DOCUMENT RESUME

02817 - [A1993053]

[Budget Treatment of the Federal Financing Bank]. July 19, 1977. 5 pp.

Testimony before the House Committee on Banking, Finance and Urban Affairs: Economic Stabilization Subcommittee; by Harry S. Havens, Director, Program Analysis Div.

Issue Area: Accounting and Financial Reporting (2800).
Contact: Program Analysis Div.
Budget Function: Miscellaneous: Financial Management and Information Systems (1002).
Organization Concerned: Federal Financing Bank.
Congressional Relevance: House Committee on Banking, Finance and Urban Affairs: Economic Stabilization Subcommittee.
Authority: H.R. 7597 (95th Cong.).

House Resolution 7597 would require that the receipts and disbursements of the Federal Financing Bank (FFB) be included in the Federal budget. The bill as proposed would put the FFB on-budget; impose a ceiling on the activities of the FFB; and require that certain guaranteed loans be financed by the FFB. Putting a ceiling on FFB's lending could force the Department of the Treasury to allocate credit among agencies and might result in agencies borrowing in the private markets at higher interest rates. Control over Federal credit programs can be exercised more effectively at the agency level than at the aggregate level. It appears that the bill would require that most guaranteed loans be financed by the FFB. This provision might eliminate the loan guarantee as a policy instrument because an FFB-purchased guaranteed loan becomes a direct loan. Loan guarantees should be retained as a policy option. If the FFB is put on-budget, but nothing is done about other off-budget activities, many of the transactions which now go through the FFB may no longer do so. Congress should require that the receipts and disbursements of the FFB be included in the budget totals, the receipts and disbursements of other off-budget lending agencies be included in the budget totals, and Certificates of Beneficial Ownership be treated in the budget as borrowing rather than as the sale of an asset. (SC)

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Before the Subcommittee on Economic Stabilization
of the
House of Representatives' Committee on Banking, Finance, and Urban Affairs

For Release on Delivery
Expected at 10:45 a.m.
July 19, 1977

Mr. Chairman and Members of the Committee. Thank you for the opportunity to testify before your Committee on the budget treatment of the Federal Financing Bank.

We have been asked to discuss H.R. 7597, which would require that the receipts and disbursements of the Federal Financing Bank be included in the Federal budget. Coincidentally, we are issuing a report entitled "Government Transactions with the Federal Financing Bank Should Be Included in the Budget Totals." My testimony will be concerned mainly with H.R. 7597, but I will also discuss the extent to which the provisions of this bill coincide with the recommendations of our report.

As we read H.R. 7597, it would do three things:

-- Put the FFB on-budget.

-- Impose a ceiling on the activities of the FFB.

-- Require that certain guaranteed loans be financed by the FFB.

We support putting the FFB on-budget in order to increase control over the government's credit activities and make the budget numbers reflect more accurately the activities of the government. But the original objective of having an FFB--to achieve better coordination of the government's borrowing activities--is still valid and should be preserved.

This bill, as we understand it, would put a ceiling on FFB's lending. We question whether this is the best way to exercise control. It could force Treasury, acting through the FFB, to allocate credit among agencies, thus giving it a power which it does not now have.

Moreover, we question just how effective this control would be. The ceiling set by appropriations is not really a ceiling because agencies

could still borrow in the private markets. In doing so, they would have to pay higher interest rates, thereby losing the advantage of consolidated Federal borrowing.

We sympathize with the goal of achieving control over Federal credit programs, but we believe that it can be exercised more effectively at the agency level than at the aggregate level.

Another provision of the bill requires that guaranteed loans be sold to the FFB. Some securities are exempted from this requirement--those "of a type which is not ordinarily bought and sold in the same markets as investment securities." While we have not reached a firm conclusion on the impact of this provision, it appears to us that most guaranteed loans would have to be financed by the FFB.

This provision might, in effect, eliminate the loan guarantee as a policy instrument because when the FFB purchases a guaranteed loan it becomes, for all intents and purposes, a direct loan. Currently, such FFB activity is left out of the budget, and this certainly creates problems. Nevertheless, we believe that loan guarantees, when properly used, can sometimes accomplish program objectives more efficiently than direct loans or direct subsidies and should be retained as a policy option. Accordingly, we suggest that the Committee reconsider the implications of this provision.

Now let me mention some of the general issues involved with credit assistance and the FFB, and then I will move on to discussion of the conclusions and recommendations of our report.

The Congress created the FFB to provide for coordinated and more efficient financing of Federal and Federally-assisted borrowing from the

public. Clearly, the operations of the FFB on the few years of its existence have done this. However, this could have been accomplished without creating the FFB, which is actually just another name for the Treasury Department.

In a larger sense, the Congress needs to have adequate budgetary control over and information about credit assistance. With over $300 billion of direct loans and guaranteed loans outstanding, the government is involved in a massive reallocation of capital resources in the economy. These programs are basically subsidies, and they should be subjected to the same oversight as direct expenditure programs. They should not escape scrutiny or control because of their special budgetary treatment.

When some particular policy instrument, such as loan guarantees, is not included in the budget totals, it becomes more attractive to an agency than it should be. Because loan guarantees and other off-budget programs avoid budget ceilings, there is a tendency to use them when some on-budget program--direct loans, direct subsidies, etc.--might be more efficient.

The combined effects of the off-budget status of the Federal Financing Bank and other undesirable budget practices results in:

-- an inaccurate depiction of some Federal credit assistance;

-- a dilution of the meaning of Federal outlays and deficits; and

-- the potential for poor design of credit assistance devices and poor choices between credit assistance devices and other Federal assistance devices.

Placing the Federal Financing Bank on the budget would, by itself, eliminate one of these problems, but would not solve the others.

If the FFB is put on-budget, but nothing is done about other off-budget activities, many of the transactions which now go through the FFB may no longer do so. Instead, agencies might simply return to private capital markets to finance loan programs. By so doing, they would avoid the outlay effects of dealing with the FFB. In particular, Certificates of Beneficial Ownership might be sold in private capital markets rather than to an on-budget FFB. This is because the present treatment of these transactions disguises their true nature. If such sales were treated as borrowing, they could continue to be sold to an on-budget FFB, with cost savings to the government.

In order for the Federal credit assistance activity currently going through the Bank to be most adequately reflected on the budget, we recommend that the Congress:

-- First, require that the receipts and disbursements of the Federal Financing Bank be included in the budget totals.

-- Second, require that the receipts and disbursements of other off-budget lending agencies be included in the budget totals.

-- Third, require that Certificates of Beneficial Ownership be treated in the budget as borrowing rather than as the sale of an asset.

We have heard it suggested that double counting might result from putting the FFB on-budget. This would not be the case. Traditional budget accounting between on-budget agencies would prevent double counting.

In our report, we also discuss the implications of FFB operations for debt management and monetary policy.

Debt management policy involves manipulating the existing stock of public debt toward shorter or longer maturities in order to reduce the costs of borrowing. In doing this, debt management policy affects the liquidity mix of the public's asset holdings and could therefore have an indirect effect upon economic stabilization.

We concluded that FFB operations could, in principle, affect the structure of debt and the market rate of interest on different types of securities, but that the FFB's current operations are simply too small in comparison to the market to have very much effect. Therefore, there is no cause for concern at present, but the situation should be reviewed from time to time, particularly if the FFB grows rapidly in the future.

Mr. Chairman, this concludes my prepared statement. My colleagues and I would be pleased to try to answer any questions.