CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

February 12, 2014

H.R. 1872
Budget and Accounting Transparency Act of 2014

As ordered reported by the House Committee on the Budget on February 11, 2014

SUMMARY

H.R. 1872 would modify the budgetary treatment of federal credit programs. Specifically, the bill would amend the Federal Credit Reform Act of 1990 (FCRA) to require that, beginning in fiscal year 2017, the cost of direct loans or loan guarantees be recognized in the federal budget on a fair-value basis using guidelines set forth by the Financial Accounting Standards Board. A fair-value approach to accounting for the cost of federal loans and loan guarantees would produce estimates of costs that either correspond to or approximate the value of those loans or guarantees to buyers in the private market.

The bill also would require that the Government Accountability Office (GAO) produce annual reports on the progress that federal agencies make in its implementation; the federal budget reflect the net impact of programs administered by Fannie Mae and Freddie Mac; federal agencies post budget justifications on public websites on the same day they are submitted to the Congress; and the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) prepare studies on the costs of federal insurance programs and the historical application of the budgetary terms revenue, offsetting collections, and offsetting receipts.

The proposed changes to the budgetary treatment of federal credit programs would increase the estimated costs of such programs compared to measures used under current law. (This legislation would not change the terms of such credit programs, but would change what is recorded in the budget as the cost of credit assistance.) CBO estimates that if fair-value procedures were used to estimate the cost of new credit activity in 2014, the total deficit for the year would be about $50 billion greater than the deficit as measured under current estimating procedures. Because that increased cost would stem from a change in concepts and definitions used to prepare federal budget documents rather than a change in agencies' legal authority to operate credit programs, it would not be an additional cost attributed to H.R. 1872 for Congressional budget enforcement procedures.

CBO estimates that measuring the cost of federal credit programs on a fair-value basis as prescribed under H.R. 1872 would increase agencies' administrative costs to operate such programs. In addition, the requirements to post budget justifications on the Internet and produce studies would require additional resources. Assuming appropriation of the necessary amounts, CBO estimates such costs would total $16 million over the 2014-2019 period. Pay-as-you-go procedures do not apply to this legislation because no additional direct spending would be attributable to H.R. 1872 since it would not change credit programs. The legislation would not affect revenues.

H.R. 1872 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 1872 is shown in the following table. The costs of this legislation fall within all budget functions that include administrative costs associated with federal credit programs.

	By Fiscal Year, in Millions of Dollars						
	2014	2015	2016	2017	2018	2019	2014-2019
CHANGES IN SPENDING SUBJECT TO APPROPRIATION							
Estimated Authorization Level	*	5	5	2	2	2	16
Estimated Outlays	*	5	5	2	2	2	16

Note: * = less than $500,000.

BASIS OF ESTIMATE

Agencies would face various administrative challenges to develop and execute new requirements that would be imposed by a change in budgetary treatment for credit programs. CBO estimates that the procedures prescribed by the bill would require federal agencies that administer credit programs to update their accounting and budget preparation systems, procure advisory services, and hire additional staff with expertise in financial asset valuation. In addition, the bill's requirement that all agencies post uniform, searchable, and sortable budget justifications and that OMB, CBO, and GAO produce reports would increase administrative costs. Based on information about the cost of carrying out similar activities and information from some federal agencies that operate major credit programs, CBO estimates that implementing H.R. 1872 would cost $16 million over the next five years, assuming appropriation of the necessary amounts.

COMPARISON OF ALTERNATIVE BUDGETARY TREATMENTS OF CREDIT PROGRAMS

The federal government provides credit assistance in the form of direct loans and guaranteed loans. Most of that assistance is offered through a few large programs; together, the Federal Housing Administration's (FHA's) mortgage guarantee programs and the Department of Education's student loan programs account for about 65 percent of outstanding federally backed credit.[1] Other major credit programs include the Department of Veterans Affairs' mortgage guarantee programs, the Department of Agriculture's credit programs for rural utilities, and the Small Business Administration's loan and loan guarantee programs. About 100 smaller credit programs currently provide assistance for a variety of other activities including international trade and investments in new energy technologies.

H.R. 1872 would amend FCRA to modify procedures for calculating the budgetary cost of federally backed credit programs. As discussed below, such changes would increase the estimated cost of such programs for budget purposes, thereby increasing the estimates of future deficits.

FCRA Procedures

FCRA specifies that the budgetary cost of federally backed credit programs are calculated and recorded on an accrual basis—unlike most items in the federal budget, which are shown on a cash basis. The main distinction between cash and accrual accounting is that, whereas under cash accounting expenditures are recorded in the years when cash payments are made, on an accrual basis the estimated lifetime cost of a direct loan or loan guarantee is recognized in the year when the loan is approved.

Under FCRA, the budgetary impact—or subsidy cost—of a direct loan or loan guarantee is calculated as the net present value of expected cash flows over the life of the loan. For a direct loan, net cash flows include payments of principal, interest, and any fees paid by the

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[1] The term federally backed credit is used to encompass all federal loan and loan guarantee programs. For this cost estimate, these programs do not include the credit assistance provided by Fannie Mae or Freddie Mac, or the Troubled Asset Relief Program.

borrower less any amounts lost due to borrower default. For a loan guarantee, fees collected from the borrower and guarantor, and payments made to make the guarantor whole if the borrower defaults would be included in the cash flows. The net present value is estimated by discounting the expected cash flows to the time of loan disbursement. FCRA specifies that discounting calculations use the interest rates on Treasury securities with maturities comparable to the terms of loans. For example, cash flows projected in the year following disbursement are discounted using the rate for one-year Treasury securities; those five years out are discounted using a five-year rate; and so on.

Cost of Credit Programs Under FCRA

Over the 2000-2007 period, the face value of loans made or guaranteed by the federal government (known as the aggregate volume of credit activity) averaged $300 billion and estimated subsidy costs under FCRA averaged $6.4 billion annually—for a net, average subsidy rate of 2 percent of aggregate loan volume. In contrast, the aggregate subsidy rate for programs covered by FCRA was negative in each fiscal year over the 2008-2013 period; that is, the government's lending activities generated an accounting profit which reduced measures of budget deficits in those years. That swing from positive to negative FCRA subsidies stemmed primarily from legislative and programmatic changes to student loans and FHA mortgage insurance. For 2013, CBO estimates that programs covered by FCRA reduced the deficit by $45 billion.

Fair-Value Procedures

H.R. 1872 would require that subsidy estimates for federal credit programs be calculated on a fair-value basis. The Financial Accounting Standards Board defines the fair value of a loan as the price that would be received if it were sold in a competitive market. Similarly, the fair value of a loan guarantee is the price that would have to be paid to induce a market participant to assume the guarantee commitment.

In practice, differences between FCRA estimates and fair-value estimates stem from differences in the effective discount rates used to calculate the present value of future cash flows. While FCRA requires that subsidy calculations use Treasury rates to discount future cash flows, fair-value estimates employ rates that also incorporate a premium for market risk. Private investors require additional compensation for market risk because investments exposed to such risk are more likely to have low returns when the economy as a whole is weak and resources are scarce and highly valued. By incorporating a market-based risk premium, fair-value estimates would recognize that the government's assumption of financial risk involves costs that exceed the average amount of losses that would be expected from defaults.

Cost of Credit Programs Under H.R. 1872

A consequence of switching to fair-value accounting is that the estimated budgetary cost of credit programs would appear higher than under FCRA. CBO has provided detailed supplementary information to the Congress about the fair-value cost of certain federal credit and insurance programs and how they compare to FCRA estimates, including an analysis of the cost of all federal credit programs in 2013.[2]

CBO estimates that if fair-value procedures were used to estimate the cost of credit programs in 2014, the total deficit would be about $50 billion greater than the deficit as measured using current estimating procedures. That increase would be split between the mandatory and discretionary portions of the budget:

- On a FCRA basis, CBO estimates net subsidies for mandatory credit programs would reduce the federal deficit by about $20 billion in 2014. On a fair-value basis, the cost of those same programs would be roughly $30 billion greater. Starting in 2015, the budget would record increased budget authority and outlays for those programs; however, because those programs are mandatory, fully funding them on a fair-value basis under H.R. 1872 would require no further Congressional action.[3] The estimated net cost of legislative proposals for establishing new mandatory credit programs or changes to existing programs (such as student loans) would generally be larger using fair-value procedures than they would be on a FCRA basis.

- Net receipts from discretionary credit programs reduced the estimated cost of appropriations in 2014 by about $10 billion on a FCRA basis. On a fair-value basis, CBO estimates that those same programs would have required additional appropriations of about $20 billion. To account for the higher subsidy costs that would be incurred by future appropriations when measured on a fair-value basis, H.R. 1872 would allow the caps on discretionary appropriations set forth in the Budget Control Act of 2011 to be adjusted upward.

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[2] *Fair-Value Estimates of the Cost of Federal Credit Programs in 2013* (June 2012), www.cbo.gov/sites/default/files/cbofiles/attachments/06-28-FairValue.pdf

Costs and Policy Options for Federal Student Loan Programs (March 2010), www.cbo.gov/ftpdocs/110xx/doc11043/03-25-StudentLoans.pdf

Accounting for FHA's Single-Family Mortgage Insurance Program on a Fair-value Basis (May 18, 2011), www.cbo.gov/ftpdocs/120xx/doc12054/05-18-FHA_Letter.pdf

Federal Loan Guarantees for the Construction of Nuclear Power Plants (August 2011), www.cbo.gov/ftpdocs/122xx/doc12238/08-03-NuclearLoans.pdf

[3] Mandatory spending refers to budget authority that is provided in laws other than appropriation acts and the outlays that result from such budget authority.

The Administration currently records transactions related to the Treasury's conservatorship of Fannie Mae and Freddie Mac on a cash basis in the federal budget. In contrast, CBO projects the budgetary impact of the two entities' operations in future years as if they were being conducted by a federal agency because of the degree of management and financial control that the government exercises over them. Therefore, CBO estimates the net lifetime costs—that is, the subsidy costs adjusted for market risk—of guarantees that will be issued by as well as loans that will be held by the entities and counts those costs as federal outlays in the year of issuance. CBO estimates that the net impact of the activities of those entities will cost an average of about $2 billion per year on a fair-value basis over the next 10 years.

PAY-AS-YOU-GO CONSIDERATIONS: None.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 1872 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

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