

# THE HERITAGE LECTURES

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Fiscal Conservatism:  
Managing Federal  
Spending

*By The Honorable Samuel R. Pierce, Jr.*



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# FISCAL CONSERVATISM: MANAGING FEDERAL SPENDING

by The Honorable Samuel R. Pierce, Jr.

It is a real pleasure for me to join with you here today. Certainly as much as any single institution, The Heritage Foundation has provided the intellectual underpinnings for the Reagan Revolution. During the past seven and one-half years, my senior staff and I have had many opportunities to see and use research material that The Heritage Foundation has produced.

You have reminded us regularly that, as Abraham Lincoln observed in his last public address, "important principles may and must be inflexible." You have called us back when, in your view, we had strayed too far from first principles. When we have disagreed, your well-reasoned position papers have forced us to carefully review our own analyses and consider alternative viewpoints. More often, I am happy to say, your significant contributions to our shared policy objectives — through such innovations as housing vouchers, Enterprise Zones, tenant management, and ownership of public housing — have been greatly appreciated and very helpful.

I have been asked today to speak about "Fiscal Conservatism: Managing Federal Spending." That is an enormous topic. As Secretary of Housing and Urban Development, I must report primarily on the fiscal affairs of that Department, and I am pleased to have the opportunity to share with you some of that experience as it relates to fiscal conservatism and the management of federal spending.

**"Macro" and "Micro."** It seems to me that there are, essentially, two ways to manage federal spending. One, which might be called the "macro" approach, is to limit the federal government's activities. How, and to what extent, are the big questions. Most of us here in Washington devote a major portion of our time to the debates that rage around these questions. And we all know how difficult it is to bring even small segments of those debates to successful conclusions.

The other way to manage federal spending is the "micro" approach — through good management of individual departments, agencies, and programs. This means doing more with less, getting more "bang for the buck" from every dollar spent in each of the government's functional and organizational areas. It includes attacking waste, fraud, and abuse; but it involves much more, too. It means using modern, cost-saving technologies, contracting out, eliminating unneeded facilities, and reducing personnel levels.

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**Assisting the Needy.** Few Presidents, if any, have come into the White House with a firmer commitment to imposing limits on government and government spending than did Ronald Reagan. Even before he took office, when he spoke to me about joining his Cabinet, he said that he wanted to reduce the size and the cost of government. At the same time, he made it clear that he wanted the federal government to assist the most needy.

I took that as a mandate, and throughout my tenure at HUD, I have endeavored to carry it out. I believe we have had some success in limiting HUD's activities, reducing its costs, introducing more efficient management, and fulfilling our commitment to serve those in need.

In 1981, when I took office, my financial people advised me that we had a huge assisted housing debt — that they expected it to reach \$250 billion by 1982. I immediately started studying HUD's programs and its administrative procedures to see how we could cut back. I soon decided that I would try to get rid of Section 8 new construction, which I considered a wasteful, uneconomical program. But it was a very important program to HUD, and I had to find something to take its place.

**Vouchers for Housing.** For help with this decision, I asked the President's Commission on Housing, which I had suggested the President form and whose members I helped select, to give their opinion on eliminating Section 8 and what there should be in its place. I also gave the same problem to my own office of Policy Development and Research. Simultaneously, they both came up with the same answer. They agreed that Section 8 should go and that HUD should adopt a voucher program. They based this decision on a study made by the Rand Corporation, which had found that there was no shortage of rental housing nationwide. There were some local shortages in certain communities, but there was no shortage of rental housing nationwide. The basic problem was one of housing affordability, not housing availability. Consequently, a voucher program was practical and made good economic sense.

Vouchers are considerably more cost effective than Section 8 new construction as a means of assisting those in need. We can house nearly three families with vouchers for the cost of housing just one family in new construction subsidized for the poor. That is what I mean by getting more bang for the buck.

In addition to getting rid of Section 8 new construction, we eliminated or improved various other housing programs, and we made a number of other significant administrative changes, including the reduction of staff.

**Dropping Debt.** Largely as the result of these actions, the assisted housing debt never reached \$250 billion, but peaked at \$244 billion in 1982 and has been dropping ever since. By fiscal year 1989, we expect it could be below \$200 billion.

But we did not — I repeat, did not — stop providing assisted housing for those in need. I put that emphatically because we hear so often, especially now that the election campaign is in full swing, that the Reagan Administration gutted housing programs for the poor. Baloney!

The facts are these. In fiscal year 1981, we were subsidizing about 3.2 million units of assisted housing. That number has risen in every one of the Reagan years, and by the end of this year it will reach approximately 4.3 million units — over one million more than when the President took office.

**American Dream.** We have also been working to make every dollar go further in the Federal Housing Administration. Now, I realize many conservatives oppose federal mortgage insurance as a matter of principle. But our thorough study of the housing market demonstrated a real need for FHA's programs. Simply put, they open up opportunities for millions of Americans to participate in the American Dream of home ownership. That dream is no Utopian fantasy. It motivates and financially supports a major segment of American industry. It has helped make the U.S. housing industry the strongest on earth. And to a significant extent, it drives the U.S. economy.

Conservatives may argue — some in the Administration have — that if FHA's job needs doing, it should be done by the private sector. There is certainly philosophical merit in that position; however, we do not believe conditions favorable to the privatization of FHA exist at the present time. Nor, I might add, does Congress show any inclination to approve privatization — even if we were to propose it.

In any event, we continue to believe that the FHA should remain in its present form; but in 1981 we could see plenty of room for improvement in its operations. One of our first objectives, achieved late in 1983, was to remove the interest rate ceiling and allow loan rates to be negotiated. This was a major step toward deregulation, imposing free market discipline on FHA even while it remained a government agency. Permitting FHA to insure alternative loans, such as the very popular adjustable rate mortgage or ARM, has also helped make it more sensitive to market forces.

**Targeting toward Greatest Need.** We have tried to target FHA mortgage insurance to the areas of greatest need: among first-time, urban, and rural home buyers for whom it represents the only path to home ownership. We recognize the potential for unfair competition between FHA's insurance programs and those of the private mortgage insurance companies. And we are working to eliminate those instances where FHA intrudes into markets adequately served by private insurers. We agree that the taxpayers should not be expected to subsidize federally insured mortgages for the middle class.

We have transferred major aspects of FHA mortgage insurance to private lenders. In the single family loan area, we introduced Direct Endorsement, which allows lenders to evaluate and approve loan applications themselves, subject only to a post-closing review by HUD. This greatly speeds up loan approval, and it substantially reduces the demands on HUD personnel. Roughly 90 percent of FHA single family loans are now being processed under the Direct Endorsement program.

This has enabled us to expand FHA's level of activity to meet demand, which rose dramatically as interest rates fell from their 1981 peaks and remains at record levels. Between 1981 and 1988, FHA insured 4.6 million housing units, in contrast to just 3 million during the previous seven years. In 1986 and 1987, FHA set consecutive all-time records for the number of homes and apartments insured: 900,000 in 1986 and 1.6 million last year.

On the multifamily insurance side, we introduced a coinsurance program, which gives lenders a greater role in loan approval. In return, they assume a greater share of the risk for losses. This program, as does Direct Endorsement, provides faster service to buyers and reduces demands on HUD. In 1987, coinsurance accounted for roughly 70 percent of all units and 60 percent of the total dollar amount insured during the year.

**New Emphasis.** In all our programs, we have been working to achieve similar improvements. Wherever possible, we rely more heavily on state and local governments and on private sector and voluntary institutions to implement local efforts to meet housing needs and rebuild communities.

We have tailored our grant programs to reflect this new emphasis, and we also have deregulated much of the application and approval procedure for Community Development Block Grants. In addition, we have turned over administration of the Small Cities Block Grant program to the states. In most instances, these measures of decentralization and deregulation have improved the programs and increased the benefits they provide to local communities.

**States Moved Ahead.** And of course, as you know, we have asked — and asked — Congress to authorize Enterprise Zones to help create jobs and opportunity in economically depressed areas. While we were urging Congress to approve Enterprise Zones, the states moved ahead with the idea. More than half of them now have their own Enterprise Zone programs, which have spurred the creation or retention of hundreds of thousands of jobs and generated more than \$6 billion in Zone neighborhood investment.

Enterprise Zones are just one example of a relatively low-cost, high-effect approach to the economic problems of our poorest communities. I am pleased that last year's Housing and Community Development Act finally gives them the nod, at least in a limited way. The regulatory relief authorized by the new legislation will certainly help generate economic activity in the designated Zones.

But think how many jobs, how much new investment, could have been produced if Congress had acted and offered a full package of incentives back in 1982 or 1983. Think of the tax revenues those newly employed workers and newly created businesses would have generated in the last five or six years.

**Managerial Revolution.** Let me turn now to what might be called HUD's managerial revolution of the Reagan years. I am quite proud of our achievements here, some of which were pioneering innovations in the federal government.

Of course, we were starting out from square one. It is hard to believe, for example, but when I came to HUD, I found there was no centralized system for keeping track of debt owed the Department. Under the circumstances, it is not surprising that debt collection was a very low priority.

We immediately instituted a debt-reporting and record-keeping system, and we began making automatic deductions from payments to organizations that were delinquent in debt



repayment. Every year, we have set ourselves higher collection goals in dollar terms and as a percentage of outstanding debt. And every year we have surpassed those goals. Since 1981, we have collected almost \$17 billion in debt. What's more, write-offs are down from 9 percent of total debt in 1982 to less than 1 percent last year. Seriously delinquent debt is also down.

**Saving \$300 Million.** In 1982, HUD became the first federal agency to use modern technology for cash payments and collections. We introduced paperless cash collection, direct-wire transfer to the Treasury, and automated claims processing, which alone saves more than \$22 million a year in interest. Our cash management initiatives since 1982 have resulted in savings or cost-avoidance of more than \$300 million.

Introducing 1980s-generation data processing throughout the Department has led to a ten-fold increase in processing capacity. Combined with the use of contracted services, this has enabled us to reduce spending on automation services staff even while our FHA programs were setting volume records.

Last year, we introduced a "Credit Alert" voice response system to allow FHA lenders to obtain credit information on their clients' previous experience with FHA mortgages. These checks avoided as much as \$37.5 million in potential claims and \$13.5 million in potential losses during the system's first three months of operation.

Our study of FHA program abuses enabled us to recover about \$7 million through administrative sanctions against those who had been using FHA to defraud the American taxpayer. The Housing and Community Development Act of 1987 provided us with additional helpful tools with which to fight fraud, such as higher penalties for equity skimming and limits on FHA investor mortgages. And our Inspector General has been extremely effective in pursuing those engaged in fraud and abuse of government programs.

Because we have been able to improve efficiency, HUD has absorbed substantial staff reductions even while our largest program was expanding its activities so dramatically. We brought our staff down from nearly 16,000 in 1981 to about 13,000 this year, saving \$150 million annually.

**Doing More with Less.** The cost-cutting innovations I have discussed, along with many others, have enabled us to fulfill our goal of doing more with less. HUD's budget authority dropped by 57 percent, from \$33.4 billion in 1981 to \$14.2 billion last year. Even this year's slightly higher level, \$15.4 billion, represents an overall reduction of nearly 54 percent.

The point here is not the relatively few billion dollars that a single Department like HUD can save, but that these things count. If the entire federal government, including Congress and its burgeoning bureaucracy, instituted similar policies and enjoyed similar success, the total savings would be truly impressive. Perhaps enough to successfully resolve the number one U.S. financial problem — the runaway national debt.

How has HUD managed these accomplishments? First, what we were doing made good sense, and we could and did prove it. We were able to demonstrate that direct assistance to the needy and sound business practices would work at HUD.

Then, too, a large measure of credit goes to my senior staff — men and women who accepted the President's mandate, which I passed on to them, to reduce the size and cost of government. They resisted the temptation to find new ways to spend money and devoted their efforts to finding ways to save it without failing the truly needy.

**Unfinished Revolution.** And, of course, in doing so we had the substantive research of The Heritage Foundation and other groups to bolster our efforts. Earlier, I said that we in the Administration are grateful for that intellectual contribution to the Reagan revolution. That revolution is, of course, unfinished; we all knew it would require more than eight years to complete.

I am reminded of a story about Winston Churchill, who was visited one day in his study by Lady Astor. She, of course, disapproved strongly of both Churchill's politics and his use of alcohol. This day, she was moved to comment on the latter.

"Winston," she said accusingly, "do you realize that if all the Scotch whiskey you've consumed were poured into this room it would come up to here?" and she indicated a point about halfway up the wall. Churchill's gaze followed her finger. He looked down at the floor and up at the ceiling. Then he replied, with a sigh, "So much accomplished, so much more to do."

