CHAPTER 6
CONTROLLING FEDERAL CREDIT

Federal Demands on Credit Markets

During the last decade, the rapid growth of Federal credit activity has helped to make the Federal Government the dominant consumer of the nation's financial resources.

- From 1955 through 1975, Federal and federally assisted borrowing, on average, absorbed less than 20% of available credit resources. (This includes borrowing by the Government to finance the budget deficit and off-budget spending, borrowing by individuals or private institutions with Government-guaranteed loans, and borrowing by Government-sponsored enterprises.)
- In the latter half of the 1970's, large deficits and rapid expansion in credit programs drove the average absorption up to 28%.
- The absorption levels reached in 1980 and 1981 (36% and 35%) have been experienced before only during the recession and recovery period of 1975-1976.

TABLE 1. BORROWING UNDER FEDERAL AUSPICES:
ABSORPTION OF DOMESTIC CREDIT MARKET FUNDS
(Fiscal years; in billions of dollars)

	Five-Year Averages						
	1955-1959	1960-1964	1965-1969	1970-1974	1975-1979	1980	1981
Total funds raised in domestic credit markets[1/]	35.5	50.8	80.6	148.6	301.7	342.5	407.8
Federal borrowing	2.1	4.5	6.4	13.0	56.8	70.5	79.3
Net guaranteed loans	4.0	4.3	5.1	13.9	13.6	31.6	28.0
Net Government-sponsored enterprise borrowing	0.4	0.7	1.0	5.0	12.6	21.4	34.8
Total funds raised under Federal auspices	6.5	9.5	12.4	31.9	83.0	123.5	142.1
Federal absorption rate	18%	19%	15%	21%	28%	36%	35%

[1/] Funds raised by non-financial sectors, excluding equities. Source: Federal Reserve Board Flow of Fund Accounts, adjusted during 1955-69 for consistency with budget concepts.

Unprecedented Federal credit demands reduce the Nation's ability to improve productivity and output. Increasing demand for credit by the Government and the borrowers it serves saps the vitality of credit markets and hampers their performance in the critical task of allocating resources to the most productive uses.

- Many unsubsidized private borrowers are crowded out of the "credit queue" because priority is given to Federal and federally assisted borrowers.
- Federally assisted borrowers are frequently less productive than private borrowers because they are not chosen with regard to the highest expected return while allowing for risk. In this way, Federal intervention distorts the market's assessment of risk and return, causing a misdirection of investment and a decline in future economic growth and productivity.
- Interest rates are exposed to continual upward pressure. With Federal borrowing absorbing so much of the supply of credit, private borrowers are forced to bid interest rates up.

- Borrowers cannot obtain stable long-term financing, which frustrates implementation of long-term investment plans and further inhibits economic growth.

The Federal demand for credit has had a major effect on expectations of future inflation and interest rates because it is a crucial link between fiscal and monetary policy.

- Throughout the 1960's and 1970's, growing Federal deficits, combined with heavy Federal credit demands, were accommodated by faster monetary growth. This caused inflation to accelerate.
- Unless the burden of Federal and federally assisted borrowing is curtailed during the 1980's, prospects for permanent monetary control and inflation reduction will be substantially lessened.

The Supply of Federal Credit

A substantial portion of Federal and federally assisted borrowing results from its lending activities which supply credit to selected borrowers. On- and off-budget agencies make direct loans. They also guarantee loans made by the private sector. In addition, Government-sponsored enterprises serve credit markets. The table below shows trends in the lending side of Federal credit activity.

TABLE 2. NET LENDING UNDER FEDERAL AUSPICES
(Net lending, fiscal years; in billions of dollars)

	Actual					
	1976	1977	1978	1979	1980	1981
Direct Loans						
On-Budget	4.2	2.6	8.6	6.0	9.5	5.2
Off-Budget	6.7	9.0	11.2	13.6	14.7	20.9
Guaranteed Loans	11.1	13.5	13.4	25.2	31.6	28.0
Government-Sponsored Enterprises	4.9	11.7	25.2	28.1	24.1	32.4
TOTAL	26.9	36.7	58.4	77.9	79.9	86.5

Direct Loans

Direct loans, in which agencies lend Federal funds to selected borrowers, accounted for $26.1 billion in Federal outlays in 1981 for such programs as the Farmers Home Administration, the Export-Import Bank, and the foreign military sales credit program.

However, of this total $20.9 in direct loan outlays were excluded by law from the budget totals.

Off-budget direct loans: the Federal Financing Bank (FFB). The outlays of the off-budget Federal entities mostly arise from the use of the FFB as a source of financing by other agencies for direct and guaranteed loans. The FFB effectively converts certain on-budget direct loans and guarantees into off-budget direct loans. This activity creates an off-budget deficit that absorbs valuable savings and capital just as does the on-budget deficit. Off-budget lending increased threefold between 1976 and 1981.

Guaranteed Loans

Guaranteed loans, private loans for which the Government guarantees the repayment of principal and interest, accounted for $28.0 billion in net credit market activity in 1981 for such programs as Federal Housing Administration and Veterans Administration mortgage insurance, the Export-Import Bank, and the Small Business Administration.

Guaranteed loans are not budget outlays, because no Federal funds are used except in case of default. Many of their effects are nevertheless similar to the effects of outlays because they effectively reallocate economic resources from privately selected to federally selected uses. Borrowing for guaranteed loans absorbs funds available to credit markets in a manner similar to direct Federal borrowing.

Government-Sponsored Enterprises

The seven Government-sponsored enterprises made $32.4 billion of net loans in 1981. The seven enterprises consist of three that support housing — the Federal National Mortgage Association, Federal Home Loan Banks, and Federal Home Loan Mortgage Corporation; the three Farm Credit Banks, which support agriculture — the Banks for Cooperatives, Federal Land Banks, and Federal Intermediate Credit Banks; and one that supports students obtaining higher education — the Student Loan Marketing Association. Most of these enterprises provide liquidity to the markets they serve through secondary market operations.

Because of their private ownership, the Government-sponsored enterprises are not included in the budget totals or controlled through the budget process. Nevertheless, Government sponsorship has provided these enterprises with advantages in the securities markets that completely private institutions do not have. This enables them to borrow at rates only slightly higher than those of the Treasury.

Steps for Control

Upon assuming office, the Administration took immediate steps to reverse the growth trends of Federal credit. An interagency Cabinet-level group was formed and undertook a comprehensive review of the Government's direct and guaranteed loan programs in order to shape a consistent credit policy. The credit budget was used for the first time to impose systematic discipline and policy control on the growth of Federal credit. The group also recommended modifying Government-sponsored enterprises into becoming completely private organizations. Additional policy changes will be recommended and implemented in the months ahead.

The Credit Budget

This Administration has worked closely with the Congress to strengthen the credit budget. Now in its third year, this framework is a major step toward full integration of credit into the budget process.

- The credit budget covers all direct and guaranteed loans, making no distinction between on- and off-budget entities. Government-sponsored enterprise loans are not included, because of their private ownership.
- The credit budget focuses decisions on gross program levels at the point of legal obligations, thereby facilitating control.

In its credit budget revisions just after taking office, the Administration proposed reduction in direct and guaranteed loan activity for 1982 of $21.0 billion below the level proposed by the previous Administration. Federal demands on the Nation's financial markets will be substantially alleviated in the years ahead despite temporarily higher Federal borrowing to finance the deficit. The 1983 credit budget marks the beginning of a steady downward path in the total burden of Federal credit demands on the nation's economy.

Under the President's credit budget proposals, significant progress is being made to reduce the Federal claims on financial resources, far below the level they would attain if the growth trend since 1976 continued unabated.

- For 1983, the Administration's credit budget proposals bring direct loan obligations down by $7.4 billion between 1981 and 1983 and substantially slow the growth in guaranteed loan commitments compared to previous growth trends.

TABLE 3. THE CREDIT BUDGET TOTALS[1/]
(In billions of dollars)

	1981 Actual	1982 Estimate	1983 Estimate
Direct Loan Obligations	57.2	56.4	49.0
Guaranteed Loan Commitments	76.5	87.1	98.4
TOTAL	133.7	143.4	147.3

[1/]The credit budget totals differ from totals shown in Table 2 because the credit budget is based on gross obligations and commitments for credit, while Table 2 shows the net change in outstanding credit.

Major programmatic changes in the credit budget include:

Government National Mortgage Association. Loan commitments for GNMA mortgage-backed securities are proposed to decrease by $9.6 billion between 1982 and 1983. Private mortgage-backed securities programs are now rapidly developing; the Administration's GNMA proposal would encourage and accelerate the success of these private efforts.

Export-Import Bank. Direct lending will be reduced by $0.6 billion between 1982 and 1983, and guaranteed loans will be held at the 1982 level. Because of the decline in demand for direct credit and the potential for the private sector to undertake increased insurance activity, these amounts will be sufficient to enable the Export-Import Bank to meet the requisite needs of exporters facing subsidized foreign competition.

Farmers Home Administration. The Administration believes that private lenders are increasingly able to fill rural credit needs adequately. Accordingly, program reductions proposed in FmHA total $2.6 billion in direct loans and $0.6 billion in loan guarantees. These changes include major decreases in direct loans for rural housing, and termination of the business and industrial, and alcohol fuels, loan guarantee programs.

International Security Assistance. The Administration plans to increase its military and economic assistance to friendly and strategically important nations in both 1982 and 1983. Direct loans will increase by $1.0 billion in 1983, and guaranteed loans, financed through the Federal Financing Bank, will increase by $0.8 billion.

Rural Electrification Administration. In 1983, REA guaranteed loans will be reduced by $0.5 billion and direct loans will be reduced by $0.4 billion. These reductions are proposed because a large number of REA borrowers can obtain credit from unsubsidized private sources at prevailing market rates.

Small Business Administration. The Administration is proposing to eliminate SBA direct loans beginning in 1983 and to reduce 1983 guarantees by 10% below the 1982 level. These reductions are proposed as part of the overall plan to control credit, because small businesses will benefit more from stable financial markets and lower interest rates than from Federal credit assistance for a few selected borrowers.

Public Housing. A decrease in direct loan obligations of $0.5 billion and an increase of $1.5 billion in guaranteed loan commitments between 1982 and 1983 result from financing transactions of prior year commitments for public housing notes.

Commodity Credit Corporation. Direct loan obligations for commodity price support programs are estimated to decrease by $2.0 billion between 1982 and 1983 due to provisions in the recently enacted Agriculture and Food Act of 1981.

Major increases in the credit budget are due to improved economic conditions for housing. As the housing industry recovers from its depressed 1981 levels, guaranteed lending increases are expected for:

Federal Housing Administration. Guaranteed loan commitments for FHA are estimated to increase by $5.0 billion in 1982 and $6.4 billion in 1983.

Veterans Administration. Increases in guaranteed loan commitments in the veterans loan guarantee revolving fund are $7.8 billion in 1982 and $2.9 billion in 1983.

Privatization of Government-Sponsored Enterprises

If their current links to the Federal Government are continued, the Government-sponsored enterprises should also be brought under closer scrutiny through the budget and credit budget process. The Administration prefers, however, to modify the special relationship between these enterprises and the Federal Government in order to transform them into completely private organizations. In particular, the Administration seeks to accelerate the development of a truly private secondary market for housing finance. Both the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA) will be active in guaranteeing conventional mortgage-backed securities in the coming year, and it is expected that both institutions will be strongly supported by the expansion of private mortgage insurance activity. Moreover, it is anticipated that the competitive advantages now accorded to FHLMC and FNMA will be gradually eliminated.

Other Administration Proposals for Control of Credit Subsidies

In the coming months the Administration plans action on:

- *Interest subsidies.* The Administration is moving to develop a consistent policy on the provision of interest subsidies.
- *The Federal Financing Bank.* The budget treatment and portfolio oversight of the Federal Financing Bank will be reviewed and improved.
- *Debt collection and default accounting.* Substantial work is now in process to create standard accounting definitions and administrative controls.

Rural Electrification and Telephone Revolving Fund Loan Authorization

AGENCY: Department of Agriculture FUNCTIONAL CODE: 271

Funding

	($ in millions)						
	1981	1982	1983	1984	1985	1986	1987
BUDGET AUTHORITY	4,816	5,097	4,824	4,183	3,990	4,051	4,163
OUTLAYS	4,715	5,088	4,809	4,158	3,951	3,996	4,094
DIRECT LOAN OBLIGATIONS	1,260	1,285	885	885	885	885	885
GUARANTEED LOAN COMMITMENTS	5,131	4.245	3,760	3,760	3,760	3,760	3,760

Program Description

The Rural Electrification Administration (REA) of USDA makes direct and guaranteed loans for construction and operation of electric and telephone utilities in rural areas. By statute, direct loans are made by REA at very low interest rates — 2% or 5% — depending upon the project and the financial condition of the borrower.

Loan guarantees were authorized to attract private capital to rural electric and telephone projects, particularly in those cases in which utilities do not have the equity or cash flow necessary to attract private loans without Federal assistance. However, since the Federal Financing Bank (FFB) was established, REA borrowers have used REA guarantees to borrow almost exclusively from the Federal Treasury through the FFB.

Proposed Change

In 1982, REA guaranteed loan commitments will be reduced by almost $1 billion to $4.2 billion. In 1983, REA direct loans will be reduced by $400 million to $885 million, ($225 million for electric and $175 million for telephone) and guarantees will be reduced by an additional $485 million to $3.8 billion. These remaining levels of lending are projected through 1987.

Rationale

These reductions are possible under existing law through administrative changes because of increased ability of borrowers to obtain part of their financing needs from other sources:

- These actions are part of an Administration objective to control Federal credit and reduce Federal demands on private credit markets.
- Although these lending programs are "off-budget," they add to the total Federal deficit and to demands on financial markets. The Treasury borrows to finance the programs, and in most cases these long-term lending programs are being financed by Treasury short-term borrowing. For example, during 1981 the Treasury paid 14% to borrow funds lent by REA at 5% costing the taxpayer the difference, or $9 million per year for each $100 million lent.
- Most of the rural telephone borrowers (approximately 70%) are eligible for the tax benefits available to private companies provided in the Internal Revenue Code, including the latest amendments which permit sale and leaseback of facilities. Many of the largest electric borrowers are eligible for the same provisions and in fact are now taking advantage of them.
- A larger portion of total program needs can be obtained from non-Federal sources without REA guarantees. Generation and transmission of electricity as well as other REA financed projects will be expected to obtain a portion of their credit needs from unsubsidized private sources without REA guarantees.

- All borrowers do not need the same proportion of Federal assistance to obtain their financing requirements. Eligible purposes for Federal loans and guarantees can be limited to those which cannot be reasonably financed otherwise.
- These subsidies are not necessary because electric and telephone service can be provided in these areas at a profit using private capital.
- REA assisted cooperatives and companies lack incentives to improve their financial positions for the purpose of attracting private capital so long as these subsidies remain available.

Electric Loans

- This program has served its primary purpose of bringing electric power to the farm.
  - When the REA electric program was established in 1935, only 11% of the Nation's farms had electricity.
  - Today more than 99% of farms have electric service, and many of the areas are served by electric co–ops.
- Because interest on capital borrowed by REA co–ops is subsidized by the Federal taxpayer, customers of REA–financed electric utilities receive service at rates on a national average which are less than average rates charged by non–REA financed utilities.
  - According to data published by the Department of Energy and REA in January 1980, customers of REA–financed systems on average paid 3.3 percent to 9.9 percent lower rates for electricity than customers of other utilities.
  - Within some individual States, however, rural electric systems may charge more than other private utilities which have access to power from low–cost hydro projects and therefore provide electricity at even lower cost.

Telephone Loans

- This program has also served its primary purpose of bringing telephone service to the farm.
  - When the program was begun in 1949, only 38% of American farms had telephone service, a large part of which was inadequate.
  - Today, over 90% of all rural households have telephone service, most of which is comparable to urban service.
- The cost of REA telephone service to rural subscribers is lower on the average than the cost paid by urban dwellers because telephone companies and co–ops have used low interest REA loans to establish, maintain and upgrade this service.
  - A recent REA study comparison of single–party residence monthly telephone rates for the Bell System and REA–financed telephone borrowers showed the following (CY 1978 data):
    - For the 45 States compared, REA borrowers in 12 States on average charged less than the Bell System; REA borrowers charged more on average in 33 States.
    - The weighted average monthly bill for all 45 States was $6.50 for the Bell System and $8.00 for the REA borrower systems. (The REA borrower average exceeded the Bell System average by 23%.)
  - The Bell System rates used in the study exclude large metropolitan area exchanges where the largest numbers of phone subscribers paid monthly bills ranging from 30% to more than 60% higher than the small Bell System service areas selected for comparison. Using the average monthly bills paid by most urban subscribers to the Bell System, Bell System rates on average would exceed REA borrower rates for single–party residence service by approximately 25%.

Effects of the Proposed Change

The effects on consumers will not be significant because:

- Large amounts of private credit at market rates is available.
- Some $700 million in subsidized loans at 2% and 5% will still be available to utilities that warrant assistance.
- Additional telephone loans will remain available from the Rural Telephone Bank at a somewhat more favorable interest rate than private markets.
- Federal guarantees (72% of 1981 total) will still be available (for both electric and telephone) from the Federal Financing Bank which also includes a subsidy.
- Although a reduction in lending levels will cause some increases in subscriber rates, the impact on individuals will be reasonable when compared with rates charged by other utilities, and the relative cost of providing service in less densely populated areas.

Rural Housing Loan Progam

AGENCY: Department of Agriculture FUNCTIONAL CODE: 371

Funding

	($ in millions)						
	1981	1982	1983	1984	1985	1986	1987
BUDGET AUTHORITY	594	1,583	1,110	1,536	1,698	1,834	1,779
OUTLAYS	130	1,092	1,617	1,723	1,775	1,706	1,646
DIRECT LOAN OBLIGATIONS	3,487	3,727	1,145	1,145	1,145	1,.145	1,145
GUARANTEED LOAN COMMITMENTS	6	—	—	—	—	—	—

Program Description

The Farmer's Home Administration's (FmHA) homeownership, repair, rental construction, site development and farm labor loan programs are available in any rural community of 10,000 or less, and in communities of 10,000–20,000 outside standard metropolitan statistical areas (SMSA's). Loans are made at interest rates as low as 1 percent.

Proposed Change

In 1983, federally assisted rural housing loan programs are proposed to be reduced as follows:

	($ in millions)		Units	
	1982	1983	1982	1983
Single Family Housing	2,730	900	67,500	20,100
Repair and Rehabilitation of Single Family Housing	24	24	6,440	5,900
Multi Family (Rental) Housing	940	200	29,400	5,740
Housing Site Development	5	2	—	—
Farm Labor Rental Housing	26	19	1,340	1,090
TOTAL	3,727	1,145	104,680	32,830

FmHA will improve its efforts to ensure that truly needy households are the primary beneficiaries of the rural housing programs. It will enforce a credit–elsewhere test to determine eligibility for homeownership loans.

Rationale

- The Administration proposes to reduce FmHA direct lending programs for housing as part of a general effort to limit the growth of Federal outlays and to reduce dependence on the Federal Government as a supplier of credit. Reduced Federal involvement in credit markets should help to relieve pressure on interest rates, particularly in the housing sector.
- This reduction is consistent with trends in mortgage markets which suggest that rural areas generally are adequately served by private credit markets.
  - — Over the period 1960 to 1978, housing starts in rural areas increased at a faster pace than the population living in non–SMSAs.
  - — At the same time, there has been steady progress in eliminating substandard housing in rural areas. Between 1970 and 1978, the percent of all rural households living in substandard housing has declined from nearly 18% to approximately 8%.
- The proposed reduction will enable FmHA to improve its loan making and servicing responsibilities to low– and moderate–income borrowers. The Agency will be able to provide more individual assistance to loan applicants and more counseling and supervision to

borrowers. These actions should help to reduce the high rate of delinquent payments, which, for homeownership loans reached 27% in mid–October.

Effects of the Proposed Change

- FmHA is not and should not be viewed as the primary lending source for rural housing. In fact, in 1980, FmHA loans financed only about 10% of all home purchases in rural America. Therefore, the proposed changes will have minimal impact on rural home purchases.

Federal Housing Administration Credit Limits

AGENCY: Department of Housing and Urban Development

FUNCTIONAL CODE: 371

Funding

	($ in millions)						
	1981	1982	1983	1984	1985	1986	1987
BUDGET AUTHORITY	412	252	134	189	283	233	235
OUTLAYS	182	-245	-1,179	-1,155	-1,142	-1,228	-1,309
DIRECT LOAN OBLIGATIONS	414	383	311	306	329	321	311
GUARANTEED LOAN COMMITMENTS	23,635	28,609	35,000	35,000	35,000	35,000	35,000

Program Description

The Federal Housing Administration (FHA) operates about 40 programs that provide insurance for home and project mortgages and property-improvement and mobile-home loans. Since its inception in 1934, FHA has insured mortgages and loans covering 17.3 million units with a value of $260 billion. FHA currently insures 5 million home and multifamily mortgages with a value of $151 billion. In fiscal year 1981, FHA insured 277,000 home mortgages with a value of $12.5 billion, 1,100 multifamily mortgages covering 116,000 units with a value of $3.6 billion, and 309,000 property-improvement and mobile-home loans with a value of $1.7 billion.

Proposed Change

FHA will be redirected to serve groups—such as first time and inner city homebuyers—that cannot obtain equivalent private mortgage insurance, and need insurance to purchase homes. By targeting FHA insurance towards these groups, the Administration will continue to encourage homeownership without interfering with private insurers. As a result of this redirection, the President proposes to reduce the current 1982 limitation of $40 billion to $35 billion in 1983 and each year thereafter.

Rationale

- This is an integral component of the President's plan to control the growth of Federal credit.
- FHA should provide mortgage insurance for only those segments of the market not adequately served by the private sector. For example, some homebuyers — particularly first time homebuyers who are able to make only very low downpayments — may be unable to obtain private mortgage insurance and thus require FHA mortgage insurance if they are to be able to purchase a home.
- The growth in the size of and capacity of the private mortgage insurance industry has provided a viable alternative to FHA mortgage insurance.

Effects of the Proposed Change

- Despite this proposed decrease in the amount of commitments FHA can make to insure mortgages, the amount of mortgages FHA will actually insure is expected to increase from $23.6 billion in 1982 to $28.6 billion in 1983. This will occur because of expected increases in both aggregate housing activity and in the rate at which commitments are used.
- More homebuyers will use lower cost private mortgage insurance; private mortgage insurors already insure about twice as many mortgages as FHA.

GNMA Mortgage-Backed Securities Credit Limits

AGENCY: Department of Housing and Urban Development

FUNCTIONAL CODE: 371

Funding

	($ in millions)						
	1981	1982	1983	1984	1985	1986	1987
OUTLAYS	-92	-118	-149	-175	-203	-228	-252
GUARANTEED LOAN COMMITMENTS	42.150	48.000*	38.400	—	—	—	—

*Reflects proposed supplemental calculation in currently enacted 1982 limitations.

Program Description

The Government National Mortgage Association (GNMA) Mortgage-Backed Securities program was authorized by Title VII of the Housing and Urban Development Act of 1968. The Act allows private lenders to pool mortgages guaranteed by FHA, VA, and FmHA and to issue securities backed by these pools. GNMA guarantees the timely payment of principal and interest of these securities. Thus, the GNMA program enables private lenders, primarily mortgage bankers, to finance their mortgage holdings by selling securities backed by the full faith and credit of the Federal government.

GNMA commitments grew from $231 million in 1970 to $42.2 billion in 1981. Loans guaranteed rose from $38 million to $16.9 billion during the same period. Outstanding GNMA securities totaled $105 billion as of the end of September 1981. This amount represents the equivalent of U.S. Treasury debt and absorbs available savings much like Treasury borrowing does.

Commitment limitations were first imposed on the program in 1981 as part of the government-wide Federal Credit Control program. The limitation was set at $64 billion in 1981. To help address current problems in financial markets, President Reagan proposed a target 25% reduction for 1982 in the GNMA Mortgage-Backed Securities program. The commitment limitation would, therefore, be set at $48 billion in 1982.

Proposed Change

For 1983, the Administration proposes a further reduction in the commitment limitation for GNMA mortgage-backed securities as a part of the effort to reduce overall Federal borrowing requirements and exert downward pressure on interest rates. Specifically, GNMA commitment authority will be limited to $38.4 billion, a 20% reduction from the 1982 level.

A second change involves increasing the fee charged for a GNMA commitment to a rate that will equal similar fees charged by private sector conventional mortgage-backed securities programs. In addition, a new fee will be charged to cover the costs of processing new GNMA issuers. The effects of these fee changes are discussed in the User Fee section.

Rationale

- The reduction in the GNMA commitment limitation is an integral part of proposed reductions in overall Federal credit programs. Federal credit reductions are designed to relieve pressure on interest rates and to open the way for sustainable and noninflationary economic recovery.
- Federal housing credit reductions will encourage and accelerate the development of a predominantly private sector housing market. In particular, both the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) have developed conventional mortgage-backed securities programs that will be operating in calendar year 1982. These programs will be strongly supported by the

expansion of private mortgage insurance activity, which is already larger than comparable government-insured activity.

Effects of the Proposed Change

The 1983 targeted reductions in the GNMA mortgage-backed securities program should:

- Positively affect aggregate credit markets and exert downward pressure on interest rates;
- Encourage the development of mortgage-backed securities programs in the private market for both conventional and government-insured mortgages; and
- Reduce budget outlays since additional income will be generated by the increase in user fees.

Export Credits and Guarantees

AGENCY: Export–Import Bank FUNCTIONAL CODE: 155

Funding

	($ in millions)						
	1981	1982	1983	1984	1985	1986	1987
BUDGET AUTHORITY	6,908	3,986	2,701	2,667	2,731	2,647	2,608
OUTLAYS	2,066	1,855	1,918	1,188	1,385	1,317	647
DIRECT LOAN OBLIGATIONS	5,431	4,400	3,830	3,830	3,830	3,830	3,830
GUARANTEED LOAN COMMITMENTS	7,416	8,000	8,000	8,000	8,000	8,000	8,000

Program Description

The Export–Import Bank provides credit support for the sale of American goods and services overseas in the form of:

— long–term direct loans on subsidized terms to purchasers of U.S. exports, and

— loan guarantees and insurance against defaults by foreign purchasers.

In recent years, programs were expanded rapidly, and rates and fees were reduced as part of a general effort by the Bank to promote exports through highly favorable financial policies.

Proposed Change

The Administration proposes to:

- reduce direct lending by $570 million in 1983 to $3.8 billion, and
- hold loan guarantee authorizations steady at $8 billion.

The proposed budget levels are supported by policy changes implemented by the Bank that will enable it to operate effectively at reduced programs levels. The Bank:

- is now targeting its resources more carefully to assure that it is supplementing and not competing with private export finance that is readily available,
- generally no longer provides direct credits 1) for sales to other industrial countries, with developed capital markets of their own, 2) for lines of credit which compete with commercial banking, or 3) for sales of older generation aircraft and other product areas where competitive products from other countries do not exist; and
- now charges a rate of interest that more closely approximates its cost of money in order to place the Bank's future financial condition on a sounder basis and limit the large losses that will occur in 1982 and 1983 because of the previous Administration's policies.

In the areas of loan guarantees and insurance, the Administration is examining new techniques for developing more independent private sector capability for servicing U.S. exporters:

- The resources of the domestic banking and insurance industry are enormous and should be capable of effectively supporting U.S. exports where competitive finance is not an issue.
- As these programs develop, the government will be able to concentrate its resources in those limited areas where activity is warranted.

Rationale

The changes support the Administration's policy to reduce federal subsidies that distort market forces. Such changes are needed because:

- The cost of interest subsidies on long-term loans is substantial; subsidized export credits transfer resources from domestic taxpayers to exporters or the foreign borrower.
- Subsidies distort trade and investment, result in a low rate of return on invested capital, and worsen the terms of trade, particularly in the short term.
- Economic gains to the general public have not been identified or measured in any rigorous manner.
- Claims that subsidized exports generate additional employment, income and Federal revenue while reducing expenditures for social programs fail to consider that credit diverted to exports must come at the expense of other sectors which will experience offsetting losses.

By limiting the size and cost of these programs, the changes that are being undertaken will reduce distortions in the economy. At the same time, the economic program being put into place by the Administration will improve the competitive position of U.S. industry generally by reducing inflation, providing generalized incentives for increased investment and improved productivity and by removing artificial restraints and disincentives to trade.

Effects of the Proposed Change

- The Bank's subsidy to foreign borrowers, estimated to be between $200 million and $1 billion in 1980 by the Congressional Budget Office, will be reduced.
- The Bank's losses, estimated to be $243 million in 1983 for the loan programs, can be reduced in future years as inflation and interest rates subside and recent international agreements to increase official export credits take effect.
- Impact on U.S. exports will be limited because:
  - — Fluctuations in U.S. export performance result primarily from cyclical changes in the U.S. and foreign economies.
  - — The Export-Import Bank's direct credits finance less than 2% of U.S. exports of goods and services.
  - — The preponderance of Bank's loan guarantee programs are not competitive financial instruments for increasing exports and have limited ability, therefore, to generate additional U.S. exports.

SBA Direct Business Loans

AGENCY: Small Business Administration FUNCTIONAL CODE: 376

Funding

	($ in millions)						
	1981	1982	1983	1984	1985	1986	1987
BUDGET AUTHORITY	292	184	0	0	0	0	0
OUTLAYS	219	211	46	0	0	0	0
DIRECT LOAN OBLIGATIONS*	871	712	554	—	—	—	—
NEW LOAN APPROVALS	292	184	0	0	0	0	0

*This includes amounts for repurchases of defaulted SBA guaranteed loans.

Program Description

The Small Business Administration (SBA) provides subsidized loans to small business to construct, expand, or convert facilities; to purchase equipment or building materials; or to supply working capital. Except for a 3% interest rate on loans to businesses that employ or are owned by handicapped individuals, interest rates on direct loans were increased in 1981 to the Government's cost of borrowing money, which is currently about 15%. Since the interest rates have been increased, demand for such loans (which still have subsidized interest rates relative to market rates) has fallen off dramatically to an annualized rate of less than $150 million.

Pursuant to existing law, direct loan funds are allocated among the following program areas:

— general business assistance;

— aid to businesses that employ or are owned by handicapped individuals;

— aid to socially and economically disadvantaged business-owners; and

— aid for energy conservation or development.

Proposed Change

The Administration proposes to eliminate SBA direct loans beginning in 1983.

Rationale

- The proposed change is an integral component of the President's plan to apply sound criteria to economic subsidy programs.
- As a group, the nation's 14 million small businesses will benefit more from the Administration's efforts to stabilize financial markets, reduce interest rates, eliminate burdensome regulations, and lower inflation than from the fewer than 4,000 direct loans made by SBA annually.
- Subsidized direct loans are costly to the small business community:
  - — They result in increased Federal borrowing and thereby reduce available private credit.
  - — They create a competitive advantage for some small firms over others that are equally deserving.
- Elimination of subsidized direct loans would reduce the number of failures of marginal small businesses that are unable to compete in the marketplace without Federal subsidies.

Effects of the Proposed Change

- The elimination of direct loans will have a negligible effect on small business. At the end of 1981, SBA had 38,671 direct loans outstanding in its portfolio. This means that less than 0.3 percent of the 14 million small businesses identified by IRS receive direct financial assistance from SBA.
- Direct loans already approved will continue through their full term. No new loans will be made as of October 1, 1982.
- SBA will continue to provide guaranteed loans at a level of $2.7 billion in 1983 to small businesses that have difficulty obtaining private financing. SBA will also continue to assist:
  - — new and/or expanding minority businesses by purchasing non-voting preferred stock and debentures of Minority Enterprise Small Business Investment Companies (MESBIC's); and
  - — new and/or expanding non-minority small businesses through guarantees of Small Business Investment Company (SBIC) debentures.

SBA Guaranteed Credit Assistance

AGENCY: Small Business Administration FUNCTIONAL CODE: 376

Funding

	($ in millions)						
	1981	1982	1983	1984	1985	1986	1987
GUARANTEED LOAN COMMITMENTS	3.616	3.156	2.850	2.850	2.250	1.750	1.150

Program Description

The Small Business Administration (SBA) provides guaranteed credit assistance to small business through its:

— guaranteed business loan program, and

— 100% guarantee of pollution control equipment loans, which are financed from the proceeds of State pollution control bonds.

Proposed Change

The President proposes to reduce 1983 guaranteed credit assistance 10% below the Administration's proposed 1982 levels.

Rationale

- The proposed reduction in SBA guaranteed credit assistance is an integral component of the President's plan to control Federal credit.
- As a group, small businesses will benefit more from the Administration's efforts to stabilize financial markets, reduce interest rates, eliminate burdensome regulations, and lower inflation than from Federal credit assistance.
- Less than 1% of small businesses receive any type of financial assistance from SBA. This is particularly significant in view of the fact that Federal guarantee assistance has not been constrained heretofore.
- Since the vast majority of small businesses are obtaining financing without Federal assistance, aid should be limited to those businesses for which a valid case can be made that the market overestimates the risk of a project or underestimates its return in terms of achieving social objectives (e.g., counteracting discrimination or generating greater economic independence for minority communities).

Effects of the Proposed Change

- Reducing the level of guaranteed business loans will not have a significant adverse effect on small business. In 1981, SBA guaranteed 23,215 business loans and had a total of 100,604 guaranteed loans outstanding in its portfolio. This means that SBA provided guaranteed business loans to less than 1% of the 14 million small businesses identified by IRS.
- By better targetting assistance and assessing more realistic guarantee fees, SBA will be able to provide necessary assistance to those firms that suffer from market imperfections. Consistent with this philosophy, 17% or $410 million of SBA guaranteed business loans will be targetted to minority-owned firms.
- Guarantees for pollution control equipment contract repayments will be maintained in 1983 at the 1982 level of $150 million.