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BETTER INFORMATION FOR DECISION-MAKING IN THE FEDERAL BUDGET

Remarks of

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BETTER INFORMATION FOR ECONOMIC DECISION-MAKING

Possible topics for a joint meeting of bankers and accountants are innumerable. Large unanswered questions mark the area in which your fields overlap. One, about which I have felt strongly for many years, has this year become more pertinent than ever. This is the need to reform our national budget on a more rational basis in order to improve the control and operations of Federal credit programs.

As bankers and accountants you preach the idea that budgeting and accounting systems should furnish the necessary information for making the best possible decisions. Measured against such a standard, budget treatment of the Federal credit programs seems to fall short.

A move toward rationalization of this area through a reduction in the amount of proliferation was attempted by this year's Participation Sales Act. This was a good idea, but to my mind it did not go far enough. As we shall see, I believe it dealt with only one part of the problem. Because possible improvements in cost and efficiency are great, an active debate looking toward further reform would be most worthwhile.

Change will not be easy because it conflicts with many political shibboleths plus entrenched procedures. However, many advances are possible and should be considered. Certainly the idea of a central Federal Credit Management Corporation, as suggested by both Under Secretaries of the Treasury, makes sense. Perhaps, however, an even better and more direct result might be achieved by a restructuring of our Federal budget and debt concepts. Federal credit programs could be gathered into a separate section of the budget. Decisions as to what amount of these programs should be financed through guarantees and grant contracts, what through debt creation, and what through taxes should be made on the basis of current economic requirements and not on the happenstance of outmoded accounting methods. Such a separate credit sector is common in many foreign as well as state and local budgets. It is frequently referred to as a "below-the-line" or credit budget.

The Credit Programs

Few recognize how all-pervasive Federal credit programs are. While figures are not exact, more than 75 different programs are scattered among almost all governmental departments and 10 or more independent offices and agencies as well. The variety of arrangements for these programs is nearly as great. Some include full or partial guarantees of loans. Others lend Government funds which are then recouped through resale operations. Still others lend money borrowed from the Treasury. Finally, some agencies lend money they borrow themselves in the market.

Over $125 billion of direct or guaranteed loans are outstanding. About a quarter of these are direct, while the rest are insured or guaranteed. The largest share of the money goes for housing and community development programs; but other significant areas include agriculture, utilities and transportation, international activities, businesses, students, disaster areas, hospitals, schools, and many more. I find the full list of credit programs a fascinating reflection of the growing pressures and needs of our society.

There are strong forces which have led to the use of credit rather than the traditional method of appropriations for these programs. Reasons for establishing the credit-type programs include:

Gaps in the credit market which private lenders are not yet ready to fill.

Risks arising from its own actions which only the Government can underwrite.

Subsidies for social reasons where the difference between private and Government interest rates are sufficient to make the program successful.

Aircraft, railroad, and ship loans where potential losses to individuals may be high.

Programs aimed at insulating individuals and firms from normal market fluctuations in the availability of credit. FNMA, FHLBB, and many agricultural programs are of this type.

In still other programs subsidies are increased by lending at less than the Government's borrowing rate.

> Finally, there are credit aids for many desirable causes, such as that of colleges or local governments which have large capital needs, but insufficient credit to borrow on their own securities.

An examination of modern trends shows a rapid increase in the types of programs for which credit assistance makes sense. Such undertakings as halting pollution, rebuilding our cities, improving urban and inter-urban transportation, expanding our schools and colleges, taking care of our aged in hospitals or homes, are all growing and their capital needs are huge.

Under existing programs, gross loans made or guaranteed run between $15 and $20 billion a year. Earlier estimates indicated that actual and contingent liabilities under these programs would soon equal 50 per cent or more of the public debt. With the heavy demands facing the country, these estimates will soon be exceeded.

The Present Procedures

The present system of budgeting treats existing programs in at least four different ways. Guarantees and insurance of loans are not counted as part of any of the regular budgets or of the public debt. Loans made from funds of certain agencies show up in the cash budget, but not in the administrative budget or the public debt. Under other programs such as some of those of the Export-Import Bank, the Small Business Administration, and FNMA, loans may appear as normal expenditures in one year, while the later sale of the resulting loan-assets (or participations in them) may be recorded as negative expenditures in subsequent budgets. Still other programs are fully reflected as current expenditures even though they result in the Government receiving back mortgages, notes, or similar evidence of debt.

Each Federal credit program must be authorized by Congress. Programs are spread through many different parts of the budget in many forms.[1/] In most cases, annual administrative expenses must be voted. On the other hand, the amount of loans made in a year, and the form they take, normally is not subject to annual action. In some instances, once an original authorization to borrow or guarantee has been made, operations can continue without further congressional action, with authorizations expanding automatically under flexible formulas. In other instances, annual obligations must be voted.

While everyone agrees that some logical reasons underlie the spread of these programs, most observers conclude that budget peculiarities have been a major factor in explaining the form of their growth. Flexibility (or less charitably lack of control) in budget practice has been a main cause of their proliferation.

Under the happenstance of our traditional accounting methods, a credit program may have a differential and frequently much smaller impact on the current administrative budget and the public debt than

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1/ For a most detailed review, cf., A Study of Federal Credit Programs, Subcommittee on Domestic Finance of the House Committee on Banking and Currency, 88th Congress, 2nd S. (Government Printing Office, February 1964).

does a similar program of direct expenditure or grant. Thus most proponents of action feel their prospects for obtaining successful executive and congressional approval are improved by shaping it to fall into the twilight budgetary zone occupied by the credit programs.

The difference in budget treatment may or may not be logical. Under most of these programs valuable assets are being created. The Government receives a claim for future payments. Any private accountant would insist that such claims be reflected in a firm's statement and in some cases the procedures do in fact come close to those that would be followed in a private firm. But in other cases no note whatsoever is taken of the additional asset.

The Costs of a Poor Information System

Our present procedures seem to result in a budget and accounting system that lacks rationality, and, in addition, is haphazard and costly. In consequence, Government money is wasted in unnecessary interest and administrative costs. More importantly, Congress and the President are unable to exercise control over major governmental programs. Furthermore, as we have seen this year, serious disturbances can be created in the money and credit markets.

Higher costs. The fact of increased costs is easy to find. Each program basically sells equivalent goods--a Federal guarantee that a debt will be paid. However, this same commodity is marketed in many forms and by varying instruments. Some are sold in minute quantities, others in large ones. This diffusion and diversity is extremely inefficient. It is costly to lenders to have to study all the features of these different instruments in order to price them.

Numerous competing and conflicting administrative and marketing staffs exist. Some lack needed skills. Many call on identical buyers. The overlapping doesn't create expanded markets. The smaller the issue and the more complicated its terms, the more likely it is that it will be distributed primarily to the same small number of large, sophisticated investors but at a higher cost to the issuer. Equivalent efforts, if unified, could offer securities shaped with greater expertise to a broader range of markets.

Over and above waste in administrative and private lender costs, the Federal Government has paid from one-eighth to three-quarters of a per cent per year additional in interest on these issues as compared to the price of U. S. Treasury borrowings.

This year's Participation Sales Act was a first attempt toward avoiding some of this proliferation and solving some of these problems, but I believe a still more basic reform is required.

Lack of control. The problem of coordination and control arises from the conflicts in the budget system. It is of the exact type, I feel certain, each of you warns your clients against. There is no single place where anyone can get an estimate of what will occur as a result of the expenditures aided by Federal credit. Some may affect each of our three different budgets, but each may be handled in rather unusual and peculiar ways.

Because of revolving funds, continuing authorizations, independent rights to market debt, and other factors, it is most difficult to review the current status of programs and to evaluate them in the light of new conditions.

This year has shown how sensitive the economy and credit structure are to minor shifts in expenditures. The movements in spending under credit programs have significant impacts on the Government's basic goals as well as on its stabilization efforts. To make certain that credit-induced expenditures aid and do not hinder our over-all goals, more knowledge is needed.

As a minimum Congress and the President require accounting procedures which will enable them to compare the expected gains as well as the economic impacts from each credit program. An annual program and budget review would enable them to estimate more clearly the expenditures to be expected under existing authorizations. They could more easily weigh the economic and fiscal thrusts of these programs and compare them with those planned for the rest of the Government.

Taxing or borrowing. If all credit programs were gathered in one place, it would be much simpler to measure their impact and to determine the proper share to be financed through taxes or through borrowing. Little logic exists at the present.

It is the possibility of avoiding budgetary control and fights over debt limits that causes so many proposals to be financed through indirect credit means. Sometimes, but not always, such end-runs around the budget serve a useful purpose. However, by attempting to relate an expenditure's form in the budget to the manner in which it is to be financed, we have gotten ourselves up a blind alley. This is the costly path reached by stressing the ever-balanced budget concept. It makes it difficult to get either surpluses or deficits when we need them. Too much emphasis has been placed on form rather than content.

Wouldn't we be much better off if we faced up to our problem directly? These programs are different from other expenditures because it is easier to measure the assets received. This does not mean, however, that they should be 100 per cent debt financed. The proper amount to be covered by taxes can only be measured as part of a complete budget document. I doubt that any of you would be willing to advise your clients how much to borrow based on his purchases or sales of one type of asset alone. You would properly insist on examining his entire expenditure and revenue program.

Debt management and monetary policy. The present system also can cause serious problems in our money markets. The Treasury has the basic responsibility for debt management. Yet 20 or 30 treasuries in other departments or agencies are also given the responsibility for issuing securities. Many can proceed independently of the Treasury. In some cases, the Treasury's advice must be followed; in others consultation is required, but no more than that; in still others independence is theoretically complete.

In September, because of the problems created by this situation, the President assumed greater responsibility for agency securities in order to minimize their interference with national goals.

The monetary operations of the Federal Reserve also suffer under the present system. The coordination of debt management and monetary policy is made far more difficult by the proliferation of debt instruments and debt managers.

Under recent Congressional action, the Federal can operate in all obligations issued or fully guaranteed by a United States agency. Numerous problems arise, however. Under the existing diffuse procedures, the blocks of securities available for purchase are often small and not readily tradeable. Because the markets for these securities are thin, any activity by the Federal Reserve in these securities may cause extremely uneven jumps or market price reactions. In addition, with so many different agencies involved, issues are constantly entering the market. Any action to buy one, as opposed to another, might raise questions of favoritism. While the timing of monetary action and Treasury offerings are carefully coordinated, like coordination is nearly impossible with respect to the constant appearance of new agency issues in the market.

A Federal Credit Management Corporation

As we have seen, at least three elements seem to be missing from the present situation:

(1) The Government lacks a unified approach as a borrower to the money and debt markets.

(2) There is no single sector of the budget which contains the myriad of programs, and which shows the form of the commitments being assumed by the Government, as well as present and potential costs.

(3) We have no basic understanding and theory of the role for Federal credit programs in the whole picture of the budget and economic activity.

The first two elements could be furnished either by a new "Federal Credit Management Corporation," or by a more direct move to a reshaped budget with the Treasury assuming the same duties and responsibilities which the agency would otherwise perform.

The Credit Management Corporation or the Treasury would assume the existing authorizations to borrow, sell participations, grant guarantees, etc. The central credit agency would borrow all the required funds. These funds could be raised through a single agency series, a separately designated set of Treasury obligations, or they could be simply an expansion of existing Treasury operations. In any case, necessary action would be taken to insure that the debts were full-faith obligations of the Federal Government. It would be expected that they would sell under the same terms and conditions and have the same relationship to monetary operations as existing Treasury securities.

While the raising of funds and the relationships to the money markets would be centralized, this would not be true of the operations of the separate programs. They could continue to function as at the present. Their relationship to the Treasury or the agency would be similar to that of the other parts of the Government to the Treasury now. They would receive their funds as a result of congressional action and need not even be concerned with how and when their monies were raised.

Congress would continue to authorize the form, nature, new obligations, and similar factors for each program separately. Each agency's authorization could include the right to borrow from the central agency as well as the terms, interest rate, and amount of subsidies involved. The cost of each program would be made explicit. The amount to be charged each borrower would be set while the cost to be subsidized would be appropriated to the program agency so that it could repay the central credit agency.

In those cases where loan guarantees serve a logical need and are not primarily a method of avoiding the present constraints of the administrative budget and the public debt ceiling, they should be continued. These would mainly be those cases where the private lender in reality acts as a co-insurer or serves a major underwriting or servicing function.

Either of these proposals could lead to a careful re-examination of our existing budget operations and doctrine. One advantage some might see in the Federal Credit Management Corporation would be that it would not break with existing traditions. The Corporation could be treated like many existing ones. It would have as the security behind its borrowing, the various loans, contracts, or other assets which now stand behind the 75 or more separate programs. In addition, it would have a direct governmental guarantee.

No questions would have to be raised concerning the relationship of existing programs to the logic of the debt ceiling. The need to list the FCMP operations with respect to each of the other programs might give a central place where a total view of the various programs could be gained, but even this would not be necessary. The present assortment of ad hoc financing and budgetary arrangements could continue.

In contrast, showing all Federal credit programs as part of the budget, but in a separate unified form, would require a complete rethinking of the logic of our existing system. Authorizations to cover all the programs either through taxes, guarantees, or Treasury borrowing would be in one place. The real costs of programs, whether from current taxes, future commitments, or lending of the Government's name, could be compared. Decisions could be made with respect to this group of programs as a whole not simply on an individual basis.

Conclusion

Obviously, I believe a re-examination of our present system to be most worthwhile. There is ample room for progress. The quicker we get down to examining the potential gains and losses from a change the better off we will be.

The national budget system envisaged here might avoid many of the disadvantages of present operations:

> Congress would be able to weigh the needs of the credit sector more easily both with respect ot its individual components and in relation to other parts of the budget.
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> The ability to measure the economic impact of Federal action would be improved.
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> The administrative costs as well as interest costs to the Government would be less.
>
> Technical problems of debt management and monetary policy would be simplified.

Experience shows that budgeting reform at any level is extremely difficult. The history of accounting and granting of credit shows how glacially we seem to move at times. On the other hand, progress does occur. Your presence here testifies to the interest in better information systems. We can hope for an enlightened debate that will bring us toward a more rational solution to these problems.