAUM. Do you have an estimate?

Mr. CUTTER. No, because it is a figure that is netted into everything else. It is one of the reasons why we have begun a credit control program.

Senator METZENBAUM. It is what?

Mr. CUTTER. It is one of the reasons why we have begun a credit control program. But I can provide it for you.

Senator METZENBAUM. How do you reconcile—you have a figure, as I see it, of a total variation in 1981 of \$53 billion, \$53.3, \$47.6 billion in 1980. Mr. Gramley talks about that administration forecasts of net credit advanced under Federal auspices, direct guarantees and sponsored, will increase by more than \$70 billion in fiscal year 1981. Now, maybe I am missing something there. But what is the difference in his \$70 billion figure and your \$53 billion figure?

¹See p. 44.

Mr. GRAMLEY. Mr. Chairman, I believe the difference is that the figure I cited represents the total of funds advanced in credit markets under Federal auspices. This total includes direct loans, guaranteed loans and lending by federally sponsored agencies. Mr. Altman's figure, I believe, represents net borrowing from the public to finance the Federally on and off budget deficit, loan guarantees and sponsored agency activities.

Mr. CUTTER. That is the reason, Mr. Chairman.

Mr. ALTMAN. I agree with Mr. Gramley's explanation. The major difference is that the Treasury figures include all Federal borrowing not just the borrowing for the purpose of making direct loans.

Senator METZENBAUM. Well, let us see. Federal and federally assisted borrowing of public debt would not include agency guarantees.

Mr. GRAMLEY. It would not include the Government sponsored enterprises, like Fanny Mae, for example.

Senator METZENBAUM. That is totally out of this budget process, then, out of these figures?

Mr. CUTTER. Yes, sir.

Mr. ALTMAN. The prominent examples of that, Mr. Chairman, are Fannie Mae—

Senator METZENBAUM. Pardon?

Mr. ALTMAN. The prominent examples of such Government sponsored enterprises whose totals I did not include are Fannie Mae, the Farm Credit system, and the Federal Home Loan Bank system.

HOW ARE LOAN GUARANTEES AND DEFAULTS MONITORED?

Senator METZENBAUM. How is the status of loan guarantees and defaults monitored?

Mr. CUTTER. We monitor in the same way that we monitor outlays or that we monitor budget requests and budget expenditures in the course of a year. It is primarily the job of the program agency to administer programs that offer direct loans or guarantees. We regard the monitoring process as a management responsibility of the issuing agency.

TRACING DEFAULTED LOANS THROUGH THE BUDGET PROCESS

Senator METZENBAUM. Now, what happened in the budget process, let us assume in the year 1980, by reason of defaults? I saw a story in the paper within the last few days about a rather good sized agricultural default of about \$8 million, I think the number was.

Now, my question is, that is one of many, many defaults. Now, what happens as far as the budget is concerned, as far—we now lose, let us say, \$8 million in the year 1980.

Mr. CUTTER. \$8 million, right.

Senator METZENBAUM. How do you go about—how does that get cranked into the whole budget process? Does it ever show up as being a deficit?

Mr. CUTTER. Well, it certainly shows up. I will walk through our process. First, as I said, the management of loan portfolios, whether it is direct loans or guarantees, is the responsibility of the issuing agency. This is because the loan activities of that nature

have been, in many instances, proposed by the Executive or by the legislative branch as program activities, not as overall credit activities.

When we review an agency's budget and its credit portfolios, we review the totals. Because OMB is a small agency, and the Federal budget is very large, we cannot ask every agency about every transaction in every credit program.

Instead, we ask why certain trends changed from one direction or another; and we determine when those trends seem to create problems. Then we probe. But I cannot say to you that a particular transaction would necessarily be an issue that could arise in a budget review that is presented to the Director of OMB. It should be. The overall experience seems to me to be the important issue.

Beyond that, though, let me make a point about guarantees. They are the most difficult things that we consider as we analyse these issues. Mr. Gramley was asked a number of questions with respect to crowding out, with respect to the degree to which credit activities of the Government substitute for or provide additional credit within the economy. I think the general position of all of us is that a Federal credit activity presents an allocation issue rather than a credit supply issue.

You have to ask yourself, why do we give a guarantee?

Senator METZENBAUM. You are giving me a philosophical discussion. And I am trying to ask why we lost \$8 billion last year, or \$20 billion.

Mr. CUTTER. I am trying to answer that.

Senator METZENBAUM. And I am trying to find out how does that loss get worked into our budget. And I would like to get the answer so I can yield the floor to Senator Boschwitz, who has some questions. And I am trying to get the nub of the issue.

DEFAULTED LOANS REFLECTED AS BUDGET OUTLAYS

Mr. CUTTER. The loss is categorized as a budget outlay, so that it is clearly counted. The philosophical point, I will insist, is important. Before you look at every single loss you must ask why did that occur? You have to ask why does one offer a guarantee. If an agency stuck to offering only those guarantees which were, in advance, clearly safe, then one could fairly ask why do have the program in the first place?

Senator METZENBAUM. I am not questioning that. That is a policy consideration that the Congress and administration makes. It is in the national interest to provide these guarantees. And there are going to be some losses. You cannot make loans without having some losses. All I am concerned about, and all this committee is concerned about, at the moment, has to do with the fact that, if there are losses, you say it then becomes a part of the outlays for that particular—now, if the agency does not charge back the losses and just carries them, then it never becomes a loss. And it is in their interest, then, not to charge back the outlays and say, "Well, we will hope to collect it someday." Right?

Mr. CUTTER. Yes, sir. But only for direct Federal Loans, which are counted as either on-budget outlays or off-budget outlays when they are made. In the case of a default of a guaranteed loan, the

private lender simply gets paid, and this is shown as a budget outlay.

Senator METZENBAUM. I will get back to that point.

Senator BOSCHWITZ, I think you had some questions.

PROPOSALS FOR CONTROLLING FEDERAL CREDIT

Senator BOSCHWITZ. Thank you, Mr. Chairman. I think, when we asked a question about these figures, Mr. Chairman, we really should have directed them to Mr. Altman, even though Mr. Cutter apparently, from his answers, would have come up with the same figures. But I see that the Department of the Treasury is the one that is projecting a surplus of 1981, and a deficit of only \$36.5 billion for 1980.

In discussion—and I would like to direct my questions to Mr. Altman and Mr. Cutter—in discussing the FFB and all the things, really, that we have been talking about this morning, it is not clear to me what you think we should do with respect to the credit budget, or with respect to what is the aim of this subcommittee is, to figure out what we should with the various elements of the credit budget. We can talk at great length about whether or not it is crowding out other borrowers. And, clearly, any borrowing crowds out somebody else. But what do we do? Are there some specific programs, some specific agencies that the FFB provides financing for, or some specific guarantee or loan program that should come in the budget? What should we do?

Mr. CUTTER. Senator, we think we have proposed, with great explicitness, what we would like to have you do, and we think that the Congress has responded in a way that is entirely consistent with our original proposals.

We said in the budget over 2 years ago that credit and its control was a problem of great concern to us. We said that we would come forward with a proposal for a credit control program. In the following budget, we came forward with a specific proposal which was then widely considered by staffs on the Hill, in the executive branch, and the Federal Reserve Board.

In the third budget year, we made a specific—

Senator BOSCHWITZ. Review that proposal briefly.

Mr. CUTTER. Surely. What we proposed was that loan obligations and commitments with respect to direct loans and loan guarantees be reflected in the budget resolutions, and then in the appropriations process, through limitations. So that, for the first time, they would not be considered free resources but would be part of the overall budgeting process of the Federal Government, both the congressional and the executive budgets.

We also proposed and indicated that OMB would develop, an overall credit monitoring system to consider credit in a more inclusive way than had been done in the past.

I think we have fully met these commitments. We made those proposals in the 1981 budget. The resolutions currently reflect those proposals in a way that I think is consistent with them. And we are now quite hopeful that the Appropriations Committees will follow through with generally consistent limitations.

We believe that the institution of a system is extremely important, and it is our objective for this year.

LOAN PROGRAM OUTLAYS NOT ON-BUDGET

Senator BOSCHWITZ. My staff person says the proposal does not put the loan program outlays on-budget, but it is still in the FFB at \$24 billion.

Mr. CUTTER. We do not regard that as a relevant consideration at this point. For us, the issue is one of control.

Senator BOSCHWITZ. What do you mean, you do not take—

Mr. CUTTER. Precisely what I said. For us, the issue is one of control. The outlays of direct loans are on budget.

Senator BOSCHWITZ. They are, they are now?

Mr. CUTTER. That is right. All of the outlays for guarantees, to the degree they result in outlays through the Federal Financing Bank, are not. We did not propose that they be on-budget. If the Congress wishes to propose that they be on-budget, then there is a difference of view. But we considered the issue, and decided that that was not relevant to our concern. We were interested in developing a credit control program which analyzed, and limited credit. And from that perspective—

Senator BOSCHWITZ. As it was on-budget or off-budget?

Mr. CUTTER. As I have said, that was not, to us, a relevant consideration.

Senator BOSCHWITZ. If it was off-budget?

Mr. CUTTER. It is off-budget in the sense that the transactions do not occur on the budget, right. We wish to count loan guarantees in a different way. That is the nature of the proposal we have made. It is also, at this moment, the nature of the proposal as it is reflected in the congressional resolution.

LIMIT GUARANTEES AND PLACE IN BUDGET RESOLUTION

Senator BOSCHWITZ. The loan guarantees you do not consider relevant, and the only part of them that are in the budget are the defaults or the provision for defaults, the direct loans are in-budget—have been as long as I have been here. I do not quite understand what changes you are suggesting. And how far has the OMB gotten in putting together a task force to oversee the credit, overlook the entire credit program of the Government?

Mr. CUTTER. I am making a different point. The guarantees are very much a part of the credit control program, as we have proposed it. We have proposed limitations for approximately 82 percent of all the guarantee programs offered by the Government. We have asked that these be included, that these limitations be included, in the budget resolutions, and that such limitations be included in appropriations. That is the way in which, in our judgment, they ought to be constituted as part of the credit control program.

It is possible to argue that they ought to be put on-budget. We do not agree with that and have not made that argument. But I do not think that it is fair to suggest that we have not included the guarantee programs in our credit control program, because we quite explicitly have.

Now, how far have we gotten in the consideration? We have made these proposals. We have proposed limitations, as I said, for 82 percent of the guarantee programs in the budget. It seems to me that is going a fair distance. We have put our overall credit moni-

toring system into effect. And for the first time in our fall review last year and in our spring reviews this year, we began to set limitations. Credit limitations have been made an explicit part of the recommendations that we present to the Director of OMB, and then later to the President. That is the nature of our proposals, and we think that the responses of the Congress are quite consistent.

Senator BOSCHWITZ. You concur, I presume, in the proposals made, Mr. Altman, by the OMB—

Mr. ALTMAN. Yes, we do.

Senator BOSCHWITZ. Do you feel that there are parts of the credit program that we should bring on-budget?

Mr. ALTMAN. Senator Boschwitz, I agree with Mr. Cutter's description fully, and I would just add to it that what we have proposed is a system of improved control over Federal credit. We have not proposed changes, at least any major ones that I know of, in the budget treatment of guarantees, direct loans, and other forms of Federal credit.

Part of the discussion that you just had is a bit apples and oranges. What is basically being proposed is a credit budget, not changes in the budget treatment of the forms of credit.

Beyond that comment, I agree completely with the way Mr. Cutter described it, and we support it fully.

OFF-BUDGET LOANS DICTATE NEED FOR CREDIT BUDGET

Senator BOSCHWITZ. Mr. Gramley, you also speak about a credit budget in your testimony, and give several recommendations. Is that the best way that we, as a committee, can treat the various credit programs of the Government; to form a credit budget so that there can be better oversight? Is that the result that you feel this subcommittee should recommend to the Budget Committee?

Mr. GRAMLEY. Senator Boschwitz, Congress needs a Federal credit control budget because these loan programs are, for the most part, not in the budget and because resource use by the Federal sector was expended and taking place outside of the unified budget.

I do not think the important issue now is whether they are off-budget or on-budget, but to proceed with the steps that have been taken by the administration, by the Congress, to bring some discipline to bear to put these credit programs under the same sort of appropriations process that governs the growth of direct Federal spending.

So I think we are going in the right direction. Now, there is a lot of room for improvement but we do not know enough about where to go from here to have any concrete suggestions for what needs to be done next. So I think the steps that have been taken have been extremely helpful, and I agree that this is the direction we have needed to go.

ESTABLISH FUNCTION-BY-FUNCTION CEILINGS ON TOTAL CREDIT

Mr. ALTMAN. I would just add to that, that I think what is particularly needed from this point on is for the appropriations committees to support this process and, in particular, to play the role relative to Federal credit, particularly loan guarantees which,

of course, they play in regard to outlays, and that is, to establish ceilings function by function, on total credit, and particularly on guarantees. There is a need for the appropriations committees to come in fully—

Senator METZENBAUM. So far, the House has refused to do that, is that not correct?

Mr. CUTTER. I hate to put as hard a word on it as "refused." There has not been a lot of movement yet.

Senator METZENBAUM. I may put you in the diplomatic corps, Mr. Cutter.

Mr. CUTTER. Thank you, sir.

CRITERIA FOR CHARGING DEFAULTS AGAINST AGENCY OUTLAYS

Senator METZENBAUM. But the bottom line is still the same, as of this moment.

Let me back you up for a moment. When you go to determine how much amount—what amount is in default, you would go through the lines of each agency as to what they have categorized a default. Then and only then is it charged back against that agency's outlays, is that correct? Or is it not even charged back then?

Mr. CUTTER. That is approximately right. Remember, for direct loans, the outlay has been counted when we make the loan. And, therefore, if it is in default, what happens is that we will never get the receipt back to balance the initial outlay for the loan.

In guarantees, the issue as to when you declare default, perhaps, ought to be addressed. Most of these guarantees are not out in the private sector, but have been taken up by the Federal Financing Bank, and the Federal Financing Bank presumably has rules as to when defaults are recognized.

My judgment is that the Federal Financing Bank operates by some quite specific and financial, not programmatic, criterion, but I am not certain about that.

Senator METZENBAUM. I would be interested to know when it is charged into the Federal budget. I want to know how you do handle this question of defaults on guaranteed loans, and when it is charged into the Federal budget.

Mr. ALTMAN. Well, Mr. Chairman, I think I should give you a fuller response for the record, but one thing I can say, or should say, is that I am informed that different agencies have different standards in terms of when a default is declared. From the Federal Financing Bank point of view, our security or our collateral is simply the guarantee of the United States. And since the authority for that guarantee is provided earlier, in specific statutes which authorize the various agencies to guarantee obligations, we look only to the guarantee to be repaid, in effect, to the authority of the agency to repay the Federal Financing Bank on any defaulted obligation. We have no need to look to the ultimate project or the ultimate recipient of the Federal credit assistance because we have a guarantee.

But I would like to get you a fuller answer for the record because the question of how agencies determine when a default has occurred and how they proceed to collect and when, in effect, an

outlay is made reflecting a default, differ from agency to agency. But I will get you an answer for the record.¹

FEDERAL STANDARDS FOR DEFAULTS INCONSISTENT

Senator METZENBAUM. All right. It is my understanding that some agencies almost never put anything into default; SBA saying, "Well, we are still trying to collect," and sometimes working on the collection process for many, many years. As a consequence, the moneys are gone, the moneys have been used. The American people would never have any way of knowing about that. And I would appreciate your actually exploring not only the question of the amount of default on an annual basis, going backward, but I would like to find out when it is in default and when it is not. And I think, as you said, the agencies have different rules.

But the fact is that the impact upon the Federal budget is just the same, whether or not, and we have no control over that. And I think it is very important that we know. I think there ought to be simplistic rules, either put out by OMB or by the Treasury Department, that when any amount in excess of one-tenth, one-one-hundredth, 2 percent of the total outstanding principal is in default for more than 60 days, then that loan is considered in default.

Banks have those rules. Accounting firms know how to establish them. But the U.S. Government, the biggest of all, as I understand it, has no such rules. And I would hope that you would respond and indicate what, if anything, the facts are and what, if anything, your recommendations are on this.

Mr. CUTTER. May I elaborate on the point?

Senator METZENBAUM. Of course.

AGENCIES FAIL TO MANAGE LOAN GUARANTEES SUFFICIENTLY

Mr. CUTTER. I think you are absolutely right on the mark. When we began to be concerned about the whole question of credit control 3 years ago, as we did our budget reviews each year, it appeared that the loan programs in agencies were, to some extent, the stepchildren of the agencies. Agencies tended not to value guarantees as resources to the same degree as they did their outlay programs. This is because guarantees, were not limited, and outlay budgets were restrained.

They tended not to manage their loan guarantee portfolios in a sufficiently businesslike manner. Now, that is an overall blanket statement. I am sure you appreciate that this statement would have to be qualified a thousand times if you were looking at the problem agency by agency. But as a general judgment, it is a feeling we began to have.

And we felt that we needed to improve the management of credit programs. In a sense, there should be a separation within agencies between the programmatic aspects of loan programs, and the fiduciary management of a loan program. Agencies have to be quite careful. They can, as you said earlier, make policy decisions to grant risky guarantee. But that is very different from the financial decision to defer declaration of a default.

¹See p. 44.

And we felt that the credit control program would provide the opportunity for improvements to evolve across a range of activities, both how we analyze credit programs and how we manage them.

We feel strongly that if we can set a system in place, then, each year we can come back to you with some improvements. I cannot say to you that the definition and establishment of the system today implies that we have satisfactorily answered the kinds of management questions and policy questions you have been raising.

ESTABLISH CLEAR-CUT DEFINITION OF DEFAULT

Senator METZENBAUM. We appreciate your comments, Mr. Cutter. I think that if we could make some headway on a definition of default so it would be unequivocal, then I think that the Congress cooperation with the administration could then provide a charge back against the outlays of the respective agencies for all loans that are in default.

And, right now, I think that sort of occurs, but it is rather ephemeral. You cannot put your teeth into it. Each agency handles it differently. And if I were running the agency and did not want to have my budget affected too much, I would not be charging many things—putting many items into the default column if I did not have to, since I know it would just make that much less money available to me for other purposes of the committee—I mean, of the program.

This would be—I think it would be very helpful if OMB and Treasury rather promptly—I do not think you even need any statutory language—attempted to establish what is and what is not a default, and required all agencies to conform with those requirements. Then I think we would be well on the way, at least, to the facts, from that point.

I think now we have—you are going to give me an answer as to what is in default, but your answer is only going to be related to what some others have told you based upon their method of evaluation. And that is not your fault. But I think it is time that we make some changes along this line.

IMPACT OF MASSIVE DEFAULTS ON FEDERAL DEFICIT

Mr. Gramley, I have a question for you. If defaults became massive, would not their initial effect be to drive up the Federal deficit sharply? And how would the Federal Reserve respond to that event? If it expanded the money supply growth in response to such circumstances, what would be the economic consequences?

Mr. GRAMLEY. I do not think I can give you a satisfactory answer to that, Mr. Chairman, because it would depend on what the nature of the problem was that gave rise to those defaults. I do not want to suggest to you that I think this is a realistic possibility, but suppose, for some reason or another, that the United States experienced an enormous collapse of housing prices as a result of a huge depression, and that a waive of defaults took place. In this circumstance, the Government would move into the housing business on a large scale. Since budget accounting treats defaults as expenditures, the budget deficit would go up.

This would hardly be a problem that the Federal Reserve would respond to by tightening up on the supply of money and credit because, by definition, the problem is one of huge depression and a collapse of the economy. The monetary authority, I am sure, would be responding to the decline in economic activity.

There are, however, many different kinds of problems and possibilities, and I am really not sure a general answer can be given to your question.

Senator METZENBAUM. Gentlemen, I appreciate your comments and your helpfulness. I think we all have a lot of work to do. I will look forward to hearing from you further with respect to some questions we raised. Particularly, I am interested in hearing A, defaults amounts going backward over the years, and B, what, if anything, the OMB and Treasury would propose vis-a-vis a better standard than that which presently exists for the determining of when a loan is actually in default.

Mr. CUTTER. Yes, sir, we will respond.

Senator METZENBAUM. Thank you very much. We appreciate it. [The following was subsequently supplied for the record by OMB:]

FEDERAL CREDIT ACTIVITIES

AGENCIES MONITOR PROGRAMS

The OMB does not monitor the individual loan transactions of each Federal program on a detailed basis because that is the responsibility of the administering agencies. However, in its oversight capacity, OMB does collect data on Government credit programs and plans. Analyses of these data are presented each year in the budget document and the Special Analysis of Federal Credit Programs. OMB also reviews credit programs through the normal budget process. When problems arise, guidance to the responsible agencies is offered through the existing budget process.

The data currently collected by OMB and Treasury do not include detailed information on the amount and rate of defaults. The processing of the data currently being collected strains the capability of the institutions, and any increases would probably require additional resources.

MANAGEMENT IMPROVEMENTS NEEDED

The Administration is aware that some credit programs require management improvements. To this end, in October, 1979, a Debt Collection Project was created in the Office of Management and Budget under the sponsorship of the President's Management Improvement Council. The Project is currently reviewing credit management and debt collection in twenty-three departments and agencies which account for over 95 percent of the debt owed the Government.

One of the objectives of the Project is to describe the universe of government receivables in terms of amounts outstanding, age of receivables, delinquency rates, default rates and write-offs. Although the Debt Collection Project has not completed its study, it has confirmed that overall amounts currently being reported by departments and agencies for defaults, write-offs, and allowances for uncollectibles are incomplete. This is because many agencies do not report write-offs. In many cases they do not have the legislative authority to write-off uncollectible debts, and have not established an allowance of uncollectibles that would give an indication of expected losses.

One of the recommendations coming out of the Debt Collection Project is that information of the amount and rate of defaults on both direct and guaranteed loans, as well as amounts written-off for all types of receivables be reported routinely to the department or agency level as well as to OMB and Treasury. This will provide a better means of monitoring the credit management and debt collection process in the various government credit programs as well as measuring performance in these programs.

The project will also recommend changes in terminology and definitions for credit transactions in order to provide for an accurate measurement of the amount and condition of receivables on a government-wide basis. Therefore, in response to your

question, we hope that the efforts of the Debt Collection Project will assist in creating better standards than those which presently exist for determining when a loan is actually in default.

DEFAULT RATES

The following table was prepared in response to your request for information on defaults. The data collected by OMB for its credit program analysis do provide significant information on default rates. However, the data were not collected for a precise accounting analysis of defaults, and therefore should be used cautiously for that purpose. The table reflects only losses on Federal credit programs and not other receivables such as overpayments and sales of goods and services. The amounts shown in the table may be understated.

The term "defaults" for Federal lending activities may be less useful than the term "losses." This is because loan guarantees in default are recorded as direct loans under the accounting practices of some agencies. Therefore, loss figures are used in order to avoid this confusion and provide a more accurate estimate of the budgetary loss to the Federal Government arising from defaults in both direct loan and guarantee programs.

ESTIMATES—LOSSES IN FEDERAL CREDIT PROGRAMS

	1979	1980	1981
Gross direct loans outstanding ¹	\$140,516	\$163,277	\$179,333
Gross loan guarantees outstanding ²	\$387,172	\$453,222	\$528,646
Primary guarantees outstanding.....	\$264,596	\$298,037	\$339,467
Total gross outstanding.....	\$527,688	\$616,499	\$707,979
Total net outstandings.....	\$405,112	\$461,314	\$518,800
Net loss on direct loans ³	\$301	\$248	\$252
Net loss on guaranteed loans ⁴	\$108	\$94	\$84
Total loss.....	\$409	\$342	\$336
Loss as a percent of total gross outstanding.....	.08	.06	.04
Loss as a percent of net outstandings.....	.1	.07	.07

¹ Total direct loans outstanding includes all on-budget and off-budget agencies and Federal entities except foreign currency transactions. The total volume of direct loans outstanding is a stock concept referring to the total of loans that have ever been made, less principal repaid to date, loans written off and receipts from the sale of loans.

² The aggregation of all loan guarantees for each program into a single gross total involves some double counting. Elimination of this double counting requires two adjustments. The first deducts loans previously guaranteed, or secondary guaranteed loans. They occur, for example, in the case of the GNMA mortgage-backed securities program which guarantees securities that are backed by pools of federally guaranteed or insured loans held by the seller. The total after deducting secondary guarantees gives net guaranteed loans. The second adjustment deducts guarantees of loans that are held as direct loans by the Government—by either on- or off-budget accounts. An example of this would be loans held by the Federal Financing Bank which were already included in our total as losses guaranteed by another agency. The total after these two deductions gives primary guaranteed loans. The table below shows totals for net and primary guaranteed loans as well as totals for guaranteed loans held as direct loans.

OUTSTANDING GUARANTEED LOANS

[In millions of dollars]

	1979	1980	1981
Guaranteed loans (gross).....	387,172	453,222	528,646
Less: secondary guarantees.....	72,371	88,100	106,896
Guarantee loans (net).....	314,801	365,122	421,750
Less: guaranteed loans held as direct loans.....	50,205	67,085	82,283
Primary guaranteed loans.....	264,596	298,037	339,467

³ Net loss on direct loans is defined as losses realized after disposition or liquidation of loans and/or collateral acquired through default of both direct and guaranteed loans.

⁴ The net loss on guaranteed loans is that portion of all guaranteed loans in default that are recognized immediately as a loss and are not converted to direct loan status for collection.

Senator METZENBAUM. Dr. Maisel and Mr. Kezer?

I now want to welcome our panel of outside witnesses, Mr. Richard Kezer, senior vice president of Citibank, and Dr. Sherman Maisel, professor of economics, University of California.

Dr. Chester Baker, of the University of Illinois, will be unable to appear today. But we will make every effort to reschedule him. Dr. Baker is an agricultural economist, and we are very interested in hearing his views on how the credit needs of the Nation's farmers should be considered in designing a credit control system.

Dr. Maisel is a former member of the Board of Governors of the Federal Reserve system. He has done major work with the Brookings Institution of the relationship of money and credit policies in the housing sector.

Citibank has played a leading role in representing the interest of the financial community in discussions of Federal credit policy.

We look forward to hearing from both of you gentlemen today, and we are grateful to you for taking the time and trouble to be with us this morning.

Mr. Maisel?

STATEMENT OF SHERMAN J. MAISEL, PROFESSOR OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA, BERKELEY

Mr. MAISEL. Mr. Chairman, I am pleased to have this opportunity of discussing with you certain aspects of the need for a system for controlling Federal credit activities. As one deeply concerned about our country's monetary and credit system, I have been interested in this topic for many years.

Today I shall merely attempt to answer some of the specific questions you have raised using for illustrative purposes some examples drawn from the housing sphere, and leaving more general comments to the discussion period.

I should make it clear that I believe there is a need for Congress and the Administration to regain control of Federal credit programs. I am going to summarize my statement, Mr. Chairman, rather than read it.

Senator METZENBAUM. Fine.

DIFFICULTIES WITH CREDIT BUDGET

Mr. MAISEL. I would primarily make the point that the proposed credit budget has several dangers, it has both some sins of omission and some sins of commission. The problem of commission is that to think in terms of a Federal credit program as a unified whole, or as a credit aggregate with similar impacts, gives an inaccurate picture of how the individual programs work. Each has a very different cost in terms of resources, in terms of its expenses to the Federal Government, and in economic influences on prices and output.

The question as to how each one influences the relationship between borrowers and lenders must be considered. It seems to me, in terms of the previous discussion of the Federal Financing Bank, that this is a clear point. What did not come out in the earlier discussion is the point that Federal credit programs are part of our total credit system, a form of intermediation. The reason that they are not in the budget, is that basically they are not outlays, they

are a form of intermediation between borrowers and lenders. And whether that form should be in the budget or should not be in the budget depends upon the particular program and how it is used.

DEFAULTED CREDIT PROGRAMS

Senator METZENBAUM. When should they be put into the budget; after default?

Mr. MAISEL. Certainly after default, let me agree with you on that point. But I think what does not come out, also, in the earlier discussion, is that most of these were inaugurated as a method of increasing capital. The idea that the budget crowds out capital formation simply is wrong. When we look at productivity in this country, we find that during the last 20 years—most of our increased productivity has probably come from education, and things of that sort.

So that if you say the student loan program is a waste of capital because it is competing with a shopping center, it simply is not the case. The same thing would be true in the energy program. If, as most of us believe, one of the most critical things for the next 10 years is energy, then, obviously, Federal programs that really can aid in bringing more energy into the country and making us more self-sufficient are far better uses of our national total of credit than are many private things that I can think of that are wasteful.

ECONOMIC IMPACT OF CREDIT GUARANTEE PROGRAMS

Senator METZENBAUM. Professor, this committee is not really addressing itself to whether there should be or should not be any particular credit guarantee program. That is the function of other committees, some of which I serve on, some I do not. The committee is only concerned with the question of the impact on the Federal Treasury, if at all—I could very well—if all the loans were repaid, then you would have a totally different kind of approach. It would still have an impact upon the economy, it still would have an impact upon the credit market, but it would be a different subject.

But we know that some of the funds are not going to be repaid. And, frankly, we do not even know how much that amounts to. The American people have no way of knowing, when the Congress cannot even find out, and we will, I guess, find out eventually. And, furthermore, there is this question of playing games and not putting items into the default column that belong in the default column.

Mr. MAISEL. Senator, I agree that that is a critical problem, but it seems to me that that is, really, a very small number compared to the numbers that we have been hearing, when we are talking about \$70 billion, or things of that sort. In other words, I am somewhat concerned that the case that has been built for the Federal credit budget, seems to me, an unfair case. It is not based upon the point you are making, which I could certainly agree with readily.

But when we start throwing around figures of \$70 billion or a trillion dollars, or things of that sort, we are dealing, really, in apples and oranges, and they do not add up. It seems to be impor-

tant that when the committee looks at this it realize that a lot of numbers have been added together that do not make sense.

Senator METZENBAUM. Well, when we are comparing something to zero—because, at the moment, the Federal credit dollars are not included at all. So, agreed, that when you increase \$70 billion, that that does not mean that there is an impact, negative impact, upon the Federal Treasury to the extent of \$70 billion. But you are a professor of economics. The gentleman next to you is a banker, I am a former businessman. And I know that if you put your name on the line for \$70 billion worth of credit, and some of the kinds of things that the Federal Government puts its name on the line to are not the kinds of things that Citibank would put its name on, without the Federal Government guarantee. We know that some portion of that \$70 billion is going to have an impact upon the Federal Treasury, and some people are going to have to pay that amount; the American taxpayer.

SPONSORED AGENCIES

Mr. MAISEL. I agree fully. My next point was that one of the areas that is left out of the budget is the sponsored agencies, and they are a very large percentage of the total. They are left out of the concept. And, yet, if we look at what has happened to the sponsored agencies—and here I feel sort of guilty because I was probably one of their main proponents and probably got them into the position they are in—if we look at the history of the past 5 years, they have been inflationary.

And yet as you were adopting the program I am concerned that you are omitting what have been probably the most dangerous parts of the Federal credit program. I cannot understand why this is so, why the part that is most dangerous, has not been included. So this is part of the omission problem.

VIEW CREDIT PROGRAMS AS A WHOLE

Again, I would try to make clear the point, that the problem is the total Federal credit programs, the guarantees and the insurances, have never been added together as a total program. If we look at the housing area, we have subsidies, we have loans, we have loan guarantees, we have sponsored agencies, and we have tax expenditures. We have at least five different types of programs, all involved in the housing field. And the question that Congress has to ask is, "When you put all five of them together, do we have a sensible program?"

And, I must say, I am afraid that we do not, that if we look at what has happened over the last 5 years or so, we find that adding the five together has given us a situation where the total simply is much less than the parts. In fact, because the parts have added together into an inflation, we have probably ended up with negative programs rather than a positive one. You do not find that by considering loans alone or guarantees alone. You would have to add all five of them together.

So that I am concerned that if the concept of an overall budget detracts from looking at the programs as a whole, it gets us into a negative position rather than a positive one.

INFLATION ACCELERATED BY FEDERAL HOUSING PROGRAMS

Senator METZENBAUM. I am intrigued by your concept that Federal housing programs have accelerated the inflation process when I can certainly see a contrary argument that a failure to have Federal housing programs will drive up the price of the present housing stock, and that with Federal housing programs, that you would have more available and therefore, bring down the price.

Mr. MAISEL. The reason, Mr. Chairman, in my mind, is fairly clear. Federal housing programs originally were devoted to the production of housing. Over the last 10 years they have become primarily devoted to increasing the prices of existing housing which, has lowered the total amount of housing. In other words, the housing programs have simply gone at a right angle compared to what they were originally set up for. They have paid much less attention now to production, which was the reason they were there.

If we had increased the amount of production of housing over the past 10 years, if we had increased our ability to build houses, then we would have had an anti-inflationary policy. But I do not think that is what we have had. I think that most of the Federal credit—I do not know what percentage, but probably 60 or 70 percent, a very high percent—has gone into the existing housing stock. It has tended to raise the price of the existing housing stock. It has raised the price of land, and so on. As a result, our cost of producing housing has gone way up, and has been a critical factor in the inflationary spiral.

Senator METZENBAUM. I am a little lost in this idea that 60 or 70 percent has gone into the existing housing stock.

Mr. MAISEL. Well, if you look at Fannie Mae for example, I do not know what the exact figures would be, but I am sure that a majority of Fanny Maes' loans go to purchases of existing housing rather than new housing. A similar thing, if you look at the tax expenditures, whatever they are, \$20 billion, you probably find that \$16 or \$17 of that \$20 billion goes to the existing housing stock, and very little of it to new production, and so on. So that if we added up the total housing expenditures in the Federal budget, we would find a comparatively small percentage goes to housing production. And this is why it has an inflationary effect rather than a noninflationary effect.

THE NEED FOR PROGRAM CONTROLS

Let me simply make my last point. I think Mr. Gramley made it very clearly, that a danger of a concept of an overall credit budget is that most of the Federal programs should be anticyclical. And yet we know from experience with the Federal budget that the question of whether you have a deficit or not is induced by what happens in the economy, and not what happens when the budget is voted. This is why the whole question of the budget resolution over the last 2 weeks to most economists was not a very good debate. If we assume that there is going to be unemployment, and so on, there is going to be a very large deficit no matter what the resolution says.

Now, when we are talking about controlling programs this becomes a very dangerous thing. If you say the Federal loan guaran-

tees should be limited to \$60 billion and you suddenly find yourself in a depression, you might well want them to be 20 or 30 percent higher than was set. I am not clear what sort of flexibility is built into this concept to make it available for credit to expand when you want it to expand. This is a critical concern of mine, whether the concept has enough anticyclical forces built into it.

I will offer my statement for the record. And I would be happy to answer any questions.

Senator METZENBAUM. Thank you, Mr. Maisel.

PREPARED STATEMENT OF SHERMAN J. MAISEL, PROFESSOR OF BUSINESS
ADMINISTRATION, UNIVERSITY OF CALIFORNIA, BERKELEY

I am pleased to have this opportunity of discussing with you certain aspects of the need for a system for controlling Federal credit activities. As one deeply concerned about our country's monetary and credit system, I have been interested in this topic for many years. Today I shall merely attempt to answer some of the specific questions you have raised, using for illustrative purposes some examples drawn from the housing sphere, and leaving more general comments to the discussion period.

CONCLUSIONS

I believe that there is a need for Congress and the Administration to regain control of Federal credit programs.

The concept of a credit budget appears to be an awkward and probably inefficient method of performing the task.

I would prefer to see the use of sunset laws. Programs should be authorized only for a limited number of years. They should then be reenacted only after careful evaluation of their accomplishments.

It also seems to me vital that programs be examined as a whole rather than as part of separate budgets. For example, in housing there are subsidies, loans, loan guarantees, sponsored agencies, and tax expenditures. Over the past decade, they have frequently gone off in opposite directions. The result has been an expensive, inflationary program that has not accomplished the tasks that each program separately was established to perform. A credit budget is as likely to do harm as good unless better coordination is introduced into the set of programs.

DIFFICULTIES WITH THE CREDIT BUDGET

The proposal for an overall credit budget has several weaknesses:

1. The concept of a total credit budget to be subdivided into parts has very little economic meaning. Each line in any such budget would have a different impact. In contrast to expenditures and receipts in the traditional budget, many of the loans included in the credit budget would be made by the private sector in any case, although perhaps under somewhat different circumstances. They are part of the financial intermediation process. How they affect both specific and total intermediation varies greatly from one program to another. The idea of dividing up a total among competing claims is simply not applicable in the credit sphere.

2. Many programs will be most useful if they are automatically contracyclical. A budget which must be planned for and adopted well in advance of events is not likely to be a useful automatic stabilizer. It will be too large if the economy is booming, and too small in a recession.

3. Some of the largest Federal credit effects arise through the programs of the sponsored agencies. These are also the ones most likely to have adverse potentials. Yet they are excluded from the proposed control system.

4. Some of the concepts advanced in support of the proposal appear unsound. For example, S. 2151 bases its need for a budget on the statement that credit is finite. This is obviously incorrect. At times in our economy, production is limited so that additional credit is primarily inflationary, but historically, credit has raised production and income. Similarly, contrary to statements in the bill, many programs have been costless, and they have also been profitable to the economy.

SOME FUNCTIONS OF FEDERAL PROGRAMS

While the growth of numerous credit programs and the sponsored agencies has clearly arisen in order to avoid budgetary constraints, it is not necessarily a bad thing. Some of the pressures arise from the difference between private or state and local accounting and that of the Federal government. The Federal budget does not

take account of accumulation of capital or assets. While transfer payments, purchases of current goods and services, of capital, and of financial assets may have different economic effects, they are lumped together in the budget. The significant Federal impacts on the nation's total capital are not shown in the budget.

However, while the avoidance of budgetary constraints may have been the most important reason for the credit programs, other significant reasons for the programs exist:

1. The Federal government can assume risks the private sector cannot. The FDIC, FHA, and GNMA pass-throughs exist because private entrepreneurs tried but failed to perform these services.

2. In some cases, risks may not be too great, but they may be so variable that a private insurer could not function. War risks are an example.

3. Private lenders have failed to move into certain markets. Parts of the mortgage and farm credit markets have not been attractive to private lenders. The secondary mortgage market is almost entirely a product of Federal programs.

4. The private market tends to increase its estimates of risks in recessions, and lending falls. Yet in such periods, large amounts of resources are going to waste. Federal contracyclical programs can raise output, capital, and productivity.

5. Some programs are outright subsidies. Perhaps these should be grouped and listed in the budget. On the other hand, subsidies through loans may be preferable to direct grants. In certain cases, loans avoid granting subsidies to those who do not need them. In contrast, many housing programs—tax expenditures and saving and loan subsidies—go mostly to those who need them least.

6. Many national programs may be desirable but not attractive to private entrepreneurs. Defense factories, hospitals, schools, pollution control may all yield large returns for national welfare. However, they might not be produced at a level desirable for the public unless aided by credit programs.

THE NEED FOR PROGRAM CONTROLS

The Committee has asked whether widespread defaults are likely to be a problem. This depends on whether the programs are well managed. If the risks are those intended in the legislation defaults should not be a problem. A concentration of defaults is most likely to arise in a recession or depression. In such periods, government support will be useful, not harmful. Dangers arise from the initial period, when resources may be wasted, not from the default period.

It is the potential waste of resources that needs to be guarded against. Many credit programs start out with a logical basis and potential. However, as in most government spheres, they tend to be captured by special interests. For this reason, sunset laws or periodic re-evaluations of entire programs make sense.

Housing again may be used as an example. To be successful, most housing programs must expand new production. They must increase credit and demand in periods when credit is short or demand low. It is generally agreed that if they add to demand in normal markets, they are more likely to be harmful than useful.

Yet, when we examine the total of housing programs in the past decade, they seem to have operated in a manner opposite to what should have been desired. They did little for production, while raising demand at exactly the wrong times. On the whole, they almost certainly aggravated inflation and led to a poorer distribution of income. While such problems exist, I see little in the proposal for a credit budget that would improve this situation. On the contrary, possibilities appear strong that harm would be done. The theoretical increase in supervision is unlikely to meet the needs of individual programs.

Senator METZENBAUM. I will have some questions. But I think I will hear from Mr. Kezer.

STATEMENT OF RICHARD F. KEZER, SENIOR VICE PRESIDENT, MONEY MARKET DIVISION, CITIBANK, N.A., NEW YORK

Mr. KEZER. I have got a six-page statement which I will generally look at. First, I want to position myself as to my field of knowledge. You mentioned a banker before. Well, there are bankers and there are bankers.

And the area that I represent participates as dealer in the public securities markets and as such we act as an intermediary between buyers and sellers, lenders and borrowers, including the Treasury Department.

The Government dealer department which is part of this money market division is 1 of 39 officially recognized to do business directly with the Federal Reserve, and in a market that has some, on a daily average, \$15 billion in transactions, we have approximately a 10-percent market share and consistently rank in the top 5 on various measurements of general participation in that market.

So I am pleased to be here today to contribute whatever it is that someone who has spent over 20 years in the bond business can add to your examination of the control of Federal credit activities.

The letter that you sent confirming my appearance here listed several specific questions, and I have made an effort to go over those questions and sort of answer them one by one, and I will just follow through on that, if that is all right.

Senator METZENBAUM. Thank you, Mr. Kezer.

CURRENT FORMS AND RECENT GROWTH OF FEDERAL CREDIT MARKET ACTIVITIES

Mr. KEZER. The first question had to do with an overview of major current forms in recent growth of Federal credit market activities and need for credit budget control over these activities. I do not think we have to spend a lot of time on that.

Everyone that has been up here has recognized that it is a problem. The fiscal year 1981 budget calls attention to the \$55 billion increase in loan guarantees outstanding in just 2 fiscal years.

S. 2151 refers to increases of over 50 percent in the volume of direct loans and guaranteed obligations outstanding in just a 4-year period. New commitments for direct loans by off-budget agencies are up almost 100 percent in 5 years, and if we look at a flow of funds, sources and uses for the period from 1976 to 1980, we see that while Treasury issues, direct Treasury issues have declined during that period from \$85 billion to \$38 billion, U.S. Government related issues during that same period have increased from around \$13 to over \$52 billion.

So those are examples, and everyone that you have heard and will be hearing, I am sure, will cite similar examples just to indicate that it has become increasingly difficult, if not impossible, for Congress to control the Federal credit activity.

I was impressed with—I did some work on this and I was impressed with two sentences in a compilation of staff working papers published in January of 1979 by the Congressional Budget Office which I thought highlighted the problem, and this is a quote, "The only credit activities currently included in the budget totals are direct loans by on-budget agencies, and they are included only on a net basis. As a result of the \$159.4 billion in federally sponsored credit activity estimated in fiscal year 1979, only \$4.3 billion, the net direct lending, is included in the budget totals."

MAJOR GOALS AND EFFECTIVENESS OF FEDERAL CREDIT ACTIVITIES

The second area that you asked to look at were the major goals of Federal credit activity such as direct loans and loan guarantees and how successful have these activities been in meeting their objectives.

The answer to that question, it seems to me in the broadest sense, is to allocate credit directly or to influence the allocation of credit. Through the use of loans or loan guarantees, Government attempts to channel credit toward specific groups in the population so these groups will have more credit than they would receive in an unregulated market.

Of course, by these actions, they channel credit away from other groups who have consequently less credit, and if you agree that credit allocation is the objective, then that objective is successfully achieved when a direct loan is made, a direct loan being a direct allocation of credit to a specific purpose.

The loan guarantees are successful if borrowers, as they generally do, have access to credit from lenders not otherwise available or at a cheaper cost. So if you assume that credit allocation is the principal objective, it seems to me that is almost a self-fulfilling thing once that is accomplished.

EFFECT OF DIRECT LOANS AND LOAN GUARANTEES ON THE COST OF CREDIT

The third area are what the effects on the cost and allocations of credit and their accumulative impact on credit markets and on economic activity generally. The effect of direct loans and loan guarantees on the direct cost of credit at any one point in time is, in my opinion, negligible.

Monetary policy, fiscal policy, inflationary expectations and the level of real economic growth are more important either individually or certainly collectively. The amount of direct loans and loan guarantees would be important in setting the general level of interest rates only if they were viewed as an aggravation of fiscal irresponsibility and thereby perpetuated inflation.

The effect on the allocation of credit is more pronounced. Credit allocation toward someone implies allocation away from someone else, and the ultimate goal of any scheme to control credit is to control spending, but I believe the fungibility of credit foils that effort.

The Government, by making less expensive debt available, can be sure that this particular form of debt will increase, but they have no control over how the money will be spent or that the ultimate beneficiary of credit will be those for whom it was intended.

For example, mortgages are used routinely as an all-purpose source of credit including for the purchase of other durable goods and for things like financing college education.

While there may be some temporary alternations on timing, the effect of direct loans and loan guarantees on aggregate economic activity is thought by the people I talked to to be slight.

To say, for example, that the demand for housing is determined by the amount of mortgage credit available, in my opinion, has got things backward and ignores other things like real family income, family formation, price, demographic changes and the relationship of the cost of the shelter to the cost of all other goods and services.

It seems to me that when Government makes inexpensive credit available in a particular market, the traditional lenders depart.

The consequence is not more credit in that market but a higher percentage of the credit outstanding held by the Government.

CRITERIA FOR ESTABLISHING PRIORITIES FOR CREDIT RATIONING

Another area you mentioned in your letter was what criteria are appropriate in determining the value of particular forms of credit activities and the aggregate amounts of direct lending and loan guarantees.

The history of the credit markets demonstrates that generally all demands can be met at some rate of interest. Establishing the priorities inherent in any attempt to ration credit is a very difficult question to answer.

There are groups in the population who have legitimate claims to subsidy such as those who are inadequately housed. The real question is whether or not credit is the way to satisfy those claims.

ECONOMIC CONSEQUENCES OF MASSIVE FEDERAL PAYMENTS ON BEHALF OF GUARANTEED LOANS

The fifth area was the possible economic consequences of a large volume of Federal payments on behalf of guaranteed loans, the circumstances in which this might occur, how likely they were to occur, and does this possibility have any implication for the total volume of loan guarantees or for the volume of particular types of guarantees.

In providing a guarantee, the Government is taking that credit risk which is borne by the market and is passing it through to the taxpayer. There are presently some 60,000 financial intermediaries that have acquired a very specialized knowledge about the markets in which they borrow and lend, and a Federal guarantee does not reduce the level of risk otherwise extent in the world.

To the extent that Federal credit programs lend at rates that do not reflect the actuarial expectation of default, the Government will incur losses that must be made up from general revenues.

If these losses become very large or became very large, they have an appreciable influence on the Government deficit. Obviously, the bankruptcy and loan default rates on all kinds of debts rise during recessions. To the extent that guaranteed loans are made on less than accepted commercial standards, the rates would be higher than experienced in the commercial world.

Beyond that, the loan programs seem to be so diverse that there is no particular circumstance that would affect them more than any other type of credit.

IMPACT OF FEDERAL CREDIT ACTIVITIES ON CREDIT MARKETS

And the last area was what effects do you think the growth of Federal credit activities in federally sponsored agencies has had on credit markets in recent years, does this have implications for the design of a Federal credit budget, how might such a budget be designed and arranged to achieve the most effective coordination of Federal credit policies with monetary policy.

By and large, despite the huge increase in credit activities and borrowing by specifically the federally sponsored agencies, the

effect on interest rates has been negligible. Funds raised by sponsored credit agencies and mortgage pool securities has increased from \$13.5 billion in 1975 to \$52.4 billion in 1979.

At the same time, however, direct Treasury borrowing has declined from \$85 billion to \$37 billion, so that the total for U.S. Government security debt instruments, thus, declined from \$98 to \$89 billion.

The crowding out theory, to date, simply is not valid, and again, I emphasize, to date. The most important consideration should be to prevent a systematic expansion of Federal credit while the Federal Reserve is trying to restrict overall credit.

Credit programs are unrelated to monetary policy. Credit programs are a form of assistance to specific groups whereas monetary policy is concerned with the control of money supply.

Nevertheless, as governments seek to dominate more and more of the process of credit allocation, it could mean the decline of importance of a free, unregulated market. It may also mean that access to credit by groups or individuals with high credit standing may be denied because of their lack of political influence.

It is for these reasons that we support the concept of a Federal credit budget so control can be exercised over the use of obligations and credit of the U.S. Government.

Thank you.

PREPARED STATEMENT OF RICHARD F. KEZER, SENIOR VICE PRESIDENT, MONEY MARKET DIVISION, CITIBANK, N.A., NEW YORK

My name is Richard F. Kezer. I am a Senior Vice President in the Money Market Division of Citibank, N.A. in New York. The Money Market Division participates as a dealer in the public securities markets to the extent that we are legally able. We do not manage the investment account of the Bank, but rather act as an intermediary between buyers and sellers, lenders and borrowers, including the Treasury Department. Our Government Dealer Department is 1 of 39 officially recognized to do business directly with the Federal Reserve and, in a market with some \$15 billion in transactions daily, we have approximately a 10 percent market share and consistently rank in the top 5 in such measures as total volume of buys, volume of sales, number of retail sales and the like. I am pleased to be here today to contribute whatever it is that someone who had been in the bond business for 22 years can add to your examination of the control of Federal credit activities. The letter that the Chairman sent confirming my appearance here this morning listed several specific questions to be answered. I'll try to answer each one, with the caveat that some are quite broad and my responses will be quick summaries of responses which may be more fully developed during the question/answer period.

CURRENT FORMS AND RECENT GROWTH OF FEDERAL CREDIT MARKET ACTIVITIES

1. Overview of the major current forms and recent growth of Federal credit market activities and need for credit budget control over these activities.

I won't spend a lot of time chronicling the growth of Federal credit assistance because the numbers are there for all to see. The President's Fiscal Year 1981 budget calls attention to the \$55.5 billion increase in loan guarantees outstanding in just two fiscal years. S. 2151 refers to increases of over 50 percent in the volume of direct loans and guaranteed obligations outstanding between 1976 and 1980. New commitment for direct loans by off-budget agencies are up 97 percent in five years. Treasury issues declined from \$85.8 billion to \$38.8 billion while U.S. Government related issues increased from \$13.5 billion to \$52.4 billion during the same period.

These are just examples but it would seem to me that it has become increasingly difficult, if not impossible, for Congress to control the Federal credit activities.

I was impressed with two sentences in a compilation of Staff Working Papers published in January of 1979 by the Congressional Budget Office, which I will quote. "The only credit activities currently included in the budget totals are direct loans by on-budget agencies, and they are included only on a net basis. As a result, of the

\$159.4 billion of Federal and federally sponsored credit activity estimated by fiscal year 1979, only \$4.3 billion, the net direct lending, is included in the budget totals."

MAJOR GOALS AND EFFECTIVENESS OF FEDERAL CREDIT ACTIVITIES

2. What are the major goals of Federal credit activities such as direct loans and loan guarantees and how successful have these activities been in meeting their objectives?

The answer to this question in its broadest sense, is to allocate credit directly or to influence the allocation of credit. Through the use of loans or loan guarantees government attempts to channel credit toward specific groups in the population so these groups will have more credit than they would receive in an unregulated market. Of course, by these actions, they channel credit away from other groups who have less credit.

If you agree that credit allocation is the objective then that objective is successfully achieved when a direct loan is made, a direct loan being a direct allocation of credit to a specific purpose. The loan guarantees are successful if borrowers have access to credit from lenders not otherwise available or at a cheaper cost.

EFFECT OF DIRECT LOANS AND LOAN GUARANTEES ON THE COST OF CREDIT

3. What are their effects on the cost and allocations of credit and their cumulative impact on credit markets and on economic activity generally?

The effect of direct loans and loan guarantees on the direct cost of credit at any point in time is, in my opinion, negligible. Monetary policy, fiscal policy, inflationary expectations and the level of real economic growth are more important individually or collectively. The amount of direct loans and loan guarantees would be important in setting the general level of interest rates if they were viewed as an aggravation of fiscal irresponsibility and thereby perpetuated inflation.

The effect on the allocation of credit is more pronounced. Credit allocation toward someone implies allocation away from someone else. Further, the ultimate goal of any scheme to control credit is to control spending. But the fungibility of credit foils this effort. The government by making less expensive debt available can be sure that this particular form of debt will increase. But they have no control over how the money will be spent or that the ultimate beneficiary of credit will be those for whom it was intended. For example, mortgages are used routinely as an all-purpose source of credit.

While there may be temporary alterations on timing, the effect of direct loans and loan guarantees on aggregate economic activity is thought by economists I talk to to be slight. To say, for example, that the demand for housing is determined by the amount of mortgage credit available has got things backward and ignores family real income, family formation, price, demographic changes and the relationship of the cost of the shelter to the cost of all other goods and services.

It seems to me that when the government makes inexpensive credit available in a particular market, the traditional lenders depart. The consequence is not more credit in that market but a higher percentage of the credit outstanding held by the government.

CRITERIA FOR ESTABLISHING PRIORITIES FOR CREDIT RATIONING

4. What criteria are appropriate in determining the value of particular forms of credit activities and the aggregate amounts of direct lending and loan guarantees?

The history of the credit markets demonstrates that generally, all demands can be met at some rate of interest. Establishing the priorities inherent in any attempt to ration credit is a difficult question to answer. There are groups in the population who have legitimate claims to subsidy, such as those that are inadequately housed. The real question is whether or not credit is the way to satisfy these claims.

ECONOMIC CONSEQUENCES OF MASSIVE FEDERAL PAYMENTS ON BEHALF OF GUARANTEED LOANS

5. What are the possible economic consequences of a large volume of Federal payments on behalf of guaranteed loans? What are the circumstances in which this might occur and how likely are they to occur? Does this possibility have any implication for the total volume of loan guarantees or for the volume of particular types of guarantees?

In providing a guarantee the government is taking that credit risk which is born by the market and passing it through to the tax payer. There are some 60,000 financial intermediaries that have acquired a specialized knowledge about the markets in which they borrow and lend. A Federal guarantee does not reduce the level

of risk in the world. To the extent that Federal credit programs lend at rates that do not reflect the actuarial expectation of default, the government will incur losses that must be made up from general revenues. If these losses became very large, they could have an appreciable influence on the government deficit.

Obviously the bankruptcy and loan default rates on all kinds of debts rise during recessions. To the extent that guaranteed loans are made on less than accepted commercial standards the rates would be higher. Beyond that the loan programs seem to be so diverse there is no particular circumstance that would affect them more than other types of credit.

IMPACT OF FEDERAL CREDIT ACTIVITIES ON CREDIT MARKETS

6. What effects do you think the growth of Federal credit activities and Federally sponsored agencies has had on credit markets in recent years? Does this have implications for the design of a Federal credit budget?

How might such a budget be designed and arranged to achieve the most effective coordination of Federal credit policies with monetary policy?

By and large, despite the huge increase in credit activities and borrowings by Federally sponsored agencies, the effect on interest rates has been negligible. Funds raised by sponsored Credit agencies and Mortgage Pool Securities has increased from \$13.5 billion in 1975 to \$52.4 billion in 1979. At the same time Treasury issues have declined from \$85.4 to \$37.4 billion. The total for U.S. Government Security debt instruments thus declined from \$98.2 billion to \$89.9 billion. The "crowding out" theory, to date, simply is not valid, so far. The most important consideration should be to prevent a systematic expansion of Federal credit while the Federal Reserve is trying to restrict overall credit. Credit programs are unrelated to monetary policy. Credit programs are a form of assistance to specific groups. Monetary policy is concerned with the control of money supply.

Nevertheless as government seeks to dominate more and more of the process of credit allocation it could mean the decline of importance of a free, unregulated market. It may also mean that access to credit by groups or individuals with high credit standing may be denied because of their lack of political influence. It is for these reasons that we support the concept of a Federal credit budget so control can be exercised over the use of the obligations and credit of the United States Government.

Thank you.

INCLUDE DEFAULT FACTOR IN DETERMINING RATE FOR FEDERAL CREDIT

Senator METZENBAUM. Thank you, Mr. Kezer, and thank you, Professor Maisel. I do have some questions.

Mr. Kezer, you mentioned to the extent that Federal credit programs lend at rates that do not reflect the actuarial expectation of default, the Government will incur losses that must be made up from general revenues.

We have a few Federal programs, not many, where a factor is included for actuarial projections of defaults or for the possibility of loss. Do you think it would be good policy for the Federal Government to provide such a factor in connection with all of its loans?

If you make an SBA loan and the going rate is 9 percent, that you would be expected to pay 9.5 percent or some factor such as that, the same with other kinds of loans.

Mr. KEZER. I think it depends on the purpose for which the loans or guarantees are being made. I think there is generally an incorrect assumption that, in all cases, public credit or public loans are being provided where private credit is not available.

And I am not sure, for instance, in all cases that relate to economic development, that that is necessarily true. I think that there are certainly loans and guarantees—Dr. Maisel mentions war

clauses in here where the private sector simply will not participate, cannot participate.

But I do not see any reason, for instance, in these programs that lead to economic stimulation and I do not mean to single them out, but SBA and EDA, for instance, that there is necessarily an absence of private credit in these same areas.

Therefore, it seems to me that there should not be some reasonable expectation that the loans made in the public sector would have the same rough credit risk as in the private sector.

CRITERIA FOR DETERMINING VOLUME OF FEDERAL CREDIT ACTIVITIES

Senator METZENBAUM. Do you have an opinion, Mr. Kezer, on what criteria are appropriate in determining the volume of particular forms of credit activities and the aggregate amounts of direct lending and loan guarantees?

Mr. KEZER. Well, that was in the paper, and I avoided it.

Senator METZENBAUM. That is what you get for listening to your staff. She said ask that question. So I asked it. [Laughter.]

STAFF. He said he avoided it. [Laughter.]

Mr. KEZER. I do not think that is up to us to make a decision on that. I think that the Congress has to establish the social priorities in this reallocation scheme and who they feel is entitled to what portion of that credit which is being reallocated from the private to the public sector.

SET RULES TO DETERMINE WHEN A LOAN IS IN DEFAULT

Senator METZENBAUM. Mr. Maisel or Mr. Kezer, the chair has indicated that I think there ought to be some simplistic rules that determine when a Government guaranteed loan is in default.

Do you have any difficulty with that concept?

Mr. MAISEL. No, Mr. Chairman, I do not. It seems to me clear that it should be. As you said earlier, I am sure Citibank lists all loans that are unpaid for more than 60 days or something like that. They do not necessarily charge them against their loss reserves at that point, because that is a tax problem.

RECOGNIZE ACTUARIAL RISK FACTOR IN CREDIT PROGRAMS

Let me go back to your earlier statement. It seems to me that really we are talking about two different things here, though. One is a management problem of Congress and the Administration, and the other is charging off the losses. For example, you said we should decide what the actuarial risk is. Clearly, Congress ought to look at that when they decide whether to inaugurate a program or not, and at that point, they ought to decide whether it should be part of the interest rate charged.

As an example, if we look at FHA, the rate was set at one-half percent 40 years ago, or whenever the program was set up. It turned out that that was a high rate for normal loans under section 2, and at a certain point, Congress decided we ought to have a central city loan program in which it was agreed that the risk was higher. Now, it seems to me that clearly as part of Congress consideration, they should have given some consideration to saying: Does this increase our risk to where the insurance would

have to be 4 or 5 percent against this program as opposed to one-half percent? That should have been part of the congressional decisionmaking process. But I do not think it would have made sense to say, therefore, we are going to charge an extra 4-percent insurance fee because that would have completely defeated the objective of the program.

In other words, I think Congress has to recognize that when they are making loan guarantees, there is a subsidy element and that the Congress ought to think about what is the amount of that subsidy likely to be which is your suggestion for some actuarial estimates. But at that point, Congress ought to say: Are we willing, if our actuarial projections are right, to vote that money through the appropriation process? That makes the decision that it would be defeating the purpose of the program to try to pass them on to the borrower.

Senator METZENBAUM. I will share with you what I attempted in the synfuels program, one that I think particularly lends itself to having the factor included. I attempted to get some factor included, and I was successful in getting something in but not really the amount it should have been.

Mr. KEZER. Our experience in this area has been quite different because what we are dealing in are publicly offered securities in connection with loans or with guarantees. The events of default are quite specific.

Senator METZENBAUM. Yes, I can understand that, but that is because you deal with the Government in that respect in an arm's length manner and as a banker would deal with any other borrower.

Mr. KEZER. That is right.

SPECIAL CONSIDERATION FOR HOUSING IN CREDIT BUDGET

Senator METZENBAUM. Whereas the Government does not have that hardnosed approach, and frankly, Government executives find that it serves their purpose not to know too much, not to have finalized the question of default, because it gives their agency a negative image.

Mr. Maisel, what special consideration, if any, should the needs of the housing sector be given in the design and management of a credit budget? You talked about housing. What do you think we ought to do there.

Mr. MAISEL. Well, my chief concern is that the sponsored agencies be brought into the budget, not left out. My second concern would be that there be a cyclical factor in the budget. The budget is brought up a year and a half before the economy reaches a certain point. You should want the Federal housing programs to expand when housing production is falling.

Again, going back to Mr. Kezer's earlier point and my experience with the Federal Reserve, I think the record of the Federal Reserve would show that they have felt that monetary policy could be better if you were able to protect housing somewhat rather than leaving it completely to the private market. The reasoning being that this is the most cyclical part of the economy. As a result the point at which you begin to get national pressures against an anti-inflationary policy comes when certain industries begin to hurt

very much. When unemployment in the construction industry, which is all over the country, goes to 25 percent, you begin to get major programs in opposition to an anti-inflationary monetary policy.

I think the Fed has always considered, therefore, that it was better to try to keep, say, construction unemployment down to 20 percent and to have unemployment spread through other areas than having it concentrated. This current recession is a clear example. If it is going to remain concentrated in two or three industries, you are going to get much greater pressures against the policy than if it were spread more evenly.

I am sure that Ohio is a good example where you are suffering much more than the economy as a whole or than we are in California, because it is the credit impacted industries that are suffering so greatly. It would be my point of view, and I would think from the Feds too it would be better if you could ease some of those credit impacts in the industries where they are hurting worse and have them spread more throughout the economy.

SPECIAL PURPOSE LOAN GUARANTEES

Senator METZENBAUM. I would agree.

Mr. Maisel, special purpose loan guarantees are increasing as a portion of total Federal credit activity. How does this affect your view that Federal credit activity should be countercyclical?

Chrysler's need for assistance may or may not be related to the business cycle as such.

Mr. MAISEL. I think we are dealing with two separate issues. One would go back to your earlier statement that if they are not cyclical then the whole problem of evaluating what the risks are, who is getting the subsidy, how large the subsidy is and why becomes much more important because then you have a real crowding out problem. In other words, if these are loans that are made at the peak of economic activity, their cost to the National Government is much, much greater than if they are loans made during a depression.

So I think this plays a critical role in determining whether they are good or not. But again, as an example, it would seem to me that the energy program would be one we would want to push forward even in terms of high employment. The same might well be true of student loans.

On the other hand, as I said earlier, I think the big fault of the housing program is that they expanded at exactly the wrong time over this last decade. If you look at the Fannie Mae loans, you would say, I think, that they were done at the wrong time. That agency simply is not doing what it was set up to do. It becomes very important in terms of the programs to look to see whether the agencies are doing what they were set out to do.

NEW APPROACH TO SPECIAL PURPOSE LOAN GUARANTEES

Senator METZENBAUM. Do the economic conditions at the present time warrant our developing something in the nature of an RFC instead of having a Chrysler loan or a Lockheed loan and a special—I do not know who is next, steel, autos.

Mr. MAISEL. It seems to me the advantage is then you could set up certain criteria. I noticed, again, I think in Mr. Gramley's presentation, he listed a set of criteria that he felt were vital that could come out of this program. Clearly if you were going to set up a new agency, the question would be would Congress then devise a set of logical criteria that would be much more likely to be followed than if you took an ad hoc approach to each one. On the other hand, the number of approaches would be much greater if you take each one individually.

Senator METZENBAUM. If you were in charge of this whole program and you had to make the final policy decisions with respect to Federal credit, loan guarantees, direct lending, what, and put yourself in the position of whatever you decide will come to pass, what would you do?

Mr. MAISEL. I think there are three things. One, it is good to look at the total. But second, looking at the individual programs and trying to make sense out of them is far more important than looking at the total.

And the third point is that looking at the individual programs, they have to be looked at together with other Federal programs. Therefore, I simply would say that the total is a control factor but that far more important is that Congress recognize what these programs are and deal with them individually in the normal appropriation procedure as part of its total package for each industry or each type of program. Saying that we can appropriate in one area and we can make loans and guarantees in another is simply not the case. The two are parts of a whole. And the tax program is, again, a critical factor. When we talk about supply side economics, we are obviously going to go for tax programs. It seems to me that they have to be very carefully evaluated against loan programs and appropriations.

Senator METZENBAUM. Professor Maisel has given us his view that he would look at some of these programs. Since you are in a position day by day to either buy or not buy and trade in certain securities, what would you do over and above looking at them?

Mr. KEZER. Well, we do not have any credit—we do not have any problems with trading the securities. They are Treasury issues. They are guaranteed, carrying the full faith and credit or they are federally sponsored.

POLICY RECOMMENDATIONS FOR FEDERAL CREDIT ACTIVITIES

Senator METZENBAUM. I have now taken you out of the bank, though. I am putting you in the Government now, and now I say to you what would you do with the Federal credit policies. I have changed your hat.

Mr. KEZER. OK. I would look at the programs, each program, to determine if it was doing what it was designed to do, and I would come at it from the basis of, if you assume that this credit activity is a reallocation of a pool of credit that is relatively finite at any point in time, is there a false assumption on some of these programs that private credit is not available.

And I would submit that if you went back and looked at each of these programs on a one-by-one basis, you would find that there is

plenty of private credit available where public credit has forced out the traditional lenders.

Second, I would look to see if these programs are doing what they are supposed to do on the basis of if you make cheap credit available, as I said in the speech, you know it is going to be used, but you are not sure it is going to be used for the purpose for which it was originally intended. That would be the second thing.

And then I would attempt to come up with some kind of rational way of explaining what was left. I know that is what you are here to figure out, and everybody seems to recognize there is a problem, but nobody has a very clearcut idea of what ought to be done about it.

But, you know, the numbers on the growth of the Federal activity are probably overstated anyway insofar as private credit is available where there is an attempt being made to substitute public credit, and then second, how you rationalize that predicament and identify and come up with either a cash flow budget or a P and L statement or a balance sheet.

I would be glad to help you work toward the solution, but right now in 30 seconds I cannot tell you what it is.

SOME FEDERAL CREDIT COULD BE REPLACED BY PRIVATE SECTOR

Senator METZENBAUM. You made a strong statement that, in some areas, we do not need Federal credit, and probably the private sector could do it. I must confess I was sitting here thinking, SBA, I doubt that; Housing, maybe in part; Agriculture, I do not know enough about. Where would you think?

Mr. KEZER. I do not want to get into the specific programs because some of these agencies are our good customers. [Laughter.] I feel like I am slitting my throat sitting up here. I would not give away SBA as being not susceptible to private credit.

It is a development of small businesses on a nationwide basis, and you know, with 15,000 banks in this country, is credit not available under any circumstances for any of the SBA projects? I would doubt that very much.

There may be certain types of businesses developmental with some sort of social benefits that you would think want to continue to sponsor it, but we see examples all the time of things that—I guess another thing I would look at would be is what is being financed because credit is available in this area of national benefit in the allocation of real resources.

And this SBA, I keep picking on SBA. I mean, there may be a program that will lead to the construction of a plant in State Y that is a plant that will not be built in State X, and it may be from the standpoint of the national economy that we are better off having the plant built in State X. That is another thing I would look at.

I mean, is the availability of credit in particular areas causing an imbalance in the allocation of real resources.

PARTIAL AND FULL GUARANTEES IMPACT DIFFERENTLY ON CREDIT
MARKETS

Senator METZENBAUM. Do you think, Mr. Kezer, that partial guarantees have a different impact in credit markets than full Federal guarantees?

Mr. KEZER. Yes. I am not even sure I know what a partial guarantee is. Do we have some that are—it seems to me they are either—

Senator METZENBAUM. SBA gives you 90 percent guarantee, that kind of thing.

Mr. KEZER. Oh, is that what you mean? The 10 percent—90 percent. Yes. What we are dealing in is the 90 percent. The 10 percent is kept by the original lender and the 90 percent sometimes is converted into a Federal security which is sold.

But the 90 percent carries a 100-percent guarantee.

PROGRAM EFFECTIVENESS BASED ON DEGREE OF GUARANTEE

Senator METZENBAUM. The next question is if the Government had a lesser percentage of guarantee, do you think the programs would be nearly as effective? In other words, if there were a 75-percent guarantee instead of a 90 percent?

Mr. KEZER. I do not have any direct experience, but my guess is it probably would work.

Mr. MAISEL. You can look at title I of FHA which is a clear example of that. It partly depends upon the cost that you are willing to pay. Title I was not set up as a subsidized program. It was one with very high rates that the banks make a lot of money on. Therefore, even though they, in theory, are carrying 10 or 20 percent of the risk, the interest rates they receive are high enough so that they are willing to take those risks. So that I think the question in most of these programs would be what sort of tradeoffs do you want in terms of the interest rate as compared to the risk.

Senator METZENBAUM. Professor Maisel and Mr. Kezer, I am due on something on the floor, but I am going to ask Senator Boschwitz who I know has some questions, to conclude the hearing.

Thank you very much.

NEED FOR SUNSET LEGISLATION

Senator BOSCHWITZ. I apologize for not being here at the time you both testified. I tried to rapidly read Mr. Maisel's testimony. It is very interesting. The three preceding witnesses seem to have focused on a credit budget as a means of, perhaps, identifying and getting a handle.

And I will look at your testimony a little more carefully because I see that you do not agree with that. And am I correct you prefer a system of sunset laws?

Mr. MAISEL. It seems to me that the whole issue is that what we are concerned with is that Congress has not properly looked at the costs and benefits of the individual programs, that the credit budget as a whole does not really give you any handle of looking at those individual budgets. In other words, it is not a pot that you can allocate. You cannot say—and I think this is Mr. Kezer's main

point, too—that we are not really talking about \$70 billion of credit here or anything like that. We are talking about x number of dollars, whether it is \$5 billion or \$3 billion or something like that in which we are reallocating, as a result of the Federal programs. Again, the Federal Government is subsidizing by an amount of Y through either lower rates or through losses that it is going to take on programs in which it desires to take a loss.

It seems to me the critical control problem is looking at those numbers, X and Y , how much effect does it really have and what is the cost of it, and those are almost entirely questions of individual programs rather than questions of the total.

A lot of the justifications in the staff papers seem to me rather naive—they were made to sell the credit budget. As a professional, I am not particularly happy about selling points, particularly when I think they were wrong in many cases. Trying to deal with this as an aggregate problem, I think simply distorts what the real problem is. This is all I am trying to point out.

EVALUATION OF CREDIT PROGRAMS

Senator BOSCHWITZ. Professor, are you familiar with any particular study that has been made that evaluates each program and its viability from your or some other viewpoint?

Mr. MAISEL. Well, I am, for example, familiar with the whole history of FHA over the last 30 years or so. I suppose I have spent a fair amount of time at different times on FHA. So I have a fairly good feeling for what this did. If you look at the program, for example, you find that nationally housing mortgage rates are a good deal less than they would have been if we did not have this program. There was a major increase of efficiency in the housing markets. If we look at housing markets now compared to 30 years ago, they are much more efficient than they were.

The second thing I think we would find is that in critical times they have been very good. They have helped housing production at times when we needed it. We can go back to individual years right after World War II and things of that sort and find where these were very critical programs in getting production that we would not otherwise have.

In contrast, when you were not here, I testified it seemed to me over the last 4 or 5 years the Federal housing programs have primarily increased inflation in housing prices and inflation in general as opposed to helping the production of housing.

Senator BOSCHWITZ. Not the FHA though.

Mr. MAISEL. Well, no, because I think the sponsored agencies have been the major part there, but, I think the fact that we have not looked at housing as a total program and asked what is it accomplishing means that we got into a situation where probably the net effect of these programs was negative over the last few years. It does not seem to me that the proposals for the Federal credit budget, even though they are the largest share of it, is going to look at that and say are we getting our money's worth or not out of these programs.

Senator BOSCHWITZ. You apparently have more faith in the idea of sunset provisions than I do.

Mr. MAISEL. I am primarily concerned that we look at each program individually. Whether a sunset provision is a way of doing that or not, I clearly am not certain, but I think we are at a point where in many of these programs, if they were looked at carefully, they would be changed. Now, how Congress is going to get itself to look at these carefully, I do not know, but it does not seem to me that the credit budget is likely to do it.

Senator BOSCHWITZ. You do not think the credit budget would at least be a source of identification, particularly for the whole area of the Federal Financing Bank and the whole area of Government-sponsored enterprises which are now no longer technically a part of the budget even though the boards are appointed by the President.

I am just not quite certain that sunset laws are the entire answer—things normally are not black and white. They are shades of gray, and I very often find myself disagreeing, for instance, with the distinguished chairman, Senator Metzenbaum.

PRIVATE MARKET PURCHASE OF GUARANTEED LOANS

Senator BOSCHWITZ. The staff has given me a question to ask, and it says, do you think the private market would buy all agency guaranteed loans and securities if the FFB were eliminated?

Mr. KEZER. They did.

Mr. MAISEL. But at very high cost.

Senator BOSCHWITZ. Yes, but they were inefficient.

Mr. KEZER. As a matter of fact, the Federal Financing Bank was formed because the various guaranteed agencies, SBA, GSA, TVA, Eximbank were all being sold in the open market at prices which—

Senator BOSCHWITZ. Do you think the FFB is a pretty effective operation then? You do not think the Federal Financing Bank should be—

Mr. KEZER. I think the Federal Financing Bank did what it set out to do which was take x billions of dollars of Federal type financing off the market.

Senator BOSCHWITZ. Did it take it off the market or rearrange it a little bit?

Mr. KEZER. Rearranged is a better term, because, as I understand it, they now raise money for this financing in the bill market, Treasury bill market sales. It is cheaper, but they are borrowing short and lending long, and how they account for periods when you have got an inverted yield curve, I do not have any idea.

It is true that the market, the private market could and did accept all of those financings on a competitive basis at one time prior to the formation of the Federal Financing Bank.

Senator BOSCHWITZ. Well, that is something we should, perhaps, consider, then, the fact that they borrowed short or they borrow long—

Mr. KEZER. Well, I think they borrow short and lend long. I believe that is how they finance the acquisitions.

Senator BOSCHWITZ. Which you are saying may drive them into the credit markets at the inappropriate moment.

Mr. KEZER. It could.

Senator BOSCHWITZ. Well, I apologize again for being away. I really do not have any more questions, but with your permission, I may call on you individually and see if I can gain a better understanding of some of the systems.

I thank you very much for coming.

[Whereupon, at 11:47 a.m., the subcommittee adjourned at the call of the Chair.]

CONTROL OF FEDERAL CREDIT

MONDAY, JUNE 23, 1980

U.S. SENATE,
SPECIAL SUBCOMMITTEE ON THE CONTROL
OF FEDERAL CREDIT,
OF THE COMMITTEE ON THE BUDGET,
Washington, D.C.

The special subcommittee met, pursuant to recess, at 10:30 a.m., in room 357, Russell Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the special subcommittee) presiding.

Present: Senators Metzenbaum, Bellmon, and Boschwitz.

Staff present: Elizabeth Tankersley, counsel; and Ann Hadley, analyst, full committee. Claudia Farris, legislative aide to Senator Metzenbaum. William L. Stringer, counsel to the minority, full committee.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. I am pleased to welcome our witnesses to the second hearing of the Special Subcommittee on Federal Credit.

At our hearing last week we talked in general about the need for greater accountability and control over Federal credit programs.

Today we would like to be more specific about the nature of the problems a Federal credit control system would solve.

Last week, for example, we talked about the size of the off-budget deficit created by the operations of the Federal Financing Bank. I hope our witnesses today will help us understand how that deficit is generated, how the FFB relates to other Federal agencies, and what would happen to that relationship under a credit control system.

We also talked about the uncertainties surrounding program default rates and the size of the Government's liability under loan guarantee and insurance programs. These uncertainties were attributed to differences in program management practices and in program design. Today I hope we can improve our understanding of what these differences are, what uniformity is possible, and how that uniformity can be achieved for the purposes of credit control.

Finally, I think it is important for us to understand how the economic effects of the various programs differ.

Some of our credit programs are financially self-sufficient. Others require direct outlays which may never be paid back.

Some programs are financed through the private market. Others are totally financed through the Federal Government.

Some programs can be varied with the level of economic activity in the private sector. Others cannot.

I believe we must ask the question: What purposes do these differences in design and operations serve, and should different credit programs be controlled differently?

We are very much looking forward to the testimony of Mr. Bob Reischauer of the Congressional Budget Office; Mr. Lawrence Herman of Peat, Marwick, Mitchell; and Mr. Harry Havens of the General Accounting Office. These gentlemen have all done important work in the analysis of Federal credit programs.

I would like to hear the witnesses in the order of Mr. Reischauer, Mr. Herman, and Mr. Havens. Gentlemen, if you could limit your remarks to 10 minutes, we would appreciate it. That way we will have more time for questions. Your full statements can be inserted in the record.

Unless we need clarification of something you have said, we will try to hold our questions until all the witnesses have testified.

I want to say that the Chair is particularly pleased at the ranking minority member's presence. He is certainly one of the most distinguished Members of the Senate and he has seen fit to be with us both at the occasion of our first meeting and at the second. We are glad to have him here. I know of nobody who demands more respect as far as budgetary matters are concerned in the Senate than Senator Bellmon.

Senator, do you have any statement to make.

Senator BELLMON. I thank you for your comments. I really have no statement and I look forth to hearing the witnesses.

Senator METZENBAUM. Mr. Reischauer.

**STATEMENT OF ROBERT D. REISCHAUER, DEPUTY DIRECTOR,
CONGRESSIONAL BUDGET OFFICE, ACCOMPANIED BY JOHN
SHILLINGBURG, ANALYST**

Mr. REISCHAUER. Thank you. I would like to introduce John Shillingburg, the analyst who has done most of CBO's work in the credit area. We are pleased to have the opportunity to discuss with this subcommittee Federal loans and loan guarantees and the budget process. With your permission, I would like to submit my prepared statement for the record and to talk briefly with you this morning on three topics:¹

First, the growth of Federal credit and the role that the budgetary treatment of credit programs may play in encouraging that growth;

Second, the proposals to establish a credit budget within the congressional budget process; and

Third, what might be done to rationalize the budgetary treatment of the Federal Financing Bank (FFB) and the other off-budget credit programs.

UNDERSTANDING THE GROWTH OF FEDERAL CREDIT

As figure 1 of my prepared statement illustrates, Federal credit assistance, in the form of direct loans and loan guarantees or insurance, has grown rapidly in recent years. In fact, in the 4-year period from 1976 to 1979, off-budget direct loans and loan guarantees by on- and off-budget agencies have grown more rapidly than have direct Federal expenditures. Only direct loans by on-budget agencies increased at a slower rate than expenditures.

One possible explanation for the growth of Federal credit programs is their budgetary treatment. Since loan guarantees are excluded by statute from the definition of budget authority, they

¹See p. 71.

are effectively beyond the control of the budget process. In addition, some direct loans are effectively hidden off budget because of sales of loan assets to the FFB and purchases by the FFB of guaranteed obligations.

Three problems have arisen because most of the growth in Federal credit programs has occurred outside any congressional control process or mechanism for allocating resources. First, the year-to-year growth of most credit programs is largely uncontrolled. The programs are often authorized on an open-ended basis or have only a high ceiling on total outstanding indebtedness that does not restrain annual growth. As a result, the Congress has not attempted to ration loans or set priorities among the competing needs of borrowers.

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

A third problem posed by the lack of a resource allocation process for credit programs, particularly loan guarantees, is the potential for making inappropriate decisions. Because these programs have no direct budget cost, they appear to be free. Several capital development programs, including Amtrak, Washington's Metro, and the new communities program, have encountered serious difficulties while financed using loan guarantees.

INCLUDING CREDIT IN THE BUDGET PROCESS

In August 1978, CBO issued a paper entitled "Loan Guarantees: Current Concerns and Alternatives for Control," which recommended that the Congress include targets for direct loans and loan guarantees in its concurrent budget resolutions. Subsequently, the notion of including Federal credit programs within the outlines of the congressional budget process was furthered by the executive branch in the administration's 1980 and 1981 budgets. This spring, the Budget Committees proposed, and the Congress adopted, aggregate targets for new direct-loan obligations and new loan-guarantee commitments. The Congress is thus experimenting with one aspect of a credit budget system: setting aggregate targets. As the Congress gains familiarity with, and experience in the analysis of, Federal credit programs, the Budget Committee may wish to consider the extension of other aspects of the budget process to a credit budget. Among the procedures that could be made part of succeeding experiments are:

One, setting aggregate ceilings in the second concurrent resolution, and enforcing these ceilings through the extension of the point-of-order provisions of section 311 of the Budget Act;

Two, including functional targets for loans and loan guarantees in the first and second budget resolutions;

Three, applying a provision to close the back door on new loan and guarantee programs, such as section 16 of the Senate's first resolution; and

Four, finally applying the May 15 deadline to bills authorizing loan or guarantee programs.

Senator METZENBAUM. What was the second one you had?

Mr. REISCHAUER. Including functional targets, as opposed to aggregate numbers, for loans and guarantees in the first and second budget resolutions.

The experience gained by the Congress through experiments with these provisions would be invaluable if the Congress eventually decides on complete integration of a credit budget into the Congressional budget process, as has been proposed in S. 2151, H.R. 5683 and H.R. 6021.

Some have proposed that we delay further steps in this direction until we know more. While there are gaps in our knowledge about Federal credit programs, these gaps do not pose insurmountable obstacles to the extension of the procedures of the Budget Act to Federal credit programs. The Congressional Budget Office stands ready to assist the Congress in achieving that goal. Along these lines, we have already helped to close the gaps in our knowledge of Federal credit programs through:

Our 1978 study on loan guarantees;

A 1979 volume that contained four papers of a more technical nature;

And a 2-day conference this spring on the economic effects of Federal credit activities.

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

RATIONALIZING OFF-BUDGET CREDIT ACTIVITIES

The final point I would like to make this morning is to urge that this subcommittee, during its consideration of credit budgeting, consider the need to rationalize the budgetary treatment of off-budget credit activities.

The distinction between on- and off-budget credit activities is not one of substance. Over 90 percent of the credit activity of off-budget entities is handled through the FFB, which acts as an off-budget lender for on-budget agencies. By purchasing loans and certificates of beneficial ownership from on-budget agencies, the FFB transfers on-budget loans off budget. The FFB also acts as a primary lender at the request of various on-budget Federal agencies. If an agency guarantees the full repayment of interest and principal in the event of default by a borrower, the FFB will make a direct loan to the borrower, at interest rates only marginally above the cost of Treasury borrowing.

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

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

Let me conclude by saying that the Congress, by adopting aggregate targets for direct loans and loan guarantees, has taken a significant step forward toward a credit budget and a credit-control system and that the CBO stands ready to assist the Budget Committees in extending the procedures of the Congressional Budget Act of 1974.

I will be happy to answer questions from the members of the subcommittee.

Senator METZENBAUM. Thank you very much for a very good statement. I have one question: Does the CBO have any better information with respect to defaults that are occurring on various loan programs at the moment?

Mr. REISCHAUER. No. As you know, we asked Peat, Marwick, Mitchell to look into that area. We have not progressed beyond their report.

Senator METZENBAUM. Thank you very much. We will have further questions later.

PREPARED STATEMENT OF ROBERT D. REISCHAUER, DEPUTY DIRECTOR,
CONGRESSIONAL BUDGET OFFICE

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

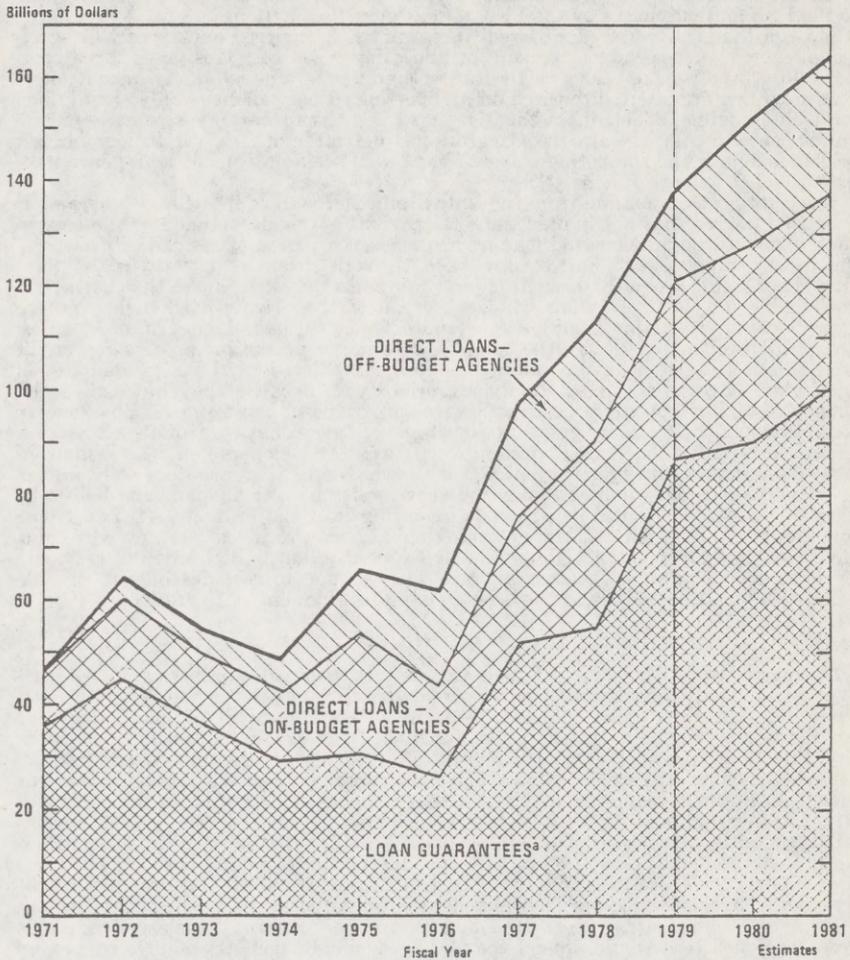
however, significant steps toward exercising greater and more systematic control over federal credit activities.

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

UNDERSTANDING THE GROWTH OF FEDERAL CREDIT

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

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



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

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

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

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

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

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

INCLUDING CREDIT IN THE BUDGET PROCESS

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

Subsequently, the notion of including federal credit programs within the outlines of the Congressional Budget Act of 1974, was further developed in both the Congress and the executive branch. The 1980 budget further discussed the proposed credit program control system, whose development culminated in the credit budget included by the Administration in its 1981 budget. In the Congress, legislative proposals were developed that would amend the Congressional Budget Act of 1974 to expand the coverage of the concurrent budget resolutions and related procedures to federal loans and loan guarantees. These proposals—S. 2151, introduced by Senator Percy, and H.R. 5683 and H.R. 6021, introduced by Representatives Mineta, Giaimo, and others—are the subject of this Subcommittee's next hearing.

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

Setting aggregate ceilings in the second concurrent resolution, and enforcing these ceilings through the extension of the point-of-order provisions of Section 311 of the Budget Act;

Including functional targets for loans and guarantees in the first and second budget resolutions;

Applying a provision to "close the backdoor" on new loan and guarantee programs, such as Section 16 of the Senate's first resolution; and

Applying the May 15th deadline to bills authorizing loan or guarantee programs.

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

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

We have also taken steps to attempt to close the gaps in our knowledge of the economic effects of federal credit programs. This spring we conducted a two-day conference on the Economics of Federal Credit Activities. At the conference eight papers by prominent researchers were presented to an audience of Congressional and executive branch staff people. While the conference was more helpful in defining exactly what we do not know than in breaking new ground, it has encouraged the academic community to begin studying in greater depth the entire federal credit universe.

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

RATIONALIZING OFF-BUDGET CREDIT ACTIVITIES

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

The distinction between on- and off-budget credit activities is not one of substance. In fact, over 90 percent of the credit activity of off-budget entities is handled through the Federal Financing Bank (FFB) which, as I noted earlier, acts as an off-budget lender for on-budget agencies. By purchasing loans and certificates of beneficial ownership (pools of loans, called CBOs) from on-budget agencies, the FFB transfers on-budget loans off budget. The FFB also acts as a primary lender at the request of various on-budget federal agencies. If an agency guarantees the full repayment of interest and principal in the event of default by a borrower, the FFB will make a direct loan to the borrower, at interest rates only marginally above the cost of Treasury borrowing.

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

The Budget Committees have made a first step toward exercising greater control over the FFB and the other off-budget credit activities by including them in the aggregate totals and by proposing that limits be placed on them, as well as on all other credit programs. As a next step, the Committees may wish to consider legislation to rationalize the treatment of off-budget activities. Such legislation could have two parts. First, the treatment of transactions by on-budget agencies with the FFB could be changed to record in their budgets the direct loans made by the FFB on their behalf. This would effectively put all of the FFB's credit activities on budget in the respective agency budgets. If the FFB were put on budget as a separate item,

the process of allocating resources by function could be distorted because the FFB serves no end purpose of its own. It simply finances agency activities. Efficiency in the allocation process requires that these activities be attributed to the proper functions. A second part of the legislation would be to put the remaining off-budget activities back into the budget, thereby making the unified budget comprehensive of all federal activities.

SUMMARY

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

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

Senator METZENBAUM. Our next statement will be from Mr. Lawrence S. Herman, principal of the firm of Peat, Marwick, Mitchell Co.

STATEMENT OF LAWRENCE S. HERMAN, PRINCIPAL, PEAT, MARWICK, MITCHELL & CO., ACCOMPANIED BY HAROLD I. STEINBERG, CERTIFIED PUBLIC ACCOUNTANT AND PARTNER, PEAT, MARWICK, MITCHELL & CO.

STUDY PREPARED FOR CBO

Mr. HERMAN. Good morning. My name is Lawrence S. Herman. I am a principal at Peat, Marwick, Mitchell & Co., and I was project director for the study we conducted for the Congressional Budget Office entitled "Loan Insurance and Guarantee Program: A Comparison of Current Practices and Procedures." I am pleased to appear before the Budget Committee today to talk about our findings and recommendations.

I have asked another partner of the firm, Harold I. Steinberg, sitting behind me, to join me here today. Mr. Steinberg is a certified public accountant and is in charge of our State and local government accounting and management consulting practices. He has worked with the CBO on this and other studies, is particularly knowledgeable about State and Federal budgetary and accounting practices, and is available to respond to questions in these areas.

Our study for the CBO represents, as best we can tell, the only comprehensive evaluation of the management and administration practices of the Federal credit program.

Our study was based upon 22 loan programs chosen to represent the characteristics of approximately 160 federally insured and guaranteed programs as of the date of our report in 1978. Please note my use of the word "approximately." This term is necessary because there is, to my knowledge, no complete list of them to be found anywhere.

MAJOR STUDY FINDINGS

I will summarize three particular aspects of our study findings.

One, the actual liability of the U.S. Government as a result of these credit activities, is difficult to assess because of significant variations in agency definition of contingent liability and the inconsistent application of agency oversight of these programs.

Two, the ability of Congress or the executive branch to monitor credit programs is restricted because of a lack of data and

inconsistencies in definition and accounting approaches for loan guarantee programs.

Three, the current congressional oversight mechanisms and procedures do not permit adequate oversight over credit program growth or practices.

I will discuss each briefly.

DEGREE OF DEFAULTS OCCURRING

Senator METZENBAUM. I am impressed with your list of three. I am wondering about a fourth that I just referred to—the one that I talked to Mr. Reischauer about. It is also one of much concern to this committee, and I notice you do not list it. That is the degree of defaults which have occurred. We had testimony the other day that the Government does not have that information readily available and, as I understand it, almost every governmental agency uses a different definition to determine when something is or is not in default.

Did you in your study address yourself to defaults as well?

Mr. HERMAN. Yes. The other side of the definition of contingent liability is, obviously, when default is recognized. One of the problems pertaining to your question that our study did find was that default activities typically can be redefined as an ongoing loan program through refinancing and a continuation of the contingency as distinguished from the default. I will comment a little bit on that definition problem later on.

But the major problem is a total inconsistency with respect to when you recognize the default and what you define a default.

Senator METZENBAUM. We would appreciate your advice on that. But you and I both recognize, and the committee recognizes, that the banks also do this kind of rollover with respect to default on loans. And we want to be certain how Government should do it in order to make their practices akin to what is done in the normal economic world.

Mr. HERMAN. Mr. Steinberg and I were talking about this issue this morning. Banks set up a reserve for loans either in default or heading for default, and there are appropriate definitions in the body of accounting literature as to when to recognize defaults. There are no analogies to that in the Federal Government.

Senator METZENBAUM. Please proceed.

TOTAL U.S. GOVERNMENT LIABILITY UNCERTAIN

Mr. HERMAN. The extent of U.S. liability, in total or based upon a portfolio analysis, is uncertain and uncalculated for a number of reasons:

The terms contingent liability, insurance, and guarantee vary considerably in usage among agencies studied by us. A variety of definitions are used for contingent liability. For example, some calculate the Government's liability as the amount of the reserve or set aside; others define contingent liability as the full amount of the loan; others only recognize the Government's liability when an actual outlay is made to meet claims. Thus, it is difficult for Congress to know what definitions are being used and to make useful cross-agency comparisons; and

Liability calculations are hampered by imprecise, and often conflicting, use of the terms "insurance" and "guarantee." Our study suggested little regard for precision in these terms. For example, in publicly accepted usage, the term "insurance" suggests a program under which Government liability is limited to a reserve for losses supported by premiums paid by lenders. The reserve and premium levels could be and are, in the private sector, actuarially calculated. Guarantees, on the other hand, are presumed to be used when risk may not be a determinable amount or where Government is willing to pledge its "full faith and credit" in support of private lending.

Even in cases where it is possible actuarial assessments of risk are often not made, thereby precluding reasonable calculation of Government liability.

Agencies do not effectively monitor their loan or guarantees portfolio, or implement effective early warning systems to provide advance notification of in trouble loans. For example, our study found that communication between the lender and the sponsor agency is often very limited—or even nonexistent—up until the specter of default. Most agencies we studied do not account for changes in the status of a loan in the event of delinquency, default or forbearance.

PROGRAM DATA LACKS COMPARABILITY

With respect to comparable program data, for effective oversight, the following is required:

One, accurate and timely data by program,

Two, comparable and consistent definitions and data collection and presentation standards, and

Three, adequate monitoring techniques.

Our study found significant variations in the frequency and timeliness of agency reports for either internal use, or for distribution to the OMB or the Congress.

Comparability is further hampered by definitional inconsistencies and fund level—as distinct from program level—accounting or reporting. For example, even estimates of defaults is not easily established. Default is whatever, within bounds, the agency or lender chooses to call default.

CONGRESSIONAL OVERSIGHT LIMITED

With respect to limited congressional oversight, our study uncovered significant evidence that mechanisms Congress needs to effectively maintain credit program oversight are currently lacking:

One, 9 of the 22 programs we studied had no limits to the amount of loans that could be guaranteed or insured,

Two, Federal Financing Bank activities, although not a direct part of our study, permit escalation of credit program activity without congressional, or effectively executive branch, oversight,

Three, 10 of the 22 programs had unlimited authority to borrow from the U.S. Treasury to cover claims payments, and

Four, 14 of the programs were backed by full faith and credit, and were not limited by the size of the reserve fund.

In general, our findings suggested that congressional oversight during appropriation hearings is oriented to past guarantee performance, not future plans or intentions. While some oversight is carried out by GAO and OMB, this oversight is typically financial, not administrative or managerial—a management audit. The issues of administrative practices, definitional difference, and default recognition or warning system are rarely addressed.

OVERSIGHT OF FEDERAL CREDIT NEEDED

In summary, based upon our study findings, Peat, Marwick, Mitchell recommended that strengthened agency-level management and congressional oversight of Federal credit programs is necessary at the congressional level. For example, our study findings generally confirm and support the need for the types of approaches embodied in some legislation already prepared which would extend the existing congressional budget process to loan and loan guarantee programs.

Peat, Marwick, Mitchell also recommends that congressional concern should extend to the agency management level, including such steps as:

One, developing uniform standards and definitions for these programs.

Two, encouraging the design and implementation of loan portfolio analysis techniques, early warning systems, technical assistance programs, and actuarial risk assessment techniques, the type of techniques found in the non-Federal private sector.

Three, encouraging the establishment of standard and uniform procedures for calculating fee and premium levels, for accounting for changes in loan status and for reporting portfolio status.

This concludes my prepared statement. Mr. Steinberg or I would be pleased to answer questions from the members of the committee.

Thank you.

Senator METZENBAUM. Thank you very much, Mr. Herman.

On the basis of your statement, I would guess that on a Bo Derek rating of 1 to 10 you would give the Government's handling of its loan guarantees and the guaranteed program closer to 1 than to 10.

Mr. HERMAN. Certainly lower than Bo Derek's rating.

CHANGES AS A RESULT OF REPORT

Senator METZENBAUM. Some of the things you say I think are actually quite shocking. I guess my real concern is that you speak the truth and you speak it based on accounting knowledge. But it is depressing. We had better address ourselves to concerns that are relative to whether it is onbudget or offbudget. Your analysis goes far beyond the question of being onbudget or offbudget, but goes to the question of the guarantee procedure, the projected impact—knowing in advance that there are going to be a certain amount of losses and doing something about it.

I gather that you did a full piece of work for the Government over and beyond your statement here.

Mr. HERMAN. Yes. A report was submitted and I believe copies have been made available.

Senator METZENBAUM. When was that submitted?

Mr. HERMAN. Approximately 1½ years ago.

Senator METZENBAUM. Have you seen or heard of any changes that have resulted therefrom?

Mr. HERMAN. Not specifically relating to the study. The primary changes have been an increased activity to finding out the extent of the programs out there.

Senator METZENBAUM. I want to say that I do not think any particular person, group or administration or Congress or anybody is at fault. I think we all share part of the fault. I think another thing you also stated that was rather shocking is that nowhere can you find a total list of how many loan programs there are—guaranteed or direct loan programs. Somewhere in the nature of 160. That ought to be very reassuring to the American people.

Mr. Havens, we are happy to have you with us.

If any member of the committee has any statement, please do not hesitate.

Mr. Havens.

STATEMENT OF HARRY S. HAVENS, ASSISTANT COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE

Mr. HAVENS. Mr. Chairman and members of the committee. Thank you for the opportunity to testify before your Special Subcommittee on Control of Federal Credit Activity. I would like to briefly summarize my prepared statement and ask that the full statement be accepted for the record.

GAO EVALUATION OF FEDERAL CREDIT PROGRAMS

GAO continues to be concerned with the various aspects of Federal credit programs. In the last 5 years, our analysis has included both the program specific aspects of certain individual credit programs and the workings, implications, and impacts of the credit assistance approach itself. Of all the policy tools at the Federal Government's disposal, credit assistance is among the least well understood, is one of the most difficult to evaluate, and has perhaps the greatest potential of being misused. There are also important questions concerning the best way to control credit programs in the executive branch and congressional budget processes.

The recent growth and changing composition of these programs should be of concern to the Congress. In fiscal year 1979, there were \$405 billion in direct and guaranteed loans outstanding, up from \$314 billion at the end of fiscal year 1977. By the end of fiscal year 1981, the total is expected to reach \$520 billion. Much of the growth in these programs in recent years has occurred in nontraditional areas with traditional housing credit programs declining as a percentage of the total amount of credit assistance outstanding. As a result, it is becoming increasingly difficult to determine the likely ultimate costs of these programs.

Like any subsidy program, credit assistance programs should be evaluated in terms of their cost effectiveness and the extent to which they achieve program objectives. The Congress needs to determine when they are appropriate, guide their design so they maximize potential effectiveness while protecting the Federal Government's interest, and control them so they compete for resources

in the congressional budget process on an equal basis with direct spending programs.

Our work on Federal credit programs has proceeded along four main analytical channels: Estimation of their direct costs and benefits; analysis of their indirect costs and benefits; determination of their appropriate use and development of guidelines for their design; and analysis of their budget treatment and control.

COSTS AND BENEFITS

We have been heavily involved in analyses in some areas such as direct cost estimation and budget treatment and control and are only beginning work in the area of indirect cost and benefit estimation. Our interest in these areas is based on the following considerations:

First, with regard to direct cost estimation, resources cannot be efficiently allocated to credit programs in the budget process without accurate estimates of their budgetary costs. There is a tendency to view these programs as costless. Our work indicates that this is not the case. They are costly.

Second, there are indirect costs imposed by these programs on financial markets and the economy which may exceed the direct costs of the programs. These costs include such things as foregone investment opportunities of nonassisted borrowers and the potential of credit programs to contribute to the volatility of the economic cycle. Our work in this area has just begun and will be a major area of concern in the future.

Third, because of the budget treatment currently accorded credit assistance programs, it is logical to conclude that credit assistance is overused and, in some cases, misused. Our efforts in this area have consisted of developing guidelines for efficient program design and analyzing the appropriate use of the credit assistance device in specific situations.

BUDGET TREATMENT OF ASSISTANCE PROGRAMS

Finally, the issue of budget treatment and control of credit assistance programs is central to our concerns over use of the device. In fact, in our opinion, appropriate budget treatment and control would alleviate many, if not most, of the current concerns over these programs. This committee made a very significant contribution in leading the successful congressional effort to establish a congressional Federal credit budget in the first concurrent resolution on the budget for fiscal year 1981.

While this step is laudable, additional actions are needed. Our work on the Federal Financing Bank, certificates of beneficial ownership, revolving funds, and Amtrak has identified numerous areas where current budget practices for credit activities distort totals, lessen understanding of those activities, and impair Congressional budget control.

CONTROL OF FEDERAL CREDIT PROGRAMS

I would like to conclude with some observations about the overall control of Federal credit assistance activity.

Accurately reflecting the aggregate outlays and commitments from Federal credit assistance programs in the budget is important, because they are the basis for some very important policy decisions. If the reported budget aggregates are not what they purport to be, misunderstanding is inevitable and the credibility of the policy formulation process itself is at risk.

It is equally important, however, that we find a means of assuring that Federal credit programs compete on the same basis as other direct expenditure programs so that decisions regarding the allocations of our Nation's resources will be made in a more balanced framework.

Whatever control mechanism is decided on, it must control more than the total. Someone has to decide about the pieces as well as the total. If the Congress does not find a way of doing so, the task—and the power that goes with it—will pass to the executive. The issues of who controls what, and how, are fundamental, as the Congress itself concluded when it enacted the Congressional Budget Act. We believe that program outlays should be approved by the Congress after weighing the benefits and costs of each program, in the context of an overall judgment on the appropriate level of total credit assistance activity. We do not believe that a mechanism which only controls the total will do the job, nor will increased visibility of the credit assistance totals alone be sufficient. Both represent a good start, but we believe the Congress should go beyond this to the development of a systematic approach for budgeting credit assistance—one which is similar to and linked with the existing congressional budget process.

Mr. Chairman, this summarizes the main points of my statement. I would be pleased to try to answer any questions.

Senator METZENBAUM. Thank you, Mr. Havens.

PREPARED STATEMENT OF HARRY S. HAVENS, ASSISTANT COMPTROLLER GENERAL

Thank you for the opportunity to testify before your Special Subcommittee on Control of Federal Credit of the Senate Committee on the Budget. In today's testimony, we will summarize the work we have done in the area of Federal credit programs and address some of the questions you posed in your request to us. I believe the most efficient way to do this is by discussing our work in the context of the issues we believe are important and at the same time focusing on your concerns as they relate to our work and the issues. We have appended a bibliography of GAO work in this area to this statement for your information.¹

The U.S. Government uses a wide variety of policy tools to affect resource allocation, income distribution, economic stabilization and growth. The Federal Government taxes, spends, borrows, lends, provides services, subsidizes, invests, produces and regulates.

Of these policy tools, credit assistance activities are the least appropriately reflected in the budget. Because of its budgetary treatment, credit assistance is probably the least well understood in its workings, is the most difficult to assess from a cost effectiveness perspective, and has perhaps the greatest potential of being misused as a policy tool.

GAO has been concerned with various aspects of Federal credit programs for a long time. For the past 5 years, our analysis has expanded from program specific aspects of credit assistance to the approach itself.

BACKGROUND

At the end of fiscal year 1979, there were \$409 billion in direct and guaranteed loans outstanding. This figure is expected to grow by over \$100 billion to nearly \$520 billion by the end of fiscal year 1981. There is no adequate mechanism in

¹See p. 87.

either the executive or congressional budget process for controlling the growth of these programs nor for allocating resources among the myriad of credit assistance programs.

We believe that the growth and changing composition of Federal credit programs should be of concern to the Congress. Much of the growth in direct loans and loan guarantees in recent years occurred in non-traditional areas. In 1965, housing credit programs, which involve a large number of small loans, accounted for about 95 percent of all Federal credit activity. This percentage has continuously shrunk over the last 15 years.

In recent years, loan guarantees have been proposed or used to finance synthetic fuels development, urban development, and to finance faltering cities, corporations and industry. The Chrysler Corporation loan guarantee is a recent and highly visible use of the loan guarantee in a non-traditional way. One of the major problems with these types of loan guarantees is that it is not possible to judge reliably, in advance, what the ultimate costs of such programs will be. Because they are large, one-time loan guarantees to activities with an uncertain future, there is no actuarial basis for arriving at reliable estimates of probable loss.

Credit assistance programs are subsidy programs. Like other subsidy programs, they should be evaluated in terms of their cost effectiveness and the extent to which they achieve program objectives. In its various functions, the Congress needs to determine when they are appropriate and when they are inappropriate, guide their design so they maximize the potential for achieving objectives while at the same time protecting the Federal Government's interest, and control them so they compete for resources in the congressional budget process on an equal basis with direct expenditure programs.

Specifically, our concerns about Federal credit assistance in the past and for the foreseeable future center on the following issues:

What are the direct costs and benefits associated with these programs? How much have they cost the Federal Government and what are the direct benefits to program beneficiaries? Without answers to these questions, it is difficult to analyze their cost effectiveness, there is no analytical basis for deciding how to treat them in the budget process and there is insufficient basis for deciding how many resources to allocate to them.

When are Federal credit programs likely to be most effective in achieving program objectives? Are there cases where they are clearly inappropriate?

What are the indirect costs of these programs? How do they affect financial markets and the allocation of the nation's real resources? Are these programs stabilizing or destabilizing in their impacts on economic activity?

How can we achieve better budgetary control over Federal credit assistance programs? This issue is crucial and must be resolved before we can gain a better understanding of the other issues that these programs pose. It is likely that if a mechanism were created for achieving better control over Federal credit programs we would also have, or discover, better answers to the other questions we have posed.

COSTS AND BENEFITS OF CREDIT ASSISTANCE PROGRAMS

What are the direct costs of Federal credit assistance programs? This is an important question for public policy and certain misconceptions are widespread, particularly with respect to loan guarantees. There is a tendency to propose and discuss these programs in such a way that they appear to cost nothing if there is no default. This is not the case. These programs do have costs. Furthermore, the direct benefits from loan guarantee programs are usually far less than the face amount of the loan. It should be apparent that, for both budget scorekeeping and program evaluation purposes, the Congress needs accurate estimates of historical, current and probable future costs of these programs.

GAO has been engaged in estimating historical and future costs of Federal credit assistance programs for some time. We hasten to add that the methodologies we have developed represent only a starting point from which Federal agencies, using their own data, may make improvements. As you are aware, OMB estimates the future potential costs of credit assistance programs by discounting to present value the cash flow from lower interest rates charged to assisted borrowers. These estimates are presented in the Special Analysis of the Budget of the United States Government, but because of the uncertainty associated with the estimation procedure, the figures are not included in the budget totals. If it were possible to estimate, with accuracy, the likely future costs associated with the various programs, there would be a budgetary measure of Federal credit assistance activity comparable to direct expenditure programs.

GAO has developed a methodology for estimating the historical costs and interest subsidy benefits associated with Federal credit programs. We believe it is important to focus on costs and their incidence across the various functional totals so that decision makers know what they have been and, in some instances, extrapolate them into the future. Our exposure draft on "A Methodology for Estimating Costs and Subsidies From Federal Credit Assistance Programs" has been widely circulated for comment inside and outside of government and in general has been favorably received.

We have also done some work in estimating the likely future costs of specific credit assistance programs. In response to a request by the Chairman, Subcommittee on Agriculture and Related Agencies, Senate Committee on Appropriations, we developed a method for estimating future costs of expanded Farmers Home Administration and Rural Electrification Administration Loan Programs.

In addition to this, we have also been concerned with cost comparisons between credit assistance and alternative policy instruments. Our report on Federal disaster assistance policy, to be issued shortly to the Senate Budget Committee, compares the costs of the loan approach with those of the insurance approach to disaster assistance.

It is clear from our work that credit assistance programs are quite costly to taxpayers. We estimate that in fiscal year 1975, direct and guaranteed loan programs had direct costs in the neighborhood of \$3.0 billion. Given trends since that time, these costs are no doubt higher today. In addition, a significant portion of the growth in costs since 1965 has occurred because of the growth in loan guarantees and direct loans outside the housing area.

IMPACT ON FINANCIAL MARKETS AND THE ECONOMY

In addition to the direct costs of these programs which arise largely because interest rates charged do not adequately cover the costs incurred in running credit assistance programs, there are indirect costs which need to be considered when evaluating existing and proposed programs. Evaluating a credit program by considering only the direct impact on the taxpayer (assuming it can be estimated) misses what may be a significant component of the overall effects of these programs.

When credit is allocated to a favored group of borrowers, it necessarily affects non-assisted borrowers mainly through changes in non-assisted interest rates or loan availability. In addition, to the extent credit assistance programs increase or redirect the supply of loanable funds, they can be either stabilizing or destabilizing in their impacts on financial markets and aggregate economic activity. The myriad of loan guarantee and direct loan programs currently in existence were, and continue to be, conceived on an ad hoc basis with little consideration given to the economic impact of the totality of programs. With Federal credit programs currently lending on the order of \$150 billion per year, it is quite likely that they are having some impact on financial and other markets.

We have begun research in this area. We are trying to answer three basic questions:

Have these programs been stabilizing or destabilizing in their impacts on economic activity? Basically, do they follow or oppose movements in economic aggregates indicative of economic boom or bust?

If they are on balance destabilizing can a mechanism be found to control Federal credit activity in a manner more consistent with movements in the business cycle?

If such a mechanism can be found, is it workable in the sense that in controlling the totals it does not seriously undermine the goals of the myriad of Federal credit programs?

We are still in the early stages of this research, but our preliminary results indicate that Federal credit programs moved in a countercyclical manner during the 1960's. During the 1970's, they have moved procyclically, thus possibly contributing the volatility of the business cycle. As our research continues, we hope to get a much better fix on this relationship, its strength and its implications.

THE APPROPRIATE USE OF LOAN GUARANTEES

Guaranteed loan programs are, to all intents and purposes, excluded from the budget. The budget treats them as if they had no cost at all. Because of this budget treatment, it is logical to conclude that credit assistance is overused and in some cases, misused—even without a program-by-program review. Existing budget treatment is therefore at least one reason for the increasing use of the credit assistance device. Also, because knowledge of these programs' indirect impacts on financial markets and the economy is limited, they have appeal because of their apparent simplicity.

GAO has been heavily involved in analyses of the appropriate use of loan guarantees. Our guidelines document, "Federal Credit Assistance: An Approach to Program Design and Analysis" outlines the unique characteristics of Federal direct and guaranteed loans and describes when those devices are likely to be most effective. It was also our purpose in this document to provide decisionmakers with suggestions and guidelines for designing credit assistance programs so they become more efficient in conferring benefits and producing results consistent with objectives.

We were heavily involved in the analysis of the New York City financial situation in 1977 when Federal involvement was being considered. We discussed the credit assistance alternative (among others) in our report on New York City's Long-Term Fiscal Outlook.

Our report on disaster assistance policy, which was requested by your Committee on the Budget, and which will be issued shortly, finds that loans and loan guarantees, though a necessary interim means of assistance, are not a long-run solution to efficient delivery of financial assistance to victims of natural disasters. We believe that superior alternatives exist. Our study shows that loans and loan guarantees have deficiencies which may promote poor locational decisions and perpetuate the incidence of disaster losses. These deficiencies result both from characteristics inherent in the credit assistance device and from improper design of the programs.

Most recently, the Comptroller General is serving as a member of the Chrysler Corporation Loan Guarantee Board. As a member of the Board, the Comptroller General has been confronted with problems of the auto industry and the intricacies of a large loan guarantee program. One point has become critical. When the Federal Government enters into a large loan guarantee arrangement, it is paramount that its risk exposure be amply collateralized because it is virtually impossible to accurately predict success or failure of the venture whose activities are being financed. The Comptroller General will continue to be involved in the Chrysler situation and based on this experience as well as studies of other industries, such as steel, we hope to publish a guidelines document on appropriate policy responses to faltering industries or companies.

BUDGET TREATMENT OF FEDERAL CREDIT ASSISTANCE ACTIVITIES

In our opinion, stronger budgetary control of Federal credit assistance will help the Congress deal with most of the current concerns over these programs. A systematic means for allocating resources to credit assistance programs within the budget process will surface these issues and allow Congress to resolve them. We are glad to see that the Congress started such an allocation in its First Concurrent Resolution on the Budget for Fiscal Year 1981, and that you are considering legislation such as S. 2151 to give this process a statutory basis.

In 1976, we presented a preliminary general overview of our position on the budget treatment and control of Federal credit programs. The major issues remain with us today. Because of the rapid and continuing growth of credit programs and because of the growing use of this device in non-traditional areas, the issues are simply becoming more critical.

We have consistently maintained that credit assistance which escapes systematic congressional scrutiny because of its off-budget status must be brought fully into the budget totals and in the congressional budget process.

We will comment briefly on aspects of credit budgeting we have covered in our work. We would first like to direct attention to the operation of the Federal Financing Bank (FFB), especially the guaranteed loans that are "purchased" by the FFB. The appropriate budgetary treatment of loan guarantees not going through the FFB is difficult enough, but their conversion into direct loans when they do go through the FFB clouds that issues even further. In our opinion, this practice is in violation of sound budget principles. However, we cannot say with any assurance that the existence of the FFB has resulted in an expansion of Federal credit assistance activity. However, the potential for this to occur exists. If the FFB were not off-budget, would the guaranteed loans that go through it actually have been direct loans? Probably not. But this does not imply an expansion of credit assistance activity, only a change in its composition. On the other hand, some programs might never have grown to their present size were it not for the ready availability of permanent financing from the FFB.

Second, we also are concerned with the current budget treatment of Certificates of Beneficial Ownership sales by the Farmers Home Administration (FmHA). By statute, these Certificates, which are used to finance FmHA lending activities, are treated in the budget as asset sales and thus as an offset to (i.e., subtraction from) expenditures. Sales of these Certificates should be treated as debt transactions, as was recommended by the Budget Concepts Commission. If they were, FmHA lending operations would be reflected in the budget totals regardless of FFB's budget status.

Currently, the Federal Financing Bank holds about \$35 billion in FmHA Certificates. By the end of fiscal year 1981, this figure is expected to reach \$41 billion. This means that since the FFB's beginning in 1974, there has been a total of at least \$35 billion in direct lending by the Farmer's Home Administration that has not been counted in the outlay totals of FmHA and the Federal budget. This has caused the budget deficit to be understated by an equivalent amount.

In our reports on these two subjects, we have recommended that;

FFB receipts and disbursements be included in the Federal budget totals;

The receipts and disbursements of off-budget agencies that borrow from FFB be included in the budget; and CBOs be treated as agency debt and, therefore, be treated in the Federal budget as borrowing.

These recommendations have not yet been implemented. We strongly believe that they should be.

We note that this Committee in its report (No. 96-654) on the First Concurrent Resolution on the Budget for Fiscal Year 1981, recommended that the President and the Congress, through the appropriations process, limit aggregate off-budget lending activities to a specified level (\$25.8 billion). This proposal, incorporated into the First Concurrent Resolution is a welcome step forward in subjecting FFB and other off-budget lending activities to the discipline of the appropriations process. It is important to bear in mind, however, that this action is only a partial remedy to the off-budget problem; it will not correct the understatement of budget outlays associated with the off-budget status of certain Federal organizations including the FFB.

Third, we have addressed certain budget control problems related to Federal revolving fund loan programs. In our report, "Revolving Funds: Full Disclosure Needed for Better Congressional Control" (PAD-77-25, August 30, 1977), we analyzed how outlay totals for public enterprise revolving fund loan programs are understated in budget reporting because of the practice of offsetting loan repayments from new loan outlays. The result is that the reported outlays are net outlays rather than total outlays. We believe that this offsetting practice distorts budget outlay amounts and makes it difficult for the Congress to accurately gauge and control budget outlays. And in our current report, "Sending Authority Recordings in Certain Revolving Funds Impair Congressional Budgetary Control" (PAD-80-29, to be issued shortly), we address the lessening of congressional budgetary control when budget authority recordings for revolving fund loan programs are expressed, largely as authorized net borrowings (gross borrowings less repayments). As a consequence of this procedure, a program's total loan obligations in a fiscal year can easily exceed its recorded budget authority for entering obligations. For example, FmHA's Rural Housing Insurance Fund made about \$4.9 billion in loan obligations in fiscal year 1979, but showed recorded budget authority of only about \$790 million. Our report recommends that the Congress set annual limitations on the obligations that may be made in individual revolving fund loan programs, and treat these limits as the relevant budget authority amounts.

I wish to point out that while the executive branch and the Congress are now moving to set statutory limits on loan program obligations, in total and for individual programs, there is no action to record these limits on direct loans as the relevant new budget authority amounts. The limitations therefore do not appear in the budget totals. We believe that the needed and logical next step is to treat the limitations as the controlling new budget authority amounts. This would put the loan programs on a more comparable basis with other programs and facilitate congressional budget control.

S. 2151, which would amend the Congressional Budget Act of 1974 to establish congressional budget process procedures for setting targets and ceilings on loans and guarantees, stops short of requiring that the limitations be treated as the budget authority amounts. We would prefer that it require such a treatment.

Fourth, in one of our recent reports, "Alternatives for Eliminating Amtrak's Debt to the Government" (PAD-80-45, March 28, 1980), we discuss certain obligations of the National Railroad Passenger Corporation (Amtrak) which highlight the need for full disclosure and strengthened control and accountability of Federal guarantee programs within the budget process. The obligations in question consist of \$850 million in loan obligations. Amtrak originally borrowed from private lenders and the loans were guaranteed by the Federal Government. Subsequently, they were converted to direct Federal loans from the Federal Financing Bank. Amtrak's guaranteed loans illustrate how loan guarantees adversely affect certain budgetary principles. The loan guarantees were converted to direct Federal loans that were not included in the budget. Budget and deficit totals were understated, creating problems in accountability such as lack of full disclosure of budget information and loss of congressional budgetary control.

CONTROLLING FEDERAL CREDIT ASSISTANCE ACTIVITY

With regard to overall control of Federal credit assistance activity, I would like to make the following observations.

Accurately reflecting the aggregate outlays and commitments from Federal credit assistance programs in the budget numbers is important, because they are the basis for some very important policy decisions. If the reported budget aggregates are not what they purport to be, misunderstanding is inevitable and the credibility of the policy formulation process itself is at risk.

It is equally important, however, that we find a means of assuring that Federal credit programs compete on the same basis as other direct expenditure programs so that decisions regarding the allocations of our nation's resources will be made in a more balanced framework.

Whatever control mechanism is decided on, it must control more than the total. Someone has to decide about the pieces as well as the total. If the Congress does not find a way of doing so, the task—and the power that goes with it—will pass to the Executive. The issues of budgetary control of the totals and the pieces and who is doing the controlling of each are important, as the Congress itself concluded when it enacted the Congressional Budget Act. We believe that program outlays should be approved by the Congress after weighing the benefits and costs of each program in the context of an overall judgment on the appropriate level of total credit assistance activity. We do not believe that a mechanism which only controls the total will do the job, nor will increased visibility of the credit assistance totals alone be sufficient. Both represent a good start, but we believe the Congress should go beyond this to the development of a systematic approach for budgeting credit assistance; one which is similar to and linked with the existing congressional budget process.

Mr. Chairman, this concludes my prepared statement. I would be pleased to try to answer any questions.

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INCLUSION OF LOAN GUARANTEE ELEMENTS IN BUDGET

Senator METZENBAUM. Mr. Havens, let us assume there is a new program involving \$100 million of loan guarantees and the Congress sets that as a maximum for loan guarantees. You would not think that that whole \$100 million should be included in the budget, would you?

Mr. HAVENS. No, sir.

Senator METZENBAUM. How much of it should be, some estimated figure as to what the possible loss ratio may be?

Mr. HAVENS. Well, I think I would go back to the principles that were established in the President's Commission on Budget Concepts in 1967, which suggested that with respect to lending programs, either guaranteed or direct, that the central principle be that in the budget there should be attached the costs associated with that program. This would include, in my snap judgment, perhaps three elements of costs. One would be the simple administrative expenses of operating the program. The second would be an estimate of the amount of the subsidy associated with that program. Third would be an estimate of the default rate likely to be associated with that program.

In my estimation, those three factors—

Senator METZENBAUM. The first one was what?

Mr. HAVENS. Administrative expenses of simply operating the program. Second would be an estimate of the subsidy associated with the program, and third would be an estimate of the default.

Senator METZENBAUM. Would you agree with that, Mr. Reischauer?

Mr. REISCHAUER. Yes, I would. But I would point out that administrative expenses, by and large, are in the budget now, as are the subsidy elements if they are a direct cost to the Government. The main piece we are lacking for inclusion is a reserve for defaults.

INTEREST SUBSIDY PAYMENTS

Senator METZENBAUM. You are saying that the interest subsidy is in at the present time?

Mr. REISCHAUER. Where it is a direct subsidy it is.

Senator METZENBAUM. Give me the distinction, if you will.

Mr. REISCHAUER. Let me turn to my colleague.

Mr. SHILLINGBURG. There are several kinds of guarantee programs in which the Federal Government pays a direct interest subsidy to the borrower. In those cases, the interest subsidy is recorded in the budget as a payment. The transaction also is considered a guarantee of credit because the interest subsidy payment makes it more likely that the borrower will successfully repay the loan in full. Most guarantee programs, however, do not have such an interest subsidy payment. They have only an implicit or indirect subsidy in that the guarantee itself acts to lower the interest rate charged the borrower.

Such an implicit subsidy is not a direct Federal cost, and the Federal Government does not pay out any money. Therefore, it is perhaps not appropriate to include implicit subsidies in the unified budget.

Senator METZENBAUM. In the budget for 1980 or 1981 there are a considerable number of dollars involved with respect to the Government student loan program.

Is the subsidy factor included in the budget?

Mr. SHILLINGBURG. Yes, sir. A subsidy is paid to the banks that represents differential between the interest rates on the loan they make and the cost of obtaining money in the private market.

Senator METZENBAUM. Let me ask the panel generally, designing a mechanism for the control of Federal credit, I gather you are saying without much question, generally all of you, that the off-budget status of various credit activities should be changed.

Is that pretty generally your view?

Mr. HAVENS. That is certainly the view of the General Accounting Office.

Mr. HERMAN. I think I would agree with that. I think it also has to be accompanied by, as we discussed previously, some stricter and more uniform system of accounting for the program.

Senator METZENBAUM. I do not think there is much question. I do not think anybody could argue about the fact, at least I cannot believe they could, that we ought to have better standards of accounting. I do not think anybody could argue about the fact, at least I cannot believe they could, that we ought to have better standards of accounting, better method of knowing how many programs there are.

NUMBER OF EXISTING CREDIT PROGRAMS

Mr. Havens, you were in the General Accounting Office. Do you know how many programs there are? Mr. Herman said he found about 160 but he would not swear to it.

Mr. HAVENS. I doubt I would swear to it, particularly after Mr. Herman's testimony. Part of the problem comes down to defining a program. Any particular number depends on how one chooses to define a program. Just as in the problem of defining what is a loan guarantee as opposed to an insured loan, there is a difference of opinion as to what constitutes a program.

But, setting that aside, we are in the process now of compiling an inventory of Federal programs which would include within it the identification of guaranteed and insured loan programs and direct loan programs as well. That work is proceeding but we have not yet completed it.

Senator METZENBAUM. When do you think it will be done?

Mr. HAVENS. We are aiming at this point—let me step back a minute.

The work we are doing is in preparation for, at least in part, a reformed oversight procedure along the lines of sunset or something similar which would require an administrative inventory of programs in order to determine which programs have been overseen and which have not. Our progress is linked to progress on S. 2 or companion bills. Our present schedule calls for, as I recall it, an initial inventory as early as next spring, if the bill passes in its present form soon. More likely a year or so later.

Senator METZENBAUM. What would be your reaction to that, Mr. Reischauer?

Mr. REISCHAUER. We are on record as supporting that proposal. Transactions with the FFB should be regarded as a means of financing. Therefore, when an agency goes to the FFB, it should be a nonbudget transaction. The proceeds that it receives could be involved in, say, a loan transaction which would be considered an outlay and the payment of that loan would represent offsetting receipts. But the borrowing from the FFB would be regarded as a means of financing.

ELIMINATE FFB

Senator METZENBAUM. Would it possibly be better to eliminate the FFB entirely and permit agencies to borrow directly from the Treasury Department?

Mr. REISCHAUER. No. I think the original purpose of the FFB and the reason for its existence have been proven correct in the last 5 or 6 years; on average, the agencies of the Federal Government that previously borrowed separately in the capital markets can obtain capital at a lower cost, and that is something worth preserving.

Senator METZENBAUM. They would still be able to get it at a lower cost if they borrowed directly from the Treasury. They would just eliminate one thing.

Mr. REISCHAUER. FFB is a part of the Treasury.

Senator METZENBAUM. Why do they need FFB? What difference would it make if we did not have FFB and the agencies borrowed directly from the Treasury and the Treasury borrowed from the people, except that it would start to get closer to being more of a reality rather than something that is in an area where many Members of the Congress, as well as all members of the public, do not realize what is happening?

Mr. REISCHAUER. Whether the Treasury or some subpart of the Treasury is going to go out and borrow the money does not make any difference at all. Nor does it matter whether we have something called the FFB.

VALUE OF FFB

Senator METZENBAUM. Do you think there is any particular value in operating through the FFB, Mr. Havens?

Mr. HAVENS. As Mr. Reischauer said, it is clear that the centralized borrowing aspect of the FFB has saved money. Now, the problem with simply eliminating the FFB is that I do not think you would necessarily—I do not think you would necessarily still have those agencies borrowing through the Treasury. Most of the agencies that we are talking about have the authority to borrow directly from the public, and the FFB was originally intended as an intermediary agency to centralize individual agency borrowing from the public. If you simply eliminated the FFB, the Farmers Home Administration, with continuing authority to borrow from the public, would probably go back to borrowing from the public, which I think would be an inefficient way of doing so.

If you accompany the elimination of the FFB with elimination of individual agency authority to borrow from the public so that you would have a central mechanism through the Treasury, there would be no problem. But I do not think the FFB itself—its elimination or maintenance—is the central issue. The central issue is

whether these agencies are limited to borrowing individually from the public through the securities market or through the Treasury.

Senator METZENBAUM. Tell me, the FFB, how many people operate that?

Mr. HAVENS. To the best of my knowledge, there is, if any, a very small staff directly of the FFB. All of the officers of the FFB are officers of the Department of the Treasury.

Senator METZENBAUM. I understand there is something like eight people. I guess my real view about the FFB is, in my opinion, has come to indicate a rose by any other name smells just as sweet. It seems to me that the FFB is another way of saying that the individual agencies are borrowing from the Treasury credit rather than the credit of the agency. I am not saying there is anything wrong with that.

ROLE OF THE FEDERAL FINANCING BANK

What I am saying is what is the game we are playing or what is the reason we are using the FFB, and I would like somebody to tell me why we need to use the FFB and why we do not say that the agencies borrow directly from the Treasury?

Mr. HAVENS. I think you have to go back to the situation as it existed prior to the creation of the FFB in which the agencies did not borrow from the Treasury. They borrowed directly from the public and the FFB was a mechanism by which to centralize borrowing from the public. Instead of having 20 or 25 agencies individually going into the securities market and floating their bonds individually at substantially higher interest rates, the FFB was a mechanism by which that was brought together into a single consolidated borrowing operation.

The fact is, as you say, FFB is the Treasury. There is only a concept of the FFB. The FFB per se does not exist except as a legal fiction. It is the Treasury. It does, however, have certain distinct features as a concept, one of which is that the activities of this institution are not on the budget. As a result of that, you have the advantages of centralized borrowing, which was the initial reason, but you also have disadvantages associated with the distortions that result from FFB transactions.

If the FFB were eliminated and the agencies were still required to borrow from Treasury rather than going to the public directly, I would have no problem with it. But you need to deal with the issue of insuring that the agencies continue going through Treasury rather than going outside.

UNIFORMITY OF OVERSIGHT MECHANISMS

Senator METZENBAUM. Mr. Herman, do you think that if we are going to get our accounting procedures clarified, if we are going to get more knowledge—at least if the Government is going to operate in a more businesslike manner, do you think that we probably need some kind of legislation in order to define what is a default, when something is in and when it is out?

I am simply saying how do you tell 160 agencies or the administrators of 160 programs what they should and should not do and how we try to bring some order out of that.

Mr. HERMAN. I think there are perhaps two areas where guidance can be offered.

One is certainly when we are dealing with programs which cover the entire executive branch and all the agencies. Uniformity is required. Otherwise, the oversight mechanisms and the ability to monitor what amounts to hundreds of millions of dollars a program is simply not possible.

Before deciding whether such an initiative should come from the Congress or the executive branch, you must have the standards established.

Second, I think there are standards that do exist in the private sector, and the body of accounting practices and common to private sector activities that do have sufficient parallels with respect to recognition of default and contingency liability that can be utilized in legislation by the Congress.

Senator METZENBAUM. Senator Bellmon.

COMMODITY CREDIT CORPORATION

Senator BELLMON. Thank you, Mr. Chairman.

First, I want to congratulate the panel for having brought into focus a major problem and saying that I benefited a great deal by what has been said here this morning. I have a couple of questions.

I wanted to ask a question or two about the Commodity Credit Corporation in particular. I am not sure if any of you have looked at it. If you have not, I will not take your time.

Mr. HERMAN. I have not.

Mr. REISCHAUER. Not particularly.

Mr. HAVENS. I have only general knowledge of it.

CYCLICAL FEDERAL ACTIVITIES THWART COUNTERCYCLICAL MONETARY POLICY

Senator BELLMON. To me this is a program that has provided a valuable service. I would hate to see it changed too much.

The problem is that those loans, when they are made up, show up as outlays and yet most of the money is recovered. Very little is lost over time and I think it would be a mistake if we went to a system that would alter it too much.

But since you have not gotten into it, I will not go into it.

Does the cyclical pattern of Federal activities tend to thwart the countercyclical activities of monetary policy? Are we guilty in the use of our policy in undoing some of the efforts of the Fed and should there be an effort made to coordinate policy? Do you have an opinion?

Mr. REISCHAUER. There is always a tradeoff of that sort. But I would point out that Federal credit activity tends to blossom in a recession at the same time that the Federal Government needs money for financing the deficit and for certain countercyclical activities. And so, at that time, one could argue that credit activity and fiscal policy might be moving in the same direction. There are other times when the Fed is trying to rein in the money supply and unrestrained increases in credit activity of a different sort are occurring that could produce a negative effect.

I think the first step in guarding against this is gaining an understanding of just how Federal credit activity changes over business cycles. A second step would be to develop some kind of congressional mechanism for controlling credit policy. The third step would be to decide the extent to which Federal credit policies are working at cross purposes to those of the Federal Reserve Board.

CREDIT USED AS A SUBSTITUTE FOR DIRECT SPENDING

Senator BELLMON. In your view, has the budget process caused Federal credit activity to be used as a substitute for direct spending? Are we, in this committee, and those involved in the budget process responsible for the rapid growth in Federal credit activity that we have seen recently?

Mr. REISCHAUER. I think there is at least some circumstantial evidence that that has been the case. The focus of the last 5 years has been on outlays and budget authority. The less visible dimensions of Federal activity—namely, regulations and certain activities that appear off-budget—have not received the same kind of scrutiny.

If we look at what has happened with respect to the FFB—agencies converting on budget activities to off-budget, by having the FFB buy up CBO's or the use of loan guarantees—that constitutes some evidence that there has been an incentive caused by the budget process.

PLACE CEILING ON LOANS AND CREDIT EXTENDED

Senator BELLMON. Does that mean that we should, as part of our budget resolution, put a ceiling on the number of loans and the amount of credit that we extend?

Mr. REISCHAUER. I think that the steps that the committees have taken this year are correct. The application of the controls of the budget process to credit activities is certainly a move in the right direction.

ENFORCEMENT MECHANISM NEEDED

Senator BELLMON. We really had no enforcement procedures. We set figures but there is no way of—do we need a policing mechanism?

Mr. REISCHAUER. If this part of the process is going to be effective, that there will have to be some mechanisms for keeping track of what is happening and, when you see that the limits are being violated, some mechanism for dealing with the violation.

Senator BELLMON. Does CBO have a way of tracking that?

Mr. REISCHAUER. We are in the process of developing one right now and have been in contact with the staffs of the Budget Committees to let them know the various methods that are available.

Senator BELLMON. Is it your plan to give us a periodic report as to the activity?

Mr. REISCHAUER. Yes. The exact form is something that we are still working out with the committee staffs.

Senator BELLMON. When can we expect the first report?

Mr. REISCHAUER. We are now developing a mechanism for tracking the extent to which the various appropriations bills that are

being reported out of the full Appropriations Committee in the House comply with the credit limits in the first resolution. We have a mechanism for keeping track of that and we will be glad to provide the committee with an ongoing status report of the current situation.

Senator BELLMON. We do get a scorekeeping card and you will add this item to the scorekeeping card?

Mr. REISCHAUER. Probably not. It will be sent to you in the form of a memo until we decide what is the most useful format for this information.

Senator BELLMON. You are not able to tell us when we will get the first memo?

Mr. REISCHAUER. Apparently the ball is in the court of the Budget Committee staff, who will determine the exact format that they would like this information in.

Senator BELLMON. I take it you are ready when we are ready?

Mr. REISCHAUER. Let me put it this way, I think we are more ready than you are.

AMOUNT OF IMPLICIT FEDERAL SUBSIDIES

Senator BELLMON. I want to change the line of questioning just a moment, if I could, to ask Mr. Havens a couple of questions.

When direct loans are provided at low market interest rates, this amounts to a subsidy. That is often not reflected as an outlay. GAO has done some work in this area, particularly in the March 31 paper which you referred to entitled "Federal Credit Assistance."

Could you summarize your findings very briefly and anything you have regarding this situation of implicit subsidy? How much are we actually subsidizing through these various credit activities?

Mr. HAVENS. I am, unfortunately, drawing a blank on the details of the report. If you want, I will supply a response for the record.

Senator METZENBAUM. Might I just interrupt for a moment? The Chair has a firm commitment and must leave at 11:30. I want to express to the members of the panel the extreme appreciation I have for your cooperation and I intend to work further with you. I want to say to my friend from Oklahoma, you may finish up the hearing.

Thank you very much.

Mr. HAVENS. Senator, I did issue a report on July 17, 1979. I am trying to determine if that is the report that you are referring to.

Senator BELLMON. The report I referred to is the March 31 report. If you do not have the information available, perhaps you can give it to us in writing.

[The following was subsequently supplied for the record by GAO:]

We have issued two reports which present estimates of direct and implicit subsidies accruing from Federal credit assistance programs. The first, issued on July 17, 1979, is entitled "A Methodology For Estimating Costs and Subsidies From Federal Credit Assistance Programs." An earlier report entitled "Federal Credit Programs: An Approach to Program Design and Analysis," dated May 31, 1978, presented preliminary subsidy estimates which were ultimately finalized and presented in our costs and subsidies report of July 17, 1979.

I would like to summarize the results from the July 17, 1979, report. In fiscal year 1975, we estimate that the direct cost to the government and direct subsidy to assisted borrowers amounted to \$2.9 billion or 1.5 percent of the \$191 billion in outstanding loans included in our analysis. The total subsidy to assisted borrowers, which represents the difference between the commercial rate of interest that would

have been paid and the actual rate paid and, which includes the implicit subsidy, was estimated to be \$3.4 billion in fiscal year 1975.

Senator BELLMON. You mentioned you feel that we should include the direct subsidy in our figure. But I am asking the implicit subsidy. Whether it needs to be a budgetary concern.

Mr. HAVENS. I think just in general it does. The implicit subsidy is—again it depends on how one defines that. There are two pieces that I think we need to be concerned about. One is the case of a loan which is made ostensibly on market terms but which, in fact, is made at a rate below that which the individual borrower could obtain on his or her own. In that case, the subsidy is not directly a budget cost because we may still be loaning the money at a price equal to or greater than cost of borrowing. But what we have done is given that individual borrower a preferred position in the credit system and made that individual a preferred customer because of the guarantee vis-a-vis someone else who may have equally worthwhile objectives but may not have access to the credit. That is not something that should be reflected in the budget.

However, it is something that should be of concern to those determining the level of Federal credit. The other form of subsidy, which is that of making a below market loan and below our cost of borrowing, very definitely should be reflected in the budget and, we believe, should possibly be reflected in the budget on a capitalized basis. That is, the current cost of—the current value of that subsidy should go in the budget as an expenditure. This is consistent with the recommendations from the President's Commission.

EARLY WARNING FOR DEFAULTING LOAN AND CREDIT PROGRAMS

Senator BELLMON. Do you feel it is realistically possible to create an early warning system for guaranteed loans and these programs? Do we know how many are going sour?

Mr. HERMAN. I think there are techniques used by banks and other financial institutions with respect to tracking loans, loans in trouble, and loans on their way to default, which could be adopted and have been proven in the private sector. For example, the technique of utilizing actuarial assessments of loan pools based on historical data can be put to our use. These typically are not utilized in the Government.

Senator BELLMON. I am not sure I understand. Take a program, any one you can choose or I will choose one, and tell me how you would tell if they were beginning to go sour? Since I am interested in agriculture, I am more acquainted with those, how would you set up an early warning system to let you know when the farm-ownership loans are going sour?

Mr. HAVENS. Quite early periodic reporting from the recipients of the loans to the sponsoring agencies is not necessarily and uniformly conducted so that financial statements, for example, submitted by the recipients which demonstrate their financial help, could be used by Federal monitors to determine whether there is an ongoing capability of repayment.

Senator BELLMON. Would we not have roomfuls of paper and forms that no one would ever look at?

Mr. HERMAN. If you take the student loan program with the millions of loans, that would be the case. In terms of spot checking,

in terms of certain statistically determined universes, I think there can be mechanisms developed. I think a combination of the historical results of an agency's experience and the application of some form of sampling to selected recipients could get around the problem you express. It is no different, to use the parallel again, from the extent of monitoring which banks conduct of their portfolios. The parallels are fairly well established.

REVOLVING FUNDS

Senator BELLMON. There is a big difference between the way banks operate and the way the Government operates.

I want to ask you a couple of questions about the revolving funds. These are loan programs where outlays are made against payments. The result is that sometimes we get a deceptively small net result as far as the total activity level is concerned. I wonder if the GAO believes that existing treatment of revolving fund is proper or should we make some changes that would give us better information?

Mr. HAVENS. Sir, we have recommended on several occasions that the treatment of the revolving fund be changed. We have urged that the gross outlays of the revolving fund be shown as the outlay level for that activity with repayments and other receipts of the revolving fund used as a means of financing rather than offsetting against the expenditures of a program.

That recommendation was made, as best I recollect, about 2 years ago to the Office of Management and Budget. It was objected to and the recommendation has not been carried forth. We are currently in the process of issuing a report which will deal with another aspect of the problem which is that of revolving funds predominantly borrowing from the Treasury, to finance revolving fund activities, under a line of credit arrangement whereby the only thing that is specified in the statute is the maximum amount of credit outstanding, not the frequency with which that credit can be borrowed, paid back, and reborrowed. The result is that in many cases, at least in some cases, the revolving fund involved has total borrowing activities which far exceed the amount of the recorded authorization for borrowings from the Treasury, because the cycle of operations, lending, repaying, borrowing, repaying, permits the reuse of borrowing authority once granted.

So we have made several recommendations with respect to changing the budget presentation for the revolving fund and associated activities.

Senator BELLMON. If those changes were adopted, how much would the Government be spending in the increase?

Mr. HAVENS. I do not have a number. It would be a substantial increase in the budget authority total, but it would not affect outlays and the total of the deficit would not change.

Senator BELLMON. Let me yield to Senator Boschwitz.

Senator BOSCHWITZ. I must say I have been away because I have been on the Senate floor. I did not have a chance to read the testimony in advance because I just received them half an hour before the hearing started.

When did you submit these to the committee?

Mr. HERMAN. My testimony was submitted Friday afternoon sometime, about 2 days after we had firmed up the appearance and the questions from the committee staff.

Mr. HAVENS. Same with the case of the GAO.

Mr. REISCHAUER. Same.

NO FIRM LIST OF THE NUMBER OF GUARANTEED PROGRAMS

Senator BOSCHWITZ. Unfortunately, I have not had a chance to read them in full. I see, Mr. Reischauer, that in your statement you said one paper compiled for the first time in one place data on Federal credit programs. And when I was here, Mr. Herman, in your testimony, you said that there was no such one place. It seems to me that I read such a list was put together, I think 10 years ago if I am not mistaken. Perhaps it was more recently. I came across that and requested a copy and have not been able to get it.

Mr. REISCHAUER. So there is no confusion between our two statements, let me explain that the paper I was referring to compiled the list at the agency level and I think Mr. Herman was talking about the program level.

Mr. HERMAN. Typically the caveats used in expressing the number of programs is "about" or "approximately." I have seen, and I think prior testimony suggests, no firm list of the number of guaranteed programs, partly because of definitional problems.

GOVERNMENT MONITORING OF CREDIT PROGRAMS NEEDED

Senator BOSCHWITZ. In just following up Senator Bellmon's question for a moment, and thinking of the Small Business Administration, where the banks allegedly monitor the loans, how would you suggest the Government become involved in monitoring the process there?

Mr. HERMAN. I think some of the items we discussed would depend on the particular program and the program history. There may be some programs in SBA, for example, which have a decent track record. There may be others which do not. At a minimum it would seem to me that the Government needs to assure itself of some form of oversight of moneys for which they have a contingent liability. This could range from simply receipt of financial statements on a selected basis to active evaluation of the monitoring that is performed at the institutional level.

In our study, we did find that even in those programs we studied there was an obligation of the bank or financial community to monitor portions of that loan, that monitoring varied significantly, often as a sheer result of the number of loans administered.

One example, is the student loan program. This issue also gets into the question of the incentives the banks have to effectively monitor when, in effect, they are held harmless from any losses because of the guarantee.

RECOMMENDATIONS FOR MONITORING

Senator BOSCHWITZ. Not totally harmless but largely harmless. It is not quite clear to me what the CBO recommends that we do to properly monitor the various programs. Is it just to create an off-

budget, separate, credit budget as it is now being done, or is it somewhat more substantive?

Mr. REISCHAUER. We made a series of recommendations. One of them was to follow the procedures that are called for in the Percy and the Giaimo-Mineta bills which would extend the Budget and Impoundment Control Act procedures to credit activity.

The second is a series of suggestions dealing with how the activities of the FFB are treated. One would be to treat sales of CBO's to the FFB and loan guarantees as a means of financing.

Senator BOSCHWITZ. What would that do for financing? Does that mean some selling of the loans would appear on the budget and not be entirely offset by the receipts?

Mr. REISCHAUER. No. The use of loans by the agency would appear on the budget and repayment to the agency would appear as an offsetting receipt. But the transaction with respect to FFB would be a means of financing. It would appear as a liability on the part of the agency dealing with the FFB and an asset on behalf of the FFB.

Senator BOSCHWITZ. Does the loan process in some way involve budget authority? How is it going to be reflected in national numbers on budget?

Mr. REISCHAUER. When the agency takes the money and uses it, say, to make loans to farmers or some group, the actual use of the money at that point appears as an outlay. When the farmers pay back the agency—say, the Agriculture Department—that is treated as an offsetting receipt. The agency, however, received the money that it was loaning to the farmers from the FFB which involved Treasury borrowing.

DEFAULT FACTOR

Senator BELLMON. On that point, if it was possible to set up a default ratio—let us say with Farmers Home. Their loss expectancy is 2 percent. When we make available to Farmers Home \$1 billion, at that point we should feel that we have spent 2 percent of that? Is this realistic? Our actual outlays would be \$1 billion but the actual spending—

Mr. REISCHAUER. This goes back to the point that Mr. Havens was making. Some contingency pot of money for defaulters as well as the interest subsidy and the administrative expenses are what should be regarded as the Government's likely expenditures, and those certainly should be on the budget.

Senator BELLMON. Is it possible for anyone in the Government, CBO, or OMB or Treasury to figure out what the proper factor to apply as far as costs—real costs are concerned for each of these 160 or more programs?

For instance, what kind of effect would you put for the Chrysler loan? How about the loan to New York City? I am not quite sure how we would.

Mr. REISCHAUER. It is probably impossible to estimate a default probability for large discrete loans of that sort. Certainly, the probability of default depends very much on Government policies, other Government policies as well as the actual loan or loan guarantee.

GRAIN EMBARGO INCREASED DEFAULTS

Senator BELLMON. The President's grain embargo certainly increased defaults of farmers.

Mr. REISCHAUER. For large, discrete and relatively risky ventures, I am not sure you are ever going to be able to calculate accurate numbers for expected default losses. For those types of activities that involve the pooling of large numbers of small loans each with very unequal individual risks, estimates like this certainly can be made. We are not in the position to make them now. My guess is that the agencies involved in administering these loan programs would be in the best position to have the data and the experience to develop such estimates.

Senator BELLMON. Could CBO make a historic recommendation as to what the loss experience might be?

Mr. REISCHAUER. A retrospective one, looking at a program and saying this is what the experience has been? I would turn to the people from Peat, Marwick, Mitchell for confirmation but I think the data in some of the agencies is so poor and confusing that it would be very difficult to go back and make this kind of estimate.

Mr. HERMAN. There are some data base problems. There are some definitional problems. The term default, while we might be using it in somewhat of a similar manner, meaning inability to pay a loan that is currently due, principal or interest, is not necessarily a uniform definition that applies throughout the agencies.

You also run into problems where the agency might choose, for a variety of reasons, including not to appear to have given out a high proportion of loans, to refinance the loan. In this case a defaulted loan, in essence, becomes a refinanced loan.

There are two problems, definition of what default is, and, two, the data that agencies have to report may simply not be available.

APPLY UNIFORM STANDARDS FOR DEFINING DEFAULT

Senator BELLMON. Could you write a definition of default that would apply to all these Government problems? I think of an EDA loan made to the State of Oklahoma in 1961 to build two lodges on a lake. It was about a \$10 million loan. It has never had a dime paid on interest nor principal. I would count that a loan that is in default. That should not be hard to find. If the loan has gone for a period of time with no payment, I think it would be default.

Mr. HERMAN. Correct. That does not preclude an agency from redefining it as a new loan and not counting it as a default.

Senator BELLMON. If Congress worked up its own definition, I think the agencies would be bound to follow our guidelines.

Mr. HERMAN. We have been working a little bit on this.

Mr. STEINBERG. I just wanted to say from the accounting prospective we always understood that default is a legal term that is triggered by one or more types of effects, such as a restructuring, in the instances we are talking about, where Congress can pass a law to change the repayment terms, foregoing of interest can be considered default, stretching out a loan can be considered a default.

So it is really a legal term that has to be defined by the people writing the contracts. What the accountants do is they decide how

that is recognized in the financial statements of both the borrower and the creditor.

DEFINITION ESSENTIAL TO ESTIMATING DEFAULT RESERVE

Senator BELLMON. This to me would not seem to be an impossible problem. Perhaps we should get to work on it. I assume if we have some kind of a realistic definition of default then we would be in a position to include a default reserve in the calculations for each agency or each loan program each year.

Mr. HERMAN. Yes.

WHAT CONSTITUTES DEFAULT?

Senator BELLMON. But first we start by deciding what is default. Would any of you care to offer a suggestion as to how we define default? Is that complicated?

Mr. REISCHAUER. Being unconstrained by any knowledge of accounting, maybe I should answer the question.

It would seem to me, as a layman in this area, that an incapacity of the borrower to meet the terms of the loan—

Senator BELLMON. A demonstrated incapacity.

Mr. REISCHAUER. That would mean any time you renegotiated the loan or changed the conditions applying to it, that would constitute default.

Senator BELLMON. Would you care to add a time factor, demonstrated incapacity for 1 year or 6 months?

Mr. REISCHAUER. That is what have been hung up on. The time factor might differ by program. If somebody did not meet their home mortgage payment for a couple of months, you would not be terribly worried about it because there would be a chance that the Government might fall into possession of a house worth much more than the loan.

On the other hand, if it is a student, a young person, who is highly mobile and almost invisible in our society, you might be worried if they miss one or two payments because you have a feeling once they miss one or two the chances of catching up with them are very, very low. So one might want to have a different time period for different programs.

Mr. HERMAN. For purposes of our study, we did have a working definition of default, which I can read:

Default is usually defined as resulting from two types of conditions. First, if the borrower violates any terms of the loan agreement or contract, the loan may be declared in default.

Second, most agencies should specify a period when a loan may be past due without getting into default, and default is defined to occur when a payment on a particular loan is not received within this grace period.

The key to understanding default, however, is not to assume that default is an objective condition that occurs when a contract is breached or a grace period exceeded. Rather, it is most often a management decision that declares a loan is in default.

This was a statement of current practices.

Mr. HAVENS. If I might add simply a small footnote to that, in the Federal sector there are events of default written into the terms of the loan. When any of those events of default, which may include balance sheet factors which get out of whack, in violation

of the agreement or loan, the loan is then determined to be in default. Some Federal agencies probably have such events of default written into their contracts. Others do not. Among those who do, some probably enforce them more rigorously than others.

As the Peat, Marwick, Mitchell study pointed out, within the Government sector particularly default is viewed as a management decision rather than the judgment—rather than a decision based on objective data and the particular event having occurred. This is probably clouded to some degree by the political nature of the decision. It is not a simple management decision. It is not an easy management decision to declare in default a large loan to a major borrower in a politically effective constituency. This is not something an agency wants to do. The incentives are to carry that loan as long as it can be, to refinance it if it is possible, to extend the maturity dates, to renegotiate the terms, to do everything possible to avoid doing something that is in the agency's judgment, for political reasons, and otherwise, an unattractive thing to do.

IMPACT OF MASSIVE LOAN DEFAULTS

Senator BELLMON. This is probably why we require the participation of some independent group, such as CBO, rather than the agencies to make those judgments.

The way we do our bookkeeping, the minute we spend the money, in effect, we count it as being gone, even though we may have built a dam or we may have built a new structure or we may have loaned someone the money to build a new house or buy land. We do not count those as assets. We do not have a capital budget. But if all our loans suddenly went into default, would this produce a crisis for the Government?

Mr. HAVENS. Let me take a stab at that if I may.

My suspicion would be that if all of our loans suddenly went into default, the situation that caused that to occur would be a much more serious crisis in the country than the events of default itself. Certainly it would be a rather chaotic situation if we had 400 or 500 billion or a trillion perhaps of loans go into default. But that would seem to me to be a rather minor side effect of something much more fundamental that went wrong that caused that.

Senator BELLMON. You are not suggesting that we are in any financial jeopardy because of the loans outstanding?

Mr. HAVENS. Individual programs are certainly in some degree of trouble. The student loan program being a classic example where the default rate got far out of control. I think we need to worry about individual programs and the way those individual programs are designed and administered.

But I do not think the contingent liability of the Federal Government as a whole is a number that we ought to throw around as a scare tactic. I think the design and implementation of individual programs is a very significant issue, the way we control the allocation of resources through the credit program is another significant issue.

DON'T BURDEN CITIZENS IN IDENTIFYING DEFAULTS

Senator BELLMON. I would personally be opposed to adopting any system whereby every person or every group that has a Government loan is required to fill out a new set of loans or send them in.

Is there any other way of realistically identifying programs that are in trouble so that we can pay attention to the areas that need attention and not plague our citizens with another wave of useless paperwork?

Mr. HAVENS. Most citizens who are the recipients of Federal loans are already filling out a good amount of paper. What it amounts to might be another question. Maybe it is filled out uselessly. I would suspect that it is possible, as with the sort of study that Peat, Marwick, Mitchell did, perhaps more detailed examination of individual programs that appear to have on the surface bad records, bad histories of default ratios and so on—that we could find out what is wrong with the program. It is not something that we would necessarily have to go ask individual citizens to find out about.

Senator BELLMON. You raise a possibility.

Can you suggest a method?

Mr. HAVENS. I think examining the administrative practices of the agencies themselves.

Senator BELLMON. By GAO?

Mr. HAVENS. GAO could do this. Peat, Marwick, Mitchell has clearly examined some of them. Certainly it is an appropriate area of examination for GAO and others.

RECOMMENDATIONS TO BUDGET COMMITTEE ON CONTROLLING CREDIT BUDGET

Senator BOSCHWITZ. It is my conception of these hearings that we are trying to get an understanding, the Budget Committee and ourselves and the Government as a whole, of the extent of loans and loan guarantees, and the activities of the FFB, which sometimes acts as a clearinghouse in order to refinance some of the banking institutions. But apparently we do not have a very good handle on the number and extent of the various programs that now exist. Perhaps it should be the first step of this subcommittee to make a listing of such programs so that we can have a better understanding and then perhaps develop some history with respect to their success or default ratio as Senator Bellmon speaks about.

I understand it is principally the student loans always that are referred to when bad experiences are sought out.

What steps do you think the Budget Committee should take, first to develop an understanding—and from understanding perhaps to placing control on the entire so-called credit budget? I might ask Mr. Herman. What steps do you think our committee should take in trying to get a handle on a problem that seems to be the subject of a good deal of mystery?

Mr. HERMAN. The first point is that while the student loan program is best known for the extent of their problems, they do not hold exclusive title to the territory.

That gets into a number of other problems in terms of how do you account and recognize them. But I think it is appropriate to

say that there are a number of other programs which have similar types of difficulty.

With respect to specific recommendations for congressional consideration, I think the need, as we struggled this morning, is to begin with definitions of key terms and uniform standards that the agencies are expected to have regarding requirements to the committee and to the Congress. Without this information, any of the other questions of warning systems or intervention to try to make right a loan in trouble cannot be done.

I think consideration of some form of establishment of this early warning system or—sufficiently early notification to permit intervention by appropriate specialists with respect to the recipient—is what is called for.

Second, there are techniques such as actuarial risks associated with the pooled loans which can be used to make better judgments.

ASSIMILATE ALL INFORMATION REGARDING CREDIT PROGRAMS

Senator BOSCHWITZ. Actuarially I suppose we can apply a figure to most of the loan guarantee programs and then whatever that figure is would appear on the budget. Unless those programs for political purposes do not want to report. As Mr. Havens pointed out, there is resistance to reporting some loans because they do not want to look bad for the record. That is, of course, a problem. We seem to be in the very primitive, beginning stage of the whole consideration of these direct loans and loan guarantees, without definitions, without even being able to collect all the names and statistics with respect to the program.

What would seem to be the first step, to collect all of that information—that is not even under one roof at the present time.

Is that the case, Mr. Reischauer, that we do not really have this information put together?

Mr. REISCHAUER. That is right. I think following the original question, that I would suggest that the proper locus of this information gathering is the executive branch where the knowledge and the experience of these programs exist. Such a catalog could be requested by the Budget Committee from the executive branch and could include a listing of how many discrete programs there are and estimates of their default experience. Before that second step is taken the executive branch would come up with a workable and more or less common definition of default.

OMB PROPER PLACE FOR INFORMATION GATHERING

Senator BOSCHWITZ. Which would differ from one program to another depending on the nature of the loan and the purpose of the loan and certain social interests that are sometimes involved in those things.

Do you agree, Mr. Havens, that it would be the executive department that puts this together? CBO apparently does not want to.

Mr. HAVENS. I think we all have enough work to do. I think it will have to come from the executive branch. Whether it is managed from the executive branch is probably a secondary consideration. I think the important issue is that the data that exists is in the executive branch and that the executive branch can more

efficiently bring it into focus in a reasonable, consistent way, if they choose to do so, if they choose to be responsive to such a request.

I would have no problem, at least initially, seeking the executive branch's assistance to carry out such a mission.

GATHERING OF INFORMATION ESSENTIAL

Senator BOSCHWITZ. Well, it is a little frustrating to me to be dealing with billions of dollars and not knowing exactly what the programs are, not having it listed. After that, the business of how to account for default by recognizing the various purposes of the program and the types of loans—I think it would not be that difficult to come up with.

How is the total figure—how does one come up with a total figure without knowing all of the programs, without having all of that information in one place?

Mr. SHILLINGBURG. It is possible to determine the total figure of outstanding liability, for instance, for active programs. The agencies submit data to OMB annually as part of their regular annual submission. In the past, these data were not very carefully scrutinized by OMB because until this year there was no credit budget. The data were provided solely on an informational basis. Consequently, the numbers were not really scrutinized at all.

OMB did not even bother sometimes to see if they added up correctly within an agency. They are now working diligently to scrutinize the data. But it is a slow process. They do receive agencywide totals for active programs.

When we say we do not have a list of total loan guaranteed programs, we are saying that there are a large number of relatively inactive programs that it is difficult to track down.

Senator BOSCHWITZ. Some are very small.

Am I correct that there at one time was a listing made? As I recall, a number of 460 or 470 such programs?

Mr. SHILLINGBURG. I am not aware of any such list. The only list I am familiar with was done by the Economic Stabilization Subcommittee of the House Banking Committee 3 years ago. It was published as a subcommittee print, and it is the one from which the figure of 160 programs is derived.

Senator BOSCHWITZ. Well, thank you very much. We will try to put together some of the basic information so that we have some understanding of it and then go on to try to find a way in which some proper accounting can be reflective of the various programs.

The hearing is adjourned.

[Whereupon, at 12:10 p.m., the special subcommittee adjourned, subject to the call of the Chair.]

CONTROL OF FEDERAL CREDIT

TUESDAY, JULY 1, 1980

U.S. SENATE,
SPECIAL SUBCOMMITTEE ON THE CONTROL
OF FEDERAL CREDIT
OF THE COMMITTEE ON THE BUDGET,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:33 a.m., in room 357, Russell Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the special subcommittee), presiding.

Present: Senators Metzenbaum, Chiles, and Boschwitz.

Staff present: Lizabeth Tankersley, counsel; and Ann Hadley, analyst, full committee. Claudia Farris, legislative aide to Senator Metzenbaum. William L. Stringer, counsel to the minority, full committee.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. The committee will come to order.

I am very pleased to welcome Congressman Bethune to the third hearing of the Special Subcommittee on the Control of Federal Credit Programs. Later this morning, we will hear from Senators Percy and Proxmire. We also will receive testimony from representatives of the users of the Federal credit programs.

The impetus for the formation of this task force grew out of concern in the Budget Committee and elsewhere, over off-budget deficits generated by Federal credit activities.

Testimony received during these hearings has made it evident that we are dealing with a massive—indeed, pervasive—presence of the Federal Government in the Nation's credit markets.

DETERMINING THE IMPACT OF FEDERAL CREDIT ACTIVITIES

At the end of fiscal year 1979, a staggering \$409 billion in direct and guaranteed loans were outstanding. This figure is expected to grow by over \$100 billion by the end of fiscal year 1981. And in spite of this truly extraordinary level of Federal activity in our credit markets, this subcommittee has been informed by impeccably credentialed witnesses from the GAO, OMB, and the accounting profession that we have no way of determining the impact of Federal credit activity on our economy. We cannot assess what it actually does, and we cannot control its effects on credit markets in particular, or on the economy in general. We have also learned that we have no way of accurately assessing the financial risk to which the Federal Government is exposed.

The Chair was particularly impressed at the last hearing with the fact that there is no way whatsoever of determining at this point what the defaults are or what they probably will be.

This general lack of information and control over the big picture applies to individual programs as well. There are wide variations in the ways in which credit programs are designed, the purposes for which they are used, and the ways in which they are managed. These variations make general information about these programs unreliable, and they make congressional oversight virtually impossible.

The solutions proposed for dealing with this morass have covered the range of possibilities—from improving our information base, to establishing uniform standards, to developing omnibus credit control legislation which would respond to economic as well as to the budgetary problems generated by lack of control.

During the next month this subcommittee will be examining this testimony in detail.

We will also be analyzing data we have requested from agencies which have credit programs under their jurisdiction—and we expect in the end to make recommendations to the Budget Committee on what the next steps in the development of the Federal credit control system should be.

Congressman Bethune has introduced a bill which suggests possible next steps. We look forward to hearing from you, regarding your legislation and the rationale behind it.

Senator Percy has also introduced legislation on credit control, and Senator Proxmire has held hearings on the subject as chairman of the Senate Committee on Banking, Housing, and Urban Affairs. As I mentioned earlier, we will be hearing from them this morning as well.

I believe that whatever approach we take to the control of Federal credit programs should be sensitive to the use of which these programs will ultimately be put. And so we will hear from representatives of the housing industry, the agriculture industry, and from experts on community and economic development on how Federal credit control might affect their operations.

DETERMINING SUBCOMMITTEE RESPONSIBILITIES

This committee recognizes that there is a strong line of delineation between our inquiry having to do with the control of Federal credit, the use of Federal credit, and substantive issues that are involved in connection with the use of that credit.

This committee does not consider it within its responsibilities to determine whether or not this program or that program is substantively good or bad, but rather to provide a method of knowing what is going on, so that the Congress might deal with the subject in a rational manner, but we do not intend at any point to indicate that we approve or disapprove of any particular area of credit use. It will be very important for us to have the views of Congressman Bethune. We had hoped to hear from Congressman Mineta this morning as well, who also has addressed himself to this subject in the House, but due to unfortunate development in his staff, he will not be able to be with us today.

Senator BOSCHWITZ, do you have an opening statement?

Senator BOSCHWITZ. No; I do not, other than to say there also does not seem to be an inventory of all those long programs, in addition to the other problems that you cite.

Senator METZENBAUM. Thank you very much.

Congressman Bethune, you can read your entire statement or you can wing it and we will put your entire statement in the record, whatever is convenient for you, sir.

**STATEMENT OF HON. ED BETHUNE, A U.S. REPRESENTATIVE
FROM THE STATE OF ARKANSAS**

Mr. BETHUNE. Thank you, Mr. Chairman.

I think I will wing it and give an overview of my statement inasmuch as I am pressed for time, and I would not want to duplicate some of the general themes that the committee has spent much time on already.¹

It is a privilege to appear before your special committee and before you, Senator, being the first occasion I have had to work with you being a new Member of the House.

My friend Mr. Boschwitz and I go back to 1978 when we were both elected to come to this place, and our relationship began immediately. It is indeed a pleasure to be here. I have been impressed as a freshman that Congress spends a great deal of time on propositions of taxing and spending. We pontificate as to the net effect on the economy of \$5 billion increase in taxes or \$15 billion decrease in taxes. Yet we are almost blase in our consideration of the effect of runaway Federal credit on the economy. In fact, even if we wanted to know the effect of credit on the economy, we would be unable to make that judgment because we do not know what is going on with respect to Federal credit assistance programs.

If Congressman Mineta were here, he would testify that his bill is identical to mine insofar as part 1 is concerned. My bill is different when I get to title III because I recommend a sequential referral of all Federal credit assistance programs through a committee of the Congress. I happen to think that eventually we would decide that Banking, Finance and Urban Affairs would be the committee in the House that would be in the best position to sequentially consider Federal credit assistance programs, but I would leave that to the Congress in its judgment to decide.

MOST RUNAWAY FEDERAL CREDIT ASSISTANCE PROGRAMS OFF-BUDGET

But before I get to that, I would second your findings. We do have runaway Federal credit assistance programs. Most of it is offbudget. It is a serious problem because Government is preempting private credit, and we must realize that when we get into this business, we are substituting political judgments for the judgment of the marketplace. Those trillions of transactions that take place every day always add up to good judgment, or have added up to good judgment for the most part. Yet we are replacing that system in many respects with our political decisions. The Congress of course has realized this and been talking about it for some time. In the 1981 budget resolution, there was at least lip service to the problem in that the first budget resolution included a sense of Congress resolution that we should come to grips with this problem and that Congress through the appropriation process should limit in fiscal year 1981 offbudget lending activity to certain levels.

¹ See p. 114.

APPROPRIATIONS COMMITTEES RELUCTANT TO ENFORCE SENSE OF
CONGRESS RESOLUTION

The question is: How are we doing it in 1981, and in some instances we are and in some instances we are not. At least that is the case in the House. In the House energy and water appropriation bill limits were set on some credit activities, but in others frankly the Appropriations Committee in the House waffled, and I give specific reference to the State-Justice appropriations bill which is about to come to the floor. In there the committee not only failed to set limits on credit as was recommended in the budget resolution, but the committee expressly declined to ride herd on the authorizing committee.

In my statement I include some language from the committee report, and I would just extract a part of it and say the committee has disapproved the request for appropriation language which would limit total commitments to guarantee loans from the Federal ship financing fund.

They go on to say they do it because there is an authorization limit in effect of \$10 billion, and the committee simply did not want to contravene existing authority.

So I think that is indicative of the fact that in the House of Representatives there is a great reluctance for appropriations committees in spite of our sense of Congress resolution only a couple of weeks ago to ride herd on this authorization that is in place already.

USE OF CREDIT PROGRAMS IN BALANCING THE BUDGET

Senator METZENBAUM. I get the feeling, Congressman Bethune, that we in the Congress are very much concerned for public consumption about balancing the budget, but use of Federal credit and loan guarantees gives us a very convenient way to achieve some of the objectives about which we are concerned without at the same time putting them on the budget?

Mr. BETHUNE. Indeed I do. Clearly Federal credit assistance programs constitute back door spending and is a subsidy. That is the only way to view it. I think we are passing favors to particular segments of the economy in a way that cost money, but because it is in the nature of back door spending, it does not show up. We have no process to reveal what it is that the Congress is doing. I agree with you wholeheartedly. My frustration comes from the fact that being a new Member here, I do not have much staff and I do not have as much clout as some of the senior Members, and so when we passed the first budget resolution, I was quite pleased.

APPROPRIATIONS BILLS LIKELY TO EXCEED BUDGETARY CEILINGS

I thought that Congress had recognized a very serious problem and as we began the appropriation process this summer that we would see some headway being made. But unfortunately as these bills are now coming to the floor, I find that we are really not doing much of anything. It is the same old story.

SIF

In the House of course, an individual Member such as myself is limited in what we can do as this matter comes to the floor because an effort to amend the appropriation bill is ruled out of order, either on the grounds that you are legislating or that the rule does not permit an individual member to attack the bill on this basis.

Senator BOSCHWITZ. That does not happen over here.

Mr. BETHUNE. Maybe the Senate can do some things we cannot do in the House. But I think we are going to bust the ceiling that we set for ourselves. The synfuels bill alone came through the House the other day and will over the long haul provide for some \$86 billion in credit assistance. I think actually the thing is out of control. I think for 1981 the battle is lost. I do not think we will make the limit that we set for ourselves or the President recommended in his initial budget proposal, but I do not believe that the battle for the minds of our colleagues is lost. I think if this committee and if individual members who are interested in this particular problem will continue to wage this battle on the floor as the bills come through, to engage in appropriate colloquy so that Members in the House and Senators can begin to become familiar with the problem as this committee is attuned to the problem now, I think we will begin to make some headway because we will build the political consensus that is necessary to pass the type of legislation that we need to bring this under control.

My personal crusade in the House will continue. Every appropriation bill that comes to the floor, I will engage in colloquy with the chairman, which is about all I can do, and I will continue to review the authorization bills to see if there is any change that can be made there.

IMPACT OF FEDERAL CREDIT PROGRAMS ON INDIVIDUAL BORROWERS

I have attached some examples of the sort of thing that I am doing there.¹ I see the problem basically can best be described with what I call proverbial pie illustration. There is a relatively stable amount of credit out there in the world at any given time. People compete for that credit and the Federal credit favors one segment of the economy over another, with some sort of subsidy or some sort of political encouragement for the institutions to make loans to that segment of the economy. Obviously it is directing that portion of the credit through that segment of the economy and taking it away from other segments of the economy.

I have no quarrel with loan guarantees. I simply think we ought to know what we are doing. If we are directing credit to a particular segment of our economy, the question comes as to whether that is productive venture. If it is nonproductive, then we are subsidizing nonproduction and presumably taking money away from an activity that might be productive. Of course, that in the long term would be inflationary.

¹ See pp. 118-120.

INCLUDE DEFAULT FACTOR IN RATE CHARGED FOR LOAN
GUARANTEES

Senator METZENBAUM. Are you more concerned with the substantive question of whether we should or should not be having a particular Federal credit program, or are you more concerned with the substantive question of whether some program should or should not use Federal credit or are you more concerned with the question to which the Chair addressed itself originally, and that is the concern of accountability, not knowing what the losses will be and the costs will be?

For example, on the synthetic fuels bill that was just passed, that is about \$20 billion program, and that is offbudget as I understand it. I do not think there is much doubt in my mind that we are going to suffer some negative impact. Now I did see to it I think that we put some factors in for every loan had to include a very small factor, I thought it should be larger, in order to provide a cover for the losses that will be experienced. But I think it is much too low. Some programs do have that in. As a matter of fact, the Chair has some strong feeling that all programs ought to have that in. So if you put out \$100 million in loan guarantees, you charge the rate, instead of it being, say, 8 percent, it becomes 8.5 percent, and half a percent goes into a fund which covers losses—defaults that may occur. The 8 percent goes to the bank and half a point goes to the Federal Government to cover those losses. Now we have that in some loan programs but not all of them.

Mr. BETHUNE. Senator, I agree with your very illuminate statement at the outset, Congress in its infinite wisdom may very well decide that we need a loan guarantee program, either in the agricultural segment of the economy or in the auto industry or in the energy field. I would not presume to second guess the collective wisdom of Congress as it goes along and makes those judgments. I think you are exactly right. What we are trying to do here, it occurs to me, is to understand better what we have done and what we are doing now and what we need to be doing in the future with respect to these types of programs. I think it is reckless for us to go much further and to pass bills of the enormity of the synthetic fuels legislation without knowing how that fits into the Federal credit assistance picture generally. I think your opening statement was right on target and is my sentiment entirely.

CONGRESSIONAL PROCESS ENHANCED BY FEDERAL CREDIT CEILING

Senator METZENBAUM. Do you think that just as now Congress is forced to make choices, choices of one program against another, trying to balance the budget, do you think if we have a ceiling on credit that this is going to help the congressional process in forcing the Congress to make the same kinds of choices as far as credit programs are concerned?

Mr. BETHUNE. Yes. I think it would create a discipline that we need here in the Congress because now as it stands those who would be favored with help from the Congress are those who get here first and who can put together the political consensus that is necessary to get the legislation passed. There is no systematic way for the Congress to try to balance the competing interests and

make decisions that are not only in the best interest of the economy, but that would be fair, as these various interests compete for the credit pie.

REEVALUATION OF BILLS AUTHORIZING CREDIT PROGRAMS

Senator METZENBAUM. Now your bill provides that each bill that authorizes credit programs has to be referred to designated committees for evaluation. The question I have is: would the committee to which the bills are referred have the ability to make substantive legislative changes in credit programs, credit program terms or devices? In other words, would the committee to which it is referred have a right to impact on substantive aspect of the program itself?

Mr. BETHUNE. No. So far as I know, my legislation is the only legislation that addresses the particular problem that I think is critical in terms of procedure here in Congress, and I address it by suggesting we need sequential referral. If I could spend a couple minutes on this particular portion, I think in the course of my statement I will answer the Senator's question.

Title III of my bill would give a committee of the House designated by the Rules Committee 15 days of sequential referral of portions of authorizing bills which contain credit programs. It is not my intent for the committee to have any say over the dollar amount authorized by the credit program. That power I think should be left with the authorizing committee subject to the limits of appropriations committees according to the process we would establish.

SEQUENTIAL REFERRAL OF CREDIT PROGRAMS

Senator METZENBAUM. You suggest two committees, Urban Affairs Committee and one other committee.

What if the same committee is the authorizing committee and the committee to which the matter is referred in connection with credit control aspects?

Mr. BETHUNE. I think that would be all right. In the case of banking, for instance, we handle the Chrysler credit—the Chrysler bailout proposal, and I think it would have been all right for the Banking Committee to have made the type of report that I seek in my legislation. It would have forced us to address the problems that I think we should address in sequential referral. For instance, what my bill would do, Senator, is it would give the House committee having sequential referral the opportunity and the responsibility, one, to analyze the nature and risk of that particular Federal credit program, and two, analyze the impact of that program and all programs on the economy.

Senator METZENBAUM. Should it not have already done that?

Mr. BETHUNE. They would do that, but they would do it in a vacuum. They would do it without reference to total amount of Federal credit assistance that is out there. The committee having sequential referral would analyze the risk relative to other risks that are in place at the time.

Second, the committee would evaluate the overall economic impact of the Federal credit by reviewing the mix of credit programs, and I think I have just mentioned that.

Third, and I think this is the most important point or one of the most important points, it would help set universal terms, definitions and default policies. Thus it would add consistency to Government credit programs.

ESTABLISH UNIFORM DEFAULT PRACTICES

I know this as we started here today, the Senator mentioned it is very difficult to know where we stand in terms of Federal credit assistance programs because there is no consistency in default practices that are employed around the country by various agencies. This is caused because default policy may be different on the west coast than it is in the Southeast, than it is in the Northeast, and it is very hard for auditors to make any sense out of all of that.

Senator METZENBAUM. And the agencies——

Mr. BETHUNE. Among the agencies as well.

Senator METZENBAUM. Including agencies that do not really want to report defaults, but rather to roll over the credit or to keep it going so it not be apparent that there has been that amount of default. There is almost an attempt to cover up the default by not calling it default. But a default by any other name is still a default, if you have some terms and specifications, but at this moment even OMB does not have any criteria for that determination to get them to do it.

Mr. BETHUNE. I agree with the Senator. I think that is why we need to bring some uniformity to this business of Federal credit assistance. One of the reasons that I think we would finally agree that the committee of referral should be the Banking Committee is that when we get into the business of passing one credit assistance program after another on the floor of the Senate or on the floor of the House, we really do not spend much time trying to analyze how that will impact our existing financial institution structure. I think the Banking Committee would be in the best position to analyze that particular problem. I know that in some instances already Federal credit assistance programs have indeed had an impact on existing financial institutions.

For example, I am told that insurance companies feel that Federal land banks have taken away much of their rural lending. Whether that would prove to be the case, I am not certain. I know every time we redirect credit in this economy here in the Congress, that we are putting somebody in business and putting somebody out of business. I just think if we are going to continue to do this, we ought to be extremely careful because we would play havoc with some of our existing institutions. That is another reason I think one committee ought to have responsibility to act as a sort or give us a check on that as we process this legislation through the Congress.

STANDARDIZE LOAN CONTRACTS

A couple other points along the same line. We have no standardized loan contracts. They are inconsistencies in interest rate structures, student loan programs have one interest rate and other programs have other interest rates. I do not know exactly why they are set at that level, and I do not know whether Congress in

setting them at that level takes into account that there is disparity in the interest rates. It occurs to me that we need come to grips with that question so that we can answer intelligently rather than passing it off as unimportant problems. It is an important problem.

EARLY DETECTION OF DEFAULTING PROGRAMS

We need to develop banker-like skills as we handle Federal credit assistance, and we need to develop some systems so we can reflect some of the programs that are in trouble.

From time to time we see news shows. I recall seeing one just this weekend—"60 Minutes"—going over again the abuses in the FmHA, so some credit assistance there is finding its way into the hands of very wealthy farmers out in San Joaquin Valley in California. One of them has a tennis ranch and another one has a horse farm. The essence of the story was that Congress is subsidizing this activity at the expense of others who are competing for credit in the marketplace, and so we hear these horror stories from time to time, and I think we need some sort of system here in Congress so that we would redflag these programs that are in trouble and perhaps have a way to catch them before we see them on the Sunday evening news show.

Senator METZENBAUM. Congressman Bethune, Senator Boschwitz has a couple questions, and I see that Senator Proxmire is here and I know he is chairing a hearing. We would like to have a couple of questions from Senator Boschwitz.

IMPACT OF REROUTING CREDIT THROUGH FEDERAL GUARANTEE PROGRAMS

Senator BOSCHWITZ. You have asked most of the questions that I had also in mind. Let me ask you, Congressman, have you seen any studies about what the impact of the rerouting of credit through government guarantee programs has been, what the impact is on the rest of the lending society? I would make the same presumption you do, incidentally, but I have not seen any—

Mr. BETHUNE. Senator, I think any such opinion right now would lack credibility for the reason that we do not know the nature and extent or the mix of Federal credit assistance that is out there right now. Accordingly, it would not be a scientific opinion, it would only be a guess. I think perhaps those who have worked in this area for a long time like Senator Proxmire could give a very educated guess as to what the impact is. But I really think that we are not in a position, I think we have to admit that we do not have the data right now. I think that is what this hearing is all about, we need to start compiling that sort of data so we can make that judgment.

UNIFORM LOAN CONTRACTS

Senator BOSCHWITZ. Have you worked on any uniform type of loan contract that you talk about in your testimony, loan contracts or financial information type of sheets? Has any of that come out of your consideration of this bill?

Mr. BETHUNE. No, but I think that is the sort of thing we need to look at. As I indicated at the outset, I am a freshman Member, and

you are looking at the entirety of my staff on this problem sitting to my left here. We have got about all we can say grace over to carry forward the message that I have brought this morning. We will continue to do that.

Senator BOSCHWITZ. As I told you a little earlier on, I think your statement is the best organized and best exposition of the problem that I have heard during the committee proceedings. You also had mentioned in your prepared testimony that there is no requirement for credit elsewhere test. You have particular inclination that that should always exist.

Mr. BETHUNE. No, not necessarily. I think that it is the type of thing that is always to be considered, and I do not like to see the Congress go about its business haphazardly. I think that is what we are doing because we are not being consistent, because I just raise that point, and my beef is not the substance of what we have done or what we might do in the future. My beef is, I think, the beef of this committee, and that is that we simply do not know where we are.

Senator BOSCHWITZ. The chairman, I am sure, will address himself to your statement that Congress goes at things haphazardly. Perhaps they do in the House, Mr. Chairman, but certainly not in the Senate. [Laughter.]

Thank you very much, Congressman.

Senator METZENBAUM. Thank you very much, Congressman Bethune. We look forward to working with you. We appreciate your interest and help on this subject.

Mr. BETHUNE. Thank you.

PREPARED STATEMENT OF HON. ED BETHUNE, A U.S. REPRESENTATIVE FROM THE
STATE OF ARKANSAS

Thank you, Mr. Chairman, for inviting me to appear before this Special Committee on Control of Federal Credit to testify on H.R. 7342, the Federal Lending Oversight and Control Act.¹ Yours is a monumental task, and I support your endeavor. The battle against inflation simply won't work if our credit policies are not coordinated with monetary and fiscal policy. To do that we need to understand where we are and we need to know more about what we are doing with federal credit.

Congress has a mechanism for controlling federal spending. We all hope that our budgetary process reforms will soon end deficit spending.

Likewise, I hope Congress will recognize the need for a permanent budgetary mechanism to control credit extended by the federal government.

You have already heard testimony from my colleague, Congressman Mineta on his bill, H.R. 5683. Since my bill is like his insofar as it concerns the need to control aggregate credit, I will concentrate today on Title III, which would amend House Rules to designate a single Committee of the House to review the makeup of Federal credit programs within the limits imposed by the budget resolution. Before doing that, though, I would like to make a few general comments about the need for Titles I and II.

TITLES I AND II, CEILINGS ON LOANS AND LOAN GUARANTEES

For fiscal year 1981, the President's budget set credit totals at \$142 billion, which is almost one quarter the size of federal budget spending. The volume of new direct loans made by off-budget federal entities grew by 70 percent between 1976 and 1979, or twice the rate of growth in total budget outlays. During that same period, new loan guarantees grew even faster, by 108 percent. Most of this growth is occurring

¹ Cosponsors of H.R. 7342 include: Campbell, Clinger, Conable, Daniel (Robert W.), Derwinski, Devine, Erdahl, Forsythe, Hinson, Kramer, Porter, Snowe, Solomon, Stanton, Stockman, Tauke, Whitehurst.

outside of congressional review because of the extra-budgetary nature of loan guarantees and the predominance of off-budget direct lending.

Congress needs to reckon with this exploding preemption of private credit.

A first reckoning occurred when Congress approved the First Budget Resolution this year which set targets on federal credit for fiscal year 1981. Language from the fiscal year 1981 Budget Conference Report reads:

"It is the sense of the Congress that the President and the Congress, through the appropriations process, should limit in fiscal year 1981 the off-budget lending activity to a level not to exceed \$28,500,000,000 and on-budget lending activity to a level not to exceed \$38,100,000,000; and new primary loan guarantee commitments to a level not to exceed \$79,600,000,000."

APPROPRIATIONS COMMITTEES RELUCTANT TO ENFORCE SENSE OF CONGRESS
RESOLUTION

But, are the Appropriations Acts for fiscal year 1981 carrying out this sense of the Congress? In the House, some are and some are not. In the House Energy and Water Appropriations bill, limits were set on some credit activities but in others the Committee waffled. (See insert A).

The State-Justice Appropriations bill did not set limits at all; to the contrary, the Committee expressly declined to ride herd on the Authorization Committee. Language from the Committee Report (96-1091) for the Federal Ship Financing Fund, for example, reads:

"The Committee has disapproved the request for appropriation language which would limit total commitments to guarantee loans from the Federal Ship Financing Fund during fiscal year 1981 to not more than \$1,200,000,000 of contingent liability for loan principal, and which would limit obligations for the principal amount of direct loans from the Fund during fiscal year 1981 to not more than \$250,000,000.

"As stated in the section of this report concerning Federal Ship Financing Fund, Fishing Vessels, Title XI of the Merchant Marine Act of 1936 authorizes a limitation of \$10,000,000,000 for this account as well as the NOAA account, on obligations guaranteed and outstanding at any one time from the Fund. Therefore, the proposed limitation on total commitments to guarantee loans during fiscal year 1981 would contravene this provision of the Act. With respect to the request for an aggregate limitation on the amount of direct loans for fiscal year 1981 that could be made from the Fund, the Committee notes that title XI provides for no such limitation on the direct loan program. Therefore, the proposed limitation on direct loans from this revolving fund, for which no appropriation is provided in the accompanying bill, would contravene the authorizing legislation and would also not be in order under the rules of the House of Representatives." (page 36)

To make matters worse, there is virtually no way an individual Member, like myself, can offer a credit limit in an authorization bill when it comes to the Floor. Such offers are ruled out of order unless the member can persuade the Rules Committee to make an exception—an unlikely occurrence until we have a political consensus to bring this matter under control.

It is apparent that Congress will bust the President's recommended ceiling and the aggregate cap set by the Budget Resolution.

The Synfuels Bill alone provides sundry financial assistance which could total \$86 billion. (See insert B).

While the battle to actually control this problem for fiscal year 1981 is already lost, the battle for the minds of our colleagues on this issue is not.

Those of us who fret about this must use the 1981 process as an educational opportunity. We must—during the remainder of this 96th Congress—build a political consensus by speaking to the issue every time we see it.

I have launched a personal crusade in the House to question and critique as many bills as I can. I'm attaching a few examples of the efforts (See Inserts A, B, and C). I have made already so you can better understand my point. I will keep it up with the hope that we can make real progress when the 97th Congress begins.

IMPACT OF FEDERAL CREDIT PROGRAMS ON INDIVIDUAL BORROWERS

The problem with off-budget federal credit assistance can best be described by referring to the proverbial pie illustration. If we assume that there is a reasonably stable amount of credit in the market place, what the federal government promotes in federal credit for some, means less for others. According to the Congressional Budget Office, "In a period of restrained growth of money supply, such as we now

face, growth in the total amount of credit provided through federal programs may well mean that borrowers not eligible for these programs who seek credit in the private market may not be able to obtain it, or may have to pay more for it through higher interest rates."

At a time when the rate of growth of our national productivity is declining, we need to know whether we are directing credit to non-productive ventures and taking it away from productive enterprise. We need to know the nature and extent of federal credit activities and Titles I and II are a step in that direction.

My legislation, like that of Congressman Mineta, would establish procedures for setting targets and ceilings, in the congressional budget process beginning fiscal year 1982. Further, it would check backdoor spending by subjecting all federal credit programs to the annual appropriations process.

TITLE III—TIGHTER CONTROLS AND OVERSIGHT OF INDIVIDUAL CREDIT PROGRAMS AND TOTAL CREDIT ACTIVITIES

Title III of my bill is different. It, to me, is the more important feature of the legislation because it would help us to intelligently assess and control the impact of federal credit assistance on national economic policy.

Specifically, Title III of my bill would give a Committee of the House, designated by Rules, 15 days of sequential referral of portions of authorizing bills which contain credit programs.

It is not my intent for the committee to have any say over the dollar amount authorized for credit programs. This power should rightly be left with the authorizing committees subject to limits of appropriations committees, according to the process we hope to establish. What my bill would do is give a single House committee the opportunity to: (1) Analyze the nature of the risk of individual federal credit programs; (2) evaluate overall economic impact of federal credit by reviewing the mix of credit programs with regard to risk and maturity; (3) help set universal terms, definitions, default policies; thus adding overall consistency to government credit policy; and (4) determine the impact of individual credit devices and overall credit on our national financial institutions.

INADEQUATE INFORMATION ON TOTAL CREDIT ASSISTANCE OBLIGATIONS

According to information provided to this Committee by Peat, Marwick, Mitchell & Company there is definite need for order and control over the many authorized programs now in existence, as well as to help provide a framework for necessary overview of their economic impact and cost. Studies show that in many instances, there is no clearcut knowledge about the nature and extent of obligations created by federal credit assistance programs.

This results from:

1. Ambiguity as to whether a program provides guaranteed loans or insured loans, and hence the amount of liability.
2. Inadequate information about the soundness of insured loan programs.
3. Lack of uniform financial information, such as debt-to-equity ratio of the project or the revenue-generating capabilities of the asset being financed for a commercial project or the income of the borrower for an individual loan.
4. Lack of standardized loan contracts.
5. Inconsistencies in the interest rate structure.
6. Lack of equity interest by the borrower in the project being financed with a guaranteed or insured loan or obligation.
7. No requirement for a credit elsewhere test, nor a requirement for collateral.
8. Inconsistent, vague definitions for default and other key terms, including delinquency and forbearance. Variations in these words make it difficult to conduct effective congressional oversight.
9. Lack of timely early warning devices about programs or borrowers that are likely to default.
10. Incomplete knowledge about the credit flow stimulated by loans and loan guarantees, which complicates the coordination of fiscal policy with monetary policy.
11. A lack of understanding about how credit programs affect the economy. Guaranteed lending programs may, during periods of high inflation bring higher borrower costs to the federal government. The issuance of large amounts of federally guaranteed debt produces, according to CBO, a large class of borrowers who are relatively insensitive to market interest rates. The Federal Reserve may have to force much higher interest rates in order to accomplish a desired cooling of the economy. Higher federal borrowing costs would be the result, and all taxpayers would end up paying the cost of loan guaranteed programs.

12. No clear understanding of how credit programs impact our existing financial institutions. For example, I am told that insurance companies feel that Federal Land Banks have taken away much of their rural lending. How many other patterns are taking place?

NO OVERALL FORMULA FOR CREDIT PROGRAMS

Granted, there is no simple uniform formula that can be applied to each federal credit program. However, Congress needs to develop banker-like skills so that government intervention in credit activities will protect the interests of the public and foster programs that are consistent with sound economic policy. If some of the problems I have described can be resolved, we may eventually be able to devise a system that can "red flag" programs in trouble—and believe me—many programs have experienced serious defaults which have required appropriations to maintain their solvency. A report prepared by OMB shows that many of the 200-plus federal lending programs have incurred significant losses. For example, \$275 million of guarantees in the student loan insurance program terminated due to default in 1979. That same year, the veterans loan guarantee revolving fund wrote off \$28 million in direct loans, and \$355.9 million in guarantees terminated due to default. The SBA business loan investment fund direct loans wrote off \$143.8 million while \$263.5 million in loan guarantees defaulted.

We could strengthen credit programs. We could better understand the impact credit policy has on our national economy. Before this is possible, however, there must be better understanding of what we are doing and a greater uniformity in federal credit policies.

Mr. Chairman, I am very sensitive to the need for workable, practical solutions, and the workload of the Congress. Even the best of intentions can go sour if they are not practical or if they cannot be implemented properly. I believe a sequential referral system is workable. Although there are well over a hundred credit programs in existence, their authorizing legislation is periodic. Thus, the work load would not be unsurmountable. For example, during the 95th Congress only 27 bills contained some kind of loan guarantee.

Finally, I'd like to say that there are strong indications of support for graining control of federal credit assistance programs. The awareness of this Committee, the targets on credit set by this Congress in the First Budget Resolution, indications from the President's new credit budget, bills introduced by our colleagues, testimony of Dr. Alan Greenspan before the House Banking Committee hearings on Chrysler, and the endorsement by 65 House and Senate members of the following resolution at the Republican Tidewater Conference this Spring is a clear signal to me that some action is necessary and that we have the backing to make it possible. The resolution from the Tidewater conference reads as follows:

I. *Resolved*, Because Federal credit programs have profound effects on the marketplace, the Federal government should amend the Budget Reform Act to establish a procedure to set annual ceilings for and determine the nature and extent of Federal loan guarantees and direct loans.

Thank you very much, Mr. Chairman.

INSERT A

(H.R. 7590, Energy and Water Appropriations)

June 24, 1980

CONGRESSIONAL RECORD—HOUSE

H 5561

are most important programs, and must be funded at higher levels than provided by this appropriations bill.

Mr. MYERS of Indiana. Mr. Chairman, I yield 5 minutes to the gentleman from Arkansas (Mr. BERTUNE).

Mr. BETHUNE. I thank the gentleman for yielding.

Mr. Chairman, I would address these questions to the chairman of the subcommittee, but first it is necessary to make a general statement so that my questions can be understood. When we were arguing over the budget here recently, there was some discussion about the fact that in addition to trying to put some limits on taxing and spending, we were trying to put some limits on lending as well. There was a discussion throughout that anguishing process in the spring of trying to limit Federal credit assistance programs, and that largely came about as a result of the interest that we had in the Chrysler bailout last fall. So during the course of the budget process, the House did pass as a part of the fiscal year 1981 budget proposal a sense-of-the-Congress resolution which provided, among other things, that it is the sense of the Congress that the President and the Congress through the appropriations process should limit in fiscal year 1981 the total budget lending authority and then set aggregate ceilings for the amount of Federal credit assistance. The aggregate ceilings were calculated by reference to recommendations that the President of the United States had made in the budget proposal. We began talking about all of this because Federal credit assistance programs are really out of control. We do not know the nature or extent of them. All we know is that they are approaching some \$500 billion. Most of it, of course, is off the budget. What we are doing, of course, in that process is backdoor spending because we are subsidizing certain activities with no systematic way to fairly allocate the subsidies to particular projects. Furthermore, the economic impact of credit is not well defined. We really do not know what it does to our economy. That was the rationale that underlay the budget proposal and that section of the proposal which said that through the appropriations process we should begin to bring order to all of our credit programs.

I have been watching for the appropriations bills to come to the floor because I am eager to see whether or not we here in the Congress are going to carry out that very important resolution that we just agreed to about 10 days ago. The bill before us has a number of credit assistance programs in it. One that I am particularly interested in is the geothermal resources development fund. I notice that the gentleman's committee set a loan guarantee limit for now and through September 2, 1984, of some \$300 million. It is delightful to me to see that the committee is beginning to act in this area. But what troubles me is how the committee arrived at this particular number. In looking at the record, I notice that just last year there was some \$350 million authorized for guarantees of this nature. However, only \$43,400,000 in such guar-

antees had actually been made. So the affected agency actually right now, if you do not do anything, has plenty of authority left. In fact, they can go all the way from \$43 million up to \$350 million.

The CHAIRMAN. The time of the gentleman has expired.

Mr. MYERS of Indiana. Mr. Chairman, I yield 2 additional minutes to the gentleman from Arkansas.

Mr. BETHUNE. I thank the gentleman. Yes, in spite of the fact that they do have apparently a reservoir of credit authority, the committee has seen fit to go ahead and boost that authority up to \$500 million. That seems to me to contravene the intent of our resolution here. Furthermore, it seems to go against the President's recommendation that for fiscal year 1981 credit assistance activities in this category be limited to \$200 million.

So, Mr. Chairman, I apologize for the fact that I have not come to you with these numbers before now but I am only a freshman here and I do not have much staff. I have dug these numbers out on my own here today, just learning recently that the bill would be coming up so soon.

□ 1540

Mr. BEVILL. I think the gentleman's point is commendable. To answer the question, these loans must be approved by banks, with the Government guarantee limited to 75 percent. I might add there has been no default on any of these loans. The record is perfect. This money is for the reserve.

Mr. BETHUNE. Mr. Chairman, I thank the subcommittee chairman for his explanation but it does not quite satisfy me. It appears to me that we really have not limited the agency and what it can do in this particular year with respect to loan guarantees. As a matter of fact, we have actually increased what they can do with respect to loan guarantees.

Mr. BEVILL. As the gentleman points out, there is a \$500-million limit spelled out in the bill. The loans must be in accordance with the basic legislation. That is the limit we have.

Mr. BETHUNE. Then it is increased this year from \$350 million to \$500 million?

Mr. BEVILL. The gentleman is correct.

Mr. BETHUNE. Would the subcommittee chairman acknowledge that presently they have only used some \$43 million of the authority?

Mr. BEVILL. That is the reserve. These loans have been approved by the banks. We have a perfect record, but that money is for a reserve to back up any loans which may default. We have had none in default, I am happy to say.

The CHAIRMAN. The time of the gentleman has expired.

Mr. MYERS of Indiana. Mr. Chairman, I yield the gentleman 1 additional minute.

Mr. BETHUNE. Mr. Chairman, I want to make one additional point. I think we must come to grips with the business of controlling this runaway Federal credit assistance. That was our intention in the fiscal year 1981 first budget resolution.

Mr. Chairman, with all due respect, the

motion that it does not cost anything to make a loan guarantee just because the loan is repaid is fallacious because, as a matter of fact, we are redirecting credit and in many instances we are directing credit to a nonproductive sector of the economy as opposed to a productive sector and, of course, that is inflationary.

Mr. BURGENER. Mr. Chairman, will the gentleman yield?

Mr. BETHUNE. I do yield to the gentleman from California.

Mr. BURGENER. Mr. Chairman, I commend the gentleman for his watchdogging efforts. They are commendable and the gentleman should keep it up. However, I would hope in this particular case we would be able to guarantee more loans, not less. Each one should be very carefully scrutinized. I think this is an excellent use of the Federal credit but Federal credit cannot be unlimited, the gentleman is quite right in that. The fact the gentleman brings to our attention will make us look at it very carefully every year. I think it is a very positive thing, and the committee is not at odds with what the gentleman is trying to do.

Mr. MYERS of Indiana. Will the gentleman yield?

Mr. BETHUNE. I do yield to the gentleman from Indiana.

Mr. MYERS of Indiana. Perhaps this is not the place to control the amount of contingent liability of the U.S. Government. Perhaps the Committee on Appropriations should not have that responsibility but at least we are assuming that responsibility at this point in the appropriation bill as the only vehicle to use. Perhaps it is not as low as needed but it is a way of achieving this investment more cheaply than having the taxpayer actually put out the money.

Mr. BEVILL. Mr. Chairman, I yield 5 minutes to the gentleman from Pennsylvania (Mr. EDGAR).

(Mr. EDGAR asked and was given permission to revise and extend his remarks.)

Mr. EDGAR. Mr. Chairman, I rise today to talk during general debate on this bill because I, like the previous speaker, am very confused about what I read in the bill and in the report. I note on page 95 of the report that under "construction, general," we plan to spend \$1,657 million in a category of general construction on some 289 projects. There will be 60 planning projects and 228 construction projects.

Mr. Chairman, when one does his homework and goes a little more deeply into the subject, the thing that confuses me is that of the 289 projects, 8 of the projects are getting special treatment.

Eight projects being funded in this bill out of the 289 projects, exceed \$30 million in funding. One of the eight projects is funded at \$225 million itself.

Let me describe these eight projects: First, the Tennessee-Tombigbee Waterway jumps out at you at a total annual cost for 1981 of \$225 million.

There is a project for \$32.9 million for Dry Creek, Calif.; \$60.3 million for the Russell Dam in Georgia; \$43 million for the lock and dam No. 26 in Illinois;

INSERT B

(S 932, Energy Security Act--Synfuels Conference Rept.)

June 26, 1980

CONGRESSIONAL RECORD—HOUSE

H 5709

(Mr. BETHUNE asked and was given permission to revise and extend his remarks.)

Mr. BETHUNE. Mr. Speaker, we are all for synfuels, but I am worried about a part of this bill, and the part of it I am worried about is that which allows for an enormous amount of Federal credit assistance.

Last fall we got all worked up about the Chrysler bailout proposal which was a mere \$1.5 billion. Here today we are talking about credit assistance which is virtually 90 times the amount we were considering in the Chrysler matter.

As a result of that debate about Chrysler, the administration and Congress got concerned about runaway Federal credit programs. The President made recommendations in his budget proposal this year that certain programs should have a credit ceiling, and that was referred to as the President's credit budget. In the Congress, in the budget resolution this year, for the first time we included a sense of Congress resolution that we should have a ceiling on the aggregate amount of Federal credit assistance programs so we will know where we are.

Why were we alarmed about the status of Federal credit assistance? The reason we were alarmed is because such programs are completely out of hand. We do not now know the nature and extent of outstanding loan guarantees and other Federal credit assistance programs. Much of it is off of the budget. The CBO says there is now nearly \$500 billion in outstanding commitments, but that is as close to it as they can get.

We are subsidizing certain activities, but we have no logical system to apportion those benefits throughout our economy because there is no disciplinary mechanism to control overall lending activity.

We do not know the economic impact. I have heard speaker after speaker take this floor and say loan guarantees do not cost anything so long as we do not have a default. In other words, if it is paid off there is no cost. That is just not correct, because there is only so much credit out there in the marketplace. If my colleagues could visualize a pie—when we subsidize a particular loan activity—we draw credit to that activity and take it away from other activities. In many in-

stances we subsidize those ventures which are the least productive ventures.

Accordingly, we are allocating money in the credit market to nonproductive ventures and taking it away from productive ventures. That is inflationary; therefore it has an economic cost in the long term.

With respect to synfuels, and with respect to Chrysler, we are getting into something a little different. In the case of FHA housing, we have a diversity we do not have in the case of synfuels and in the case of the Chrysler Corp. In the case of FHA housing, we have many people who are buying homes. We also have geographical diversity in that loan program and, accordingly, the risk of loss is very small. But in the case of synfuels, we are putting all of our eggs in one basket. If the synfuels concept is bad we are stuck with it because it will all go down at one time. It either all stands or it all falls.

□ 1330

This idea started out as a \$3 billion program. I remember when it came through the Banking Committee under the guidance of our distinguished chairman, and I supported it. All of us are for shifting to coal and doing what the Germans did in World War II—making gasoline out of coal—developing alternative sources of fuel. But now this thing has mushroomed to the point where we are talking about \$20 billion, and then another \$68 billion in credit assistance. All of this is going to be off the budget. As I said before, we will be locked into it. We will not be able to get away from it.

Under no circumstances would this Congress let this program fall so that we would have to pick up those debts. So, we will just keep going on and on, as was predicted during the Chrysler matter. What we are doing is busting our own credit budget which we just set about 10 days to 2 weeks ago in this Congress, and we are probably busting the President's recommendation on credit because, as I understand it, he only wanted to use about \$2 billion in fiscal year 1981 for synfuels credit. We really do not know what we are doing here insofar as the extension of Federal credit is concerned.

My main point is I think probably we are moving too fast. We may be making

a mistake by getting the cart before the horse. We should develop a system to control these off-budget assistance programs so we can analyze the economic impact of what we are doing here in the Congress. We spend all kinds of time talking about the economic consequences of tax and spending, but we spend almost no time talking about lending activity which impacts the economic system just as much as taxing and spending.

I think before we launch into this much farther we ought to take a second look at it. It has been rushed to the floor because there is pressure to get this done by July 4 so the President and Congress can declare Energy Independence Day on July 4. I am not really impressed with the urgency because I recall last year when the \$3 billion plan was before us here, the majority leader said, "We need to pass it by July 4 so we can declare energy independence on July 4." So this is really Energy Independence Day No. 2 we are worshipping here. We have let a whole year go by since the smaller bill was considered last July 4. We should spend a little more time and get the cart before the horse by setting up a system to discipline this body in the way it hands out Federal credit assistance.

Unfortunately the rules of the House do not permit us to slow down and amend the legislation to limit runaway credit assistance. If the rules permitted it, I would do it—but they do not. We only have the option to vote up or down on the conference report with no amendments.

Even though I am voting for this bill it is my intention to continue pressing for a system to get credit assistance programs under control. We need synfuels but we also need to realize that we cannot continue to make carte blanche extensions of off-budget credit and spending. It will catch up with us by and by.

The SPEAKER pro tempore. The time of the gentleman has expired.

Mr. STANTON. Mr. Speaker, I ask unanimous consent to yield 4 minutes to the gentleman from California (Mr. SISKIYOU).

The SPEAKER pro tempore. Is there objection to the request of the gentleman from Ohio?

There was no objection.

INSERT C



Congressional Record

PROCEEDINGS AND DEBATES OF THE 96th CONGRESS, SECOND SESSION

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No. 108

House of Representatives

EXCESSIVE USE OF CREDIT ASSISTANCE

(Mr. BETHUNE asked and was given permission to address the House for 1 minute and to revise and extend his remarks.)

Mr. BETHUNE. Mr. Speaker, last fall the Congress passed the Chrysler bailout proposal. Yesterday the synthetic fuel proposal passed. In those proposals, of course, there were provisions for loan guarantees and other Federal credit assistance. It adds up to quite an amount. Right now we have nearly \$500 billion in off-budget credit assistance items.

Mr. Speaker, I am not opposed to loan guarantees. In fact I voted for the synthetic fuel bill yesterday. My point is this: I think we need to be careful because Government is preempting the field of private credit, and political decisions are replacing market decisions as to where the credit in this country should be allocated. I think it will hurt us in the long run. If we decide politically to encourage credit for nonproductive ventures it can be inflationary.

I think the President was on the right track when he made his recommendation for us to be sensitive to this problem. The Congress was right when we put a target credit ceiling in our budget proposal. But we still do not have a good, air-tight mechanism to control this problem.

Mr. Speaker, I have a bill which would create a system to bring some order to this business so that we will know what we are doing in the field of credit assistance before we get too far out of line. I am afraid we are going to get blindsided by this entire problem if we do not get it under control now.

Senator METZENBAUM. We are very privileged and pleased this morning to have one of my good friends in the Senate and one who has certainly given distinguished leadership to the field of banking as well as so many other areas in the Senate. We are delighted to have you with us, Senator Proxmire. We know of your efforts in this respect in the past and look forward to the wisdom of your comments this morning.

**STATEMENT OF HON. WILLIAM PROXMIRE, A U.S. SENATOR
FROM THE STATE OF WISCONSIN**

Senator PROXMIRE. Thank you very much, Senator. I very much appreciate that introduction. With me is Elinor Bachrach, who has done a great deal of work on this and is very familiar with it.

As the chairman of the Committee on Banking, Housing and Urban Affairs, which is the committee of the Senate responsible for Federal credit in all its aspects, I have long been concerned about the lack of budgetary controls over Federal credit programs—direct loans, loan guarantees and lending activities of Federally sponsored agencies.

An article in this week's U.S. News & World Report, titled "Uncle Sam, the Big Lender," describes the basic problem—the burgeoning, largely unchecked, growth of these programs. I ask that the article be printed in full in the hearing record. It is a short article, only about 200 words in length.

Senator METZENBAUM. Without objection, so ordered.
[The following was received for the record:]

Uncle Sam, The Big Lender

WHEN IT COMES to federal loan programs, the 1.5 billion dollars in help finally made available to Chrysler Corporation is only the tip of the iceberg.

Government-backed lending is expected to grow by 72 billion this year, to an outstanding balance of 601 billion by September 30. Such financing accounts for \$1 of every \$6 loaned to individuals and business.

Uncle Sam is helping Chrysler by guaranteeing that lenders who funnel funds to the ailing auto maker will be repaid, even if the cash has to come from the U.S. Treasury. Chrysler on June 24 sold its first notes under the guarantee, for 10 years at 10.35 percent interest, and got two checks totaling 496.8 million dollars from investment bankers.

Chrysler is far from alone in getting loans guaranteed by Washington. New York City, Lockheed, Amtrak and the Washington, D.C., subway have received help, as do college students. Home loans alone account for 60 percent of federally guaranteed lending.

The U.S. also lends money directly for such purposes as providing rural electrification and phone service, encouraging exports and aiding disaster victims.

Still other direct loans for various needs are made by independent U.S.-sponsored agencies, such as the Federal National Mortgage Association and the Farm Credit Administration.

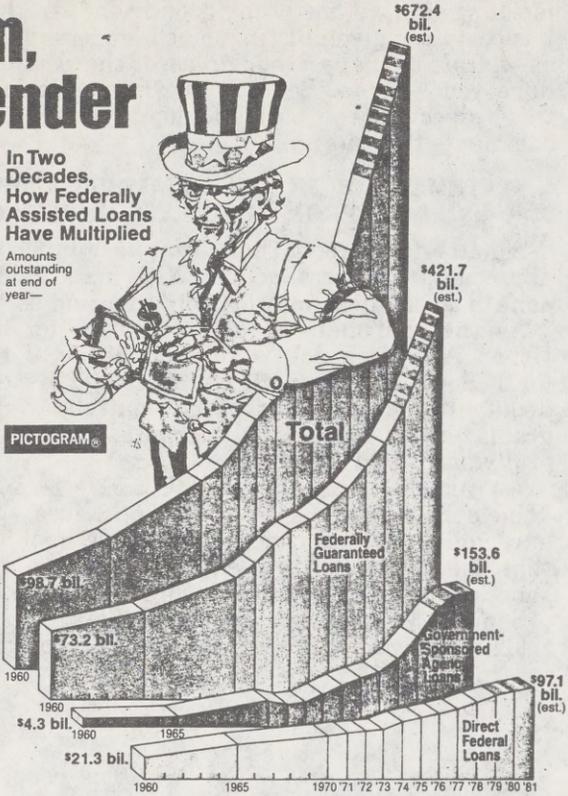
Wide range. The programs aid groups across the economy—farmers, veterans, public-housing projects, local governments and shipbuilders, among others.

Some economists contend the guarantees and loans add to inflation by boosting credit demands. They also question the favored treatment borrowers get. For one thing, money borrowed with U.S. support comes cheap. The Office of Management and Budget estimates that borrowers this year will save 20.7 billion over the life of their loans because of below-market interest rates.

Federally assisted and direct loans fell from 17.2 percent of all lending in 1970 to 10.6 percent in 1976, but zipped back to a record 17.9 percent in the year ended last September 30. The administration now is proposing tighter control over lending, but the array of beneficiaries raises doubts about any major cutback. □

In Two Decades, How Federally Assisted Loans Have Multiplied

Amounts outstanding at end of year—



Note: Totals may not add because of rounding. Years ended June 30 through 1976, September 30 thereafter.

Largest Federally Guaranteed Loan Programs

Estimated balances outstanding on Sept. 30, 1980—

Program	Amount
Federal Housing Administration (housing loans)	\$121.0 bil.
Veterans Administration (housing loans)	\$100.9 bil.
Federal Financing Bank (loans guaranteed for numerous federal agencies)	\$ 63.3 bil.
Farmers Home Administration (farm loans)	\$ 43.4 bil.
Public-housing loans	\$ 15.3 bil.
Rural-electrification loans	\$ 11.8 bil.
Student loans	\$ 10.9 bil.
Small-business loans	\$ 9.7 bil.
Export-Import Bank (trade loans)	\$ 8.1 bil.
Foreign-military-sales loans	\$ 7.9 bil.

USDA/IFF charts—Basic data: Office of Management and Budget

Senator PROXMIRE. I would like to read a couple excerpts from it.

When it comes to Federal loan programs, the \$1.5 billion in help finally made available to Chrysler Corporation is only the tip of the iceberg.

Government-backed lending is expected to grow by \$72 billion this year, to an outstanding balance of \$602 billion by September 30. Such financing accounts for \$1 of every \$6 loaned to individuals and business. . .

The article concludes:

Federally assisted and direct loans fell from 17.2 percent of all lending in 1970 to 10.6 percent in 1976, but zoomed back to a record 17.9 percent in the year ended last September 30. The Administration now is proposing tighter control over lending, but the array of beneficiaries raises doubt about any major cutback.

Last March I wrote to the chairmen of the House and Senate Budget Committees and urged that aggregate ceilings on Federal credit programs be established in the first Congressional budget resolution for fiscal year 1981. I pointed out that the unchecked growth of these programs could undermine fiscal and monetary policy and other Government efforts to combat inflation. I ask that a copy of the letter be included in the hearing record.

Senator METZENBAUM. Without objection, so ordered.

[The letter referred to follows:]

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C., March 11, 1980.

Hon. EDMUND S. MUSKIE,
Chairman, Committee on the Budget,
U.S. Senate, Washington, D.C.

DEAR ED: For some time, I have been concerned about the burgeoning growth of Federal credit programs and the lack of budgetary controls on these programs. If this situation is permitted to continue, it could conflict with fiscal and monetary policy and with other government efforts to combat inflation.

Figures included in the President's fiscal year 1981 budget show that credit advanced under Federal auspices represented about one-sixth of all funds advanced in the U.S. credit markets in 1979, a far larger proportion than in previous years. Given the necessary constraints placed on monetary and credit growth in the private sector by the Federal Reserve, there is every reason to believe that this Federal portion could rise still higher in the 1980 and 1981 fiscal years, in the absence of any meaningful budgetary controls.

The increase is particularly marked in those credit programs which are not included in the Federal budget. A recent Congressional Budget Office publication notes that off-budget direct loans grew by 70 percent between 1976 and 1979, which is twice the rate of growth in budget outlays. For loan guarantees, all of which are off-budget, the growth over this period was even greater—108 percent. During the period from 1979 through 1981, off-budget direct loans outstanding are slated to increase by 58 percent, while loan guarantees outstanding will increase by 28 percent. The use of the Federal Financing Bank to purchase guaranteed loans, thereby in effect converting them to off-budget direct loans, further clouds the budget treatment of these programs.

At the present time, with the vital need to stem inflation, the problems presented by the relatively unchecked growth of Federal credit programs are more pressing than ever. As Chairman of the Committee on Banking, Housing, and Urban Affairs, I am concerned about the impact on monetary policy and efforts to control the growth of the monetary and credit aggregates, as well as about the implications for the financial markets and for the economy in general. As Chairman of the Committee on the Budget, I assume that you are concerned about the impact on fiscal policy and efforts to cut the Federal budget and reduce its inflationary pressures. Given these concerns, I believe it would be a grave mistake not to include tighter controls on Federal credit programs in the list of emergency anti-inflation measures to be adopted in the coming weeks.

The President's fiscal year 1981 budget takes a modest step toward asserting more control over Federal credit programs by recommending that the Appropriations Committees establish limitations on some of these programs in Appropriations Acts. However, these recommendations suffer from two defects. First, they exempt some key categories of programs, notably housing programs with the result that the

proposed limitations cover only about 45 percent of new 1981 direct loan obligations and 40 percent of new loan guarantee commitments, while the lending activities of Federally sponsored enterprises, such as the Federal National Mortgage Association, are excluded altogether. Second, there is no provision for setting an aggregate ceiling on Federal credit activity comparable to the aggregate ceiling on budget authority and outlays contained in the Congressional budget resolutions. Without the discipline of an aggregate ceiling, it is doubtful that individual program limitations will be effective in curbing excessive growth in Federal credit programs or in making Federal credit policy consistent with fiscal and monetary policy.

I believe that the Congressional Budget Act provides ample authority for including an aggregate ceiling on Federal credit programs in the concurrent resolution on the budget. Section 301(a)(6) states that the concurrent resolution shall set forth "such other matters relating to the budget as may be appropriate to carry out the purposes of this Act." Placing a ceiling on Federal credit programs would clearly be consistent with this authority.

Accordingly, I recommend and urge that the Budget Committee address this issue by setting an aggregate ceiling on Federal credit programs in the first concurrent resolution on the budget for fiscal year 1981. Moreover, in view of the concern about inflationary pressures in the months immediately ahead, serious consideration should be given to establishing a similar limitation in the third concurrent resolution for the present 1980 fiscal year. Such actions would not affect the levels of budget authority or outlays in either fiscal year.

The aggregate ceiling established should cover all direct loan and loan guarantee programs identified in the President's budget, without any exceptions. In addition, there should be special consideration given to including the lending activities of Federally-sponsored enterprises within the aggregate ceiling, since they make up a major part of the funds advanced under Federal auspices in the U.S. credit markets. Arguments for excluding these and other credit programs from budgetary controls revolve around the need for them to be responsive to changing economic conditions. I find these arguments unpersuasive, since they could also be applied to many Federal spending programs, which are included in the budget. In my view, both the Congressional budget resolution procedures and the appropriations process offer sufficient scope for making mid-course modifications in budget limitations as to render it unnecessary as well as inadvisable to forego such limitations with respect to Federal credit programs.

Once the practice of setting an aggregate ceiling on Federal credit programs is established, then it should be possible to develop a real credit budget and bring some rationality to the formulation of Federal credit policy. At the present time, loan guarantees and off-budget direct loans are viewed as a free good, and little thought is given to the most appropriate use or allocation of these valuable financial resources. For instance, I find it absurd that the Federal government is providing \$1.5 billion in assured credit—loan guarantees, with an implicit interest subsidy—to the Chrysler Corporation, at a time when homeowners and healthy small businesses and agricultural concerns are being squeezed to the bone by stringent monetary policy measures and may not be able to borrow at all. To my mind, this points up sharply the need to examine our priorities in allocating Federal credit to direct scarce financial resources into areas that are likely to have the most beneficial impact on our economy and on meeting the needs of the public as a whole. A Federal credit budget should serve this important function.

I know that you share many of the concerns expressed here, and I look forward to working with you and your Committee on this important issue.

Sincerely,

WILLIAM PROXMIRE, *Chairman.*

CONCERNS OF CONGRESS REGARDING FEDERAL CREDIT PROGRAMS

Senator PROXMIRE. In addition, of course, the principal reason, Mr. Chairman, why I think we should establish this program is because our economy is directed as much or more by credit as it is by spending, by Federal spending. The credit programs as pointed out have grown enormously. We have a definite and systematic method of controlling and directing our spending. We do not have that systematic and comprehensive control of our lending. The result is that much of what the Federal Government does, much of the impact it has on the economy, we do not know about, let alone

handle it in a concerted way that would give us the kind of anti-inflation program or progrowth program that we should have.

Senator METZENBAUM. May I inquire, you have been here longer than I have by far, and it has also impressed me that here we have massive Federal credit program, loan guarantees, and no accounting whatsoever of it. There is no accounting of the defaults. How do you think that happened? Was it just by way of nobody really wanting to point the finger at it?

CEILINGS FOR DIRECT LOANS AND LOAN GUARANTEES

Senator PROXMIRE. As you know, we do have some credit programs included in the budget, and some are not included in the budget. I think one of the reasons for it is when you have an instrument like Federal Financing Bank, outside the budget, it is very tempting for the administration which wants to balance the budget and hold down its accounting for on-budget spending, and for the Congress too, to shove things into the Federal Financing Bank or to follow some policy which will enable us to achieve the social ends we want to achieve without having to be accountable for them. The result is we have a vested interest in saying we can dole a few billion or a few hundred million dollars without accountability through the budget process. I might say that the Budget Committees did respond to my letter: They put ceilings on direct loans and on loan guarantees in the first budget resolution for fiscal year 1981. I commend the members of this special subcommittee for their role in this effort. A good first step.

Senator METZENBAUM. You said that they put ceilings on it. I think they actually put targets on, did they not?

In the first budget resolution, I think we just established targets.

Senator PROXMIRE. The Senator from Ohio is certainly an expert on whether it is a target or ceiling. I like to think of it as a ceiling. I am hoping it would be a ceiling.

Senator METZENBAUM. I share your hope, but I do not think we have quite bitten the bullet as yet on that subject. I think we hope to move in that direction in the second budget resolution.

FURTHER STEPS NEEDED TO DEVELOP COMPREHENSIVE CREDIT BUDGET

Senator PROXMIRE. At any rate, I think it is a good step forward.

As I said earlier, further steps are needed to develop comprehensive Federal credit budget. I believe the Banking Committee can play an important role.

The logical next step is to make the credit budget procedures begun in the first 1981 budget resolution permanent. The bill proposed by Senator Percy would do this, and I commend him for his efforts. I know he proposed it originally as an amendment to the Chrysler bill, and then withdrew it due to time constraints. I thought it was an excellent proposal then, and I offer it my full support now.

The Percy bill, and the companion Mineta bill in the House, would subject direct loans and loan guarantees to the same Budget Act limitations and procedures as spending programs, including reporting deadlines and points of order. It would also require that

these credit programs be subject to the appropriations process. This is an excellent provision. I feel strongly that the only effective way to implement a credit budget process is through individual program limitations set in appropriations acts.

My only problem with the Percy bill is that it leaves out the federally sponsored agencies, such as the Federal National Mortgage Association and the Federal Home Loan Bank system. While I know there are questions about including these agencies, I see no way that we can have an effective credit budget process while ignoring this major component of Federal credit activity. Thus I urge you to include these agencies on some basis.

REVIEW OF FEDERAL CREDIT ACTIVITIES AND POLICIES BY BANKING COMMITTEES

I am happy to see that the Percy bill would specifically involve the banking committees of the Congress in the credit budget process, and I think that is essential. I should like to conclude my statement by discussing some of the ways in which the banking committees should be active in this process.

First, the bill would require these committees to make recommendations each year to their respective budget committees regarding the appropriate level of total Federal credit under the different programs. In doing this, I believe the banking committees should conduct at least annually a review of Federal credit activities and policies, similar to our reviews of monetary policy. In this review, we should look at the proposed levels of Federal credit activity and their potential impact on monetary policy, on the financial markets, and on the economy. We should draw on the resources of the Federal Reserve Board and the Congressional Budget Office in making our recommendations, and probably also on the Treasury and OMB. In our report to the budget committees, we should make recommendations regarding gross levels of Federal credit activity. It might also be advisable to make recommendations on net lending, that is new lending minus repayments, since this might be a better measure of economic impact.

ELIMINATE "BACKDOOR" FINANCING ROLE OF FFB

A second step I will propose that the Banking Committee take is to eliminate the off-budget "backdoor" financing role of the Federal Financing Bank, which comes under our jurisdiction in the Senate. At present, FFB purchases of guaranteed loans convert these to direct loans off-budget, and FFB purchases of loan assets and certificates of beneficial obligation, CBO's, of certain agencies, notably the Farmers Home Administration, are treated as repayments rather than borrowing, which greatly understates the amount of direct loans these agencies actually make.

To remedy this situation, I intend to propose the following:

First, that guaranteed loans financed through the FFB be counted in the budget as direct loans of the originating agencies.

Second, that sales of loan assets and CBO's be treated as borrowing by the originating agencies and not offset against direct loan outlays.

The committee might consider other provisions as well, but the basic intent would be to insure that the FFB will be solely a conduit for Federal agency borrowing and lending activities, without any impact on the budget totals.

LONG-TERM CREDIT BUDGET PROCEDURES

There are many other questions to be considered over time, including such things as the appropriate treatment of direct loans and guarantees in the expenditure budget, uniform standards for these programs, and the whole question of deciding which device is most appropriate to address any specific problem.

The establishment of a comprehensive Federal credit budget process which brings Federal lending programs under the same sort of controls as Federal spending programs should contribute to a more rationale use of all Federal financial resources. It should enable us to set priorities and allocate scarce Federal credit more efficiently. I must say that I found it rather ironic to see the Federal Government channeling \$1.5 billion to Chrysler at a time when credit for housing, for farmers, for small businesses—and indeed for automobile buyers—was being severely restricted.

Whatever our individual views about Chrysler, I know we all think that more needs to be done to control Federal credit programs. I applaud the efforts of the Special Subcommittee in this area, and I will do all I can to aid in your efforts.

Senator METZENBAUM. Thank you very much, Senator Proxmire.

PREPARED STATEMENT OF HON. WILLIAM PROXMIRE, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Mr. Chairman, members of the Special Subcommittee, I am pleased to be here today to discuss measures to improve control of Federal credit programs.

As Chairman of the Committee on Banking, Housing and Urban Affairs, which is the committee of the Senate responsible for Federal credit in all its aspects, I have long been concerned about the lack of budgetary controls over Federal credit programs. These programs include direct loans and loan guarantees of both on-budget and off-budget Federal agencies, plus the lending activities of Federally sponsored agencies such as the Federal National Mortgage Association (FNMA). The lack of budgetary control is accompanied by a lack of any adequate scrutiny of the appropriate uses of Federal credit programs and of their economic impact.

CONCERNS OF CONGRESS REGARDING FEDERAL CREDIT PROGRAMS

As you probably know, I wrote a letter last March to the Chairmen of the Senate and House Budget Committees urging that aggregate ceilings on Federal credit programs be established in the first Congressional Budget Resolution for fiscal year 1981. In that letter I expressed a number of concerns which I believe are shared by other Members here today on both sides of the witness table. They include the following:

The burgeoning growth of Federal credit programs in recent years, especially those which are "off-budget," mainly loan guarantees. As previous testimony at these hearings indicated, loan guarantees outstanding are slated to rise to \$422 billion by the end of fiscal year 1981, an increase of \$56.6 billion over 1980, or 15 percent—far greater than the increase in Federal spending;

The impact of Federal credit activities on monetary policy, on financial markets and on the economy in general. This is of particular interest in a period of inflation and credit restraint, where there is great potential for Federal credit programs to run at cross-purposes with other economic policy measures. For example, I found it ironic to see the Federal Government channeling \$1.5 billion in guaranteed loans to the Chrysler Corporation at a time when credit for housing, for farmers, for small businesses—and indeed for automobile buyers—is being severely restricted;

The impact of Federal credit programs on fiscal policy and on efforts to balance the Federal budget and reduce inflationary pressures; and

The lack of any formal procedures for setting priorities and allocating scarce Federal credit resources among competing uses. This is coupled with the lack of any effective means of determining which type of credit or spending program constitutes the most appropriate way of dealing with a particular problem.

So these are the concerns I raised in my March letter, and I know they are familiar to all of you. I am delighted that the Budget Committees responded as well as they did: by including aggregate ceilings on direct loans and on loan guarantees in the first concurrent resolution on the budget for 1981.

FURTHER STEPS NEEDED TO DEVELOP COMPREHENSIVE CREDIT BUDGET

This is a good first step. Now further steps are needed to develop a comprehensive Federal credit budget, as part of an overall Congressional budget process that relates credit activities with expenditures and revenue measures and assesses their impact on the economy. While recognizing that many questions remain to be resolved, I think we need to move forward and confront those questions head on. Thus in the remainder of my testimony I will discuss further actions to be taken, with particular attention to the role the Banking Committees can play in developing an effective credit budget process.

A logical next step is to institutionalize and expand upon the credit budget procedures begun by the Budget Committees in the first concurrent resolution for 1981. The bill proposed by Senator Percy (S. 2151), and by Congressman Mineta and others in the House, would do this, and I commend these Members for their efforts. I know that Senator Percy proposed his bill as an amendment to the Chrysler bill when it was being debated on the Senate floor, and then withdrew it in exchange for a promise of full consideration by the Budget Committee, which has come with these hearings. I thought this was an excellent proposal then, when time constraints were too severe to do it justice, and I offer my full support for it now. Since Senator Percy describes his bill in some detail in his statement, let me just mention a couple of important points:

It requires that the budget resolution in each year set forth the appropriate level of direct loans and loan guarantees overall, and also break down those estimates by budget function;

It subjects these programs to all aspects of the Congressional budget process, including the May 15 reporting deadline and the points of order against bills exceeding the budget totals; and

In addition, and this is vitally important, it requires that direct loans and loan guarantees be subject to the appropriations process. As a member of the Appropriations Committee, and Chairman of the HUD-Independent Subcommittee which handles the bulk of these programs, I believe that the only effective way to implement a Federal credit budget process is through limitations on individual credit programs established in annual appropriations Acts. Indeed, the Appropriations Committees are already taking major steps in that direction, with the support of the President's Office of Management and Budget.

REVIEW OF FEDERAL CREDIT ACTIVITIES AND POLICIES BY BANKING COMMITTEES

I am pleased to note in particular that the Percy bill would require the Banking Committees of the Senate and House to make recommendations each year to their respective Budget Committees regarding the appropriate level of total gross direct loan obligations and of total commitments for guaranteed loans. In my view, it is essential that the Banking Committees play a major role in the credit budget process, and I intend to work to develop that role. Specifically, I believe that the Banking Committees should conduct at least annually a review of Federal credit activities and policies, similar to our continuing review of monetary policy. In this connection, we should examine various aspects of the proposed levels of Federal credit activity, including the relationship to monetary policy, the implications for financial markets, and the potential impact on the economy as a whole and on particular sectors of the economy. In this effort, we should obtain assistance and recommendations from the Federal Reserve Board and from the Congressional Budget Office. Probably the Treasury Department and the Office of Management and Budget should also be involved in this review.

Based on the information obtained in this review and the Committee's analysis of it, we could then make recommendations to the Budget Committees regarding gross levels of Federal credit activity. It might also be advisable for the Banking Committees to consider recommendations on net lending, i.e. total new loans and guarantees minus repayments of those outstanding, since this figure might be a better

measure of certain types of economic impact, such as the effect on the financial markets.

BUDGET TREATMENT OF FEDERALLY SPONSORED AGENCIES

In this context, I have to raise the issue of the budget treatment of Federally-sponsored agencies, such as FNMA and the Federal Home Loan Bank system. There is some resistance to including these agencies in a credit budget, the argument being that they are privately owned and also that their countercyclical role might be hampered by subjecting them to budget limitations. Nonetheless, I see no way that we can establish an effective credit budget process while ignoring this major component of Federally-related credit activity, and I know other witnesses at these hearings have expressed a similar view. Thus I urge you to explore means of incorporating Federally-sponsored agencies within the credit budget process on some basis. Perhaps the problem of accommodating unanticipated countercyclical demands could be handled as it is with the expenditure budget, through changes in the budget resolutions and supplemental appropriations measures. Or if quicker action might be needed, then there could be some clearance procedure established with the Budget and Appropriations Committees.

Going beyond these points, I believe there is a need for additional measures to close certain loopholes in the budget process which hamper the ability of Congress to control Federal credit programs.

One is to place all of the remaining off-budget agencies in the budget, so that all loan programs receive the same treatment. The Banking Committee has done this with programs under its jurisdiction, including the Export-Import Bank and the elderly housing program. I hope that other committees can be pushed to do the same.

ELIMINATE "BACKDOOR" FINANCING ROLE OF FFB

Another measure would be to eliminate the off-budget "backdoor" financing role of the Federal Financing Bank (FFB). The FFB comes under the jurisdiction of the Banking Committee in the Senate (it is under Ways and Means in the House).

It was created as an off-budget agency because it was intended to be merely a conduit for financing programs of other Federal agencies, with no effect on the budget. In practice, as you know, this has not been entirely the case. FFB purchases of loan guarantees have in effect converted them to direct loans off-budget, and FFB purchases of loan assets and certificates of beneficial obligation (CBO's) have been treated as repayments rather than borrowing, thus understating the net lending of agencies selling this paper to the FFB. To remedy this situation, I intend to propose legislation to amend the FFB Act by requiring:

That guaranteed loans financed through the FFB be counted in the budget as direct loans of the originating agencies; and

That sales of loan assets and CBO's be treated as borrowing by the originating agencies, and not offset against direct loan outlays. In the course of consideration of such legislation, the Banking Committee may consider other ways of amending the FFB Act, but the basic intent would be to make the FFB solely a conduit for Federal credit activities, without any influence on the budget totals.

LONG-TERM CREDIT BUDGET PROCEDURES

Looking still farther ahead, there are other questions which ought to be addressed as the credit budget procedures are put in place. These could include the following:

The question of the appropriate treatment of direct loans and loan guarantees in the expenditure budget. At the present time, direct loans are counted in the budget on a net lending basis—new loans minus repayments—while loan guarantees escape the budget completely. Many have argued that the economic impact is the same. Congress could consider including direct loans and loan guarantees on the same basis within a credit budget and including in the expenditure budget only those aspects of both which are most like expenditures, such as the amount of interest subsidy (implicit or explicit), the administrative costs, and the projected losses from defaults.

Further consideration should be given to establishing uniform standards for all loan and loan guarantee programs, as an additional basis for according them equal budget treatment. This idea is under consideration by OMB and the General Accounting Office and could be explored further by the Banking Committees and other relevant committees of Congress.

Another broad question is that of determining the best device to use in each case, whether it be a direct loan or a loan guarantee or some type of expenditure program. The present system builds in strong incentives to rely on loan guarantees

simply because they are off-budget, whether they are appropriate to deal with the problem or not.

In sum, the establishment of a comprehensive Federal credit budget process which brings Federal lending programs under the same sort of controls as Federal spending programs should contribute to a more rational use of all Federal financial resources. I applaud the efforts of this Special Subcommittee to accomplish that goal, and I will do all I can to aid in those efforts.

MR. AND MRS. ROBERT L. WALDO,
Charing Cross Road,
Madison, Wis., May 28, 1980.

Hon. WILLIAM PROXMIRE,
U.S. Senator, New Senate Office Building,
Washington, D.C.

DEAR SENATOR PROXMIRE: Attached is a letter encouraging me to steer customers to business loans eligible for government loan guarantees through the SBA, Farmers Home Administration, DOE and other agencies.

I have been very much impressed with your position supporting fiscal responsibility on the part of government, and supporting the fiscal restraints necessary to stop inflation. I thought you'd like to know about this situation, if it hasn't already come to your attention, since there can't be much public need for these loan guarantees if the agencies' capacity is such that the guarantees can be "marketed" by a private company. Further, by promoting and proliferating credit, aren't these agencies working at cross purposes with the Fed?

Keep up the good work.

Sincerely,

ROBERT L. WALDO.

AMERICAN REALTY CREDIT CORPORATION,
Houston, Tex., May 22, 1980.

Mr. ROBERT L. WALDO,
President, Verex Assurance, Inc.,
Madison, Wis.

DEAR MR. WALDO: If you are not now using the government loan guarantees available to your customers for business loans you could be passing up a real profit maker for your company. The Small Business Administration, the Farmers Home Administration, the Department of Energy and the Economic Development Agency all have loan guarantee programs that can be used to finance almost any business project that comes along. Most of the programs mentioned above give 80 percent or 90 percent government guarantees, these guaranteed portions of the loans can be readily financed in the secondary market. In all cases my company has the ability to finance the 80 percent or 90 percent guaranteed portion of these loans, and in most cases we can finance 100 percent of a credit worthy project.

If you think you would have an interest in any of the above please give me a collect call at (713) 526-0355.

Sincerely,

BILL MORITZ,
Vice President.

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, D.C., June 11, 1980.

Mr. ROBERT L. WALDO,
Charing Cross Road,
Madison, Wis.

DEAR MR. WALDO: It was good to hear from you and I appreciate your sending me a copy of the notice you received from the American Realty Credit Corporation promoting federal loan programs.

I am attempting to determine if this company receives federal funding for this purpose and I shall be in touch with you again just as soon as I have been able to obtain this information.

Warmest regards.

Sincerely,

WILLIAM PROXMIRE, U.S.S.

ELIMINATE FEDERAL FINANCING BANK

Senator METZENBAUM. Toward the end of your statement you address yourself to the Federal Financing Bank and you say,

That guaranteed loans financed through the FFB be counted in the budget as direct loans of the originating agencies and that sales of loan assets and CBOs be treated as borrowing by the original agencies and not offset against direct loan outlays.

Let me ask you, recognizing the value of the U. S. Treasury as being a conduit or means of raising money, probably at a lesser rate than obligation of the agency itself, is there any reason to continue with the Federal Financing Bank—does it add anything to the process or should we eliminate FFB entirely and merely provide that the agencies can arrange their loans through the Treasury. You come out with the same result, do you not?

Senator PROXMIRE. I think you are right. I think the principal function of course frankly is to avoid the budget process. You state it very well. You point out that advantages that you do get lower rate of interest because any time the Federal Government backs any kind of loan, it is risk free. I do not think it serves any vital purpose. However, I would like to see us advance in this way and then once we get it underway, see whether or not we could dispense with the Federal Financing Bank rather than do it outright.

IMPACT OF PROCYCLICAL HOUSING CREDIT PROGRAMS ON INTEREST RATES

Senator METZENBAUM. Dr. Maisel of the University of California testified before this subcommittee that the procyclical nature of the housing credit programs contributed to the runaway interest rates we recently experienced. Will you comment on this and on whether you think Federal credit activities should be countercyclical?

Senator PROXMIRE. Yes. I think that federal credit policy should be countercyclical. I think, as you know, in a period of recession—we have been reminded of that dramatically in the last few weeks—in a period of recession interest rates tend to fall anyway, and this by itself has a profound countercyclical effect. The housing market may come back now because interest rates have fallen so sharply. Certainly corporate borrowing may increase. The prime rate is down from, what, 20 percent, to 11, 11.5, and that kind of spectacular countercyclical activity in the market itself dwarfs much of what the Federal Government can do.

ADDITIONAL LEGISLATION FROM IMPLEMENTING CREDIT CONTROLS

Senator METZENBAUM. If Congress adopts aggregate ceilings on Federal credit activities, then it has to take those aggregates as seriously as it does those for budget authority and outlay.

Would you expect implementation of credit controls to significantly increase the magnitude and volume of work, volume of legislation with which Congress must cope annually?

Senator PROXMIRE. No, I do not think so. I do not think it will increase the volume of legislation. I think it means, as I indicated in my testimony, that we should have hearings on Federal credit programs, which we do not have at the present time. That is only a

matter of a couple of days a year. I do think it may mean more staff work. I think we have staff that is competent and available to do the job, both in budget committees and banking committees. I think it is the kind of thing that could be handled with a minimum of additional burden on the Congress.

CREDIT CONTROLS INFLUENCE DECISION ON PROGRAM CONTINUATION

Senator METZENBAUM. As a matter of fact, is it not very likely that if we were to establish some actual controls, and knew exactly what the programs cost, and what impact they would have on the budget, what the estimated loss ratio would be, is it not entirely likely that this might have a strong impact upon the advisability or lack of advisability of going forward with some programs?

Senator PROXMIRE. Absolutely. Of course, this would be the purpose of it. The Senator is absolutely right. We might decide certain housing programs under these circumstances can and should go ahead or should not. We might decide that the Chrysler loan guarantee, the New York City loan guarantee and so forth, can move ahead or should not. The important thing is that we know what we are doing, that we be in a much stronger position to have confidence in our actions in this area. In that sense, I think there might even be less work for members of the Senate than it is at the present time. We can make our mind up based on facts we do not have available now.

PROVIDE LOSS FACTOR FOR LOAN GUARANTEE PROGRAMS

Senator METZENBAUM. The Chair has had the opinion that in many of these loan guarantee programs there would be a value in providing a factor to cover the loss, the possibility of loss. I think that is the case with respect to certain housing programs. The bank gets x percentage and there is an extra factor in to cover losses. Do you think that makes sense for us?

Senator PROXMIRE. Yes. We have done that with EDA and housing programs, and I think it is an excellent device. However, I do think with something like Chrysler, which is one of a kind, or New York City, it is extremely hard to make an estimate as to whether this may or may not work out. It works out best, of course when you have enormous variety of borrowers such as you have in housing. There are thousands of units involved, and you can make a calculation of losses which is likely to be quite accurate. It is very difficult to do this in the case of a very large guarantee for one borrower.

Senator METZENBAUM. Senator, do you have time for us to hear from Senator Percy?

Senator PROXMIRE. By all means.

Senator METZENBAUM. Go ahead and proceed, Senator Percy.

We are very happy to have you with us this morning. I know you have been a strong advocate of legislation along this line for some time. We certainly are pleased to get the benefit of your thinking on the subject.

**STATEMENT OF HON. CHARLES H. PERCY, A U.S. SENATOR
FROM THE STATE OF ILLINOIS**

Senator PERCY. Thank you, Mr. Chairman.

Senator Proxmire and I seem to be thinking alike. I also brought along the U.S. News & World Report chart because it certainly symbolizes what needs to be done. I really think what I should have done is brought a Bell & Howell projector and shown a segment of last Sunday's "60 Minutes" program. They took a look at one segment of Federal credit programs, Farmers Home Administration, disaster loans. Millions of people watching that program must have been as angry as I was at the abuse in this program, "60 Minutes" showed wealthy farmers in in San Joaquin valley of California, many of whom are millionaires, taking advantage of the FmHA subsidized interest program. Some of them have a net worth of as much as \$40 million yet they can borrow as much as \$15 million at 3-percent interest. It must have enraged people watching that, when they are looking at the double-digit interest costs they have to pay to see these millionaires getting subsidized through a Government program.

Senator METZENBAUM. Why do you not look at industrial revenue bond program that is being used by some of the largest corporations in America to borrow money with the Federal Government subsidizing it?

You ought to give your attention to it.

Senator PERCY. I think we could go right on through other Federal programs and find other areas of credit abuse. That is why I felt the establishment of this task force was so essential. The control of Federal credit programs, is a serious problem. The suggestions I have made coincide with the comments of others about credit programs.

Senator Proxmire has been a leader in this area. Earlier this year he wrote to the Budget Committee urging that annual ceilings be set for Federal loans and loan guarantees. Unlike the administration's proposal, Senator Proxmire urged that all Federal credit programs, whether direct loans or guarantees on or off budget, be included in a credit budget. I agree with the recommendation and I ask that Senator Proxmire's letter be included in the official record of this special subcommittee if it is not already.¹

Senator METZENBAUM. It will be done.

Senator PERCY. I would also like to pay tribute to Representative Mineta who originated the concept behind S. 2151 and who has moved Federal credit control ahead in the House of Representatives.

Last December, when the Senate debated the Chrysler Loan Guarantee Act, I simultaneously introduced S. 2151, the Federal Credit Program Control Act, and an identical provision as an amendment to the Chrysler bill.

Introduction of the amendment served the purpose of expressing my concern about the willy-nilly way in which Congress deals with important financial tools like loan guarantees.

At that time, I was assured on the floor of the Senate that the Budget Committee would have hearings on how the Congress can

¹See p. 123.

examine credit programs in the budget process. As a result, I withdrew my amendment to the Chrysler bill. Senator Proxmire participated with us in that colloquy.

I want to congratulate you for conducting these hearings now. The many forms and purposes of credit extended by the Federal Government do not lend themselves to simple characterizations. There is a real need, however, for uniform, systematic congressional review of the myriad credit programs as part of our budget process.

I would like to incorporate my statement into the record in full, Mr. Chairman, because I would like to skip through it for the sake of brevity this morning.

Senator METZENBAUM. The entire statement will be included.¹

ANALYZING THE EXPANSION OF FEDERAL CREDIT

Senator PERCY. The Federal Government began issuing loan guarantees and having an impact on credit markets as far back as the 1930's. It has not been until the past decade, though, that loans and loan guarantees have mushroomed. Originally, these credit programs were limited to housing, but that, too, has changed as synthetic fuels, Chrysler Corp., and economic development have become the beneficiaries of these convenient, often off-budget financing techniques.

In less than a decade, the total of new Federal loans—and by that I mean loans by both on- and off-budget agencies, and loan guarantees—has increased from approximately \$47 billion in fiscal year 1971 to approximately \$140 billion in fiscal year 1979. That is nearly a 200-percent increase in 8 years and does not include loans by Government-sponsored enterprises such as Fannie Mae (Federal National Mortgage Association) and Sallie Mae (Student Loan Marketing Association).

DISPLACEMENT OF PRIVATE BORROWERS

Another problem of credit programs is that although loans and loan guarantees, even on-budget loans, do not show up in the budget like spending programs, they have a direct impact on the economy through the displacement of private borrowers. The more credit used by the Government, the less is available, particularly for small businesses and small- and medium-sized corporations. The central thrust of budgetary control of credit is that Congress should set priorities as to who should receive credit subsidies and to what degree private borrowers should be displaced. Federal credit demands ebb and flow depending on program needs. When there is a great demand for credit, issuance of major loans or guarantees can push up interest rates and increase inflationary pressures. Even if economic circumstances are such that there is no displacement of private borrowers, there continues to be a reallocation of credit that can result in nonsubsidized borrowers paying higher interest charges than they otherwise would.

The Federal Reserve Bank of San Francisco recently reported that the combination of Federal deficit and heavy borrowing by mortgage-financing agencies could make the Federal presence in

¹See p. 138.

credit markets the dominant element in the credit markets this year. Total Federal and federally assisted borrowing could account for perhaps 23 percent of all funds raised in credit markets in 1980, compared with the 20 percent average of the 1977-79 expansion. That 23-percent figure, although considerably lower than the Federal share in the 1975 recession year, could give some substance to the argument that Federal borrowers are crowding out private borrowers from the market.

REFORM BUDGETARY TREATMENT OF CREDIT PROGRAMS

The importance of dealing with credit programs in a straightforward manner has been recognized by others over the years. The President's Committee on Federal Credit Programs in 1963 and the President's Commission on Budget Concepts in 1967 recommended that reforms be made in the budgetary treatment of Federal credit programs.

Now we have another opportunity to formulate a more honest way to deal with these credit programs. We are fortunate that today there exists a framework on which we can build the needed techniques to control credit programs. That framework is the Budget Reform Act of 1974. The Budget Act does not specifically direct the Budget Committee or the Congress to estimate or limit credit programs. It is that shortcoming, in legislation originally developed by and reported out of my own committee, Governmental Affairs, that my bill now seeks to remedy.

I do not know why we did not tackle credit programs in the Budget Reform Act. They slipped through. It was a loophole that we now have to plug.

SEPARATE COST AND COST ACCOUNTING FROM LIMITS ON GUARANTEED LOANS

Senator METZENBAUM. You used two words in your statement, and there is such a difference in their impact that I would like to have you address yourself to which you consider to be the most important.

One is the Budget Act does not specifically direct the Budget Committee or the Congress to estimate or limit credit programs.

It is one thing to estimate and know the cost of the program. This is in the nature of accounting and good bookkeeping, good business. The other one is a substantive issue to which this committee does not feel it has any right to address itself to and is trying to separate the question of cost and cost accounting and the whole factual basis from that which I consider to be substantive issues of whether or not we ought to limit the amount of housing credit, whether we ought to limit the amount of small business credit, whether we ought to limit the amount of Government-guaranteed loans for students. That I believe to be a subject not necessarily within the prerogative or concern of this subcommittee but rather, and I am not certain that it belongs even in the Budget Act as to those—nothing bothers me more than to have the staff tell me we have already done that, which I said we should not be doing, since we have already done it, I guess that is fait accompli,

and I will not emphasize that point. I do believe the two subjects are very much different.

Senator PERCY. When I served on the Appropriations Committee, I was absolutely aghast that we did not look at the whole budget. During the year I served on the committee, we did not really grapple with that. That is why I felt, we needed to step back and view the full impact of the budget. We had to look at what the total consequences would be. Now what we have got to do is look at the full economic and budgetary consequences of credit programs as well. They impact just as effectively on the economy as Federal spending itself does. It does no good to sit here and balance the budget if credit programs are escalating. It is like trying to hold a featherbed down. You hold it down over here and it pops up over here. Credit programs are out of control. This legislation, S. 2151, will pull under the umbrella then that end of the budget which is now not subject to congressional control. That is all we are trying to accomplish here.

S. 2151—A SYSTEMATIC MECHANISM FOR OVERSEEING CREDIT PROGRAMS

Mr. Chairman, simply put, my bill S. 2151, adds one new section and minimally amends certain other sections of the Budget Reform Act so that we establish the procedures for setting targets and ceilings, in the congressional budget process, for loans and loan guarantees. I would like to explain the key aspects of how my bill would accomplish the goal of establishing a systematic mechanism for overseeing credit programs. The bill would:

First, require that the budget resolution each year set forth the appropriate level of direct loans and loan guarantees. The budget is also required to itemize estimates of loan guarantees and direct loans by budget functions.

Second, require credit plans to be submitted to the Budget Committee by each authorizing committee. Presently, committees must submit their spending plans to the Budget Committee by March 15; the bill would extend this to loans and guarantees.

Third, require the Banking Committees to submit to the Budget Committees by March 15 each year their estimates and recommendations for the appropriate level of overall guarantees and loans for the next fiscal year. The Banking Committees would, in effect, evaluate the credit needs of private and public borrowers.

Fourth, stipulate that bills or resolutions authorizing new loans or guarantees must be reported from their respective committees by May 15. Bills reported after that date would face a point of order on the floor, as do all spending bills under the budget process.

Fifth require the Congressional Budget Office to report annually to the Budget Committees on credit programs of the Federal Government.

Sixth, permit a point of order to be raised, after the second budget resolution is passed, against loans or guarantees that exceed the totals in the budget.

Last, the bill stipulates that loans and guarantees must be included within appropriations bills. Points of order could be raised

against loans or guarantees that do not subject themselves to the Appropriations Committees.

I know that there are other efforts underway in the Budget Committees and in the administration. It seems the "iron is hot." I think it is essential that both onbudget and offbudget loans as well as loan guarantees be included in whatever system we finally agree upon. The problem of loans by Government-sponsored enterprises may be something that has to be dealt with through other means.

Two prominent economists have endorsed my bill. Henry Kaufman, a partner with Salomon Bros., investment bankers, and Alan Greenspan, former Chairman of the Council of Economic Advisers, have both written in support of the bill. I would like to have their letters made a part of the record.

Senator METZENBAUM. Without objection, they will be.
[The letters referred to follow:]

SALOMON BROS.,
MEMBERS OF THE NEW YORK STOCK EXCHANGE, INC.,
New York, N.Y., March 31, 1980.

HON. CHARLES H. PERCY,
U.S. Senate, Committee on Governmental affairs,
Washington, D.C.

DEAR SENATOR PERCY: I am responding to your recent letter in which you commented on my column in the Washington Post which reprinted a portion of the talk that I gave to the American bankers association in February. A copy is enclosed.

You also enclosed in your letter a copy of the bill that you introduced in Congress concerning the Federal credit programs. I applaud your bill because Federal credit activity has proliferated and is preempting a substantial volume of funds in the marketplace without being subject to adequate surveillance for limits. I have been concerned about this matter for about a decade and I greatly hope that your efforts will bear fruit.

Incidentally, you might be interested in the enclosed copy of my memorandum on "The New Anti-Inflation Program." The memo has a brief table showing the magnitude of both U.S. Treasury borrowings and the direct borrowings of the Federal credit agencies during this calendar year as well as in two earlier periods of credit stringencies.

Thank you for calling your proposal to my attention, and I do hope that we will have the opportunity to meet either here in New York or in Washington.

Sincerely,

HENRY KAUFMAN.

ALAN GREENSPAN,
One New York Plaza,
New York, N.Y., March 31, 1980.

HON. CHARLES H. PERCY,
U.S. Senate, Committee on Governmental Affairs,
Washington, D.C.

DEAR CHUCK: S. 2151 is a type of bill which is long overdue. There is no question that inflation is a credit problem and that the federal government, both on budget and through its credit guarantees, is a major culprit. I wish you well on your bill.

Best personal regards.

Cordially,

ALAN GREENSPAN.

Senator PERCY. Let me close with two thoughts. Although each credit program may have highly desirable objectives, taken altogether, credit programs out of control can have significant detrimental effects on the economy. Second, control of credit programs does not mean cutting back in all cases. The Congress is trying to balance the budget. That means a process of constantly struggling to establish priorities. What I urge that we do is control credit

programs so that we can determine where such programs fit in with all the other programs that the Federal Government supports, whether it be by direct expenditure, direct loans, or loan guarantees.

I think the happy ending, Mr. Chairman, to the "60 Minutes" program last Sunday night was that it was a replay. Last October they played the original program. People were so outraged that FmHA put a cap on its loans. A program that was out of control got under control because they scaled those loans back to where maximum loan could be made under the program was a half million dollars. That agency got rid of these \$5, \$6 or \$7 million loans. We cannot expect "60 Minutes" to investigate every one of these credit programs. Why not do it ourselves?

That dramatically shows what the Budget Committee could do. If "60 Minutes" can do it, so could the Budget Committee.

That is all we are simply saying.

Senator METZENBAUM. Thank you, Senator Percy.

PREPARED STATEMENT OF HON. CHARLES H. PERCY, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Mr. Chairman, Members of the task force, it is a pleasure to appear before you today to comment on the serious problem of controlling Federal credit programs and to offer my proposal to establish a systematic mechanism to oversee credit programs by amending the Budget Reform Act of 1974.

I am particularly pleased to be testifying with Senator Proxmire who has been a leader in this area. Earlier this year he wrote to the Budget Committee urging that annual ceilings be set for federal loans and loan guarantees. Unlike the administration's proposal, Senator Proxmire urged that all federal credit programs, whether direct loans or guarantees or on or off-budget, be included in a credit budget. I agree with the recommendation and I ask that Senator Proxmire's letter be included in the official record of this Special Subcommittee if it is not already.

I would also like to pay tribute to Representative Mineta who originated the concept behind S. 2151 and who has moved Federal credit control ahead in the House of Representatives.

Last December, when the Senate debated the Chrysler Loan Guarantee Act, I simultaneously introduced S. 2151, the Federal Credit Program Control Act, and an identical provision as an amendment to the Chrysler bill.

Introduction of the amendment served the purpose of expressing my concern about the willy-nilly way in which Congress deals with important financial tools like loan guarantees.

At that time, I was assured on the floor of the Senate that the Budget Committee would have hearings on how the Congress can examine credit programs in the budget process. As a result, I withdrew my amendment to the Chrysler bill. Senator Proxmire participated with us in that colloquy.

I want to congratulate you for conducting these hearings now. The many forms and purposes of credit extended by the Federal government do not lend themselves to simple characterizations. There is a real need, however, for uniform, systematic Congressional review of the myriad credit programs as part of our budget process.

I will concentrate my remarks in two areas. First, I would like to discuss why it is so important to establish Congressional control over credit programs. Secondly, I would like to suggest how we can build on existing budget structures as set out in the Budget Reform Act of 1974 to insure that credit programs are exposed uniformly to the light of the authorization and appropriation process. In other words, I will outline the problem and describe my recommended solution.

ANALYZING THE EXPANSION OF FEDERAL CREDIT

The Federal Government began issuing loan guarantees and having an impact on credit markets as far back as the 1930's. It has not been until the past decade, though, that loans and loan guarantees have mushroomed. Originally, these credit programs were limited to housing, but that, too, has changed as synthetic fuels, Chrysler loan guarantees and economic development have become the beneficiaries of these convenient, often off-budget financing techniques.

In less than a decade, the total of new Federal loans—and by that I mean loans by both on and off-budget agencies, and loan guarantees—has increased from approximately \$47 billion in fiscal year 1971 to approximately \$140 billion in fiscal year 1979. That is nearly a 200 percent increase in eight years and does not include loans by government-sponsored enterprises such as Fannie Mae (Federal National Mortgage Association) and Sallie Mae (Student Loan Marketing Association).

ROLE OF THE FEDERAL FINANCING BANK

The Federal Financing Bank (FFB) deserves special mention because I believe it has played a major role in the expansion of Federal credit since its creation in 1973. The FFB borrows money from the Treasury off-budget. The FFB then buys loans that have been made by both off and on-budget agencies. The result is that the on-budget loans are transferred off the budget. Thus merely through a bookkeeping transaction, the Federal deficit is reduced. As we all know, of course, the off and on-budget borrowing by the Federal government is a distinction without any economic difference. In fact, Congress has to continue raising the debt ceiling dollar-for-dollar for all the loans whether on or off-budget.

The FFB was set up to coordinate and reduce the cost of federal borrowing by having one agency, the FFB, do the borrowing rather than many individual agencies. Those are important functions. The FFB has reduced the interest cost of agency borrowing and has provided the debt management skills that many agencies don't have. Nevertheless, as Nancy Teeters, a Governor of the Federal Reserve Board said, "the FFB has reduced the accountability of Federal credit programs, because lending activities are attributed to the FFB rather than to the agency originating the transaction." I urge this special subcommittee to fully examine the role of the FFB as part of your study of the proper ways to control federal credit.

DISPLACEMENT OF PRIVATE BORROWERS

Another problem of credit programs is that although loans and loan guarantees, even "on-budget loans," do not show up in the budget like spending programs, they have a direct impact on the economy through the displacement of private borrowers. The more credit used by the Government, the less is available, particularly for small businesses and small and medium-sized corporations. The central thrust of budgetary control of credit is that Congress should set priorities as to who should receive credit subsidies and to what degree private borrowers should be displaced. Federal credit demands ebb and flow depending on program needs. When there is a great demand for credit, issuance of major loans or guarantees can push up interest rates and increase inflationary pressures. Even if economic circumstances are such that there is no displacement of private borrowers, there continues to be a reallocation of credit that can result in non-subsidized borrowers paying higher interest charges than they otherwise would.

The Federal Reserve Bank of San Francisco recently reported that the combination of Federal deficit and heavy borrowing by mortgage-financing agencies could make the Federal presence in credit markets "the dominant element in the credit markets this year. Total Federal and Federally-assisted borrowing could account for perhaps 23 percent of all funds raised in the credit market in 1980, compared with the 20 percent average of the 1977-79 expansion. That 23 percent figure, although considerably lower than the Federal share in the 1975 recession year, could give some substance to the argument that Federal borrowers are 'crowding out' private borrowers from the market."

TARGETS AND CEILINGS FOR LOANS AND LOAN GUARANTEES

The importance of dealing with credit programs in a straight-forward manner has been recognized by others over the years. The President's Committee on Federal Credit Programs in 1963 and the President's Commission on Budget Concepts in 1967 both recommended that reforms be made in the budgetary treatment of Federal credit programs.

Now we have another opportunity to formulate a more honest way to deal with these credit programs. We are fortunate that today there exists a framework on which we can build the needed techniques to control credit programs. That framework is the Budget Reform Act of 1974. The Budget Act does not specifically direct the Budget Committee or the Congress to estimate or limit credit programs. It is that shortcoming, in legislation originally developed by and reported out of my own committee, Governmental Affairs, that my bill now seeks to remedy.

S. 2151—A SYSTEMATIC MECHANISM FOR OVERSEEING CREDIT PROGRAMS

Mr. Chairman, simply put, my bill, S. 2151, adds one new section and minimally amends certain other sections of the Budget Reform Act so that we establish the procedures for setting targets and ceilings, in the Congressional budget process, for loans and loan guarantees. I would like to explain the key aspects of how my bill would accomplish the goal of establishing a systematic mechanism for overseeing credit programs. The bill would:

Require that the budget resolution each year set forth the appropriate level of direct loans and loan guarantees. The budget is also required to itemize estimates for loan guarantees and direct loans by budget functions.

Require credit plans to be submitted to the Budget Committee by each authorizing committee. Presently, committees must submit their spending plans to the Budget Committee by March 15; the bill would extend this to loans and guarantees.

Require the Banking Committees to submit to the Budget Committees by March 15 each year their estimates and recommendations for the appropriate level of overall guarantees and loans for the next fiscal year. The Banking Committees would, in effect, evaluate the credit needs of private and public borrowers.

Stipulate that bills or resolutions authorizing new loans or guarantees must be reported from their respective committees by May 15. Bills reported after that date would face a point of order on the floor, as do all spending bills under the budget process.

Require the Congressional Budget Office (CBO) to report annually to the Budget Committees on credit programs of the Federal government.

Permit a point of order to be raised, after the second budget resolution is passed, against loans or guarantees that exceed the totals in the budget.

Stipulate that loans and guarantees must be included within appropriations bills. Points of order could be raised against loans or guarantees that do not subject themselves to the Appropriations Committees.

I know that there are other efforts underway, in the Budget Committees and in the Administration. It seems the "iron is hot." I think it is essential that both on-budget and off-budget loans as well as loan guarantees be included in whatever system we finally agree upon. The problem of loans by government-sponsored enterprises may be something that has to be dealt with through other means.

Two prominent economists have endorsed my bill. Henry Kaufman, a partner with Salomon Brothers, investment bankers, and Alan Greenspan, former Chairman of the Council of Economic Advisers, have both written in support of the bill. I would like to have their letters made a part of the record.

Let me close with two thoughts. While each credit program may have highly desirable objectives, taken altogether, credit programs out of control can have significant detrimental effects on the economy. Second, control of credit programs does not mean cutting back in all cases. The Congress is trying to balance the budget. That means a process of constantly struggling to establish priorities. What I urge that we do is control credit programs so that we can determine where such programs fit in with all the other programs that the Federal government supports, whether it be by direct expenditure, direct loans or loan guarantees. Thank you.

BUDGETING FOR LOAN GUARANTEES

Senator METZENBAUM. "60 Minutes" might have 40 million listeners, but we might have a \$40 million deficit.

I would like you both to address yourselves to this question including the amount of loan guarantees, and I gather that that would be handled in a somewhat separate manner from the budget itself because it would not be included in as an actual budget item except that it would be reflected in the budget as to amount.

Are you saying one part of the budget addresses itself to outlay authorization as well as revenues, and another part of the budget addresses itself to indicating what the loan programs and loan guarantee programs are? Do you intertwine the two in some way? Does one have an impact upon the other?

Senator PERCY. You should separate accounts here. The committee has already gone about it in a sensible way, in the fiscal year 1981 budget.

I would like to read from the First Concurrent Resolution on the Budget for fiscal year 1981, which discusses the credit budget in a separate chapter 8 "Credit Budget."

The committee recommends aggregate targets for Federal credit activity—new direct loan obligations and new loan guarantee commitments—for fiscal year 1981, and calls upon the President and Congress to use the appropriations process to hold Federal credit activity in fiscal year 1981 to the recommended levels. In addition, the Committee proposes that the Senate adopt a new point of order procedure under which all legislation authorizing new loans or loan guarantees would be subject to appropriations review.

In other words, the distinction between credit and spending programs should be preserved.

Senator PROXMIRE. I would say that the chairman makes a very good point. If you add these up, you are adding apples and oranges. A guarantee is not an expenditure; neither is a loan. We ought to have a comprehensive inclusion of all expenditures and of all loans and guarantees, as Senator Percy has said, but not add them up and expect them to indicate any total. It is extremely important that the credit programs go through the same discipline of the budget process so that we realize with a guarantee, just as much as an expenditure, that we are shifting resources from one sector of the economy to another. When we provide a guarantee that will be used, it means that amount of credit will go into low-income housing, for instance, and not into some other activity in the economy. We do not say so now.

Senator PERCY. The credit budget should be separate.

IMPACT OF DEFAULT FACTOR ON OUTLAYS

Senator METZENBAUM. That is only laying the foundation. The second part is that say we have \$200 million in housing guarantees, taking a particular program. We know we ought to be able to estimate that that \$200 million in housing guarantees is eventually going to cost the Federal Government 10 percent, \$20 million, or whatever the figure is. There can be some estimate made. Should that estimate be put in and moved from the Federal credit budget to the spending side. Because every time you have a default you have losses. The money comes from somewhere and it has got to come out of the Federal Treasury. Therefore, should not there be included a projected estimated cost of the loan guarantee program?

Senator PROXMIRE. Yes. I think that is true and I indicated that to some extent in my statement when I said, "Congress should consider including direct loans and loan guarantees on the same basis within a credit budget and including in the expenditure budget only those aspects of both which are most like expenditures, such as the amount of interest subsidy (implicit or explicit), the administrative costs, and the projected losses from defaults."

If you do that, then I think you reconcile the differences.

Senator METZENBAUM. The Chair feels that if you do not do that, if you do not somehow take the cost factor from the credit programs and get it into the direct budgetary process itself of outlays

and revenues, then you have still left missing x number of dollars that would never be accounted for and would never be known.

Now, it is true that you have to operate in part upon estimates and in some part upon realized cost, at least until we can find out and get the Office of Management and Budget to determine what the default cost is. They testified last week they do not have those figures. It is the default cost which is a factor.

Senator PROXMIRE. You will always have estimates. They always may be a little off. You can never get them precise. I wholeheartedly agree you must make those estimates and you can improve them as you go along and realize that is as much of an expenditure as any part of your regular expenditure programs.

Senator METZENBAUM. Senator Percy, do you think the proposed reporting system—

Senator PERCY. Could I go back to the last question?

Senator METZENBAUM. Certainly.

Senator PERCY. Chrysler is before us. It was before us just yesterday. The impact of that guarantee is tremendous. As Henry Kaufman said, the volume of Federal credit is preempting private credit needs.

If, as you go down the line, it looks like it is going to be in default, it then has to be reflected in the budget as an outlay. There is no question about it.

Senator PROXMIRE. That is the hardest kind of situation because it is so big and you cannot make an estimate that is very reliable. In a sense, it is all or nothing.

Senator METZENBAUM. Most of the programs you can.

Senator PROXMIRE. Housing you can.

RESTRICTIVE EFFECT OF PROPOSED DEFAULT REPORTING SYSTEM

Senator METZENBAUM. Housing, small business, student loans and various programs of that kind.

Senator Percy, do you think the proposed reporting system would restrict the ability of the agency to finance activities?

Senator PERCY. From what?

Senator METZENBAUM. Do you think the proposed reporting system would restrict the ability of agencies to efficiently finance activities?

Senator PERCY. No, I do not.

Senator METZENBAUM. Senator Chiles.

Senator CHILES. I have no questions.

Senator METZENBAUM. I think you have helped us tremendously. I am very enthusiastic and optimistic about the directions in which this committee should move. We are going to need your support to do it because the highlighting of credit programs and Federal loan guarantees is going to bring to the surface some facts of life that many in Congress would just as well not make much of a point about. I think it is important that we know what we are doing in the budgetary cost to the American people.

Thank you very much.

Senator PERCY. Thank you very much, Mr. Chairman and Senator Chiles.

Senator PROXMIRE. Thank you.

Senator METZENBAUM. On the impacts of Federal Credit controls, our next panel will consist of Robert Mullins, assistant director of legislative services, National Farmers Union and C. Robert Kemp, president, Opportunity Funding Corp.

Mr. Mullins, we are happy to have you lead off and we are happy to have you with us today.

STATEMENT OF ROBERT J. MULLINS, ASSISTANT DIRECTOR OF LEGISLATIVE SERVICES, NATIONAL FARMERS UNION

Mr. MULLINS. Thank you, Mr. Chairman.

I am Robert J. Mullins, assistant director of legislative services of National Farmers Union in Washington, D.C.

I appreciate the opportunity to appear before the Budget Committee today to comment on the proposals to establish a Federal Credit Budget. I will skip through my prepared testimony and request that the entire statement be submitted for the record.¹

Senator METZENBAUM. Without objection, so ordered.

Mr. MULLINS. I am pleased to appear before this committee today representing an industry which produced products valued at more than \$133 billion, as well as having contributed over \$32 billion in foreign exchange earnings to offset the rising costs of imported oil and other raw materials and manufactured goods.

For more than four decades, direct loan and loan guarantee programs of the Federal Government have assisted American farmers to build our highly productive agricultural system that is the envy of the world. There can be no question that these wise investments in American agriculture have been returned many times over.

BOOKKEEPING MECHANISM FOR FEDERAL CREDIT ACTIVITY

Since direct or guaranteed credit has become a widely used tool to achieve the goals of public policy and represents a significant intervention in the economy, it is prudent for Congress to know the total volume of such activity and its effect on the economy. It is reasonable and desirable for Congress to establish a mechanism to gather and evaluate this information.

IMPACT OF ESTABLISHING LIMITS FOR LOANS AND LOAN GUARANTEES

The proposals in the joint budget resolutions and S. 2151, however, go well beyond establishing this type of bookkeeping mechanism. Both budget resolutions accept the proposal of the executive branch to place limits on the total amount of Federal loan and loan guarantee activity. The proposal for imposition of limits presumes that the volume of loan activity is now or is about to become excessive. The proposals go beyond what is necessary to establish control over Federal credit programs. They would place limits on the amount of Federal credit and would place these programs into the regular budgetary and appropriations process.

Senate Concurrent Resolution 86, provides in section 16 for a new rule to accompany the proposed Federal credit budget which would limit appropriations for on-budget and off-budget direct

¹See p. 147.

loans as well as loan guarantees to the aggregate levels specified in the budget resolution. Adoption of such a rule would make the limit a strict limit, and it would advise the authorizing and appropriations committees to exercise fiscal restraint. This would be a reasonable management tool for the Congress to adopt when the need for strict limitations has been demonstrated.

CURRENT NEED FOR CONTROLS QUESTIONED

The proposed "Federal Credit Program Control Act of 1979," S. 2151, presents a thorough package of amendments to the Congressional Budget Act of 1974 and the Budget and Accounting Act of 1921 for establishing control over the Federal credit programs. We find no fault with the proposed procedures and control mechanisms, except that it may be unnecessary to impose them on the budget process at this time. Both the Senate committee and conference committee reports present findings of the members that authority to establish a credit budget is provided in section 301(a)(7) and section 302(b)(2) of the Congressional Budget Act.

AGRICULTURAL AND RURAL DEVELOPMENT LOAN PROGRAMS

We feel agricultural and rural development programs may be affected adversely. Loan programs of the Commodity Credit Corporation, the Rural Electrification Administration, the Economic Development Administration, and the Small Business Administration may be brought into the annual budget and appropriations process. Programs which primarily benefit residents in sparsely populated rural areas are likely to be disadvantaged in a competitive annual appropriations process. It should be noted that some of these programs, like rural electrification, operate on revolving funds and are essentially self-financing.

EXEMPT COMMODITY CREDIT CORPORATION FROM CREDIT BUDGET

The original budget proposal presented to Congress by the President recommended that loan programs of the Commodity Credit Corporation be exempted from the proposed Federal credit budget. We believe this recommended exemption is wise and necessary. The growth in loan activity of the Commodity Credit Corporation during recent years is the result of fundamental changes in the design of price stabilization programs enacted by Congress. During the past decade, Congress replaced many direct payment and Government storage programs with loan programs to farmers. We have welcomed the establishment of the farmer-held reserve program because it provides farmers greater economic flexibility. The farmer-held reserve, however, represents a food reserve for the whole Nation. It is in the public interest to maintain such a reserve, and the public should therefore bear some responsibility for it.

The shift from direct payments and Government-held reserves to storage loans and a farmer-held reserve has provided savings to the Government. Storage loans are repaid to the Commodity Credit Corporation with interest. The public ultimately pays little or nothing to maintain this strategic national food reserve. To provide greater efficiency in the use of these loan funds, farmers should be

permitted to pool their credit for construction of cooperative storage facilities.

JUSTIFICATION FOR EXEMPTING CCC QUESTIONED

Senator METZENBAUM. I question why the Commodity Credit Corporation should be exempted from the proposed Federal budget. We know what is going on, what the losses are, what the impact is.

Mr. MULLINS. Mr. Chairman, one of the problems we have with that is simply the volatility of the agricultural economy. It would be very difficult to predict what the weather is going to be like 19 months before planting the crop.

Senator METZENBAUM. What does that have to do with what the facts are?

Everytime I go to the floor somebody asks me why should we have special exemptions for farmers including those who make liquor, sell cat and dog food and make candy. I don't see any reason for coming to this committee and saying that the Congress and the American people should not know what the facts are. If you exempt them, how will they know the facts? Why do we have to have a special exemption for agriculture?

I am not saying that we ought not to provide assistance, but why should we not have the accounting available to us?

Mr. MULLINS. I don't think I am challenging the accounting made available to you. If we could change some of the accounting systems over in the Commodity Credit Corporation, it would be beneficial to the Congress to find out that many of these programs have not cost the taxpayers anything; in fact, it has made money for the Federal Government in repayment of loans and interest. I have no problem with accounting for it. It has to be accounted for.

IMPACT OF LIMITING COMMODITY CREDIT CORPORATION BUDGET

What we are fearful of, Mr. Chairman, is that at some point we may be putting a cap on say Commodity Credit Corporation loans. How can you project months in advance what the weather is going to be, what the international situation is going to be, what our trade posture is going to be?

All of this affects the Commodity Credit Corporation's program and the amount of money necessary to loan to producers to hold commodities in either a farmer-held reserve or international reserve.

Senator METZENBAUM. We have other programs. When business gets very bad, when the Small Business Administration needs more funds, shouldn't they be making more funds available to small businessmen?

Mr. MULLINS. Yes, sir.

Senator METZENBAUM. We have to accommodate that. We can make some projections with respect to a known program. We don't know for certain but we can estimate. To provide a special exemption for any one category is to open the door wide to others insisting upon the same exemption and then you destroy the process.

Mr. MULLINS. That is a very difficult proposition when you are sitting on this side looking at it. I can only say I think in projecting business trends, it would be a little easier, possibly to project

future needs for small business, for economic loans, but I still maintain that it is more difficult and it would be a disservice to producers as well as stability in our food supply if we were to put a cap at some point on Commodity Credit Corporation loans.

NON-REAL-ESTATE LOANS TO FARMERS ESCALATING

Senator METZENBAUM. From 1940 to 1975, outstanding, non-real-estate loans to the farmers by the Farmers Home Loan increased from \$400 million to \$1 billion. Since 1975, those Farmer Home Loans have increased to over \$6 billion.

As you stated in your prepared testimony, there is no clear evidence of an excessive volume of Federal credit. If that is so, how would you comment on this rapid escalation in Farmers Home lending and would you suggest some criteria for determining an excessive level of Federal credit?

Mr. MULLINS. I would say prior to the increase in the outstanding amounts by the Farmers Home Loan Administration, it has to be related to the increased cost of agricultural land, accumulation of additional land, and some new farmers moving into farming. When you consider the average price just to acquire a piece of property is \$400,000—

Senator METZENBAUM. My question was addressed to non-real-estate loans to farmers.

Mr. MULLINS. Excuse me.

Senator METZENBAUM. In that area, I am talking about the rapid escalation.

Mr. MULLINS. Are we talking now about equipment loans?

Senator METZENBAUM. I am advised production loans, disaster loans, and economic emergency loans.

Mr. MULLINS. All three of those.

The Senator pointed out one of the problems with some of those loans was that there was no ceiling on them and people who in our estimation were not deserving of those loans were getting these huge loans. There should be some level, and the department has moved to institute levels on those, but you have to have the production loans.

REPORTING INSTANCES OF LOAN ABUSE

Senator METZENBAUM. Your organization knew those loans were taking place. Did you do anything to bring the abuses to the Department?

Mr. MULLINS. We brought it to the attention of the Secretary of Agriculture.

Senator METZENBAUM. When?

Mr. MULLINS. Prior to this whole—

Senator METZENBAUM. Prior to 60 Minutes?

Mr. MULLINS. Yes; prior to 60 Minutes because there were people in Texas who were getting these loans and my people down there brought it to the Secretary's attention personally.

We are not challenging the need for accountability here, Mr. Chairman, it is the volatility of the agricultural sector.

Senator METZENBAUM. Proceed.

I interrupted your statement.

Mr. MULLINS. I have already made my next few points. I will close with that, Mr. Chairman. I have stated pretty much what we feel.

Senator METZENBAUM. Your entire statement will be included in the record at this point.

Then we will hear from Mr. Kemp and then we have some questions.

PREPARED STATEMENT OF ROBERT J. MULLINS, ASSISTANT DIRECTOR OF LEGISLATIVE SERVICES, NATIONAL FARMERS UNION

I am Robert J. Mullins, Assistant Director of Legislative Services of National Farmers Union, 1012 Fourteenth Street, N.W., Washington, D.C.

I appreciate the opportunity to appear before the Committee today to comment on the proposals to establish a Federal Credit Budget.

American farmers and the Federal Government share responsibility for maintaining an adequate supply in food in the United States and for producing agricultural products for sale in export markets. During the past year, the export sale of agricultural products contributed over \$32 billion in foreign exchange earnings to offset the rising costs of imported oil and other raw materials and manufactured goods. Last year, American farmers produced products valued at more than \$133 billion. For more than four decades, direct loan and loan guarantee programs of the Federal Government have assisted American farmers to build our highly productive agricultural system that is the envy of the world. There can be no question that these wise investments in American agriculture have been returned many times over.

The basic concept embodied in these proposals is prudent management. Section 2(a)(4) states, in part: "... there is no systematic mechanism in either the Congress or the Executive Branch for reviewing the volume of total Federal credit activity, and therefore no systematic way of considering the resource allocation effects of Federal loans and loan guarantees or the reasonableness of the total volume . . ."

BOOKKEEPING MECHANISM FOR FEDERAL CREDIT ACTIVITY

Since direct or guaranteed credit has become a widely-used tool to achieve the goals of public policy and represents a significant intervention in the economy, it is prudent for Congress to know the total volume of such activity and its effect on the economy. It is reasonable and desirable for Congress to establish a mechanism to gather and evaluate this information.

The proposals in the joint budget resolutions and S. 2151, however, go well beyond establishing this type of bookkeeping mechanism. Both budget resolutions accept the proposal of the Executive Branch to place limits on the total amount of Federal loan and loan guarantee activity. The proposal for imposition of limits presumes that the volume of loan activity is now or is about to become excessive. The proposals go beyond what is necessary to establish control over Federal credit programs. They would place limits on the amount of Federal credit and would place these programs into the regular budgetary and appropriations process.

IMPACT OF ESTABLISHING LIMITS FOR LOANS AND LOAN GUARANTEES

Senate Concurrent Resolution, Number 86, provides in Section 16 for a new rule to accompany the proposed Federal Credit Budget which would limit appropriations for on-budget and off-budget direct loans as well as loan guarantees to the aggregate levels specified in the budget resolution. Adoption of such a rule would make the limit a strict limit, and it would advise the authorizing and appropriations committees to exercise fiscal restraint. This would be a reasonable management tool for the Congress to adopt when the need for strict limitations has been demonstrated.

The proposed "Federal Credit Program Control Act of 1979," S. 2151, presents a thorough package of amendments to the Congressional Budget Act of 1974 and the Budget and Accounting Act of 1921 for establishing control over the Federal credit programs. We find no fault with the proposed procedures and control mechanisms, except that it may be unnecessary to impose them on the budget process at this time. Both the Senate committee and conference committee reports present findings of the members that authority to establish a Credit Budget is provided in Section 301(a)(7) and Section 301(b)(2) of the Congressional Budget Act.

CURRENT NEED FOR CONTROLS QUESTIONED

At this time, we must question the need for establishing strict limitations on Federal credit programs and for instituting elaborate and detailed procedures for adopting a Credit Budget. We are aware of no clear evidence that the total volume of federal credit is excessive, as a limitation presumes. The proposed limits appear to be somewhat arbitrary. We are aware of no clear evidence that federally guaranteed loan programs are widely abused, except for a reported high rate of default on student loans. The high default rate, however, suggests inadequate administrative procedures rather than an excessive volume of loan activity.

Agricultural and rural development programs may be affected adversely. Loan programs of the Commodity Credit Corporation, the Rural Electrification Administration, the Economic Development Administration, and the Small Business Administration may be brought into the annual budget and appropriations process. Programs which primarily benefit residents in sparsely populated rural areas are likely to be disadvantaged in a competitive annual appropriations process. It should be noted that some of these programs, like rural electrification, operate on revolving funds and are essentially self-financing.

EXEMPT COMMODITY CREDIT CORPORATION FROM CREDIT BUDGET

The original budget proposal presented to Congress by the President recommended that loan programs of the Commodity Credit Corporation be exempted from the proposed Federal Credit Budget. We believe this recommended exemption is wise and necessary. The growth in loan activity of the Commodity Credit Corporation during recent years is the result of fundamental changes in the design of price stabilization programs enacted by Congress. During the past decade, Congress replaced many direct payment and government storage programs with loan programs to farmers. We have welcomed the establishment of the farmer-held reserve program because it provides farmers greater economic flexibility. The farmer-held reserve, however, represents a food reserve for the whole Nation. It is in the public interest to maintain such a reserve, and the public should therefore bear some responsibility for it.

The shift from direct payments and government-held reserves to storage loans and a farmer-held reserve has provided savings to the Government. Storage loans are repaid to the Commodity Credit Corporation with interest. The public ultimately pays little or nothing to maintain this strategic national food reserve. To provide greater efficiency in the use of these loan funds, farmers should be permitted to pool their credit for construction of cooperative storage facilities.

IMPACT OF LIMITING COMMODITY CREDIT CORPORATION BUDGET

Our principal concern over placing the Commodity Credit Corporation on a limited budget is the potential that it will tie the hands of the Secretary of Agriculture when he needs to respond quickly and affirmatively to changes in crop production, crop forecasts, or changes in market conditions.

Farmers cannot control weather conditions, disasters like the eruption of Mount St. Helens, or international political events which drastically effect their prices. The grain embargo of January 4 is a case in point. The Secretary had only days or hours to announce credit programs to remove embargoed grain from the market to avoid a disastrous effect on prices. Even under current authorities, American grain farmers have lost billions of dollars as a direct result of the embargo. The situation could have been much worse if the Secretary had been limited to a budget predicated on "normal" conditions. Farmers need to be able to depend on the measure of security provided by the Secretary's current ability to respond decisively to unforeseen developments.

ADMINISTRATIVE AGENCIES NEED BUDGETARY FLEXIBILITY

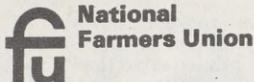
All administrative agencies need a measure of flexibility to respond to changing economic conditions. Two months ago, inflation was out of control and the economy called for fiscal restraint. Today, the economy has cooled somewhat, and many members are actively discussing a tax cut. Administrators who regulate government loan activity should have flexibility to respond to such rapid changes in economic activity so that these programs can have a stabilizing influence on the economy.

We recommend that this Committee proceed cautiously in considering proposals to set strict limits on Federal credit programs. We feel that establishing a two-year program of data-gathering and study would be preferable to establishing credit limits at this time. Such a program would provide the Congress and the Administra-

tion with a more complete understanding of the aggregate effects of such programs on the economy.

It will then be possible to determine more accurately the appropriate levels of such credit activities. If limits are placed on Federal credit programs, they should establish a permissible range of activity to permit needed administrative flexibility.

Government programs should be designed to ensure an adequate flow of credit to independent farmers at reasonable rates of interest. If the Committee decides to launch a program of credit limitation at this time, we recommend that the Commodity Credit Corporation loan programs continue to be exempted from the proposed budget as provided in the First Concurrent Budget Resolution, adopted May 12, 1980. Our reasons for support of this position are detailed in the attached legislative message from National Farmers Union President George W. Stone, dated May 5, 1980.



National
Farmers Union

URGENT LEGISLATIVE MEMORANDUM

May 5, 1980

M E M O R A N D U M

To: Members of the United States Senate
From: George Stone, President
Re: Section 16 of Sen. Con. Res. 86

National Farmers Union urges your support to delete Section 16 of the 1st Concurrent Resolution on the FY 1981 Budget.

If Section 16 is adopted in its present form the Commodity Credit Corporation would be restricted to amounts set forth in the Appropriations Acts. This would be a fundamental shift in our agricultural price support programs and result in an administrative nightmare.

The amount of CCC commodity loans should not be restricted by dollar amounts in the Appropriations Acts for several reasons:

1. CCC price support loans are mandatory in nature. The Corporation must make an offer, open to all producers, to make loans upon any quantity of basic commodities and six non-basic commodities that producers wish to place in the loan program.
2. By their very nature CCC loan outlays and the resulting money needed to fund the loans will vary by season, weather factors, market conditions and other variables which are impossible to calculate months ahead of time.
3. Such a restriction would disrupt the basic concept of the price support programs. Arbitrary dollar ceilings would disrupt and distort the functioning of the price support loan mechanism and defeat the whole purpose of having a floor under market prices.

In addition, such arbitrary limitations would be very discriminatory between producers, commodities and various regions of the country.

Again, we urge your support to delete Section 16 of the Budget resolution.

STATEMENT OF C. ROBERT KEMP, PRESIDENT, OPPORTUNITY FUNDING CORPORATION

Mr. KEMP. Thank you, Mr. Chairman.

My statement is relatively short, so I just propose to read it into the record.

Senator METZENBAUM. Very well, you may do so.

Mr. KEMP. Mr. Chairman, members of the subcommittee and members of the committee, I am C. Robert Kemp, president of Opportunity Funding Corporation. On behalf of the corporation, its board of governors and most of all its clients, I thank you for inviting me to appear today and present our views on this most important matter now under consideration by the subcommittee.

Senator METZENBAUM. What is the Opportunity Funding Corporation? Where is it located? What does it do?

Mr. KEMP. It is a 501.3(c) not-for-profit corporation initially capitalized with a grant from the Office of Economic Opportunity. I will refer to the characteristics of the organization as I speak.

Senator METZENBAUM. All right.

IMPACT OF CREDIT CONTROLS ON PROGRAMS FOR LOW-INCOME AND MINORITY COMMUNITIES

Mr. KEMP. I will not speak to the overreaching issue of whether there is a need to have greater congressional control of Federal credit assistance programs. Both the administration and Congress, by their respective actions to date, have indicated that they feel a need for such controls. We do not quarrel with the concept, but we are vitally interested in how it is done and the impact it will have on Federal credit assistance programs that are designed to promote the economic development of low-income and minority communities.

We note from the excellent work done by the staff of this committee that there has been a substantial expansion in direct loan and loan guarantee programs over the last 15 years. Some observers seem to be alarmed by the expansion. It is not clear whether that alarm is generated by the nature of the programs supported by Federal credit assistance or by the fact that there were no elaborate 5-year plans governing the expansion. In any event, almost all of the direct loan and loan guarantee programs that promote economic development in low-income and minority communities have been established during the last 15 years, and I am alarmed that these programs have not expanded more rapidly than they have. I am particularly dismayed that the National Public Works and Economic Development Act has languished in conference committee for more than 6 months when its programs are so desperately needed by certain segments of the community.

PRIMARY PURPOSE OF OPPORTUNITY FUNDING CORPORATION

Opportunity Funding Corporation was chartered in 1970 and began operations that year with \$7.4 million provided by the Office of Economic Opportunity—now the Community Services Administration. Its primary purpose was to devise new or modified financing techniques that could induce private capital to flow into low-

income and minority communities in support of business ventures. We sought, thereby, to demonstrate two things:

First, that private sources of capital would invest in minority-owned and community development ventures if the risks could be reduced to an acceptable level; and

Second, that such enterprises could grow and prosper in a free enterprise economy if adequate sources of capital were available to them.

PROVIDE PRIVATE INVESTORS WITH GUARANTEES AGAINST LOSS

Over the years, OFC has used its rather modest capital to generate or leverage approximately \$65 million in capital for the enterprises we have been able to assist. Much of this has been done through providing private capital sources with guarantees against loss. These guarantees have almost always been much lower than those provided by most Federal loan guarantee programs, but they have proved acceptable. Therefore, on the first point, we are being successful in our effort to induce private capital sources to make capital available to low-income and minority community businesses.

However, we cannot say that we have wholly succeeded because the cost of capital is still generally higher in the communities that we serve and private capital sources still seek the added protection of an OFC guarantee or something similar before making investments in those communities. When the cost differential and the back-up guarantee are no longer required, we will have succeeded in our demonstration of the first point.

OPPORTUNITY FUNDING CORPORATION RESTRICTED BY LIMITED ASSETS

On the second point, the conclusions are much more tentative. Having limited assets at its disposal, OFC has been able to assist only a limited number of ventures. The total to date is slightly over 130. There have been, of course, many ventures that needed capital support which we could not provide. The failure rate of such ventures has probably exceeded the failure rate of OFC-assisted ventures. As a result, private capital sources remain convinced that it is inordinately risky to do business with minority-owned or low-income community based ventures. Based on our experience, we conclude, therefore, that adequately capitalized community or minority-owned ventures will generally succeed. But such successes are so outnumbered by the failure of inadequately capitalized ventures, that the level of risk perceived by private capital sources is not appreciably reduced. We suggest to this subcommittee that if adequate capital were available to OFC and similar organizations so that our programs could be expanded, more ventures would be reached, fewer ventures would fail for lack of capital, and the perception of risk on the part of private capital sources would start to change.

In its attempt to expand the sources and variety of its assistance, OFC has designed and participated in the capitalizing of several financing entities during the past 3 or 4 years. These include the Southern Agriculture Corp., Syndicated Communications, Inc., and Fulcrum Venture Capital Corp. The first deals with minority and

limited resource farmers in the Southeast, the second with minority acquisitions in the broadcast media, and the third is a MESBIC. Since all of these vehicles are capital mobilization efforts in their own rights, OFC, by participating in their creation, has expanded arithmetically, if not geometrically, the number of ventures it might reach.

DIRECT FEDERAL LOANS OR LOAN GUARANTEE PROGRAMS ESSENTIAL TO OFC

Over the years OFC has been involved in many financings in which a Federal direct loan or loan guarantee programs played a critical role. I think it safe to assert that many of those financings would never have been completed without that assistance. Such programs have also been a factor in leading OFC to create some of the financing entities listed above.

For example, Fulcrum Venture Capital Corp., our MESBIC, was created with the knowledge that it would qualify for SBA investment and thereby be able to serve proportionately more business ventures. Fulcrum was started with \$2 million of private capital at a time when a MESBIC license could be obtained with a \$150,000 investment of private capital. It is now the largest MESBIC in the country and OFC has increased Fulcrum's ability to assist through use of a Federal credit assistance program.

Many of the programs that will be affected by the deliberations of this subcommittee and of the Congress have been developed in the years since 1967, the worst year of civil disorders in this country. Some might consider it gross exaggeration to say that many who might have espoused revolution have instead espoused economic development, but I think they are wrong. Without the Federal credit assistance programs, there would have been a false ring to speeches on economic development because no capital would have been forthcoming. But the programs were created. The people in the street listened, and new, more constructive courses were charted. Not many people know it, but H. Rap Brown, once noted for his revolutionary speeches, is now the proprietor of a small business. There are many other examples, though perhaps less well known.

FEDERAL INTERVENTION NECESSARY TO INSURE EQUAL ECONOMIC OPPORTUNITIES

The point which I want to make is this—if we are going to have a free enterprise system in this country, it is incumbent upon all of us to see that its opportunities are available to all. While it may sound contradictory to assert that only through Federal intervention can these opportunities be made available to all, that is precisely what I assert. No one will deny that our free enterprise system has its imperfections when it comes to allocating capital and wealth. That system, with some beneficent assistance from Government policies in taxation and regulation, has managed to allocate approximately 80 percent of the wealth to less than 20 percent of the people. It would seem to be the height of enlightened self-interest to foster, protect, and nurture programs that offer the less privileged an opportunity to make the free enterprise system

work for them. In our view, that is the role of the Federal credit assistance programs that promote economic development in low-income and minority communities. They should be expanded and continued.

IMPACT OF BUDGET CONSTRAINTS ON ECONOMIC DEVELOPMENT PROGRAMS

Therefore, we urge the subcommittee to take appropriate steps to assure that when budgetary constraints are placed on Federal credit it be done in a manner that will avoid strangling the programs I have been discussing. While S. 2151 does not propose that the Congress establish budget ceilings for each direct loan and loan guarantee program, it seems inevitable that question must one day be faced as available resources become more limited. When that time comes, we respectfully suggest that ample time be provided to hear from the beneficiaries of the Federal economic development programs for low-income and minority communities. Only by so doing can you measure the worth of such programs in human terms as well as dollar terms.

Mr. Chairman, that concludes my prepared remarks. I have provided the staff some printed materials on OFC and its affiliated organizations that provide more detail on our activities.

Thank you for inviting me to present these views. I would be pleased to answer any questions that you might have.

CAPITAL FORMATION AVAILABLE TO OFC

Senator METZENBAUM. Mr. Kemp, what vehicles for capital formation are available to you other than the Federal Credit?

Mr. KEMP. Basically none. In the private capital market, we have encountered difficulty for capital formation. One exception is indicated—Communications, Inc.—a venture capital corporation we formed for assisting minorities in broadcast media. We have had the purchase of preferred debentures in Syncom by insurance companies, but to a very limited degree, something on the total of \$500,000.

RURAL SECTOR DEMANDS FOR FEDERAL INTERVENTION

Senator METZENBAUM. Mr. Mullins, the rural sector of the economy is often cited as having particular need of Federal intervention. Do you think this need has increased or decreased over the past several decades?

Mr. MULLINS. Well, sir, I think it has increased. I think this past spring was a prime example. Even if a producer could afford the interest rates in many areas of the Northwest, in Minnesota and the Dakotas and Wisconsin, money simply wasn't available to loan for production loans. The money had to be made available through some sort of federally insured guaranteed direct loans, some sort of loan programs, that the Federal Government had to make available in those areas. Money was absolutely not to be had at any cost.

FEDERAL RESERVE BANK PROGRAMS AVAILABLE FOR TARGET BANK
NEEDS

Senator METZENBAUM. As a matter of fact, the Federal Reserve Bank does have special programs available for target bank needs, that is banks in rural areas, and has not hesitated to use that.

Mr. MULLINS. I wish I had the figures used in the emergency there. I will be happy to provide the information to the committee. It was insignificant. The impact on the local banks was insignificant for their loan needs. We have that documented. I will be happy to provide that to the committee.

[The following was subsequently supplied for the record:]

[From the National Farmers Union's Washington Newsletter, April 25, 1980]

"FED" ACTION ON SEASONAL CREDIT JUST A TOKEN PROGRAM, NATIONAL FARMERS
UNION BOARD COMPLAINS

The temporary seasonal credit program announced April 17 by the Federal Reserve Board provides too little money and does too little about the distressingly high interest rates now prevailing, the full board of directors said at a meeting in Denver. Acknowledging that the Federal Reserve would allow banks with less than \$100 million in deposits and a loan-to-deposit ratio of 68 percent or higher to draw funds from the discount window for loans to farmers and small businessmen, the Farmers Union statement pointed out that each participating bank could draw loan funds equal to only 5 percent of their existing outstanding loans. Thus, a bank with \$80 million in outstanding loans could borrow only \$4 million under the new program and this would not reach far in meeting the needs of small businessmen and farmers, NFU said.

The Federal Reserve said that the participating banks would have to stay within the 9 percent growth limit on loans ordered as a part of the Administration's credit restraint strategy. Thus, banks would have to cut back on non-essential loans to stay within the limit, the "FED" said, although banks lending largely to priority borrowers could exceed the 9 percent limit.

The Federal Reserve said that participating banks would be able to obtain the limited seasonal credit loans at the discount rate of 13 percent, without the current surcharge of 3 points.

"This will be of some help, particularly to country banks which are virtually out of loanable funds," said the Farmers Union board, "but the amount of loan funds made available will fall far short of what is needed. Unfortunately, the most important action which could have been taken under the Credit Control Act of 1969 was not taken—a general roll-back of the cost of money."

NONRECOURSE LOANS FOR FARMERS

Senator METZENBAUM. There are aspects of the Federal commodity price support loans which are different from other types of agricultural loans?

Mr. MULLINS. As far as the nonrecourse loans?

Senator METZENBAUM. Yes.

Mr. MULLINS. Those loans mature usually 9 months after they are taken out with the exception of the farmer-held reserve, all of those loans are repaid with interest or the Federal Government takes possession in full payment of the commodity, so it is a short-term loan.

Senator METZENBAUM. You approve the concept of nonrecourse loans?

Mr. MULLINS. Yes.

Senator METZENBAUM. Why?

Mr. MULLINS. No. 1, it provides some marketing flexibility to the producer.

Senator METZENBAUM. Tell us how it works, will you please?

Mr. MULLINS. Certainly. When I harvest my crop, and let us say, for example, the market price on wheat is \$2 a bushel and the loan on wheat is \$2.50, I will pledge my commodity as collateral and be given a loan at the rate of \$2.50 a bushel for whatever I choose to put into the loan.

I then have this working capital at the point where if the market price moves above the loan or where I think I can recoup my investment, then I will sell that commodity, repay the loan with interest and—

Senator METZENBAUM. What if you sell it for less? You say the market price is \$2. You borrow \$2.50?

Mr. MULLINS. Right.

Senator METZENBAUM. That is pretty good. As a matter of fact, that is quite unique in the whole of banking practice where you borrow 25 percent more than the value of the product that you use as collateral; right?

Mr. MULLINS. I would think so.

RATIONALE FOR FARMERS TO HAVE NONRECOURSE LOANS

Senator METZENBAUM. Give me the rationale, why should the farmer have nonrecourse? The businessman does not; the student does not have nonrecourse. The homeowner who borrows does not have nonrecourse, if the value of his home goes down. The farmer may be extremely wealthy—why?

Mr. MULLINS. The basic concept of the program, Mr. Chairman, was to provide marketing alternatives. There have been and there continue to be abuses in that. At some point we are going to have to address the question of how much can a farmer put under the nonrecourse loan. That will come before the Congress when we have to write a food and agricultural policy in 1981.

Senator METZENBAUM. What do you mean?

Mr. MULLINS. At this point it is virtually an entitlement program. If I produce 500,000 bushels of wheat, I can get a loan on each one. If another producer has only a thousand bushels, he can put a thousand bushels in. At some time we will have to address the question: Is there a limit—as we have done—on payments? We put a cap on that. We put a cap on loans. I will defend the system, although at times it is providing capital to some people who do not need it.

Senator METZENBAUM. You would be more apt to apply nonrecourse to the farmer as opposed to agri business.

I think Senator Chiles would like to address that.

Senator CHILES. You are asking, Why did we have this and why did it come about? I think part of it came about because not only were we trying to do the farmers a favor, we are trying to provide that we would have some stability in the price of crops and what they would be to the consumer. Whatever we have done in farming and governmental policy, although we can talk about all of the problems with it, it has not been too bad because we have the cheapest food any place in the world and more opportunity of supply, generally speaking. These programs were designed to take some of the cyclical swings out. What happens in farming in my experience, people get a good price for watermelons one season and

then everybody plants them—and that is when I did—and then nobody gets a dime.

Next year no one plants watermelons and they bring 60 cents a pound. Now we are talking about our basic staples of wheat and corn in which we have tried to set these prices and, primarily, from the public policy standpoint it would be that you are providing so that there will be enough farmers who plant wheat every year and not every cyclical year, so that you run into these programs.

The point Mr. Mullins makes is very valid though. We do have to determine how much are we going to allow a farmer to plant at prices, as you are saying, at more than it is worth in any amount, so normally we have set these programs, we also used to have set-asides at the same time so we regulated the amount by what the set-asides would be, what you allowed the farmer to, in fact, plant.

CREDIT PROGRAM LIMITS COULD CREATE RATIONING

Senator METZENBAUM. What about the argument that if you put this on budget where you had an upper limit, that would really require the board itself to do this distribution because now there is another limit so we can't grant unlimited credit to everybody so, in effect, they would be rationing the credit. Having set the provision, how many would you be able to put in the plan?

Mr. MULLINS. That would require, Senator, a change in the basic law. Commodity Credit Corporation has to give the producer the loan. It is a difficult question.

Senator CHILES. You might well have to provide the change in the law.

Mr. MULLINS. Absolutely. That is a difficult question to decide, which area of the country gets the money, if you are having a bad year. Let us say you are having problems with agriculture, and you start harvesting wheat in Texas 3 months before you start harvesting it in North Dakota, who is going to say that these fellows down here can get the loan and the guys in the North, by the time you get up there, won't get a loan because there isn't any money left? That is a problem you have to face as well.

Senator CHILES. You are taking the tack that they would make a geographical rationing of it when they could just as well make that an acreage rationing or—

Mr. MULLINS. Or unit rationing.

Senator CHILES. A bushel or unit allocation as well?

Mr. MULLINS. Yes. At some point we will have to address the issue of how far do we go? Can I put everything I produce into the loan or do I put in limits, Senator Chiles?

NEED FOR CREDIT BUDGET

Senator CHILES. From the standpoint of the Budget Committee, you might say from where we should be looking at the problem, I think our concern is that we are not talking about, and we were with the budget act, we are going to require Congress to have to make some rational decisions based on first having to face up to the information before they make those choices or those decisions.

What we are trying to do from the budget act, from the time we start holding our first meeting, is to say what does it look like the

revenue defense will be? How much revenue will it produce? What are the economic factors? That is a question. We listened to all economists and we get their appraisal of how the economy is going to perform in the next year. After we do that, we look at what are the pressing needs of the country and we begin to debate overall how the pie should be divided, how much for defense, how much for agriculture, and based on that, we put the information together on the first budget resolution and we go to the floor. For the first time that is debated at the front end of the process, whereas the way we have been operating, we always took up an appropriation bill and there was also a constituency for it.

I always hear from people who want me to go for them. I never hear from those constituents who want me to go ahead. We vote out these 12 or 13 separate appropriation bills and, at the end of the time, we appropriated more than we took in. We did it every year. It was a rare thing and it happened once every 12 years or more and somehow the revenue caught up and we didn't appropriate more. We are going to start with this figure that we should be able to run the Government within, and we then debate within the front end, how much we should spend for defense, how much for agriculture, how much for education.

BUDGET PROCESS DISCIPLINE

If you look back historically, over a few years, it is amazing how the shift of money would go. It would kind of depend on what is the hot item in Congress at the time. We saw how we shifted tremendously from defense really after Korea and Vietnam. We shifted to the social programs but again, it was not even in a rational way as to how we shifted to those social programs, where the money went, because we didn't have any mission budgeting. We didn't know if we were doing enough for child services. The whole discipline for the budget proposal is to make Congress make those choices with more information at the front end of the process in somewhat of a more rational way in which we have faith in our kind of Government working in which the people are properly informed that they will make some right choices more than part of the time.

CREDIT BUDGET NECESSARY FOR CONGRESSIONAL DISCIPLINE

So we find now that we have that process, I think it is working. I know it is working better than the irrational way I was doing it when I first came to the Senate and the way we have been doing it the years before that, but there is a major piece of the puzzle outside and that is the major credit area.

How do we deal with that? I understand every group dealing outside and all budget media is alarmed and says what is this going to do to us. We better be against that, and we don't know what that does with us. We know how we function with the Secretary of Agriculture. We know how we can interface with him and deal with him. At some point you have to take a stand and say that here is some reason for this budget process, and then that reason should extend to the fact that we need to bring this information in too because we are talking about trillions of potential

liabilities of the Government in all of the guarantees that we have out there.

EVALUATE LIABILITIES AND ASSETS OF CREDIT PROGRAMS FIRST

The worst problem again is that I don't think we are dealing with it in an entirely rational way. We are not dealing with them in the front end of the process. If we put all that information in too, then I think the same interests that were for those programs to start with, knowing that agriculture has to have some way of taking the cyclical basic out, some ways of financing knowing that we have got to do something about how we bring minority businesses on the stream, and part of that is providing adequate capital for them and that is essential; then I have to think that those things that are valid and have a logical and rational argument for their being, will not suffer under that process. In fact, they might well do better but, overall, we will again be able to take the proper view that we should be able to take.

My concern, a little bit, is to tell you that we are careful as we factor this in that we don't throw this in and say oh, my gosh, that means we are running at a deficit 10 times greater than we thought we were and have to cut back on everything else. We have to know what is the asset and liability side of these programs. We have to deal with them kind of on that basis and we have to be sure that we do not just put it in as an effort to say that therefore it means that we are spending much more than we thought we were spending unless we thought that was a fact because there is an asset to this program as well as a liability and we need to see how this bill is entered.

Mr. KEMP. I think you are absolutely right regarding the conclusion you reached as to assets and liabilities. However, the discipline of the budget process as described assumes perfectly functioning financial markets and, as we know, that is not particularly the case. The concern that I would simply mention to you is that in the attempt to set the limitations on credit or be able to manage it effectively, that the response to effective demand which in turn stimulates the economy not be dealt with in an arbitrary fashion limiting the potential for increase in growth.

RATIO OF SUCCESSFUL OFC ENTERPRISES VERSUS PROGRAM DEFAULTS

Senator METZENBAUM. How would you value the successful enterprises you have financed against the default rate of the programs you use?

Is there a better way for us to get these successes than that which we are presently using?

Mr. KEMP. In answer to the first question, I can cite OFC's experience. We have experienced on the gross side \$2 million in losses associated with \$7.4 million in capital. When you net that out against earnings and recoveries, it comes out to about \$300,000, so that our experience over that period of time has been something slightly less than phenomenal.

We have provided some technical and management experience to the firms we provide the guarantees to. That has been the cost. In most of the financings, the lender or financial institution is unable

or unwilling to provide technical management required to oversee it. Transaction cost is a critical part. If that can be minimized, you have reduced perceived risk appreciably.

The second part of the question, if I understand you correctly is, in what ways could it be improved?

Senator METZENBAUM. Yes.

Mr. KEMP. It would require substantial technical assistance or educational and training programs to provide managerial expertise to efficiently run a business operation.

Senator METZENBAUM. Thank you very much.

We appreciate your testimony and the information that you gave in developing this program.

Mr. KEMP. Thank you.

Mr. MULLINS. Thank you.

Senator METZENBAUM. Our next panel consists of Dr. Mark J. Riedy, executive vice president, Mortgage Bankers Association of America, and Robert Waldo, president, Mortgage Insurance Co. of America who is expected to arrive shortly.

Mr. Riedy, why don't you proceed on behalf of the Mortgage Bankers Association of America, accompanied by Peter E. Kaplan, senior staff vice president, Government agency relations; and Robert Waldo, president, Mortgage Insurance Co. of America, accompanied by John C. Williamson, executive vice president, Mortgage Insurance Co. of America.

**STATEMENT OF MARK J. RIEDY, EXECUTIVE VICE PRESIDENT,
MORTGAGE BANKERS ASSOCIATION OF AMERICA, ACCOMPANIED BY PETER E. KAPLAN, SENIOR STAFF VICE PRESIDENT, GOVERNMENT AGENCY RELATIONS**

Dr. RIEDY. Thank you, Mr. Chairman.

Senator METZENBAUM. I assume you will submit the entire statement for the record and give us the essence?¹

Dr. RIEDY. Yes, indeed.

My name is Mark J. Riedy. I am executive vice president of the Mortgage Bankers Association of America, the trade association of this Nation's mortgage banking industry.

We appreciate the opportunity to testify on the various proposals that would place credit budget limitations on Federal insurance and guarantee programs. MBA shares the concern of the Congress and others, especially in today's turbulent economic and financial climate, regarding the need to develop stronger measures for monitoring and controlling the actual and contingent liabilities of the Federal Government.

However, MBA is concerned that the imposition of credit budget limitations on certain actuarially sound, time-tested, and successful Federal insurance and guarantee programs—specifically in the home mortgage credit area—will create unintended and undesirable disruptive effects on the orderly functioning of these programs. The successful programs about which we are most concerned include several of the Federal Housing Administration's (FHA's) insured home mortgage loan programs, the Veterans' Administration's (VA's) home loan guarantee program, and the mortgage-

¹See p. 165.

backed security (MBS) program of the Government National Mortgage Association (GNMA).

As acknowledged in the testimony presented to this committee on June 19 by the Board of Governors of the Federal Reserve System, "research in the area of Federal credit programs has barely begun * * *." Because the nature of Federal loan and guarantee programs is so diverse, there is need for caution in any attempt to apply broad-brush or across-the-board limitations on these programs, lest those that are properly functioning as intended by the Congress are damaged in the process of the gaining of control over those programs that merit much greater attention.

EXEMPT FHA, VA, AND GNMA FROM CREDIT BUDGET LIMITATIONS

Accordingly, MBA respectfully urges the Congress not to place the actuarially sound, demand programs of the FHA, VA, and GNMA under such credit budget limitations. Until the nature and composition of the full gamut of Federal loan and guarantee programs is better understood and more accurately measured, it would be a mistake to apply credit budget limitations on an across-the-board basis, sweeping the actuarially sound and successful programs into the restrictive and inflexible net that would be the result. The costs of disruption to this Nation's mortgage delivery system—particularly to moderate- and middle-income homebuyers—would far outweigh the added benefits that can be reasonably anticipated from their inclusion under credit budget limitations at this time.

Senator METZENBAUM. I wanted to point out that the gentleman seated in the chair 20 minutes ago said that the farmers and Commodity Credit Corp. should not be included, and if we eliminate that and the programs about which you concern yourself, those and some others, we might as well kill the cow before we ever begin.

I am wondering whether or not if you were seated here as a U.S. Senator, you would not say which program you do include if we are going to exempt all these programs plus the farmer's program. If we do it for farmers, then EPA, the Small Business Administration program, the student loan programs, have we not then destroyed the process before we have ever gotten into it?

Does not the MBA really have a concern about the impact of this whole Federal home loan program—the inflationary impact, its lack of control, its lack of accountability?

Are you not zeroing in on the immediacy of its concern without looking at the broader picture?

DEVELOP OVERALL ACCOUNTING SYSTEM FOR ALL LOAN AND GUARANTEE PROGRAMS

Dr. RIEDY. I hope not. I share your concern about monitoring the full program. The objective I would seek, if I were sitting in your place, would be to first develop an overall—I do not want to use the word budget—accounting system of all the loan and guarantee programs. At least they should be assessed. I think that is a worthwhile objective.

I go along with this idea. You have to have a handle on the whole thing, but when you start controlling individual programs, you have to discriminate among those that are actuarially sound, those that are of a higher or lower social priority, the quality of individual programs and how flexible they need to be. We haven't figured out the qualities and characteristics of each. We tried a broad approach, but we do not want to throw out the baby with the bathwater.

Senator METZENBAUM. If we do not do it now, when will we do it?

Dr. RIEDY. I agree with developing a system to pull them all together. Once that accounting type system is developed, you can begin pulling it into the budget control program. Congress needs to control the budget, but it cannot or should not be a program that controls actuarially sound programs subject to market demands in the economy.

ACTUARIAL SOUNDNESS OF HOUSING PROGRAMS

Senator METZENBAUM. Are some of the housing programs not actuarially sound?

Dr. RIEDY. Yes; and they are already under the appropriations process.

Senator METZENBAUM. Some of the programs that are actuarially sound are sound because the Government provides rental subsidy which makes them sound; is not that the case?

Dr. RIEDY. They would be in the general risk or insurance fund category subject to appropriations, so they are covered that way already. We have no problem with that at all. That is appropriate.

In the remainder of my remarks, I hope to explain why the actuarially sound FHA, VA, and GNMA programs should not be subjected to credit budget limitations. The demonstrated success of these programs over time has been due, in important part, to their demand nature. Consumers depend on accessibility to FHA and VA programs especially during periods of tight money and credit, when conventional mortgage credit is restricted as to its availability, and financing terms are increasingly onerous. Significantly higher downpayments on conventional mortgage credit have been especially troublesome during such periods for moderate- and middle-income homebuyers. Thus, FHA-insured and VA-guaranteed mortgage loans have played an important countercyclical role in stabilizing the availability of mortgage credit over many interest rate and housing demand cycles. This countercyclical role requires that FHA and VA financing must respond flexibly to the ebbs and flows of market demand—a flexibility that could be seriously constrained by the Federal budget crafting process, which is operationally inflexible on a short-term basis.

MBA is also concerned that such limitations do not take into account the actuarially sound nature of the VA's and many of the FHA's most effective housing programs for moderate- and middle-income home purchasers. In our formal written statement, which you said would be made a part of the record of these hearings, we explain in considerable detail the actuarial soundness of these programs, as well as the GNMA MBS program.

CATEGORIES OF FEDERAL LOAN GUARANTEES

Rather than repeat the details available in our written statement, let me simply provide a brief overview of how the FHA, VA, and GNMA programs fit into the three major categories of Federal loan guarantee and insurance programs. The first category includes actuarially sound programs—those wherein the insurance premiums or fees charged, or the revolving loan funds appropriated, cover basic operating and administrative costs as well as the losses incurred under the programs.

In the housing field, this category includes FHA property improvement loans and loans within the mutual mortgage insurance fund (MMIF), the cooperative management housing insurance fund (CMHIF), guaranteed loans, and others. This category would also include GNMA mortgage-backed securities.

The second category consists of programs that require subsidies because the individuals or firms pose greater than ordinary risks, or because there is a greater probability of default or there is a lack of acceptable collateral. Many of the housing programs in the FHA's general insurance fund and the special risk insurance fund fall into this second class of programs. These housing programs, however, are already subject to congressional reviews, limiting their contract authority.

The third category of programs consists of federally guaranteed loans to large or discrete ventures, to a single borrower, for example, New York City, Chrysler, Lockheed, or to a few borrowers, and pose an uncertain contingent liability to the Government for several reasons. This type of loan, to date, has not been utilized to fund any housing programs for mortgage insurance or loan guarantee.

To the extent that the FHA programs have experienced losses, these losses have occurred chiefly in the special risk programs, which were not designed to be actuarially sound. Nor are they pure demand programs. Rather, these programs have social goals, such as the revitalization of older, declining urban areas, and the provision of housing for high-risk mortgagors. Thus, it is appropriate that these FHA programs are already subject to congressional appropriations and contract authority limitations.

As for the VA program, for which no insurance premiums are paid by mortgagor-veterans, but is an entitlement program provided by Congress, the program was initially capitalized with a loan guarantee revolving fund. Claims against the fund for the most part have been satisfied by income generated from past loan and property sales without requiring appropriations to pay off claims. Thus, the actuarial soundness of the VA loan guarantee program has been demonstrated over many years of experience.

Turning to the GNMA mortgage-backed security program, GNMA charges initial and annual guarantee fees and has always made a profit on its MBS activities. Defaults by private sector issuers of GNMA securities normally do not result in a loss to GNMA. In fact, losses have only rarely occurred in the history of the GNMA MBS program, and even then never to the extent that they caused the GNMA program on the whole to operate at a loss.

CONSUMER BENEFITS FROM HOUSING PROGRAMS

In addition to recognizing the important stabilizing role played by FHA, VA, and GNMA programs in the Nation's housing and mortgage markets, it is important to recognize also the direct benefits to consumers that result from these programs. For example, since it began in 1934, FHA has played a major role in assisting American families of low, moderate, and middle incomes to buy their own homes. It has functioned to make mortgages readily available and marketable on a nationwide scale. It has played a significant role in making housing opportunities available to families in the inner city. Further, FHA, and VA have fostered consumer protections and contributed to the upgrading of the Nation's housing stock by requiring properties to conform to minimum property standards. New construction technologies and energy-saving techniques have also made substantial headway because FHA and VA have encouraged and approved these innovations and offered financing.

FEDERAL HOUSING ADMINISTRATION INSURED LOANS

Also, FHA in particular should be recognized for having fostered the origination and acceptance of creative financing techniques, such as the highly popular section 245 graduated payment mortgage program.

In the process of achieving these social and economic benefits, FHA has insured more than \$229 billion of mortgages through 1979, covering 16 million single- and multi-family homes. For its part, in the 36 years that the VA has offered a loan guarantee program, it has guaranteed over \$152 billion to cover 10 million loans. The home loan insurance and guarantee mortgage programs of FHA and VA have contributed significantly to a percentage of homeownership in America that is unparalleled worldwide.

COMPETITIVELY PRICED MORTGAGE CREDIT A RESULT OF GNMA SECURITY

At the same time, we need to recognize that GNMA's creation of a standardized, federally guaranteed instrument backed by FHA and VA mortgages has provided liquidity and marketability to mortgage investors and has proven to be one of the most beneficial developments ever in the evolution of the Nation's mortgage markets. As a result of the GNMA security, moreover, FHA and VA mortgagors are assured of competitively priced mortgage credit.

Reserves in the GNMA mortgage-backed security reserve fund, which total approximately \$160 million, cover \$78 billion of outstanding securities backed by FHA-insured and VA-guaranteed loans, the original balances of which total more than \$100 billion.

This Nation stands at the threshold of the 1980's, a period when demographic factors assure us that the demand for housing—particularly among younger first-time homebuyers—will increase strongly to unprecedented high levels. It is a period when we must become even more creative and conscientious in fashioning housing and mortgage credit programs geared toward achievement of the housing goals of the Nation, goals that are being made much more

difficult to achieve by the rapidly escalating prices and costs of acquiring and maintaining a home and other necessities of life.

MBA OPPOSITION TO LIMITING VA, GNMA, AND FHA CREDIT
PROGRAMS

With strong conviction, therefore, given the actuarial soundness of the VA, GNMA, and many of the FHA programs, and the substantial benefits these programs have achieved for America's moderate- and middle-income families. MBA opposes the imposition of limitations on these programs at this time. Perhaps additional Government research can lead to satisfactory methods of discriminating among the full range of Federal loan and guarantee programs in developing the methods or systems that are necessary to control the actual and contingent liabilities of the Federal Government where such controls are needed. At present, however, such limitations and controls are not likely to be implemented and administered without causing more harm than good—at least with respect to the Nation's housing and mortgage markets, and to the moderate- and middle-income homebuying public in particular.

The mortgage banking industry historically has contributed greatly to meeting this Nation's commitment to providing affordable housing in sufficient amounts to the American people. MBA, representing this Nation's mortgage banking industry, believes that the imposition of limitations across the board on FHA, VA, and GNMA programs, as part of a broad Federal credit budget, will seriously deter this Nation from further meeting its housing goals and will, in fact, decrease the opportunities for and affordability of home ownership.

I appreciate this opportunity to express our views, and will be happy to furnish additional information or attempt to answer any questions you may have.

Senator METZENBAUM. Thank you very much.

[The following information was submitted for the record:]

PREPARED STATEMENT OF MARK J. RIEDY, EXECUTIVE VICE PRESIDENT, MORTGAGE
BANKERS ASSOCIATION OF AMERICA

Mr. Chairman and Members of the Committee, my name is Dr. Mark J. Riedy. I am Executive Vice President of the Mortgage Bankers Association of America.¹ MBA is the trade association of this Nation's mortgage banking industry. Accompanying me are Burton C. Wood, MBA's Legislative Counsel and Sharon Canavan, MBA's Associate Legislative Counsel.

We appreciate the opportunity to appear before you today to testify on the various Federal credit control proposals that would place credit budget limitations on Federal insurance and guaranty programs, as contained in S Con. Res. 86, the First Concurrent Budget Resolution for fiscal year 1981, H Con. Res. 307, the First Concurrent Budget Resolution for fiscal year 1981, and S 2151, "The Federal Credit Program Control Act of 1979."

¹ The Mortgage Bankers Association of America is the only nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership is comprised of mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate mortgage loans. Mortgage investors acquire mortgage loans from originators for their investment portfolios. Members include: Mortgage Banking Companies; Life Insurance Companies; Commercial Banks; Mutual Savings Banks; Savings and Loan Associations; Pension Funds; Mortgage Brokers; Title Companies; Private Mortgage Insurers; State Housing Agencies; Investment Bankers; and Real Estate Investment Trusts.

MBA is most concerned about the disadvantageous effect such limitations, under a credit budget, would have on actuarially sound housing programs such as the Federal Housing Administration (FHA) insured home mortgage loan program, the Veterans Administration (VA) guaranteed home loan program, and the Government National Mortgage Association (GNMA) mortgage-backed security (MBS) program. We respectfully urge Congress not to place these programs under such a credit budget.

MBA shares the concern of Congress and others over the need to institute credit controls over the liabilities of the Federal government—both actual and contingent. However, this concern must necessarily be balanced against the need to maintain a healthy and stable housing and mortgage finance industry. This is particularly true with respect to actuarially sound, demand programs such as the FHA, VA, and GNMA programs.

The success of these programs is due, in part, to their demand nature. Consumers depend on the accessibility to FHA and VA during periods of tight money when conventional mortgage lenders offer mortgage financing on more onerous terms, often requiring significantly higher downpayments. Mortgage markets depend upon this flexibility in order to assure adequate sources of affordable financing on reasonable terms at all times. Because the budget crafting process takes place more than a year before economic events may occur, it is not likely that a credit budget could allow mortgage markets the flexibility that is essential to their successful functioning.

Additionally, these programs cover large numbers of loans of relatively small dollar amounts with economic and geographic diversity. These factors combine to reduce the spectre of limitless Federal liability, because the probabilities of massive defaults are diminished substantially by the diverse nature of these insured and guaranteed loans.

LEGISLATIVE BACKGROUND

During the 96th Congress, various legislative proposals have been introduced that would impose a credit budget limiting all loan guaranty and insurance programs of the Federal government, without regard to the actuarial soundness or operating history of a given program (HR 5683, HR 6021, HR 6056, S 2151, and others).

The Task Force on the Budget Process of the House Committee on the Budget held hearings on this issue in November 1979. In March 1980, the Task Force on Federal Spending Limitation Proposals of the House Committee on Rules also held hearings. The purpose of the latter hearings was to assist in making a recommendation to the House of Representatives on this issue. However, to date, no recommendation has been made.

The President's fiscal year 1981 Budget, as originally submitted, contained limitations on Federal loan guaranty and insurance programs. However, housing programs were specifically exempted from those limitations. In the revised budget, as submitted by the President in March 1980, specific limits were added for the FHA, GNMA and VA programs.

In the First Concurrent Resolution on the Budget for fiscal year 1981, the House recommended an overall credit limitation of \$79.6 billion for new commitments in guarantee loan principal. The Senate Resolution provided for a limit of \$77.0 billion. In addition, the Senate Resolution included an enforcement mechanism whereby a point of order could be raised by any member of either House where the credit budget limits would be surpassed by any particular bill. The point of order could be overridden, however, by a majority vote of the Senate. This point of order enforcement provision was dropped in the Conference report on the Budget Resolution. Rather, the conferees expressed the sense of the Congress that total Federal credit activity be limited and reviewed via the appropriations process. The Conference also adopted the House total of \$79.6 billion for an overall credit budget.

The House Appropriations Committee on June 19, 1980, reported out HR 7631, the HUD—Independent Offices Fiscal Year 1981 Appropriations bill. In this bill, the Committee sets limits on FHA's mortgage insurance program at \$34.15 billion and GNMA's MBS guaranty program at \$53 billion. While VA loan guaranty activity is estimated, no limitation is formally imposed as in the case of FHA and GNMA.

With respect to the FHA program, the Committee Report (House Report 96-1114) contains the following language on page 8: "The revised 1981 budget proposed credit control language to limit commitments for mortgage insurance to \$34,154,732,000. The Committee has included that language in the bill. The Department is directed to notify the Committee promptly if it appears the limitation will require a moratorium on commitments."

The report is silent on the GNMA MBS program.

The Subcommittee on HUD—Independent Offices of the Senate Appropriations Committee, has not yet scheduled action on the fiscal year 1981 appropriations bill.

In an April 22, 1980 letter to every Member of Congress, the following housing, real estate, and mortgage lending industry trade associations expressed their deep concern and opposition to the imposition of credit limitations on the FHA, VA, and GNMA programs: Mortgage Bankers Association of America, National Association of Home Builders, National Association of Housing and Redevelopment Officials, National Association of Mutual Savings Banks, National Association of Realtors, National Housing Conference, National Leased Housing Association, National Savings and Loan League, and United States League of Savings Associations.

(See Exhibit 1)¹

MBA strongly opposes limitations on home loan insurance and guaranty programs because such limitations do not take into account the actuarially sound nature of the VA's and many of the FHA's most effective housing programs for moderate- and middle-income home purchasers. Further, administrative problems associated with the implementation of such limitations could severely disrupt the flow of funds into FHA and VA markets, and the markets for securities guaranteed by GNMA. Also, administrative fiat would replace market forces of supply and demand in allocating FHA and VA loans and the volume of GNMA guaranteed securities, leading to an inefficient and imbalanced allocation of these resources across the Nation.

It is most important and very revealing to explore the previous experience shared by the Administration, the Congress, and the housing and mortgage finance industries, when such limitations were imposed in the past. Prior to 1961, limitations had been imposed annually on the authorization levels for FHA programs but there was no fixed time period, as there is today, on FHA's continuing insuring authority. The problems that this raised were noted in the Senate Banking Committee report accompanying the 1961 House Act (Senate Report 281, May 19, 1961, 87th Congress, 1st Session, page 41, to accompany S. 1922, the Housing Act of 1961):

FHA GENERAL INSURANCE AUTHORIZATION

Section 503 (b) and (c) of the bill would remove the present dollar ceiling on FHA's general mortgage insurance authorization and the existing law would be amended to provide that loans or mortgages, except certain programs which have their own time limitation, may be insured until October 1, 1965.

The previous dollar limitations on the general insurance authorization have proved to be inadequate from two standpoints. At certain times the volume of insurance written has increased over a short period to unprecedented and unanticipated amounts causing FHA either to exhaust its authorization or to ration commitments for insurance in order to stay within the dollar limits. At other times the dollar authorization has been more than adequate for a longer period of time than was anticipated. It has become extremely difficult to make even a rough approximation of the increased dollar authorization necessary to assure FHA operations over a fixed period. Because of the vast amount of outstanding FHA mortgage insurance, the "roll-over" resulting from mortgage payments covers a relatively modest change in "rollover" accompanied by a change in volume of new insurance may result in a significant change in net insurance utilization.

Since the Congress has always limited the availability of FHA authorization, an extension of the FHA authority to write new insurance provided by the bill would be limited to 4 years. A time limit avoids the uncertainties inherent in a dollar limitation.

During the hearings several witnesses testified that placing an expiration date on the FHA's mortgage and loan insurance activities could be interpreted as an intent to eliminate the FHA altogether by October 1, 1965. These witnesses further stated that in view of this possible interpretation, many lenders and mortgage investors may be reluctant to plan for investment in FHA-insured mortgages and loans as the expiration date draws near.

The concern expressed by the witnesses is not shared by the committee as there is no intent, on the part of the committee, to eliminate the FHA nor to permit the expiration date to pass without granting further extensions. The committee feels that an expiration date on the general insurance authorization is no different in principle or intent than the present dollar limitation on such authorizations. In the fall of 1958, the dollar limitation was, for all practical purposes, exceeded by the Commissioner when he entered into "agreements to insure" mortgages.

Subsequently, the FHA was prohibited from * * * entering into any kind of agreement or other undertaking to insure mortgages if the commitment to waive such mortgages would be unlawful under the limits so established.

¹See pp. 176-178.

Under a dollar limitation, the agency could find itself in the position of suspending operations should the limitation be exhausted during a time the Congress was not in session so that it could provide for an increase in the general insurance authorization.

The committee wishes to reiterate and emphasize that it has no intent to eliminate the FHA by placing a statutory expiration date on the general insurance authorization.

This view was ultimately adopted by the Conference on the 1961 Housing Act (House Report 602, 87th Congress, 1st Session, June 27, 1961, page 54, to accompany S 1922, the Housing Act of 1961).

HISTORICAL BACKGROUND

The concept of an amortized, even-payment, government insured home mortgage loan was developed and instituted in 1934 with the creation of FHA's Section 203 home mortgage insurance program. Previously, lenders had required large downpayments with lump sum "balloon" payments at specified, short-term intervals. The Depression wreaked havoc on mortgage markets not only because high levels of unemployment made these large payments impossible with resultant foreclosures, but also because deflation substantially reduced the value of the underlying securities, so the solvency of numerous financial institutions was threatened by high foreclosure rates.

Despite the obvious need to institutionalize a different mortgage form, the private sector had had insufficient experience to determine the actuarial soundness of long-term, evenly amortized mortgages. FHA, by pooling the risks of any individual loan across a large group of loans, was able to reduce the cost of risk-taking with mortgage insurance and still involve the private sector by leveraging private funds with the inducement of a government guaranty. As the FHA gained experience, the amortized, long-term loan ultimately gained widespread acceptance, and eventually was copied in the private sector by conventional private mortgage insurers.

CATEGORIES OF FEDERAL LOAN GUARANTIES

Loan guaranty and insurance programs offered by the Federal government can be broken down into three major categories.¹ The first category includes actuarially sound programs. These are programs where the insurance premiums or fees charged or the revolving loan funds appropriated cover the basic costs of administering and operating the programs as well as the losses incurred under the programs.

In the housing field, this category includes FHA property improvement loans and loans within the Mutual Mortgage Insurance Fund (MMIF), the Cooperative Management Housing Insurance Fund (CMHIF), guaranteed loans, as well as others. This category would also include GNMA Mortgage-Backed Securities, which are not only guaranteed themselves, but cover FHA and VA loans that carry their own underlying insurance or guaranty. While contingent liability exists under these programs, the likelihood that these programs would result in governmental losses is not borne out by historical experience.

The second category consists of programs that require subsidies because the individuals or firms pose greater than ordinary risks, or because there is a greater probability of default or there is a lack of acceptable collateral. In this category, the government carries a greater risk, because the fees or premiums charged to the borrowers are set below the level necessary to provide for an actuarially sound program.

In addition to this "indirect" form of subsidy, many of these programs may also carry a "direct" subsidy, in the form of a legislatively mandated interest rate reduction. Many of the housing programs in the FHA's General Insurance Fund and the Special Risk Insurance Fund fall into this second class of programs. These housing programs, however, are subject to Congressional reviews, limiting their contract authority.

The third category of programs consists of Federally guaranteed loans to large or discrete ventures. These large loans are made to a single borrower (e.g. New York City, Chrysler, Lockheed) or a few borrowers (e.g. Synthetic Fuels Corporation). These loans pose an uncertain contingent liability to the Government for several reasons. The class of borrowers is small, the available assets or collateral often may not be easily disposed of in the event of a default, and often these ventures involve new technological processes or uncertain economic enterprises.

¹ Source: Congressional Budget Office, "Loan Guarantees: Current Concerns and Alternatives for Control," August 1978, pp. 10-13.

Although loans insured or guaranteed under this category have been few, they usually involve large amounts, with the result that a default under even a few of these arrangements could involve heavy financial burdens for the government. Also, these have become increasingly popular recently as financing mechanisms, because insurance and guaranty arrangements do not require budgetary reviews or fiscal outlays. This type of loan, to date, has not been utilized to fund any housing programs for mortgage insurance or loan guaranty.

CONSUMER BENEFITS

A primary benefit inuring to the consumer under housing mortgage insurance and guaranty programs is the more favorable downpayment requirement. FHA requires a low downpayment, while VA requires no downpayment, enabling consumers who cannot meet conventional mortgage downpayment requirements to obtain mortgage credit. Of course, where the sales price of the property exceeds the FHA/VA appraised value, that differential must be added to whatever downpayment requirement exists. Conventional mortgages, utilizing private mortgage insurance, offer only a partial guaranty. Therefore, a higher downpayment may be required in order to reduce the risk to the insurer and the lender.

While VA requires no mortgage insurance premium (MIP), resulting in a substantial benefit to the borrower, FHA imposes a MIP of one-half of 1 percent on the declining scheduled balances in its Section 203(b) home mortgage insurance program. Conventional mortgage insurance premiums vary according to the loan-to-value ratio, and the risk presented to the mortgage insurer. The MIP may be charged as an upfront lump sum, or applied on an annual or monthly basis.

FHA and VA have also made significant contributions toward innovation in mortgage lending. A recent example is the Graduated Payment Mortgage (GPM) program that reduces initial loan payments, thus qualifying more first time homebuyers and younger families whose incomes are expected to rise.

FHA and VA have fostered consumer protections by requiring properties to conform to Minimum Property Standards. New technologies in construction and energy-saving techniques have also made substantial headway because FHA and VA have approved these methods and offered financing.

These arguments do not presume that conventional mortgage lenders do not apply reasonable construction standards. It is simply true that FHA and VA programs, backed by the government guaranty, have fostered innovative lending and building techniques that are accepted by conventional mortgage lenders after they have been proven.

The home loan insurance and guaranteed mortgage programs have contributed to a percentage of homeownership that is unparalleled worldwide. By offering this assistance on a demand basis, FHA and VA programs have helped this Nation reach for its asserted goal of providing safe, decent and sanitary housing for all Americans. GNMA programs have fostered a nationwide secondary mortgage market that has attracted private financing into housing in an exceedingly successful fashion.

FEDERAL HOUSING ADMINISTRATION

Since its inception in 1934, the FHA has played a major role in assisting American families—low-, moderate- and middle-income—to buy their own homes. It has also functioned to make mortgages easily available and marketable on a nationwide scale. It has played a significant role in making housing opportunities available to families in the inner city. It has furnished strong impetus to the establishment of minimum property standards toward an upgrading of the Nation's housing stock. In addition, it has fostered the origination and acceptance of creative financing techniques. Over \$229 billion in mortgage insurance has been written by FHA cumulatively through 1979, covering 16 million multi- and single-family units.

There are four FHA insurance funds established to cover losses and administrative expenses incurred under particular programs. Three of the funds were originally designed to be actuarially sound; that is, income generated from mortgage insurance premiums is designed to equal or exceed projected losses. The fourth fund was developed to cover higher risk loans, without the explicit intention that the fund be actuarially sound.

MUTUAL MORTGAGE INSURANCE FUND

The Mutual Mortgage Insurance Fund (MMIF) was established in 1934 to provide reserves for the FHA Section 203 home mortgage insurance program. The Section 244 Coinsurance and Section 245 Graduated Payment Mortgage programs were added as recently as 1974 and 1977, respectively. By the end of fiscal year 1979, the MMIF held reserves totalling nearly \$2.4 billion. The MMIF is self-sufficient by any

measure, and its funds are used to help finance the Federal debt. Mortgage insurance premiums are paid into reserve accounts: one reserve covers losses and the other, a participation reserve account, was established for the payment of dividends. In fact, the MMIF has not only been actuarially sound, but through September 1979 had paid out participation payments amounting to \$523.7 million to homeowners upon termination of their mortgages. Additionally, the MMIF covers all administrative expenses connected with the programs it covers.

GENERAL INSURANCE FUND

The General Insurance Fund (GIF) was established in 1965, and is used to insure mortgages under various socially desirable programs, some of which are high-risk insurance programs that might have been placed in the Special Risk Insurance Fund, had it been established at that time. The cumulative deficit of \$2.7 billion in the GIF is attributable primarily to the high-risk programs contained in the fund and also to the transfer of GIF moneys into the Special Risk Insurance Fund when it was established. Although the fund was intended to be actuarially sound, the placement of high risk programs in this fund affected that intention. The inclusion of special risk programs, notably the Section 221(d)(3) below-market-interest-rate rental program for low-and-moderate income families, which does not even charge an insurance premium, has diminished the GIF and required the transfer of funds from the MMIF, as well as additional appropriations and Treasury borrowing.

Nonetheless, a number of the programs classified under the GIF have low claims rates evidencing their actuarially sound nature. Otherwise, the major difference between the GIF and the MMIF is that the GIF is not designed to pay dividends to mortgagors—it is simply designed to cover losses reasonably projected under its programs and administrative expenses. Like the MMIF, administrative expenses are also paid from this fund.

COOPERATIVE MANAGEMENT HOUSING INSURANCE FUND

The Cooperative Management Housing Insurance Fund (CMHIF) was instituted in 1965. Currently it is successfully operating with a positive reserve of \$21.2 million generated from payments of mortgage insurance premiums. Like the MMIF, it is designed to be actuarially sound, to cover administrative expenses, and to pay dividends to participating mortgagors, whenever reserve requirements are exceeded.

SPECIAL RISK INSURANCE FUND

The Special Risk Insurance Fund (SRIF) was established in 1968. It is intended to provide mortgage insurance for (1) subsidized mortgages for low-income mortgagors, (2) low- and moderate-income mortgagors with irregular income patterns or credit histories, and (3) properties located in older, declining urban areas. Originally the SRIF was funded with a \$5 million advance from the GIF, and by 1975 a total of \$20 million had been advanced from the GIF. The SRIF has never been, nor was it designed to be, actuarially sound. The programs it covers, however, are not pure demand programs; rather, they are subject to Congressional appropriations and contract authority limitations. This limits the potential liability of the Treasury and gives the Congress an opportunity to determine annually how large the program should be.

Although the SRIF originally incurred substantial losses, these losses have diminished as programs have been revised. The original Section 235 program, which involved a deep subsidy, has an estimated ultimate claims rate of 21.2 percent with a loss ratio of 47.1 percent; that is, while approximately one-fifth of the loans originated under Section 235 are expected to result in claims, those claims have resulted in payoffs of nearly one-half of the mortgage balance. That is, while the claim would be submitted for the mortgage balance, once the property was disposed the claim as paid would be lowered significantly. When the program was revised, in 1976, however, its track record improved significantly. The revised Section 235 program has an estimated ultimate claims rate of 14 percent, with a loss ratio of 26 percent. (See Exhibit 2 and text on pages 17-18.) As program experience has developed, losses under the special-risk insurance programs have been cut significantly.

To the extent that the FHA insurance funds have experienced losses, these losses have occurred chiefly in the special risk programs. These programs, however, have social goals, such as revitalization of older, declining urban areas, and provision of housing for high risk mortgagors, so financial soundness is relative. Even so, the losses experienced have been relatively small when compared with the amount of housing delivered. Also, these programs are already subject to the budget process with annual Congressional appropriation limits and budget reviews.

MBA believes that mortgages lending institutions have a proven record of responsibility and protection of the Treasury, dating back to 1934 and the establishment of the FHA. The partnership between private enterprise and the Federal government has delivered housing to the American public in an efficient, orderly, and cost-effective manner, with no unexpected cost to the Treasury for nearly half a century.

VETERANS ADMINISTRATION HOME LOAN GUARANTY

The VA loan program is not a mortgage insurance program, but rather a loan guaranty program. The basic difference is that no mortgage insurance premium is paid by the mortgagor—rather, a fund was initiated upon the establishment of the program. The VA program provides a guaranty of 60 percent of the outstanding loan balance up to a maximum of \$25,000. According to the VA, its Loan Guaranty Program is one of the least costly veteran's programs in relation to the benefits provided to the veteran. In the 36 years that VA has offered a loan guaranty program, it has guaranteed over \$152 billion to cover 10 million loans.

The VA home loan guaranty program was initially capitalized with a loan guaranty revolving fund. Claims against the fund have for the most part been satisfied from income generated from past loan and property sales without requiring appropriations to pay off claims. Thus, the actuarial soundness of the VA loan guaranty program has been demonstrated over many years of experience.

Congress has provided Veterans a lifelong entitlement to home loan guaranties offered by the VA. The bills proposing a credit budget have not exempted VA home loan programs from proposed credit ceilings. However, HR 7631, the HUD-Independent Agencies appropriations bill for fiscal year 1981, as reported out by the House Committee on Appropriations, places no overall limit on the VA home loan guaranty program.

DEFAULT, FOREBEARANCE, ASSIGNMENT, AND FORECLOSURE PROCEDURES

Both FHA and VA have established procedures for handling loan in default. A borrower is considered in default when two mortgage payments are in arrears. The lender is required to notify FHA within five working days or VA within 45 days after a borrower has defaulted. The borrower is also notified about the loan's default status.

VA is more lenient than FHA in allowing forbearance. VA encourages the lender to forebear for a reasonable time, and the lender is responsible for determining the reasons for default and for making a decision regarding forbearance based on the facts as determined. FHA allows forbearance, but sets a time period after which assignment or foreclosure proceedings must begin. Written permission is required for forbearance periods of 18 to the maximum 36 months. Both FHA and VA allow reinstatement by payment of a lump sum until foreclosure is concluded.

The earliest time that a lender may initiate foreclosure is after a FHA or VA borrower has been in default for three months. VA specifies no maximum limit, but FHA requires foreclosures to be started within one year of the default or 60 days after the grace period prescribed by state law. Where the property is abandoned, where the borrower has refused further payment in writing, or where the property has been rented, FHA allows for accelerated initiation of foreclosure proceedings so that the value of the security will not be diminished.

The Department of Housing and Urban Development (HUD) employs two measures to avoid foreclosure—recasting and assignment. A mortgage cannot be recast unless the lender agrees, if the default was caused by circumstances beyond the borrower's control. The unpaid principal balance of the mortgage may be increased to cover the total unpaid amount and/or the mortgage term can be extended up to ten years without HUD's approval. Where the term will be extended more than ten years, approval is required. Under the assignment program, the lender can assign its interest to the HUD Secretary when the defaulted borrower's situation meets certain specified conditions. MBA has worked closely with both HUD and VA in strengthening and improving their respective procedures for handling problem loans. We have been very pleased with the performance of both agencies in this regard.

THE SECURED RISK: CLAIMS RATES AND LOSS RATIOS

A default rate is statistically compiled by HUD on an ongoing, as well as quarterly, basis. This statistic is fairly meaningless in that borrowers suffering a temporary setback often reinstate quickly. The ultimate claims rate (see Exhibit 2) is a more telling statistic in determining the government's potential liability, as it represents the percentage of a given group of mortgages that are expected to result in an insurance claim throughout the life of that group of mortgages. However, the claims

rate would not reflect all foreclosures, because a foreclosure does not necessarily result in a claim or a loss if the entire mortgage balance is satisfied from proceeds of a foreclosure sale. Loans in default or held in the assignment program do not automatically figure into the claims rate, because a borrower can reinstate.

The loss ratio (see Exhibit 2) under a program is a figure estimated and projected for the purpose of determining the actuarial soundness of any particular program. It represents the percentage of a claim that may result in a loss once the claim is paid after the security is sold. The loss ratio and claims rates represent an assumption made for the purpose of analyzing the adequacy of insurance reserves for accounting purposes. These figures are developed from actual program experience; they are projected only where a program is new and has not yet established an experience record.

Thus, as an example, for a group of Section 203 loans originated this year, the ultimate claims rate of 6.9 percent is an assumption that that percentage of loans will be submitted for a claim over the 30 year term of that group of loans. The loss ratio of 51.6 percent means that in the group of loans (6.9 percent) submitted as claims, the final payment would be an average of 51.6 percent of the claims as submitted, or just approximately 3.6 percent of the loans originated this year.

In addition, the risk factor of home mortgage insurance is limited because a mortgage by its very nature is secured by a substantial asset—property. Further, inflation diminishes the risk as property values increase beyond the original mortgage balance. Thus the homeowner-borrower typically is better off selling the house at a profit and paying the mortgage in full rather than losing the house through foreclosure. In brief, the borrower's best interests and those of the government (FHA and VA) are coincident.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

GNMA has two programs for marketing FHA and VA loans—the Mortgage Backed Security (MBS) program and the Tandem Program. Under the MBS program, mortgage originators package FHA/VA mortgages as securities ("Ginnie Maes") and sell them in the capital markets to permanent investors. GNMA prescribes a standard format for the securities and guarantees the performance of the originator/issuer who must pay investors in full each month, regardless of whether all funds have been received from homeowners. Multifamily and mobile home loans can be sold as "Ginnie Maes," but most are backed by single family mortgages. GNMA charges initial and annual guaranty fees and has always made a profit on its MBS activities. In the fiscal year 1981 House and Senate Concurrent Budget Resolutions, the MBS program has been treated as a secondary guaranty program because the FHA and VA loans guaranteed by the GNMA-MBS program also carry Federal insurance or guarantees. In this terminology the FHA and VA programs are referred to as primary loan guaranty programs.

The GNMA tandem program is quite different. It is not a guaranty program. GNMA purchases mortgages at below market rates and resells them at a discount to investors. The difference between the purchase and sales prices is a housing subsidy for which funds must be authorized and appropriated by the Congress. At the present time, only multifamily projects are eligible for tandem.

The Mortgage Backed Security Reserve Fund administered by GNMA contains approximately \$160 million in reserves to cover \$78 billion worth of outstanding securities backed by FHA insured or VA guaranteed loans, the original balances of which total nearly \$100 billion. A default by an issuer normally does not result in a loss of GNMA. In fact, losses have only rarely occurred in the history of the GNMA MBS programs.

DISRUPTION OF MARKETS AND INCREASED ADMINISTRATIVE EXPENSES

Primarily, the various FHA/VA and GNMA programs have traditionally operated as demand programs, that is, programs in which market demand determines usage levels, rather than having predetermined ceilings control demand. Imposition of ceilings on FHA/VA and GNMA programs would disrupt the efficient operation of mortgage lending and the secondary mortgage markets, and give rise to significant administrative problems for both the Department of Housing and Urban Development (HUD) and mortgage lenders.

Credit controls would necessitate institution of a complicated allocation system, which would first have to be devised, then implemented and administered. Approximately half of the conditional commitments issued by FHA never proceed to the firm commitment stage resulting in final insurance coverage. Thus, in order to track remaining available funds for any particular program, a precise system that could be updated frequently would have to be developed. Additionally, some form of

allocation system to even out inequities would have to be devised. While a first-come, first-served system might be easiest to administer, such a program would work inequities. Although a state-by-state or population-based allocation might at first glance appear fairest, such an allocation would ignore regional demographic and construction needs. Also, program performance and soundness might be pitted against social goals in setting limits. Allocations will inevitably hurt that sector of the population—moderate- and middle-income families—whose needs the FHA and VA have so successfully addressed in the past.

FHA and VA would require more staff merely to allocate funds and monitor their distribution, without regard to the sufficiency of any ceilings. Should these artificial ceilings be set below program demand, serious disruptions in the orderly functioning of the FHA/VA and GNMA programs will certainly occur. Significant additional costs, which lenders will pass along to the consumer, will result as lenders are, in effect, forced to bid for limited commitment dollars.

Because administrative expenses to operate FHA are paid out of the respective FHA Insurance Funds, the expense of monitoring and tracking numerous relatively small conditional commitments to insure (that may or may not result in a final commitment to insure) will create an undue burden. The same principal is true for the VA Loan Guaranty program, but its expenses are paid out of the VA general operating expenses with annual appropriations. The current self-sustaining quality of those successful home loan programs that are actuarially sound (FHA-MMIF and CMHIF, and the VA Loan Guaranty Fund) will decrease.

A ceiling on GNMA guaranteeing activities would have additional negative consequences on the secondary market. The creation of a standardized, federally guaranteed instrument backed by FHA/VA mortgages has provided liquidity to mortgage investors and has proven to be one of the most beneficial developments ever in the evolution of the Nation's mortgage markets. By guaranteeing full and timely payment to investors, GNMA has provided access to the long-term capital markets, and a competitive, national secondary market for FHA/VA mortgages has been created. As a result of the GNMA security, FHA/VA borrowers are assured of competitively priced mortgage money.

The soundness of the GNMA MBS idea is best attested to by its many imitators in the private sector, including such institutions as the Bank of America and Merrill Lynch. As small savers become increasingly unwilling to subsidize mortgage borrowers, the entire mortgage sector is growing more dependent on access to the long-term capital market. Undercutting the GNMA MBS will potentially deprive the moderate- and middle-income users of the FHA/VA programs of this possibility, while higher income groups increase their access through private-sector MBS programs backed by conventional mortgages.

CONCLUSION

During periods of credit ease, a healthy supply of mortgage funds typically exists from a wide range of available sources. When credit restraint develops, these sources dry up, limiting the availability of conventional funds. Homebuyers in greater numbers must then turn to programs using private funds but backed by Federal insurance and loan guarantees. If credit ceilings are imposed, this release valve for tight money situations will be restricted, increasing pressure on mortgage interest rates. As demand for limited money exceeds supply, interest rates will rise. Thus, a credit budget would serve to exacerbate inflation by tightening mortgage supplies and forcing interest rates higher.

The increasing volatility of credit markets in recent years underscores the importance of a demand system that can respond flexibly to market conditions. However, the lengthy Federal budget crafting process is too cumbersome to respond to fast moving economic forces. Imposition of credit controls will surely hurt the American homebuyer as well as the mortgage lending industry. Without this source of sufficient FHA/VA financing that qualified consumers have traditionally relied upon, many will be forced to forego homeownership, or at least to delay the purchase of a home, only to sit on the sidelines of the market watching house prices continue to climb, perhaps to levels that are out of reach.

MBA shares the concern of the entire Congress over the current inflationary spiral, with its worsening rather than improving trend, and the overwhelming disruptive impact of rampant inflation on the American economy. In addressing this problem, and in attempting to set limits on the growth of Federal spending and contingent liabilities, we believe that all sectors of the economy should carry their fair share of the battle. At the same time we would point out that in the current inflation fight, a heavy and perhaps disproportionate burden has already been imposed on the residential construction and real estate industries, and on this Nation's housing consumers.

Admittedly, loan guaranty and insurance programs have burgeoned in recent years. While housing programs, with the institution of FHA in 1934 and VA loan programs in 1944, initiated the mortgage insurance concept and for many decades represented the lion's share of the Federal government's contingent liabilities under loan guaranty and insurance programs, this is not true today. Many others have now sought and qualified for Federal aid in the form of loan guaranties. Few, if any, of these enterprises has the track record of actuarial soundness found present in the history of the FHA and VA home loan insurance and guaranty programs. Nor can many of these programs point to the social benefits present in the FHA and VA programs, which have fostered homeownership opportunities and helped over 70 percent of American families to own their homes—the highest percentage of homeownership in the world.

Controlling the economy through manipulation of Federal loan guaranty and insurance programs is an extraordinarily complex proposal. While restraint on the growth of the Government's contingent liabilities may be necessary generally, MBA believes that there has not been sufficient investigation of the devastating impacts of restraints as they would apply to housing, to the American consumer, and to the mortgage lending industry. The institution of a credit budget will seriously deter this Nation from meeting its commitment to provide an adequate supply of affordable housing. MBA believes that the imposition of limitations on housing mortgage insurance and guaranty programs will not help to achieve the goal of efficiently coordinating the Government's allocations with its fiscal policies and direct expenditures, but rather will decrease the opportunity for, and affordability of, homeownership.



Mortgage Bankers Association of America

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(202) 785-8333

April 22, 1980

(Letter sent to all Members of Congress)

The undersigned organizations are seriously concerned about the provisions of the First Budget Resolution that would impose limits on actuarially sound Federal loan and mortgage insurance programs regardless of the fact that they do not involve expenditure of government funds. We urge that credit limitations not be imposed on these programs.

The actuarially sound nature of mortgage insurance and guaranty programs under the Federal Housing Administration (FHA), the Veterans Administration (VA), and the Government National Mortgage Association (GNMA) over a lengthy time period demonstrates the viability and relatively risk-free nature of these socially beneficial programs. Predetermined limits on FHA, VA, and GNMA programs would not serve to protect the Federal Treasury from contingent liabilities. We strongly oppose across-the-board limitations because they would seriously undermine the efforts of the housing and mortgage finance industries to deliver an adequate supply of affordable housing and fulfill the National housing goals to provide decent, safe, and sanitary housing.

The activities of FHA, VA, and GNMA have established a working partnership between private enterprise and the Federal government that has responsibly delivered housing to the American public in an efficient, orderly, and cost-effective manner. Since 1934 FHA has written over \$229 billion in mortgage insurance covering 16 million multi- and single-family units. GNMA has provided access to a secondary market for FHA and VA loans with only two net losses since its inception.

Mortgage loans backed by Federal guaranties and insurance have not only provided a necessary source of mortgage funds, but have fostered a secondary market that mobilizes money on a nationwide basis for the mortgage market. GNMA has created backing for a readily marketable security, through its Mortgage-Backed Security (MBS) program, and provided the necessary assurance for investment in the mortgage market.

FHA financing provides equal opportunities for homeownership to lower- and moderate-income families because of its credit evaluation and downpayment requirements. Except for programs specifically designed to provide subsidies, the provision of FHA insurance does not subsidize interest rates. It should be stressed that these programs offer many families their only opportunity for homeownership.

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The primary benefit accruing to FHA borrowers is the low downpayment requirement. The Mortgage Insurance Premium (MIP) charged in single-family programs is designed to cover reasonably projected losses—thus making the programs actuarially sound. Where the program is actuarially sound, as is the case with the FHA Section 203 homeownership program, as well as others, there is no subsidy—rather, profits are redistributed to borrowers covered by the Mutual Mortgage Insurance Fund (MMIF) and the Cooperative Management Housing Insurance Fund (CMHIF).

Although FHA has experienced losses in its General and Special Risk Insurance Funds, these have been significant only in several programs with an acknowledged higher risk and social benefits. These programs were designed with specific social goals, such as the revitalization of older, declining urban areas, and provision of housing for high risk mortgagors. Even so, these programs are already subject to the budget process with annual Congressional appropriation limits and budget reviews.

The lengthy budget crafting process is too cumbersome to respond to fast moving economic forces. This was demonstrated when FHA insurance was previously subjected to absolute limits. Prior to 1961, FHA insurance programs were subject to dollar limitations, rather than annual reauthorization provisions as is the case today. That experience should prove educational, because when those ceilings were reached it was necessary either for Congress to enact emergency legislation or for FHA insurance activities to halt entirely for a time. Artificial cutoffs are counterproductive and severely impact the chain of housing production with a rippling effect on the economy. Congress, recognizing the difficulties encountered whenever the ceilings were reached, remedied this situation in 1961.

Without regard to the sufficiency of any ceilings, if they should be imposed, a tracking system would have to be developed to provide precise and timely information regarding usage levels for program allocations. Difficult choices would have to be made in the allotments of funds among geographic regions with different levels of demand and demographic patterns. The same difficulty would be present in allocating mortgage insurance among the several FHA programs. If administered ceilings are set below market demand, serious disruptions in the orderly functioning of the FHA, VA, and GNMA programs will certainly occur.

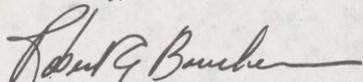
Attempting to control the economy through the manipulation of Federal mortgage insurance programs is an unnecessarily complex proposal that will not truly address the resolution of the Nation's economic problems. The undersigned organizations feel that there has been insufficient investigation of the devastating impacts of limitations on housing construction and sales, on the mortgage lending industries, and on the American consumer, particularly during the depressed conditions expected through 1981. Nor do we feel that there has been sufficient consideration of the soundness and safety of the FHA programs developed nearly half a century ago with

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relatively small impacts on the Federal Treasury over time, or of the favorable impact on secondary markets fostered by GNMA. The institution of credit limitations will seriously deter this Nation from meeting its commitment to provide an adequate supply of affordable housing.

Thus, the undersigned organizations respectfully urge you to oppose proposals to impose such limits, for all of the reasons outlined above.

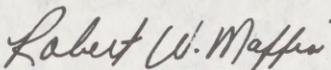
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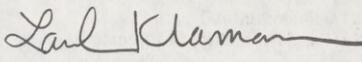
Robert G. Boucher
President
Mortgage Bankers Association
of America



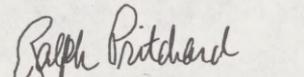
Merrill Butler
President
National Association of Home Builders



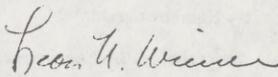
Robert W. Maffin
Executive Director
National Association of
Housing and Redevelopment
Officials



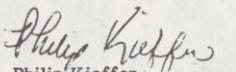
Dr. Saul B. Klamon
President
National Association of
Mutual Savings Banks



Ralph W. Pritchard
President
National Association of Realtors



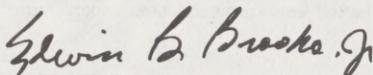
Leon N. Weiner
President
National Housing Conference



Philip Kieffer
President
National Leased Housing
Association



James H. Cousins
Senior Vice President for
Government Affairs
National Savings and Loan League



Edwin B. Brooks, Jr.
President
United States League of
Savings Associations

Exhibit 2

The following table lists the claims rate determined by taking a class of loans based on 15 to 20 years of experience and further projecting inflation rates to establish an estimated rate for claims in a particular class of loans.

<u>Program</u>	<u>Claim Rate</u>	<u>Loss Ratio</u> (Percentage of Claim Paid after Sale of Security)
<u>Mutual Mortgage Insurance Fund</u>		
Section 203(b) (Homeownership)	6.9%	51.6%
Section 244 (Multifamily Coinsurance)	6.9%*	51.6%
Section 245 (Graduated Payment Mortgage)	6.9%*	51.6%
<u>General Insurance Fund</u>		
Section 207 (Multifamily Rental)	22.3%	27.2%
Section 221 (d) (2) (Homeownership)	17.2%	75.4%
Section 221 (Market Rate)	33.5%	48.7%
Section 223f (Existing Multifamily)	20.7%	35.0%
Section 6234 (Condominium)	6.7%	30.2%
Section 222 (Homeownership, Servicemen)	6.7%	30.4%
<u>Cooperative Mutual Housing Insurance Fund</u>		
Section 213	3.7%	24.8%
<u>Special Risk Insurance Fund</u>		
Section 223(e) (Inner city, Homeownership)	35.4%	98.8%
Section 235i (Original, deep subsidy; Homeownership)	21.2%	47.1%
Section 235 (Revised; Homeownership)	14.0%	26.4%
Section 236 (Multifamily)	26.1%	50.6%

Source: Department of HUD, prepared by MBA Legislative Department, June 26, 1980.

*Very little activity has occurred under these sections, therefore, these figures represent assumptions made for the sake of determining projected actuarial soundness under these programs.

Senator METZENBAUM. We will hear from Mr. Robert Waldo now.

STATEMENT OF ROBERT WALDO, PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA, PRESENTED BY JOHN C. WILLIAMSON, VICE PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA

Mr. WILLIAMSON. Mr. Waldo, president of Mortgage Insurance Companies of America who was scheduled to testify here today is flying in from Madison, Wis. His plane is due to arrive at 11:30. He might come through the door at any time. He is more competent than I to discuss the subject. If he comes in, I will just sit aside.

This is a relatively new trade association in the housing field and the industry we represent is relatively new. The first company went into business in 1957. We now have 14 companies and the insurance in force of the 14 companies will probably reach \$100 billion in July or August of this year, and I might add more than the FHA insurance in force on unsubsidized home mortgage insurance programs. We are really talking about the principal activity of the FHA. That is the standard home mortgage insurance program. Of the \$21 billion insured by the FHA in fiscal year 1979, \$17 billion represented the insurance activity that we are going to talk about. The other represented subsidized programs. Beginning on page 2, I will read Mr. Waldo's statement.

CONSEQUENCES OF LIMITING FEDERAL MORTGAGE INSURANCE PROGRAMS

The imposition of a cap on Federal mortgage insurance programs has generated some controversy in the housing industry. Opponents have charged that a cap would threaten to disrupt the home mortgage market.

Specifically, the question emerges as to the consequences of imposing \$1 limitation that may prove to be too low with the result of slowing down or ceasing FHA mortgage insurance activity.

In evaluating such consequences, the subcommittee should be aware of the state of the private mortgage insurance industry, the market it serves, and its capacity to meet the mortgage insurance requirements for low-downpayment financing in the unlikely event that any ceiling imposed by the Congress causes a temporary disruption of the FHA's share of the market. I want to emphasize that we are neither advocating nor opposing a ceiling. Our sole purpose in this testimony is to assist the subcommittee in making a judgment on the consequences on the housing industry of imposing such a ceiling.

ROLE OF THE PRIVATE MORTGAGE INSURANCE INDUSTRY

If a ceiling on the dollar volume of FHA single family insurance had been imposed for fiscal year 1979 and had proved too low, the private mortgage insurance industry could have easily absorbed any FHA shortfall. In fact, based upon industry data at the end of 1979, the private mortgage insurance industry had the capacity to insure an additional \$30 billion worth of residential mortgage loans, almost twice the \$17 billion volume of FHA insurance on unsubsidized home mortgages during the calendar year. Further-

more, we could have absorbed the market with less insurance cost to the homebuyer. Our initial premiums on a 90-percent loan are the same as the FHA's but our annual renewal premiums are half of the FHA's, and unlike the FHA, private mortgage insurance policies rarely run beyond 8 years. FHA insurance runs for the full term of the mortgage.

For several years the private mortgage insurance industry has insured more home mortgages than the FHA. In 1978 our companies insured 695,620 home mortgages, more than the FHA (300,551) and the VA (354,776) combined. In 1979 private insurers insured 578,111 home mortgages compared to 415,866 for the FHA.

LOW-DOWNPAYMENT LOANS

Private mortgage insurers insure mortgages with as little as 5 percent downpayment—these low-downpayment loans constituted 34 percent of our business in the first quarter of this year.

The market served by private mortgage insurers is substantially that served by the FHA. In the first quarter 1980 the average privately insured mortgage was approximately \$47,000 with \$53,000 the average purchase price, well below the national average and median of houses in the market today. In this quarter, 60 percent of privately insured mortgages were under \$50,000.

Our industry insures mortgages for all types of lenders. Savings and loan associations originate 56 percent of the mortgages we insure; mortgage bankers, 21 percent; commercial banks, 14 percent; and savings banks and credit unions, 9 percent.

Thirty-four percent of the mortgages our members insured in the first quarter 1980 involved homes located in urban areas; 58 percent in suburban areas; and 7 percent in rural or resort areas.

Our companies insure mortgages through 210 regional underwriting offices located in all 50 States and Puerto Rico. No State is served by less than 4 companies, and 20 States are served by more than 10.

On May 31, 1980, MICA members had insurance in force on \$98.5 billion of loans. This is more than the FHA insurance in force on unsubsidized single family homes.

Private mortgage insurance companies insure the risk portion of a low-downpayment mortgage—the top 20 percent of a 90-percent loan, or the top 25 percent of a 95-percent loan. This enables private insurers to charge a lower premium than the FHA which insures 100 percent of a mortgage.

GOVERNMENT-SPONSORED SECONDARY MARKETS

The Government-sponsored secondary markets, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, purchase conventional low-downpayment mortgages and these mortgages are required to carry private mortgage insurance. In 1979, these two agencies purchased \$11 billion in mortgages more than 50 percent of which carried our insurance. In 1975, these two agencies contracted with the Arthur D. Little management consulting firm to conduct a study of the financial solidity of our industry. The study concluded that the typical private mortgage insurer could survive economic adversity comparable to that

of the early 1930's and remain solvent. A significant factor of the industry's financial solidity is the State law requirement that a mortgage insurer allocate half of each earned premium dollar to a contingency reserve for a 10-year period.

On December 31, 1979, the combined assets of this industry exceeded \$1.5 billion.

LIABILITY OF PRIVATE MORTGAGE INSURANCE INDUSTRY

Senator METZENBAUM. You talked about combined assets being \$1.5 billion. What is the combined liability?

Mr. WILLIAMSON. I will be glad to supply that for the record. Mr. Waldo will be able to supply that.¹

Senator METZENBAUM. With the volume of loans you have, \$1.5 billion in net worth would appear to be one-half percent of the total.

Mr. WILLIAMSON. Insurance in force is measured by the total dollar amount of the mortgage. The risk portion of the mortgage is 20 or 25 percent. By State law and requirements of Fannie Mae, our exposure can be 25 times our policy holders' surplus and capital. It is measured not by the total mortgage, but the risk portion of the mortgage which averages about 22 percent.

Senator METZENBAUM. Twenty-five times your policy holders'?

Mr. WILLIAMSON. Times capital and policy holders' surplus—25 times.

CAPITAL-TO-RISK RATIO OF PRIVATE MORTGAGE INSURANCE INDUSTRY

Senator METZENBAUM. In State law, your outstanding loans may be 25 times your capital and surplus?

Mr. WILLIAMSON. Yes, capital and surplus.

Senator METZENBAUM. Surplus in the company?

Mr. WILLIAMSON. Twenty-five is measured by the exposure and not by the total amount of the mortgage. The average ratio in the industry is around 20 or 21. They could go up to 25.

Senator METZENBAUM. That is how you got 376?

Mr. WILLIAMSON. The additional \$30 million which would still stay within the 25-to-1 ratio.

I want to discuss in conclusion—

Senator METZENBAUM. You said you could take on an additional \$30 billion. Your total assets are \$1.5 billion; \$30 billion is 20 times the loan and you are saying that is how much additional you could have. You say of the \$30 billion, you count in only 20 percent of that?

Mr. WILLIAMSON. Yes, the exposure. Here is a footnote in Mr. Waldo's statement that explains that.

On December 31, 1979 the industry had approximately \$301 million in excess policy holders reserves. Based upon a statutory 25 to 1 capital-to-risk ratio, statutory insurance capacity would be about \$7.5 billion. Since MIC loan coverage is on a coinsurance basis generally insuring the top 20-25 percent of the loan the true capacity in terms of the principal balance of the loans to be insured would equal over \$30 billion.

Senator METZENBAUM. OK; I appreciate that.
Thank you.

¹ Not received at time of publication.

PRIVATE MORTGAGE INSURANCE INDUSTRY VIEWED AS COMPETITION
BY FHA

Mr. WILLIAMSON. Just as a concluding statement, our industry's industrial situation vis-a-vis the FHA is a unique one because we are apparently viewed as a competitor by the FHA in its major activity—the home mortgage market. For example, our major customers are savings and loan associations and banks. The FHA has distributed to interested agencies proposed regulations revising its coinsurance program designed to encourage these lenders to use the FHA more, and as a result, our industry less. The FHA offers two inducements for making this shift, both of which are denied to private insurers. The first a premium rebate, which the lender can pocket even though the homebuyer pays the premium. Premium rebates by insurance companies are outright violations of State law. The second inducement is delegated underwriting whereby an office of the lender can bind the United States on an insurance risk. If any of our companies were to offer delegated underwriting to its customers, it would probably result in disqualification by FNMA and FHLMC—the two Government-sponsored secondary markets.

ADMINISTERED CEILING WOULD NOT DISRUPT MORTGAGE MARKET

In conclusion, it is our opinion that even if an administered ceiling is set below-market demand it would not disrupt the market because of the capacity of the private mortgage insurance industry. Because the VA home loan guarantee program is an entitlement program, we have not covered that agency in our testimony. On the other hand, the FHA single-family mortgage insurance program is a demand program, in direct competition with the private mortgage insurance industry, and therefore an appropriate subject for this analysis of our capacity to ameliorate any difficulty resulting from a ceiling ostensibly below FHA market objectives.

We are aware that a decline in FHA activity may result in a lower volume of GNMA issues. However, this impacts adversely only on dealers in GNMA issues. Savings and loan associations and commercial banks are now authorized to issue conventional mortgage-backed securities and these are proving highly receptive to investors.

That concludes our testimony.



MORTGAGE INSURANCE COMPANIES OF AMERICA

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JOHN C. WILLIAMSON
EXECUTIVE VICE PRESIDENTSTEVEN P. DOEHLER
DIRECTOR OF RESEARCH AND ECONOMICS

July 11, 1980

The Honorable Howard M. Metzenbaum, Chairman
Subcommittee on Control of Federal Credit
Senate Budget Committee
Senate Office Building
Washington, D.C. 20510

Dear Senator Metzenbaum:

My apologies again for missing the opportunity to testify at length at the hearing of the Subcommittee on Control of Federal Credit on July 1, 1980. I very much appreciate your allowing John Williamson to start the testimony on my behalf; and you were also gracious in allowing me to go forward upon my arrival.

With the Subcommittee's permission, I would like to add to the prepared statement of the Mortgage Insurance Companies of America this supplementary letter reflecting views which I had intended to present orally as part of our testimony.

The private mortgage insurance industry and the FHA's standard 203(b) home mortgage insurance program provide insurance protection to lenders should borrowers default in payment on their residential mortgages. The programs serve essentially the same market -- the borrowers whose loans we insure are typically young, first time home buyers, purchasing a home that is both smaller and less costly than the "median" home. In 1979, the average loan insured by private insurers was \$44,250, with the average purchase price \$49,534; the comparable figures for the FHA 203(b) Program were \$39,426 and \$42,447, respectively. (NOTE: At the July 1 hearing, the witness for the Mortgage Bankers Association compared the private industry's first quarter 1980 average loan of \$46,979 with the FHA's average loan for 1977 of \$34,900. The correct comparison should have been \$35,178 average loan for the private mortgage insurance industry as against \$34,900 for the FHA's 203(b) Program in 1977.)

The FHA insurance program started in the 1930's. The private insurance industry started in 1957, but well over 75% of the total business written by

AMERICAN MORTGAGE INSURANCE COMPANY COMMERCIAL CREDIT MORTGAGE INSURANCE CO. COMMONWEALTH MORTGAGE ASSURANCE COMPANY FOREMOST GUARANTY CORPORATION HOME GUARANTY INSURANCE CORPORATION INSMOR MORTGAGE INSURANCE COMPANY INTEGON MORTGAGE GUARANTY CORPORATION MORTGAGE GUARANTY INSURANCE CORPORATION FMI MORTGAGE INSURANCE CO. REPUBLIC MORTGAGE INSURANCE COMPANY TIGER MORTGAGE INSURANCE COMPANY TIGER INVESTORS MORTGAGE INSURANCE COMPANY UNITED GUARANTY CORPORATION VEREX ASSURANCE, INC.

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private insurers has been written in the last ten years. Notwithstanding the private industry's recent entry into the arena, by the end of the 3rd quarter 1980 we will have insurance in force on \$100 billion of home loans, which we are certain exceeds the FHA's insurance in force in all of its unsubsidized home insurance programs.

Basically, three concerns have been expressed as to the effect of limiting the FHA's capacity to write insurance.

First, concern was raised as to the capacity of the private mortgage insurance industry to insure all of the loans requiring insurance. We can say with the utmost confidence that the industry now has or can generate the capital capacity to meet the mortgage insurance needs now provided by the industry and the FHA home sale programs for the indefinite future. Our statement points out that had the FHA insured no home mortgages in 1979, this industry could have covered its own business, the FHA business, and had capital capacity of approximately \$13 billion to spare.

Furthermore, the industry has the capacity to generate initial capital. In 1979 and so far in 1980, \$55 million of new private capital has been dedicated to private mortgage insurance, creating additional capacity to insure \$6.5 billion of loans. In addition, the industry can and will generate additional capital from its operations, so long as its market is not disrupted by competition from a government agency that can offer insurance programs with inducements denied by law to private insurers.

Second, concern was raised as to the ability of private industry to serve the housing market in recessions. Because of the relative newness of private mortgage insurance, we can compare only our business with the FHA's during the 1973-75 and the current recessions. The number of loans insured by the private industry and in the FHA standard 203(b) Program by year is as follows:

<u>Year</u>	<u>FHA 203(b)*</u>	<u>Private Mortgage Insurance Industry</u>
1972	216,820	396,008
1973	126,238	499,895
1974	142,284	330,621
1975	214,789	321,950
1976	230,371	452,023
1977	284,294	617,398
1978	300,551	695,620
1979	415,866	578,111
1980(5 mos.)	150,973	141,031

*Includes for 1976-80 other unsubsidized programs; i.e. GPMs, Co-insurance, and condos.

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Recessions are normally times of high interest rates. In 1974-75, interest rates on mortgages -- conventional and government alike -- exceeded state law usury rates in about 15 states. During the last quarter of 1979 and the first quarter of 1980, state usury limits were exceeded by conventional and government mortgage rates in almost all states. The FHA and VA loan rates are specifically exempt from state usury laws. In effect, then, for almost six months the FHA and VA loan programs were "the only game in town." Yet, in all recession years the private industry has nearly equalled or exceeded the number of loans insured in the FHA Programs! With federal preemption of state usury limits now a fact, the artificial distinction between FHA loans and conventional loans arising from the previous usury exemption has been removed.

A third concern related to the secondary markets. It has generally been recognized that in the future a larger proportion of mortgage funds will come from non-traditional investors. The secondary market has been tapped to the tune of \$100 billion through the issuance of GNMA certificates to date. However, since 1976, other secondary market mechanisms have developed and are flourishing. The Mortgage Corporation has approximately \$13.8 billion outstanding in participation certificates; and \$2.3 billion outstanding in guaranteed mortgage certificates; and FNMA is working on a conventional mortgage backed security program awaiting HUD approval. The simplicity of the GNMA program is that GNMA pools can be created in relatively small dollar amounts (the minimum being \$1 million) which eliminates the structural and risk problems of accumulating \$50 to \$100 million of mortgages and reissuing pass-through certificates against the pools. Private industry is working on a GNMA concept -- but a hurdle to overcome is the SEC registration requirements with which private issues will have to comply, whereas GNMA pools are exempt from SEC registration.

When the private mortgage insurance industry began in the mid 1950s, and through the early 1970s, it was a simple program that involved essentially two premium plans (an annual plan and premiums for 4 and 10 years) and a relatively limited number of customers. Since the early 1970s, however, with The Mortgage Corporation and FNMA being empowered to purchase conventional loans, private industry has created a number of new premium plans and coverages to tailor a private insurance coverage to FNMA and Mortgage Corporation requirements. As a result, private industry now offers over 600 combinations of coverages and premium plans, so that a lender can "tailor make" the insurance coverage to meet specific needs of the individual loan. By contrast, the FHA home insurance programs still offer only 100% insurance for premiums of $\frac{1}{4}$ % per year during the term of the loan.

In addition to innovating premium plans and coverages, private industry has had to innovate the ancillary services which it provides to lenders. For this reason, the private industry has continually improved its methods of underwriting and processing insurance applications, to provide the fastest and most timely service possible to lenders. It is now an accepted industry practice that a loan will be accepted or rejected for insurance within 24 hours of the time the application and supporting documents are received by the insurance company; and the insurance companies have devised systems ranging from courier

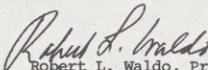
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pick up service to electronic lender interface to assure that applications do not depend on the U.S. mails alone. By contrast, the FHA still requires at least a week and frequently longer to process an application for a "spot" loan.

In conclusion, it is the position of MICA that government credit should be employed judiciously, sparingly, and in areas where existing economic factors dictate a desirable social end which cannot be met by the private sector. The need for federal credit in the form of insurance on housing loans is very narrow, indeed. There is a flourishing, healthy privately financed and capitalized private industry capable of meeting substantially all of the housing credit insurance needs of the nation. Therefore, the amount of government housing insurance that can be written should be monitored and controlled by the Congress to permit optimum growth of private enterprise.

I would greatly appreciate your inserting this letter in the printed record of the hearings at the conclusion of Mr. Williamson's and my testimony.

Respectfully submitted,



Robert L. Waldo, President

P.S. During Mr. Williamson's testimony he was asked by the Chairman what were the combined liabilities of the industry. He advised that this would be supplied for the record. As of December 31, 1979 the aggregate liabilities of the thirteen members of MICA, according to annual convention statements filed with the state insurance departments, was as follows:

Unearned Premium Reserves	\$257,556,571
Statutory Contingency Reserves	\$686,146,497
Other liabilities	\$ 88,792,032
	<hr/>
Total liabilities	\$1,032,495,100



FHA SUGGESTING PREMIUM REBATE THROUGH LENDERS

Senator METZENBAUM. Mr. Riedy, Mr. Williamson made a presentation that suggests that private mortgage insurance companies could serve the market as well or better than the FHA; that they could do it for less cost, and that they are prepared to do so.

But they also suggest that the FHA is now competing as if it were a private company and actually suggesting premium rebates through the lenders, the justification for which I have difficulty understanding, and I intend to inquire after this hearing as a Senator, but not necessarily as a member of this committee.

I am interested in the Mortgage Bankers Association opinion vis-a-vis this question because there is not a Member of Congress that would not like to get the Government out of business wherever we can, and this may be an opportunity and I think we will explore it.

IMPACT OF CREDIT CYCLES ON MORTGAGE LENDERS

Mr. RIEDY. We won't disagree. As an alumnus of the private mortgage insurance industry and a former Government regulator, I come at your question with a lot of perspectives. The bottom line is that FHA closed \$17 billion of mortgages that the private mortgage insurance industry did not pick up. We have no quarrel with their becoming much more competitive and serving the public better. However, certain aspects are not subject to the control of the mortgage insurance industry in that specifically when credit gets tight, lenders from my perspective over time get increasingly restrictive. There are higher downpayments. They raise interest rates. Lenders quit making the type of loans that the private mortgage insurance industry is capable of insuring. It goes beyond them.

Senator METZENBAUM. What is that?

Mr. RIEDY. When credit gets tighter, lenders—savings and loan associations or anyone—have less money and search for higher quality risk, less risk. They increase downpayment requirements on home loans. FHA's and VA's specialty is low downpayments. So in effect private lenders use the type of loans during tight credit periods that private mortgage insurers normally would insure.

When that happens, what is left is the FHA and VA loan insurance and guarantee programs. They are countercyclical.

Senator METZENBAUM. PMI could insure those?

Mr. RIEDY. They could, but for whatever reason, they don't. They have never taken the entire market. If the PMI industry would take the mortgage insurance market through all phases, it would be satisfactory. The important point is that they are not capable of dictating when private lenders will stay in or get out of the market because they don't control the lenders.

RATIO OF APPLICATIONS TO ACTUAL MORTGAGES INSURED

Senator METZENBAUM. What is the degree of obligation or acceptance of PMI's as against the FHA with respect to loans? Is there less willingness to provide insurance on the part of PMI than FHA?

Mr. RIEDY. You are asking about rejection rates?

Mr. WILLIAMSON. The difference between MIC applications and actual mortgages insured is about 7 percent. Ninety-three percent of our applications are accepted. The Veterans' Administration fallout is either 13 or 17 percent. I know it is low. According to the testimony of the Secretary in the recent House Appropriations Subcommittee hearings, only 54 percent of FHA applications end up as an insured mortgage. They have a 46-percent fallout.

Now, I don't know the reason for that. It may be that people get applications and then go off and try to get a better deal. I don't know what it is, but that seems to be a tremendous fallout and perhaps Dr. Riedy has some reason for it.

Senator METZENBAUM. Dr. Riedy?

Mr. RIEDY. May I ask Mr. Peter Kaplan to speak to it? He is MBA's senior staff vice president for Government Agency Relations.

Mr. KAPLAN. You have to draw a distinction between the declination rate and the fallout rate. Mr. Williamson has stated the fallout rate, not the declination rate.

Mr. WILLIAMSON. Forty-six percent do not materialize into actual insured mortgages. I don't know the reason for it.

OBTAINING AN INSURED MORTGAGE—FHA VERSUS PMI

Senator METZENBAUM. If the PMI's had the right to determine policy for the Federal Government, would they advocate that the PMI's be the only way you could get an insured mortgage in keeping the FHA in a good competitive factor?

Mr. WILLIAMSON. FHA has a tremendous task to do in the multi-family field which we do not cover, and in the housing assistance field. In the FHA 203 standard program they are in direct competition with private industry.

We would be happy if FHA limited its activity to multifamily and people who are at a disadvantage in the marketplace.

Senator METZENBAUM. Do you think that would not be in the best interests of the country, Dr. Riedy?

MAKE CONVENTIONAL MARKET MORE COMPETITIVE WITH FHA-VA MARKET

Mr. RIEDY. As I said earlier, the private mortgage insurance industry can take over more of the FHA-type 203 programs, and that would be fine. One of the key problems we are working on with the private mortgage insurance industry is the development of conventional mortgage-backed securities, which would limit FHA and increase the use of private mortgage insurance. That has to do with conventional mortgage lending.

One of the reasons FHA and VA loan volume has held up as well as it has is that these are the only loans packaged and sold in any great volume in the Nation's secondary mortgage market.

We would be as happy as the private mortgage insurers when we achieve full marketability of mortgage-backed securities which would make the conventional market more competitive with the FHA-VA market, although you would have to look at terms and conditions of the loan.

Senator METZENBAUM. Mr. Riedy, this year the administration began selling federally guaranteed public housing bonds to the FFB because these bonds are otherwise unmarketable.

Would you comment on the wisdom of this?

Mr. RIEDY. Well, I am not clear what you mean, but I would guess, as an economist, this is like a few other programs with the Small Business Administration and student loan programs. Without the use of the FFB to purchase securities, there would be no credit granted and that, to me, simply indicates that Congress has determined a high social priority that is not tied to economic benefit necessarily other than that program.

Mr. WILLIAMSON. I want to make one point. You asked Dr. Riedy about what happens during the recession when the conventional market shrinks and the FHA market moves up to meet the demand. In the first 5 months of this year, the FHA insured more mortgages than we did in January or February because we were still under the handicap of State usury ceilings; whereas most FHA and VA's were exempt from usury laws. For March, April, and May we insured more mortgages each month than the FHA-VA. In May, FHA insured 19,000; we insured 26,000.

IMPACT OF STATE LAWS ON PMI

Senator METZENBAUM. How did the State laws impact upon you?

Mr. WILLIAMSON. They did to a substantial degree when the conventional mortgages exceeded usury limits in many States.

Senator METZENBAUM. There were no mortgages?

Mr. WILLIAMSON. Yes, and the Congress provided for preemption of State usury laws which was effective January 1 for a 90-day period, and then was extended further. Prior to that, FHA and VA mortgages were exempt from State usury in most of the 50 States.

Senator METZENBAUM. Mr. Waldo has just arrived. Mr. Waldo, Mr. Williamson has read your statement almost in its entirety and we have had a fair degree of colloquy on the subject, but your having just gotten off the plane and having come here especially for this purpose, the Chair does not want to deprive you from sharing gems of wisdom. If you have some that are over and above the statement, we will be happy to hear you.

Mr. WALDO. Thank you. I appreciate that.

I dashed from the airport. The cab driver did give me a very good ride. I don't know what Mr. Williamson has said on behalf of Mortgage Insurance Companies of America. I was going to use my 10 minutes to summarize and supplement my written statement merely to point out that the mortgage insurance industry, as it has been created in 1957, has done a superlative job, in my opinion, of insuring loans for moderate-income persons.

FAMILY DWELLINGS NOT FINANCED BY PMI

Senator METZENBAUM. Could you tell me why you have not moved into family dwellings?

Mr. WALDO. The first reason is that the mortgage insurance company, the companies insuring residential homes are prohibited by law from insuring anything but one- to four-family residential.

Senator METZENBAUM. Where a property becomes a co-op or condominium, are you in a position to insure individual units?

Mr. WALDO. Yes. In order to insure loans on apartment projects,

we would need to create separate companies. We did do that. There were several companies in the industry that had several insurance companies sharing apartment loans. These risks were considerably different from single-family risks in that a person who buys a home has no commercial purpose for it other than to shelter his family; whereas somebody developing an apartment project intends to do this as a commercial enterprise and any cost that gets into his profit margin is a cost that he avoids if he possibly can. As a result, insurance companies were getting only marginal credit risks. It is not a good business for us to be in.

AVERAGE PREMIUM COST FOR HOME LOAN INSURANCE

Senator METZENBAUM. What is the average home premium cost? One-quarter percent? One-half percent?

Mr. WALDO. On an average loan, one-half percent for the first year and one-quarter percent thereafter.

On a loan that exceeds a 90-percent value ratio, depending upon the percent of coverage, for 25-percent coverage, the premium is 1 percent the first year and again one-quarter percent for renewal.

Senator METZENBAUM. Do you have any additional charges that come about by reason of the title insurance instead of title guarantees or extra charges for doing the paperwork?

Mr. WALDO. No, sir. The premium I have cited is the entire premium I have cited for our insurance. Our insurance too may be kept in force at the lender's discretion, so long as the lender feels the need for insurance. Our approximate policy life has been 7 to 8 years. FHA insurance remains in force for the entire period of the loan.

NEED FOR EXTENDED TENURE OF LOAN INSURANCE

Senator METZENBAUM. Is that wasteful? After you have paid for 8 years, you have enough equity so that it does not continue to make sense to pay insurance.

Mr. WALDO. I don't know that I would characterize it as wasteful. After 7 or 8 years, the loan has matured so that the insurance is not required. The insurance is to protect the lender against loss. So if the buyer's situation has improved through buildup of equity or a demonstrated record of timely payments, there is good reason not to require the borrower to keep that insurance in force.

Senator METZENBAUM. Who makes that determination as to whether the insurance will be canceled? The borrower or the lender?

Mr. WALDO. Generally it is the lender. There have been instances where the borrower has inquired of the lender whether or not the insurance is still necessary. I cannot tell you how often that happens. We are not privy to the dialog between the lenders and borrowers. On occasion, the question has been raised.

BORROWER RESPONSIBILITY IN EVENT OF LOSS AND FORECLOSURE

Senator METZENBAUM. When the insurer is subjected to a loss, let us assume a loan on a \$60,000 property is paid down to \$40,000 or there is a loss and foreclosure of property, so it is sold at \$32,000, is the borrower held responsible by the insurance company for that \$8,000 spread?

Mr. WALDO. No; they are not. By law we cannot collect deficiency judgments against borrowers.

Senator METZENBAUM. If you paid to the bank, then you required the bank to indemnify you. Do you subrogate to their positions?

Mr. WALDO. No, sir, we do not. We settle the claim and that is the last we see of it. We sell the claim either by paying a percentage of the loan which is specified in the policy and then, at that point, we are just completely out of the picture or we buy the property and turn around and sell it.

If we buy the property, we pay the lender the entire amount of loan due together with cost of foreclosure.

Senator METZENBAUM. You said percentage of loan covered. Do you not cover 100 percent?

Mr. WILLIAMSON. The top part.

Senator METZENBAUM. The 20 or 25 percent?

Mr. WILLIAMSON. That is correct.

Senator METZENBAUM. Do any of you have any questions? If any of you have something to add, we will be glad to have it.

IMPACT OF STATE REGULATIONS ON MORTGAGE MARKET

Mr. RIEDY. Regarding competition between FHA, PMI and whether they serve the same market, Mr. Williamson quoted a number of average, privately insured loans of \$47,000. Two years ago FHA loans closed by mortgage bankers averaged only \$34,900. It is a significantly lower market. VA, \$38,000; conventional loans, \$47,000, the same as he quoted. There is a great difference there.

Looking at the need to innovate in the mortgage market in the future, because of the strong demand that we all agree is out there, there may be one major difference that we should keep in mind. If you are a private lender in the market trying to be creative, if you are in the private market, it would be easier to deal with Ginnie Mae and Fannie Mae, which is private, or FHA or VA, than trying to work with 50 State commissioners where they require regulatory approval. To the extent we have to be concerned about creativity and innovativeness, we have to keep that in mind with respect to innovations, especially changes that must be timely and flexible in response to inflation.

Senator METZENBAUM. Mr. Riedy, the Mortgage Bankers Association has indicated its opposition to improving these programs on credit control in the future. You have not addressed yourself to one aspect of the question that I think is important. I think the Bankers Association should advise us as to their caveats, if any, in the event we decide to include these programs within the Federal credit control approach which this committee will recommend.

It is entirely likely that we will not provide exemptions to opening it very wide. During our hearing, we had two witnesses saying it is a great idea. Don't count us in.

The committee is going to try to approach counting everyone in, but we certainly want to be responsible to see that we do not do any harm to any aspect or segment of the guaranteed program that is presently in effect. We would appreciate your comments along that line.

Mr. RIEDY. We would be happy to furnish them and work with your staff if we can.

[The following was received for the record:]



Mortgage Bankers Association of America

1125 Fifteenth Street, N.W.
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Dr. Mark J. Riedy
Executive Vice President
(202) 861-6501

July 25, 1980

Honorable Howard M. Metzenbaum
Committee on Budget
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

During my testimony at the hearings on the various pending Federal credit control proposals contained in the First Concurrent Budget Resolution for Fiscal Year 1981 (S. Con. Res. 86 and H. Con. Res. 307) and The Federal Credit Program Control Act of 1979 (S 2151), you requested that the Mortgage Bankers Association of America (MBA) submit suggestions on lessening the impact that setting insurance and guaranty limits would have on the various Federal Housing Administration (FHA), Veterans Administration (VA), and Government National Mortgage Association (GNMA) mortgage programs. This letter is in response to that request.

You will recall that MBA's concern is that limits may disrupt the actuarially sound FHA, VA, and GNMA programs, which are backed by self-sustaining reserves but do contain the remote possibility of contingent liability. Our concerns center on the fact that the FHA, VA, and GNMA programs currently possess extraordinary flexibility that enables them to help meet the Nation's housing needs by providing readily available and affordable mortgage credit. This flexibility is extremely important due to the cyclical nature of the housing and mortgage finance industries. In order to remain effective, these programs must be dependable sources of mortgage credit. This is particularly important during extremely difficult economic times, such as we have experienced during the first half of this year, as well as during times of extremely high demand for mortgage credit. Our fear is that insurance and guaranty limits would reduce or perhaps even eliminate the flexibility these programs currently possess and thus curtail their effectiveness.

With this in mind, we have formulated several suggestions regarding institution of insurance and guaranty limits. We believe these suggestions will help lessen adverse impacts such limits could have on the FHA, VA, and GNMA programs.

FHA AND VA

Discretionary Authority

A major apprehension MBA has regarding FHA insurance and loan guaranty limits is that these limits could be reached at a time of extremely high demand, with conventional financing unavailable and Congress unable to act either because of a recess or more

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pressing legislative business. In order to avoid such a situation, MBA suggests granting the Secretary of HUD and the VA Administrator standby authority to increase the limits a maximum of 10 percent during the fiscal year if they find that the limits have been reached or are about to be reached.

The grant of standby authority would serve the dual purpose of limiting the Federal government's contingent liability, while preserving part of the flexibility currently enjoyed by the FHA and VA programs in meeting the housing finance needs of low- and moderate-income families. The 10 percent figure should prove adequate to accommodate even relatively extreme unanticipated upsurges in mortgage credit demand. During this past decade, the greatest single year-to-year increase in dollar amounts of FHA and VA loans originated was from 1976 to 1977. In that time period, the approximate percentage increase in dollar volume of FHA loans was 60 percent over the previous year and 40 percent for VA. While such tremendous year-to-year increases do not occur regularly, they are not unprecedented and the grant of standby authority would permit HUD and VA to act quickly and flexibly in the event of a recurrence.

Effect of Increased Mortgage Limits

Congress periodically adjusts the maximum mortgage limits for the FHA and VA programs. Since the early 1940s, these limits have been increased to meet increased costs for materials, land, and labor. Both the House and Senate versions of the 1980 Housing and Community Development Act would increase the current \$67,500 FHA mortgage limit. Legislation is also pending in the Senate to increase the VA loan guaranty limit.

MBA is concerned that Congress could inadvertently constrict the overall number of mortgages, and therefore the number of American families, eligible for FHA and VA mortgage assistance when maximum mortgage limits are increased. When the maximum FHA mortgage amount is statutorily increased, the average size of FHA mortgages increases. In 1978, the first full year the FHA maximum was at \$60,000, the median mortgage amount increased by \$4,000. This translated into a dollar volume increase of over \$1 billion. The experience was similar for VA loan guarantees. Ceilings that are adequate under current mortgage limits could very well prove inadequate long before the end of a fiscal year, as larger loans are insured or guaranteed under higher mortgage limits authorized by Congress.

In order to avoid this problem, provision should be made for automatic proportional increases in the insurance and guaranty ceilings if mortgage limits are increased during the fiscal year, after passage of the second Congressional budget resolution for that fiscal year. Such a provision would guarantee that the FHA insurance and VA guaranty ceilings are predicated upon the current mortgage limits and are adequate to cover the expected volume for that fiscal year.

Allocation

With respect to the FHA programs, MBA urges that Congress give the HUD Secretary the discretionary administrative authority to determine how insuring authority be allocated,

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July 25, 1980

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both on a programmatic and geographical basis. Experience over the years has shown that legislative allocation has proven to be counter productive. The HUD Secretary is in a better position to deal with day-to-day economic developments with respect to housing needs.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

The GNMA Mortgage-Backed Security (MBS) program should be excluded from the Federal insurance and guaranty ceilings, because it is a secondary guaranty program, i.e., the program covers only loans that are already federally guaranteed or insured. The size of the GNMA-MBS program would already be effectively limited by any constraints on FHA insurance and VA guaranty activity. In recent years, as much as 80 percent of FHA/VA single-family production has been placed in GNMA-MBS mortgage pools. GNMA cannot guarantee more pools than there are FHA/VA mortgages to place in them. (It should be noted that certain loans guaranteed by the Farmers Home Administration are also eligible for inclusion in GNMA pools; however, to date few if any such loans have been included.)

We believe that our objection to a limit on GNMA-MBS activity remains valid even if the Congress decides that, because the VA is an entitlement program, it cannot be subjected to a credit ceiling. Limiting the GNMA-MBS constitutes a limitation on the VA program. If such a limitation cannot rightfully be imposed directly, neither should it rightfully be imposed indirectly via limits on the GNMA-MBS program.

Under the MBS program, mortgage originators package FHA/VA mortgages as securities ("Ginnie Maes") and sell them in the capital markets to permanent investors. GNMA prescribes a standard format for the securities and guarantees the performance of the originator/issuer, who must pay investors in full, each month, regardless of whether all funds have been received from homeowners. Multi-family and mobile home loans can be sold as "Ginnie Maes," but most are backed by single-family mortgages. GNMA charges initial and annual guaranty fees and has always made a profit on its MBS activities.

Subjecting FHA/VA mortgages to a second, redundant layer of limitation when they are pooled as Ginnie Maes serves no useful purpose, but will give rise to substantial costs and inefficiencies. As a result, the effectiveness of the program will be reduced, and homebuyers will ultimately pay more for their mortgages.

Under the present system of unlimited GNMA commitments, lenders are free to seek out the best price. For example, single-family lenders move back and forth between the GNMA and Federal National Mortgage Association (FNMA) programs while multi-family lenders choose among the GNMA-MBS and other FHA financing vehicles. Price competition among FHA/VA lenders is intense, and borrowers are assured of the most favorable rate available in the market at any time. However, ability to respond to changing market conditions depends on obtaining GNMA commitments, in advance, sufficient to cover all anticipated production, even though some loans will probably finally be sold using other mechanisms.

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In the first eight months of FY 1980, GNMA issued \$40-plus billion in commitments for an annual rate of \$60 billion. This is in excess of the \$53 billion ceiling proposed for FY 1981 in H. Con. Res. 307. Actual GNMA issues in FY 1980 will probably be in the \$20-25 billion range, depending on the total level of FHA/VA activity and the attractiveness of other alternatives. It is impossible for the Congress to predict demand for GNMA-MBS issues in advance as would be dictated by a credit budget procedure, because demand is predicated upon the vagaries of the market.

Because the GNMA-MBS program is a secondary guaranty and does not add measurably to the Government's actual exposure, it is not worth risking the disruption of such an important and successful program. The GNMA-MBS program would be effectively restrained by any limits that would be imposed on the FHA or VA programs.

INSTITUTION OF A CREDIT BUDGET AS AN ON-BUDGET OR AN OFF-BUDGET PROCEDURE

MBA recommends the institution of a separate credit budget that would reflect the true nature of the loan insurance and guaranty programs that are backed by self-sustaining reserves (i.e., the FHA Section 203 insured home loan program and the GNMA mortgage-backed security program). This credit budget would show that the Government's ultimate liability on the loan insurance and guaranties being written that year will be quite small in proportion to the annual volume.

The credit budget would project ultimate liability based on past experience and, for example, under FHA's 203(b) program, would take into account the expected reduction in liability through sales of foreclosed property. It would also reflect the fact that claims are satisfied out of the self-sustaining insurance and guaranty funds, rather than through annual Congressional appropriations.

NET VERSUS GROSS LIMITS ON PROGRAM ACTIVITY

The various bills call for limits on "gross" commitments to insure. In GNMA, as well as FHA/VA financing procedures, commitments do not necessarily result in insurance or guaranties. In the FHA home mortgage insurance program, for example, builders obtain commitments from the FHA to insure mortgages for buyers of all the houses in a subdivision or construction project. Seldom do all buyers use the FHA-insured financing, because conventional or VA financing appears more attractive to some, but the availability of FHA financing for each house helps the builder sell them all. In a similar way, the commitments made by VA, GNMA, and FHA in other programs are not all taken up. This "fallout" results in a wide variance between a gross commitment figure and the final net total of insurance written.

MBA recommends that the authority contained in expired commitments be recaptured for use without again being charged against the insurance and guaranty limits. Recapture would not increase the Government's contingent liability since the expired commitments would already have been included in the Congressionally authorized loan and guaranty limits.

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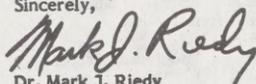
CONGRESSIONAL COMMITTEE JURISDICTION

MBA believes that the House and Senate Committees most informed and qualified to determine the appropriate level at which to set limits on self-sustaining insurance and guaranty programs are those committees charged by Congress to deal with those programs—the Senate Banking, Housing and Urban Affairs and the House Banking, Finance and Urban Affairs Committees.

A split of jurisdictional authority seems to be developing in Congress between the authorizing, the appropriations, and the budget committees. Housing programs, particularly those demand programs that pay their own way, often operate in complex ways responding to market developments and shelter needs. Therefore, the committees with the greatest knowledge of the programs would seem to be the logical choice for at least the initial projection of annual activity for the various programs, in this case the Banking Committees.

MBA appreciates this opportunity to expand upon its views and to submit recommendations concerning the institution of limitations on Federal loan guaranty and insurance programs. Should you have any further questions or need additional information, please contact us.

Sincerely,



Dr. Mark J. Riedy
Executive Vice President

MJR:js

Senator METZENBAUM. There are some groups who wished to be heard and could not be present. Those groups may submit letters and comments and, in all probability, they will be included in the record.

I want to thank all of you and you, particularly, Mr. Waldo, for having come a long distance. I think Mr. Williamson did an effective job.

Senator METZENBAUM. Thank you very much.
The committee stands adjourned.


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KENNETH N. HYLTON
 Chairman of the Board

LEON N. WEINER
 President

July 22, 1980

The Honorable Howard M. Metzenbaum
 Chairman
 Special Subcommittee on Control of
 Federal Credit
 Committee on the Budget
 United States Senate
 Washington, D.C. 20510

Dear Mr. Chairman:

We should like to draw to your Subcommittee's attention our serious concerns over the adverse impact on housing opportunities in the United States that various proposals for setting credit budget limitations will have. We request that this statement be included in the hearing record on the subject of credit budget ceilings.

The National Housing Conference is the nation's oldest organization concerned with the availability of decent housing and good neighborhoods. We have witnessed during our nearly 50 years of existence a significant improvement and expansion of housing and home ownership opportunities for American families which has been brought about largely by Federal efforts to allocate to housing a better share of the finite supply of credit. A cornerstone of that effort has been Federal loan and guarantee programs for housing finance which the Congress has devised consciously over the past 50 years to offset the competitive disadvantages investment in housing has over other forms of long-term investment.

We believe that in the present rush to institute a massive control system over loan and guarantee programs, the deleterious impact on future housing opportunities is not fully understood. We shall confine our remarks to explaining why the proposed control system can thwart their nearly 50 years of governmental effort to fulfill the vital social need of better housing for all Americans.

With respect to housing-related loans, it appears the proposal sets up a "straw man"--the threat of a huge future financial outlay by the Federal Government--and then knocks it down by calling for the development of ceilings on that potential, highly theoretical loss. Thus, superficially, limits on guaranteed and insured housing loans may appear fiscally wise, but in practice, they are unnecessary.

Established 1931 to promote better communities and decent homes for all Americans

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The specific housing and community development programs whose success would be impaired if the credit budget proposal in its present form were to be inaugurated are: veterans housing, loan and mortgage insurance programs of FHA, secondary market programs for housing, public housing, certain aspects of the Community Development Block Grant Program, and rural housing programs.

It appears that one of the primary arguments for establishing a credit budget is that Federal insurance and guarantee programs are burgeoning and their impact on credit markets is not fully understood. We do not believe that inadequate data, sheer growth and insufficient understanding of their effects are valid reasons to superimpose a control system which threatens to undo the work that has been going on in Congress toward developing and fine-tuning a system for allocating more capital to housing in lieu of other less fundamental and critical sectors of our economy. This is especially true because the present system of Federal insurance and guarantees for housing mortgage loans has not proved financially burdensome to the nation's taxpayers; and it has resulted in an increased, but still inadequate, share of investment funds for housing.

Another argument often presented for a system of controls is the large total volume of loan guarantees and insurance into which the government has entered. That argument assumes, incorrectly, that Federal housing loan insurance and guarantee programs are putting the government in a precarious financial situation with a huge contingent liability in the event of massive defaults. That argument ignores the fact that the loans involved are secured by real estate and, more importantly, disregards the existence of mortgage insurance premiums paid by borrowers with respect to the vast number of insured loans, making the bulk of the housing programs actuarially sound.

It is often argued that credit budgets are necessary in order that Congress may control the growth of loan guarantee and insurance programs. This is not persuasive with respect to housing because under the present system, the budget and appropriation processes already operate as fiscal constraints on those housing programs which involve expected direct expenditures. Direct loans and authority to enter into long-term contracts for assisted housing construction, finance and operation all fall under careful annual Congressional and Executive Branch scrutiny, and are now subject to budgetary ceilings. Furthermore, housing loan guarantee and insurance programs are reauthorized annually by the Congress, the ultimate means of control over their future.

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The appropriations and budgetary processes, in our view, more than adequately control potential future expenditures and, in some ways have proven to be far more fiscally conservative than is warranted. For instance, in the existing appropriations-budget process we have witnessed misconceptions and over-statements of the real annual dollar cost to the government of assisted housing; and as a consequence, we have seen a harmful, negative and unfounded reaction. Housing assistance levels have fallen far below the nation's needs and financial resources.

A parallel for the future, if housing loan guarantee and insurance programs were to be placed under a system of annual dollar ceilings, may be drawn from experience with the Section 8 housing assistance program. Those involved in the budget process, to which Section 8 is subject, must speak in terms of billions of dollars in theoretical cost over the hypothetical life of the units authorized to be assisted each year. This comes about through the practice of calculating budget authority for the Section 8 program by multiplying the full annual rent for a unit--for which a tenant with no income will receive assistance--by the maximum potential term of the assistance. No other Federal program or activity, despite its long-term life, is treated in this fashion. The result is a large budget authority amount that stands out in complete disproportion to other budget items and subjects the Section 8 program to budget-trimming attacks that bear no relationship to actual expenditures in the coming fiscal year.

If annual budgetary ceilings were placed on all Federal loan and guarantee programs, including housing, our lawmakers would be dealing with cumulative figures in the magnitude of hundreds of billions of dollars. This highly theoretical risk of loss, based on the mistaken premise that the full amount of such insurance or guarantees will have to be paid out, could easily be misconstrued. Inescapably, the government would be exposing itself to an entirely unjustified barrage of criticism founded on astronomical, yet imaginary, numbers.

One of the most critical problems that those of us who are seeking expanded housing opportunities see is the lack of stability in the supply of mortgage money for homes. To offset this, the carefully crafted government insurance and guarantee programs play a vital role. They counter downward cycles in the allocation of credit for housing, especially for those of modest means who must rely on the Federal programs with downpayment requirements much lower than those of conventional lenders at all times, and most particularly, during times of tight money. The insurance and guarantee ceilings would have by their very nature, to be established far in advance of any change in the mortgage money cycles. This rigidity defeats the very purpose of the present demand system which stands ready to operate when other economic changes threaten to disrupt mortgage money supplies.

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The dollar level of the ceilings would have to be established almost arbitrarily, because of the practical inability to predict mortgage money needs. Setting insurance and guarantee ceilings ridiculously high so as to meet all contingencies would be a meaningless action; setting them too low would negate the usefulness of these programs as social tools and a counter-cyclical force.

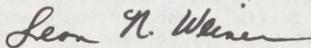
The proposed controls would have an inflationary effect on interest rates because their imposition would create an artificial shortage of Federal guarantees and insurance, necessitating some sort of rationing plan during times of need. It is fundamental economics that a shortage in supply brings about an increase in costs. Yet, reasonable cost is a primary goal of mortgage loans and guarantee programs in the first instance.

Once the government has embarked on a rationing-type program, then a new and elaborate superstructure of regulations must be produced to assure that the limited supply of guarantees and insurance is spread evenly and equitably across the nation. Not only posing a regulatory nightmare, such a system would be disruptive to the nation's mortgage lending system, with inevitable competition, conflict and controversy over whom should be entitled to guarantees and insurance and where they might most effectively be employed, both geographically and in terms of housing types.

The impact of these proposals on the secondary market would cause further disruptions to our nation's residential mortgage financing system. Just as Federal insurance guarantees for residential mortgage loans evolved in response to a shortage of mortgage credit, the secondary market system came into being as a device for improving the liquidity of mortgage loans, making them a more attractive investment. The GNMA program of packaging and guaranteeing insured or guaranteed loans would be severely hampered. GNMA's program would fall under the proposed budget ceiling, just as would the individual loans packaged by GNMA. As a consequence, Federal housing programs could be subject to double jeopardy.

In summary, we should like to reiterate that the carefully devised system for allocating more credit to the enhancement of our nation's housing opportunities should not be made the victim of inflexible constraints which will operate to undo the substantial strides our nation has made in housing its people. The present system is basically actuarially sound, the risks are minimal, the Federal investment is modest and the accomplishments, while far short of perfection, are monumental.

Sincerely,



Leon N. Weiner
President

[At 12:20 p.m., the hearing was adjourned subject to the call of the Chair.]

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