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Statement by

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Mr. Chairman and members of the Committee, I am pleased to be here today to comment on the Administration's proposals for improving control over Federal credit programs. I wish to emphasize that my opinions and analyses are my own. The Board of Governors has not taken a position on this issue. However, I have had a continuing interest on this subject for several years. In fact, I personally consider the lack of unified Congressional control over Federal credit allocation activities a major loophole in the Congressional budget process.

The provision of credit assistance through direct loans, guarantees, and other means is, of course, a legitimate activity of the Federal Government. It has traditionally been used to provide credit to groups that would otherwise encounter difficulties in obtaining accommodation and/or to enable borrowers to obtain credit at a lower cost than they would otherwise have to pay. During periods of credit stringency, for example, loan guarantees have been of major help to families purchasing homes. The credit related activities of the Government, moreover, have fostered many worthwhile developments in financial markets. The equal monthly installment payments of a home mortgage, for example, are a Federal innovation -- one so successful that private lenders have fully adopted it.

It should be recognized, however, that, while Federal credit programs can help promote social objectives that have wide public support, these benefits are not obtained without cost. The lower interest costs paid by groups receiving credit can in effect be viewed as a form of subsidy provided by the Government. Moreover, since the supply of credit is not unlimited, when certain groups obtain credit with Federal assistance, other groups find it more difficult to do so.

There is general agreement, I believe, that procedures currently being followed to evaluate, authorize, find, and account for the Federal Government's direct lending and credit assistance activities are seriously deficient. Because of these deficiencies, the Congress in its deliberations is able to make only an imperfect assessment of the relative value of individual credit programs and is unable to consider the impact of all such programs on the economy's allocation of resources. If "off-budget" credit assistance and preferential tax treatment were given the same attention as direct Federal expenditures, for example, the extent of Federal assistance to particular sectors would look much different than it does when direct loans are considered alone. The amount of total assistance to agriculture and housing is approximately double the volume of direct loans made to these sectors. Moreover, the citizens of our country are not being properly informed as to the extent of the Government's involvement in credit allocation.

The magnitude of Federal credit activities has become quite large in recent years, and rapid further growth is in prospect. Altogether, loans by fully-owned Federal agencies and guaranteed loans outstanding amounted to about $315 billion at the end of the last fiscal year; just 10 years ago the level was only $150 billion. In addition, loans held by agencies operating under Federal sponsorship totalled $127 billion at the close of last year, up $100 billion from the level 10 years earlier. These credit activities, moreover, are expected to continue to grow rapidly, with loans under all programs projected to increase around $50 billion in fiscal year 1979 and fiscal year 1980. Such activity is expected to account for about one-sixth of the total net funds raised in credit markets during these periods.

Only a small proportion of this credit activity is recorded as outlays in the unified budget. Loan guarantees, of course, do not involve an expenditure of funds and are thus not reflected in the unified budget, except in the cases where appropriations are required to cover defaulted loans. Credit extended by sponsored credit agencies is also not recorded in the budget since these agencies are privately owned. However, the liabilities issued by these agencies to finance their operations have an implicit (and in some cases explicit) Government guarantee. And, although the Administration is proposing to include these activities only in a credit information system and not the credit control system, the Congress should take cognizance of them in the overall evaluation of Federal credit assistance. Finally, only a comparatively small proportion of the direct lending by fully-owned agencies of the Government is shown in the budget, because many of their activities have been placed "off-budget" by the Congress.

I am personally concerned that "guaranteed credit" has been extended into new areas that are not necessarily appropriate. The original uses of guaranteed credit were in the areas of home and farm mortgages involving large numbers of relatively small loans secured by a physical asset. We now have proposals or programs to fund a large number of unsecured, small loans -- such as student loans -- and others to assist a small number of very large loans -- such as synfuel. The nature of guaranteed credit or proposals for such credit has changed markedly.

Another element which clouds the picture of Federal credit activities is the operation of the Federal Financing Bank. The FFB uses funds borrowed directly from the Treasury to support the lending activities of Federal agencies and to acquire certain types of guaranteed loans. In carrying out this function, the FFB has successfully performed the function it was established to do, since it has eliminated the congestion which often occurred when the agencies attempted to finance their operations directly in the credit markets. In the process, however, it has reduced the accountability of Federal credit programs, because lending activities are attributed to the FFB rather than to the agency originating the transaction.

These problems of accountability are matched by imperfections in the Congressional review process. All credit programs, of course, have been authorized by law and are subject to oversight by the Congress. In the case of some loans made by "on budget" agencies, this oversight is conducted annually. But for most programs, there is no annual review, and authorizations to engage in activities may be given for several years. Also, limits that are set in most cases are stated in terms of net credit extended (or loans guaranteed) rather than in terms of the gross volume of such lending activity.

The proposals developed by the Administration to improve the way Federal credit programs are controlled in the budget process are generally sound in my view. In particular, I strongly support the proposal for the establishment of a Federal credit control system which would include all credit activities by agencies fully owned by the Federal Government. This system would be presented by the Administration and considered by the Congress in concurrence with the regular budget process, and thus all programs would be subject to annual review and control. I also agree that this process should set an aggregate ceiling on all credit programs and binding limitations on each direct loan and loan guarantee program. These deliberations should consider how each program will affect the ceiling for all credit programs and how it will integrate with other credit and non-credit programs designed to accomplish specific budget functions.

Moreover, the process of evaluation should be made within the framework of the overall demand for credit. Flow-of-funds statistics are now available, and projections of "flow of funds" are legion -- not as pervasive as GNP projections -- but plentiful. This will serve to emphasize that the nation's credit supply has limits and will indicate the extent to which it is used by the Government, directly and indirectly.

I also agree that a program's gross lending (or extension of guarantees) should be a major concern, as well as the net increase or decrease in total commitment in each functional area. And the proposal that sales of loans or certificates of beneficial ownership in pools of loans should be recorded as a form of borrowing rather than as a negative outlay is also well advised.

I find myself in general agreement with most of the Administration's other proposals. In particular, the Administration has indicated that, as part of its control system, it is considering a requirement that would call for FFB outlays and budget authority to be attributed to the agency and function where loans are originated. This seems a sensible approach to me.

I recognize that if such an approach were adopted, agencies may be tempted to obtain funds directly in the credit markets. If this were to occur, the benefits being provided by the FFB in reducing agency demands in credit markets would be lost. Thus, it may be necessary to develop guidelines to discourage agencies from guaranteeing obligations to be sold directly to the public, if these obligations are of the same nature as those presently being acquired by the FFB. The inclusion of all loan guarantee programs in the credit control system and the imposition of limitations on these programs, of course, will reduce incentives to channel loan guarantees away from the FFB. Safeguards will also have to be established to constrain agencies from turning to other arrangements -- such as long-term leasing agreements and price support agreements -- which can be used to achieve the same purpose as loan guarantees. The budget control system, being prepared by the Administration, does not have provisions for the establishment of such constraints, and it will thus be necessary to develop procedures to achieve this objective.

One of the Administration's proposals in the scorekeeping area should not be adopted in my view. Rather than continuing to include direct lending of Federal agencies in the budget, I believe it would be advisable instead to take these loans out of the unified budget and to record them only in the credit control budget. Direct loans are not the same as other Government outlays, since financial assets are acquired in conjunction with the dispersal of funds. In addition, direct loans appear to have essentially the same implications for economic stabilization, resource allocation, and income distribution as do loan guarantees. In recommending the removal of direct loans from the unified budget, I am, of course, assuming that coincidentally the Federal credit budget will be put into place, so that there would be no loss in scrutiny and control over these various programs by Congress and the Administration. Certainly, the direct lending programs should not be removed from the budget until these alternative budgetary arrangements are working.

While a broad range of questions pertaining to the budgetary treatment of Federal credit activities are covered by the Administration's proposals, I believe there remain important issues that require further study. I wish to emphasize the great need to develop guidelines for determining the trade-offs 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 guarantees. Because guaranteed loans are specifically exempt from the budget control act, there has been a proliferation of questionable "loan guarantee" proposals and programs.

In addition to these broad issues, there is a need to study the appropriate budget treatment of non-recourse loans, such as those made by the Commodity Credit Corporation to farmers. Since these loans need not be repaid and in many cases are not repaid, there is the ongoing question as to whether these transactions should be treated as outlays or as loans at the time when funds are dispersed. Similar questions as to appropriate budgetary treatment can also be raised in connection with other direct non-recourse loan programs, especially foreign loans. For example, it is far from clear how to account for funds dispersed as loans under programs of International Development Assistance and International Security Assistance. The ultimate collectibility of such loans depends on international developments, which are, of course, highly uncertain.

Given the importance of these unanswered questions, I believe it would be advisable to appoint a new budget commission to study these questions and other related issues. Such a commission study would not, in my view, create any need to delay the implementation of the Administration's proposals. Rather, it would be advisable to push ahead and set up the new control system, and then make amendments to this system should the commission study indicate that procedures need to be augmented or changed.

It is to be hoped that establishment of an effective framework for appraisal, control, and scorekeeping of Federal credit programs will lead to proper evaluation of new programs and activities to prevent such activities from falling outside the annual budget process. Past experience, however, suggests that the mind of man is highly inventive in this regard. Whatever restrictions are put on fiscal activities, or credit allocation, ways will be found to circumvent them. Thus, I would further recommend that the Congress carefully consider the advisability of establishing formal rules to require the reconvening, at regular intervals, of a budgetary commission to review conceptual and measurement problems that may have developed with respect to the unified budget and the credit budget.

Allocation of credit either directly through Government loans or indirectly by Federal guarantees (regardless of whatever inventive name is applied) falls between the traditional concepts of "fiscal" and "monetary" policy. It is a gray area between the two. The decision, I believe, is basically a fiscal one, but, if the amount of priority credit assigned is too large a part of the total available supply of funds, there inevitably will be impacts on general interest rates and the conduct of monetary policy. Clearly the allocation of credit on better than market terms is a Federal activity that creates a preferred status for certain groups in the credit market. Government has a responsibility to make sure that this activity is serving the public interest.

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