CHAPTER 1

The Federal Government as Banker

The federal government is the biggest and most influential financial institution in the world, a fact often hidden by the widespread public conception that the American government largely stays out of business activities. The government's recent frenetic interventions in the financial system, such as the rescue of the banking system or the Federal Reserve's massive direct support for the financial markets, are therefore generally seen as aberrations. Yet even the narrowest measure of the government's traditional role in lending shows that it directly or indirectly provides credit in an amount significantly larger than the loans on the books of any of the country's largest private sector banks. In fact, as shown in table 1-1, the government's outstanding commitments in its traditional programs supporting loans and guarantees for housing, farming, education, and business totaled approximately $2.3 trillion in 2010, roughly one-third the size of the loans on the books of all the banks in the United States combined.

Moreover, the federal government's credit activities were recently expanded far beyond this core of traditional programs. Temporary government-controlled programs provided almost another $6 trillion of credit, primarily through Fannie Mae and Freddie Mac (the massive government-sponsored enterprises that guarantee mortgage lending), the extraordinary credit activities of the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Troubled Asset Relief Program (TARP), established to address the 2008–09 financial crisis. This list does

Table 1-1. *Federal Loans Outstanding, 2010*
Billions of dollars

Loan category	*2010*	*Percentage of 2010 loans*
Traditional programs		
Housing	1,275	54.8
Education	744	32.0
Farm	170	7.3
Business	139	6.0
All traditional programs	**2,328**	**28.3**
Other programs	**68**	**0.8**
Emergency programs	**5,836**	**70.9**
Total	**8,232**	**100**

Sources: OMB (FY 2012); Fannie Mae (2010); Freddie Mac (2010); FDIC (2010).

not even include the Federal Home Loan Banks that hold nearly a trillion dollars of assets. These banks have close government ties and benefit significantly from a perception by most investors that the federal government would rescue these entities if they deteriorated further, as it did Fannie Mae and Freddie Mac.[1] Unfortunately, most of this exceptional credit provision is likely to remain under federal control for some time. In particular, the federal government is likely to be closely involved for many years in winding down Fannie Mae and Freddie Mac's $5.5 trillion in mortgage-related assets and guarantees, even if a smaller government role in supporting new mortgage origination eventually emerges. The sale or transfer of these obligations to private investors in the near term is infeasible, as it would swamp the market, potentially causing a sharp increase in mortgage rates.

The Importance of Federal Credit Programs

Americans have a major stake in the federal credit programs, because the programs affect so many citizens in so many ways. Millions of Americans

1. Federal Home Loan Banks also benefit from the agreement that they are jointly and severally liable for the debts of each bank, allowing each to borrow with the full strength of the entire system. In addition to aiding the weakest of these banks the agreement also contributes to the perception of an implicit government

rely on government credit to buy a house, run a farm or small business, or attend college or for some other purpose. Millions more work for, or own stock in, a company that benefits from government lending, such as for energy projects, exports and imports, investment overseas, or support of a small business. Others work in the housing industry or another field where government loans are critical to sales. There are yet others who work for a bank that accepted money or other federal support during the recent financial crisis.

Still more Americans work for, or own stock in, businesses that compete with or cooperate with government lending programs, such as banks and other financial institutions. The profitability and growth potential of these firms is often heavily affected by the government's actions. Some government partners—such as Fannie Mae and Freddie Mac—were extremely profitable for years because of their close government connections. Other firms have benefited from contracts to work with the government. Sometimes, however, the government displaces business that would otherwise go to the private sector, such as when it lends directly, eliminating the role of banks.

Americans as taxpayers also bear the considerable cost and risk of the government's lending programs: they are currently committed to more than $8 trillion in loans and guarantees. Most of this will be repaid with interest, but not all, so it is critical that the credit programs be run well. The loss of even 10 percent of the total commitment would represent an almost $1 trillion hit to taxpayers. According to the fiscal year 2012 budget proposal, the government budgeted a subsidy of $75 billion for its credit programs between 2009 and 2012. But this figure does not take into account the likely loss over time stemming from programs run by Fannie Mae and Freddie Mac—a loss that some analysts have projected to be as high as $400 billion, once the dust settles on the housing crisis.

Credit availability is also a major driver of economic activity, affecting everyone in the nation. The recent recession and the current sluggish recovery were caused in great part by a substantial contraction in credit, which has not completely reversed. To counteract the decline in private sector loans, the government has given trillions of dollars more in credit than it supplied even four years earlier. The government's credit support

guarantee, since the system as a whole appears too big to fail. In combination these factors make it less likely that any single Federal Home Loan Bank will fail but more likely that a government rescue of the whole system will be required.

also shifts the composition of lending significantly toward favored areas such as housing. This can be good, if it promotes valid public purposes, but it can also be bad. For example, most analysts believe that the government went overboard in recent years in promoting homeownership and that this was one significant factor in the housing bubble that helped create our recent severe financial crisis. At a still more detailed level, the way in which the government lends can have substantial effects on the particular sectors it supports. Looser or tougher government requirements can encourage or discourage certain types of activities that are reliant on borrowing.

Policy and Political Reasons for Federal Credit Activity

Why do we have such large lending programs when a strong national consensus maintains that the government should not conduct business activities? There are both policy and political reasons why federal credit programs can make sense; these are listed below and expanded on in chapter 2.

Proponents of credit programs virtually always justify their existence on the basis of one or more market failures, such as the private sector's failure to act efficiently, to the detriment of society, or to take into account ways in which certain loans might provide larger societal benefits. For example, the ways in which financial institutions are organized or operate can make it difficult to offer certain types of loans that would in fact be worthwhile. Private financial institutions are not well suited to make long-term, uncollateralized loans to individuals, for instance, which is one strong justification for the federal student lending program. The private sector is also prone to booms and busts; the resulting collapse of credit availability can exact a severe economic cost for the nation as a whole. Many of the major federal credit programs began as a response to the collapse of private financial institutions and markets in the Great Depression. Similarly, the most recent financial crisis brought a flurry of additional programs to substitute for failing markets. Finally, financial institutions and markets are run by humans who can fall prey to prejudices that lead them to avoid certain economically sound transactions.

In other circumstances, private lenders may be acting sensibly and efficiently in their own narrow interest, but fail to make loans that would be good for society as a whole. For example, student loan programs benefit the economy by encouraging a highly educated workforce. Since many of these societal benefits could not be captured directly by the lenders, there is a need for the government to lend directly or to encourage lending through guarantees or other incentives.

In addition, lending in new areas or through innovative products can be hindered by lack of sufficient information to adequately evaluate the risks a lender is taking on. A federal program, such as the Federal Housing Administration in the Great Depression, can be used to demonstrate the feasibility of a new approach, and its experience can provide data for the private sector to use to repeat the success.

There are also counterarguments weighing against the establishment of federal credit programs. Sometimes the market failure could be cured more efficiently through regulation, information gathering by the government, or outright grants to encourage certain activities or redistribute wealth. Even if an alternative solution is not feasible or desirable, the costs and problems associated with federal credit programs may outweigh the benefits.

For example, political and bureaucratic barriers exist to making sound credit decisions in these programs. In particular, it is difficult for government programs to deny credit or charge more for it based on differences in the level of risk between different applicants. This adds to taxpayer costs and decreases the efficiency with which financial resources are allocated in the economy. It can also be quite hard to eliminate a federal program if the situation changes and it is no longer needed.

There are also more subtle costs to federal credit support. Federal credit programs tend to increase the total amount of credit offered to the private sector, but they also redistribute credit toward favored sectors and away from the rest. Worthy projects in non-favored sectors can find funding more difficult and expensive. In addition, encouraging an activity such as attending college tends to increase the price for that activity, as a simple function of supply and demand. One of the reasons for the persistent inflation of college costs is the ready availability of federally supported credit to pay the higher tuition bills.

Whatever the policy arguments, politics usually favors the creation of new federal credit programs as the solution when there is a perceived problem in the economy or markets. Credit programs can appear to provide much more impact for each dollar of budget cost than other government responses. Politicians can announce a \$10 billion loan program for the same economic cost as, perhaps, a $1 billion grant program. Even better, from their point of view, they can use optimistic assumptions to assert that there would actually be little or no cost, which is difficult to do with a grant program or a tax break. The biggest political obstacle tends to be the resistance of existing lenders, but this opposition can often be co-opted by running the program as a guarantee program supporting private lending rather than a direct government lending program. This still leaves room for opposition by groups that believe government should not get involved, but they might well object to any program to direct resources to the favored sector and therefore may not exert additional political pressure to avoid lending as the tool of choice.

Tools Available for Providing Credit

The government has essentially four ways of aiding credit markets. It can directly lend money, guarantee loans made by the private sector, create or assist a market in purchasing loans that have already been made, or work through a partnership between the public and private sectors, such as a government-sponsored enterprise like Fannie Mae.

Direct lending can be the cheapest and most straightforward approach, and one that takes advantage of the government's low borrowing costs. However, government bureaucracies are not well designed to make complex credit decisions or to step in when a borrower becomes troubled, and they are subject to political pressures to underprice their loans and to favor borrowers in other ways. Programs that insure or guarantee repayment of private loans can partially avoid the problems of public sector lending by enlisting the profit motive of private lenders. A full or partial government guarantee of the repayment of principal and interest can be a strong incentive to lenders to make loans to a particular sector. (There may also be an interest rate subsidy offered to the lenders to encourage lower rates for borrowers.) If the program is structured to retain incentives for lenders to favor good borrowers, such as by offering only a partial guarantee, then the government can theoretically benefit from the private sector's ability to allocate credit to the best borrowers. On the other hand, private lenders may end up with too little at stake to apply their normal credit judgments. They will also have incentives to maximize the explicit and implicit subsidies they receive from the government, including the ability to lobby for changes that increase their profits.

Decades ago, the government played an important role in creating or expanding secondary markets, where lenders could gain liquidity by selling their loans. The ability to sell loans as needed made it easier and less risky to offer loans in the first place. This tool of government intervention has become less necessary as the private sector has improved its ability to create these markets on its own, leaving few opportunities for the government to do it better. Nonetheless, the government remains a major guarantor of secondary market activity, partly for historical reasons.

The government can also charter private corporations, which receive special privileges in exchange for taking on duties to the public. Most notably, Fannie Mae and Freddie Mac are government-sponsored entities focused on the housing sector. However, the recent massive financial disasters at those two entities make it unlikely that new partnerships will be entered into for some time.

History of Federal Credit Programs

The major government credit programs were, in general, born out of crisis, particularly as a response to the Great Depression. (Chapter 3 elaborates on this point.) There was relatively little federal credit activity from the founding of the republic until the creation of the Federal Reserve System in 1913. (Although one does not generally think of the Fed as a credit program, its original role, and still an important one, was to stand ready to make collateralized loans to banks that were experiencing runs by their depositors. Lately, of course, that credit role has temporarily expanded to include a much wider range of activity.) The Fed's birth was a delayed response to the Panic of 1907, which underlined the need for a true central bank in America.

Farm credit was the next area of federal intervention, with legislation in 1916 that authorized the establishment of cooperatively owned federal land banks, aided by federal seed money of $125 million, a significant sum at the time. This cooperative system was bolstered in 1923 by further federal legislation establishing another level of credit providers, the intermediate credit banks. In 1929 the federal government crossed the Rubicon by authorizing its first pure credit program, the Federal Farm Bank, which was allowed to lend up to a total of $500 million to support farmers.

The Great Depression, which started in 1929, was a watershed event for federal credit programs. It caused many financial markets to function so badly, and so obviously badly, that there was a clear reason for massive federal intervention. This led to the initiation of a number of major credit programs for housing, the expansion of the farm programs, and the creation of substantial new business lending initiatives. Thus three of the four biggest areas of federal credit activity were sparked by the Great Depression or substantially augmented in response to the problems of that period. Equally important, the Depression sounded the death knell for longstanding views that the federal government should essentially stay away from business, regulating as little as possible and avoiding any direct business activity, except in rare cases. After the Depression and the ensuing world war, the public and politicians were much more willing to consider federal intervention in business matters, including direct participation as a credit provider.

That said, the passing of the economic and military crises did lead to some retrenchment of federal credit activities in the 1950s as the private sector reasserted its desire and ability to provide the necessary financing for the country. During this period the Reconstruction Finance Corporation, which had provided credit widely to businesses, was cut back to leave just the Small Business Administration and the Export-Import Bank. Both of these were deemed to meet special needs that the private sector was not in a position to fill completely.

The final big area of federal credit, lending money to students wanting to attend college, began in the late 1950s in response to a new nationwide focus on scientific education. This was triggered by Soviet technical advances, epitomized by the launch of their Sputnik satellite. The college loan program widened in scope in the 1960s as an adjunct to Great Society programs to eradicate poverty, finally becoming, by the 1970s, the broad-based program that it is today.

The recent financial crisis led to another burst of massive federal credit intervention, expanding most of the traditional credit programs and creating major new ones at the Treasury Department, the Fed, and the FDIC. The emergency programs are intended to fade away, but it will be some time before it is clear whether they do vanish fully and what their legacy will be for future credit activity by the federal government.

What Is a Credit Program?

The federal government assumes many kinds of financial risks from the private sector, such as the risk of flood damage or of loss of pensions owing to corporate bankruptcies, in addition to accepting the risk that those who borrow from the government will not repay their debts. It also sets many of the rules that determine how risks are allocated between private sector entities and sometimes between them and the government.[2]

This book focuses solely on the subset of federal risk taking that primarily involves credit risk in lending to the private sector—the risk that a loan will not be repaid on the originally agreed terms. Thus direct federal lending to the private sector is included, as well as government guarantees of lending by private sector financial institutions, including guarantees of securitizations of loans. Taking a wider view of federal risk taking would have some benefits but would considerably expand the size of this book and forfeit the advantages of a tighter focus.

In accepting credit risk, these federal programs often also take on certain other types of risk, such as interest rate risk and liquidity risk. These risks are largely ignored in this book because they principally arise from potential mismatches between the way the government funds its operations and the attributes of the loans and guarantees that it makes. However, the Treasury Department makes its funding decisions on bases that are largely unrelated to the exposures of credit programs, making it difficult to usefully consider interest rate risk. Similarly, the federal government's virtually unlimited ability to borrow from the markets at need renders it unlikely that a federal credit program would need to sell any assets before maturity, largely eliminating the relevance of liquidity risk.

The author has had to make some judgment calls as to when to consider an activity a credit program. In particular, the federal government sponsors two corporations that guarantee particular types of financial institutions but do so in a manner that excludes them from the analyses presented here. One is the Pension Benefit Guaranty Corporation, which provides employees and retirees of private sector companies with protection against the loss of benefits from a defined-benefit pension plan in the event that the sponsoring company becomes insolvent at the same time as the pension trust has insufficient funds to pay all of the promised pensions. The other is the Federal Deposit Insurance Corporation, which guarantees most deposits at banks and thrift institutions.

In both cases, the government's credit risk is a contingent one that is largely implicit, since both organizations are structured as essentially

2. Please see Moss (2002) for a discussion of the full extent of the government's risk management role.

mutual insurers whose payments are intended to be funded through ex ante and ex post insurance premiums. The federal government's only explicit promise to the Pension Benefit Guaranty Corporation is to lend up to $100 million, if needed. The FDIC has the ability to borrow considerably larger sums from Treasury but is still expected to meet its claims from premiums and assessments on the banking industry and faces potential losses far in excess of the authorized Treasury line of credit.

Including these implicit, contingent commitments in the numbers presented in this book would risk substantially distorting the overall figures, given the sheer size of the banking industry and of private pension funds. Many of the tables in this book present exposures in terms of the amount that could be lost if everything went wrong, since risk-based figures that would reflect the differing likelihoods of loss at the different programs are often not available in a useful form or at least have to be supplemented by looking at total exposures. The use of total exposures, rather than risk-adjusted ones, makes the figures presented here particularly sensitive to large but relatively low-risk programs.

The author prefers to risk understatement rather than raise the suspicion that the case is being made overly strongly. If the FDIC and the Pension Benefit Guaranty Corporation were to be included, the arguments about the importance of the federal credit programs would take on even greater force. The FDIC is included, however, in one capacity. In addition to its normal activities, the FDIC took on a number of emergency missions in the recent financial crisis, which clearly do fall into the realm of credit programs and are therefore included in discussions of the emergency federal credit programs.

For its part, the Federal Housing Administration (FHA) is included as a federal credit program even though its largest component is technically structured as a mutual insurance program. One reason for its inclusion is that the risk is explicit, straightforward credit risk on housing loans. In addition, there is little ability to make up losses from existing mortgage participants, substantially increasing the likelihood that taxpayer funds would be used if the FHA's mutual insurance fund were to become insolvent.

The government's capital injections into the banks as part of the Troubled Asset Relief Program (TARP) are also included as federal credit programs, even though the injections were technically in the form of equity rather than debt. The author, along with the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO), views the preferred stock as economically a form of debt, even if this is not true as a purely legal matter.

In addition to larger, longer-term credit programs, the federal government has also provided ad hoc credit support on a few occasions in the past when a major employer or set of employers ran into financial problems. These individual interventions have been relatively rare. Lockheed received loan guarantees in 1971, the first Chrysler rescue was in 1979, and several airlines were aided after the terrorist attacks in 2001 hit them extremely hard. On the other hand, many companies, including major employers, have been allowed to slip into bankruptcy in the United States without receiving credit support from the government. It appears to take an unusual mix of political and economic circumstances to create the conditions for such support for an individual company. This book does not address these one-off interventions because of their rarity, their relatively small size, and the special circumstances that surrounded each one.

Finally, the Fed, and to a lesser extent the U.S. Treasury, also purchased debt from Fannie Mae and Freddie Mac as well as large amounts of securities backed by guarantees from those two firms. These transactions total well over $1 trillion but are not discussed further in this book because the two firms are essentially owned by Treasury at this point, and therefore the Fed is taking no real credit risk from these transactions, and because Treasury's own credit risk related to Fannie Mae and Freddie Mac is already included in our figures. There are, of course, other market risks, such as interest rate risks, should the Fed wish to sell these assets before they mature, but these fall outside the scope of this book for the reasons described earlier.

A Note on the Data Used in This Book

A careful reader will note that there are some differences in the tables and figures throughout this book between how the programs are broken down for different purposes. This is an unavoidable result of the necessity to rely on federal budget documents for many of the key figures. For reasons that are unclear, these documents use different groupings of programs when listing the levels of outstanding loans as compared with the levels of new loans, or originations. The author was unable to find a safe way of translating from one categorization to the other and therefore used the data as they were reported.

The reader may also note that for one important federal program credit volumes have not been listed. The Government National Mortgage Association (Ginnie Mae) provides protection only on loans that are already federally insured, such as those insured by the FHA. Including Ginnie Mae guarantees would double-count the federal government's credit risk. However, Ginnie Mae does make profits and losses, which are included in the total subsidy figures.

Overview of Current Federal Credit Programs

As table 1-2 shows, federal credit programs today fall into five major categories: housing, education, farming, business, and emergency responses to the financial crisis. These are described in further detail in chapter 4 and the major subcategories can be seen in the table.

Figure 1-1 illustrates the dramatic growth in federal credit provision in response to the recent financial crisis. Figures for Fannie Mae and Freddie Mac are shown together (dotted bars) until the effective federal takeover in 2008, since even as firms with purely private ownership they were closely tied to the government. They are shown together in solid bars after the government rescue, which left the taxpayer as the clear majority owner, even though federal accounting continues to show them as private firms.

Emergency Responses to the Recent Financial Crisis

The federal government intervened massively in the financial markets starting in 2008 as part of a successful attempt to avoid having what was by then an inevitable severe recession turn into a true depression. The key new federal credit programs included the following:

The Troubled Asset Relief Program (TARP), at the Treasury Department, was a commitment of up to $700 billion to infuse capital into financial institutions, buy illiquid financial assets, aid homeowners facing foreclosure, and even participate in the restructuring of two of the major automakers. The core objective was to restore confidence in the financial system so that credit would not dry up completely.

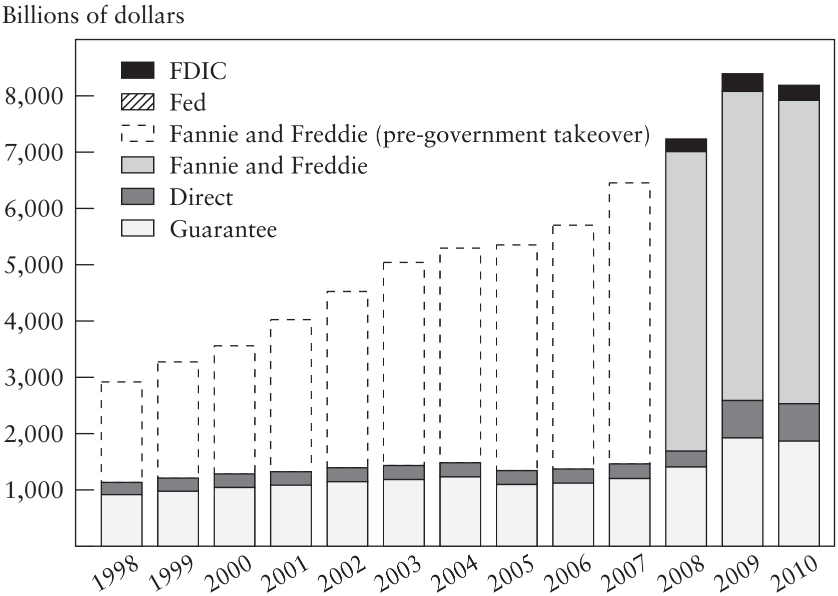
Emergency credit programs were created by the Federal Reserve and the FDIC. The Fed created multiple programs with an aggregate potential size of well over a trillion dollars. These programs were all fundamentally focused on shoring up or reviving key financial markets in order to keep

Table 1-2. *Federal Loans Outstanding, 2009–10*
Billions of dollars

	2009		*2010*	
Loan category	*Total*	*Percentage of all loans in category*	*Total*	*Percentage of all loans in category*
Housing programs				
FHA	819	80	1,025	80
VA	194	19	225	18
HUD	9	1	10	1
Other	0	0	15	1
All housing programs	**1,022**	**12**	**1,275**	**15**
Education programs				
Federal Family Education Loans	457	66	390	52
Federal Direct Student Loans	179	26	254	34
Temporary Student Loan Purchases	51	7	100	13
All education programs	**687**	**8**	**744**	**9**
Farm programs				
Farm Service Agency, Rural Development and Housing	97	65	118	69
Rural Utilities and Telephones	44	30	45	26
Commodities Credit Corporation	7	5	7	4
All farm programs	**148**	**2**	**170**	**2**
Business programs				
Small Business Administration	75	61	76	55
Export-Import Bank	48	64	54	39
Small Business Disaster Relief	10	21	9	6
All business programs	**123**	**1**	**139**	**2**
All traditional programs	**1,980**	**24**	**2,328**	**28**
Emergency programs				
Fannie and Freddie	5,491	87	5,389	92
FDIC	309	16	269	5
TARP	541	27	135	2
Federal Reserve	0	0	43	1
All emergency programs	**6,342**	**76**	**5,836**	**71**
Other programs	**57**	**1**	**68**	**1**
Total	**8,379**	**100**	**8,232**	**100**

Sources: OMB (FY 2012); Fannie Mae (2009–10); Freddie Mac (2009–10); FDIC (2009–10).

Figure 1-1. *Total Federal Loans and Guarantees, Fed, FDIC, and GSE Commitments Outstanding, 1998–2010*



Source: OMB (FY 2001–FY 2012); Fannie Mae (1998–2010); Freddie Mac (1998–2010); FDIC (2008–10).

credit flowing to the economy. The FDIC did its bit by agreeing to provide guarantees of much of the new borrowing by banks as well as substantially increasing its insurance of deposits.

Fannie Mae and Freddie Mac were rescued by the Treasury Department. The two firms, which were already closely tied to the government and viewed by the markets as having an implicit government guarantee, were taken over by the Federal Housing Finance Agency (FHFA). In conjunction with this, the Treasury Department infused capital into the institutions in the form of senior preferred shares in an amount that it estimates will reach $224 billion at its peak in 2012. It could end up investing considerably more if Fannie and Freddie perform worse than expected.

The way in which these emergency programs were created and structured yields many interesting comparisons with the formation and operation of the traditional federal credit programs. These insights are discussed in chapters 6 and 7.

Costs and Benefits

Are the federal credit programs providing good value overall for the taxpayer money spent on them? Chapter 5 tackles this crucial question. It is not an easy one to answer, since it raises a series of subordinate questions that do not themselves have crystal clear answers. As a result, any overall conclusion must remain somewhat subjective and uncertain. Unfortunately, the most comprehensive research strongly suggests that the overall cost outweighs the quantifiable benefits. However, that research is somewhat dated, and there will always remain elements of the cost-benefit analysis that are necessarily subjective.

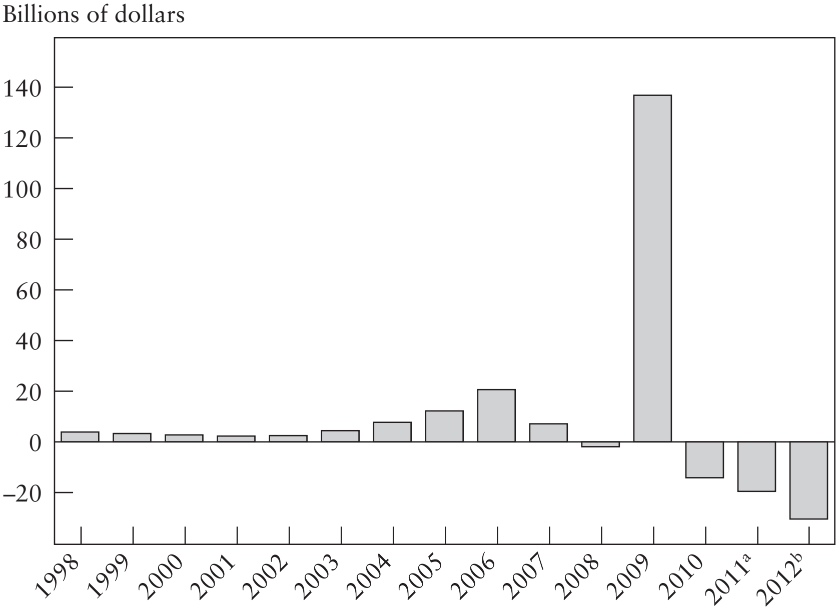
Any cost-benefit analysis of these programs requires answers to several subsidiary questions, each of which presents its own measurement difficulties.

What is the direct taxpayer cost of the programs? There is near-universal agreement that the direct costs ought to be measured by comparing the cash outflows over time with the flows back in, using an appropriate interest rate to put everything in terms of today's dollars. However, there is a critical policy argument as to whether to use an interest rate based on what the government pays on its debt or to use a higher rate that reflects the level of risk of the loans and guarantees. There are also other uncertainties, such as the need to use estimates of future repayments, that reduce the ability to provide a definitive cost figure.

What are the indirect costs of the programs? Federal credit programs tend to divert credit from other sectors, in addition to increasing the total credit supplied to the private sector. This has two negative effects. First, sectors that are not favored by federal credit programs will face a lessened availability of credit and a higher cost of loans than would otherwise be the case. Second, the favored sectors compete with one another to some extent, raising the level of federal assistance required to achieve a target loan volume or interest rate reduction. Estimating these inefficiencies requires a reasonably complex economic model, which necessitates making a number of assumptions that increase the range of uncertainty.

What is the targeted benefit of the credit programs? It is often difficult to know what a given credit program is trying to do. Proponents usually assert a range of positive effects, which often get carried over to the formal objectives of a program once it is created. However, it is difficult to determine the optimal prioritization of these objectives.

Figure 1-2. *Total Subsidy Budget Authority on Direct Loans and Guarantees, 1998–2012*



Source: OMB (FY 1998–FY 2012).
a. Continuing resolution from President Obama's proposed 2012 budget.
b. Proposed 2012 spending from President Obama's proposed 2012 budget.

What are the specific, quantified benefits? A comprehensive model can produce estimates, for the favored sectors and in the economy overall, of the increase in lending and the changes in interest rates. With considerably more difficulty, and imprecision, these estimates can be used to calculate the likely gain or loss of wealth in the different sectors. It becomes even harder to estimate changes in employment or the growth of industries or regions. Even if all the relevant outcomes can be estimated, there is likely to be no clear, objective method for weighting the various results to produce an overall assessment.

Figure 1-2 shows the subsidy costs for the federal credit programs, as reported initially for each year's new loan originations. Unfortunately, these estimates are subject to later revision to reflect how loans actually perform as well as changes in interest rates and other economic factors. As figure 1-3 illustrates for the housing programs, these reestimates can alter

Figure 1-3. *Original Housing Subsidies, 1998–2007, versus Subsidy Reestimates, 2008–11*[a]

Source: OMB (FY 2001, FY 2011).

a. The subsidy reestimates reflect changes in the old estimates rather than estimates for new credit.

considerably the original appearance of profitability. Note that the housing programs were originally expected to have a negative subsidy, meaning that they would have made a profit for taxpayers, as measured by the federal budget rules.

Conclusions

This introductory chapter has endeavored to make clear the critical importance of the federal credit programs and has hinted at some of their complexities. The remainder of this book attempts to fill in the details so that an interested member of the public, a policy analyst, a government employee, or a politician will be able to understand the history, current state, and key policy issues surrounding federal credit programs.

There is considerable evidence that taxpayers are not receiving the value for money that they should. The author believes that a number of steps should be taken to increase the effectiveness and efficiency of federal credit programs. Explained in the final chapter, these include the following actions:

—Target borrowers more carefully.

—Take more account of the relative risk of different loans.

—Use the same budget rules for all federal credit programs.

—Use risk-based discount rates for federal budget purposes.

—Avoid having the Fed run credit programs, to the extent possible.

—Formalize the process of initiating new credit programs.

—Create a federal bank to administer all credit programs.

—Focus more on optimizing the allocation of money between programs.

—Spread best practices more effectively.

—Improve the compensation and training of federal financial workers.