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June 17, 2015

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Before the Joint Economic Committee

Economic Exposure of Federal Credit Programs

Mr. Chairman, Vice Chairman Brady, Ranking Member Maloney, and members of the committee, I appreciate the invitation to appear before you today. My testimony will explain why so-called "fair-value accounting" would distort the budget by making federal credit programs appear more expensive than they really are.

The current method of accounting for federal credit programs fully records — on a present-value basis — all the cash flowing into and out of the Treasury.[1] That includes the risk of default — the likelihood that some direct loans will not be paid back in full or that a borrower will default on a loan that the federal government has guaranteed.

In contrast, fair-value accounting would add an *extra amount* to the budgetary cost, based on the fact that loan assets are less valuable to the private sector than to the government for several reasons: businesses must make a profit; they can't put themselves at the head of the line when collecting a debt; they borrow at higher interest rates; and private-sector investors are risk-averse — they dislike losses (in this case, higher-than-expected loan defaults) more than they like equal, and equally likely, gains (lower defaults). None of these factors represents an actual cost that the government incurs when it makes loans.

Fair-value accounting is misguided for four reasons.

First, the budget should reflect only the federal government's actual income and outgo — that is, funds that the Treasury actually receives or disburses. Including in the budget a *phantom cost* that the government *does not actually pay* would overstate spending, deficits, and debt, making the federal budget a less accurate depiction of the nation's fiscal position.

[1] Paul N. Van de Water and Joan Huffer, *House "Budget Transparency" Bill Would Make Budget More Opaque,* Center on Budget and Policy Priorities, June 18, 2013, http://www.cbpp.org/sites/default/files/atoms/files/6-18-13bud.pdf.

Second, fair-value accounting would treat different federal programs inconsistently, because it would not impose a risk-aversion penalty on non-credit programs, many of which have costs that are at least as uncertain and variable as those of credit programs.[2] Regardless of one's position on whether a particular credit program is worthwhile, the budget should put lending and other programs on a level playing field. Fair-value accounting would tilt the playing field against credit programs, thereby distorting the process of setting priorities.

Third, even if one thought that the federal government should be risk-averse on behalf of its citizens, as advocates contend, fair-value accounting presents an incomplete and misleading picture of federal credit programs. Federal loan programs do not increase financial risk for U.S. citizens overall. If the cost of a loan program turns out to be higher than originally estimated, taxpayers will eventually have to cover the higher costs — but students, farmers, homeowners, or other borrowers will have received more help. Fair-value accounting considers only the first half of this equation.

Fourth, cost estimates by themselves are not designed to assess whether a federal program is worthwhile — and should not be expected to do so. Deciding whether a federal program or project is worth undertaking entails evaluating many factors in addition to its cost to the government. Replacing a worn out and heavily travelled bridge might have substantial benefits, for example, while building one from nowhere to nowhere would be a waste of money. A bill's cost estimate will never reflect all of these factors, and trying to make it do so would be both vain and foolish.

My conclusion is the same as that of former Congressional Budget Office Director Robert Reischauer, who says that fair-value accounting "represents a misguided attempt to mold budget accounting to facilitate a cost-benefit analysis, with the result that neither the budget not the cost-benefit analysis would serve their intended purpose well."[3]

[2] David Kamin, "Risky Returns: Accounting for Risk in the Federal Budget," *Indiana Law Journal*, Spring 2013, pp. 723-72, http://ilj.law.indiana.edu/articles/14-Kamin.pdf.

[3] Robert D. Reischauer, Letter to Representative Chris Van Hollen, January 23, 2012; see Van de Water and Huffer.