Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

Special Series: Health Reform Issues

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STUDENT LOAN REFORM IN HEALTH BILL WOULD SAVE MORE THAN $60 BILLION AND INVEST IN ACCESS TO COLLEGE

By Chuck Marr and Gillian Brunet

The health reform legislation heading for a vote in Congress within the next few days includes major reforms to the student loan system that would save more than $60 billion over ten years and invest more in educational opportunity for millions of aspiring students.

Under the proposal, the federal government — which now pays banks generous subsidies to provide a large share of taxpayer-subsidized student loans — would instead provide all such loans directly. This change would generate more than $60 billion in savings between 2010 and 2020, according to the Congressional Budget Office (CBO), much of which would go to protecting and expanding Pell Grants to help low- and moderate-income students afford college. While critics have branded the proposed changes in student loans a "government takeover" and claimed it would cost jobs, both claims are inaccurate.

Proposal Would Eliminate Wasteful Subsidies and Improve Efficiency

To make college more affordable for lower-income and middle-class families, the federal government provides subsidized loans through two programs: the Federal Family Education Loan (FFEL) program, which subsidizes banks and other financial institutions to make the loans, and the William D. Ford Federal Direct Loan (DL) program, which makes the loans directly to families. The loans made through the two programs are *essentially identical* for borrowers since the loan limits, maximum fee amounts, and maximum interest rates are all set in statute.[1]

The Office of Management and Budget (OMB) under both Presidents Bush and Obama, the Government Accountability Office, and CBO have all concluded that the DL program is more

[1] The Congressional Research Service (CRS) has stated that the FFEL and DL programs "make available essentially the same set of loans." See David P. Smole, "Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers," Congressional Research Service, September 1, 2009. CBO has described the loans from the two programs as "nearly identical." See Congressional Budget Office, "Budgetary Impact of the President's Proposal to Alter Federal Student Loan Programs," p. 2, March 15, 2010, http://www.cbo.gov/ftpdocs/113xx/doc11343/03-15-Student_Loan_Letter.pdf.

efficient from the perspective of taxpayers because it provides essentially the same loans at lower taxpayer cost. The legislation would end FFEL and rely on the DL program to provide all taxpayer-subsidized student loans. This would save $68 billion in mandatory spending over the 2010-2020 period, according to CBO.[2]

Not only is paying banks to make the loans less efficient than making them directly, but recent events have demonstrated that private-lender funding is not always reliable. In 2008 the debacle in the subprime mortgage securitization market spilled into the student loan market, forcing private-sector lenders to ask the federal government to step in and provide capital; Congress responded by passing the Ensuring Continued Access to Student Loan Act of 2008. Relying on the DL program to provide loans would prevent such a situation from recurring.

Given that the federal government already bears virtually of the risk (97 percent) of defaults on "private" FFEL loans, channeling all loans through the DL program would pose little additional risk. The reform would eliminate private lenders' role at the *front end* of the loan process (i.e., originating the loan), where it has been problematic,[3] but retain a major role for private entities at the *back end* of the process — i.e., servicing the loan.

Under FFEL, the financial institution that originates a loan also services it. In contrast, under the DL program, loan servicing contracts are awarded to private entities through a competitive bidding process, which is a more efficient approach. By expanding the DL program, the proposal should increase this efficiency.[4]

Main Criticisms of Proposal Are Groundless

Critics have not contested the central facts about the reform proposal — that it would produce significant budget savings that would be used to make college more affordable. Instead, some

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[2] Congressional Budget Office, "Budgetary Impact of the President's Proposal to Alter Federal Student Loan Programs," p. 1, March 15, 2010, http://www.cbo.gov/ftpdocs/113xx/doc11343/03-15-Student_Loan_Letter.pdf. Adjusting for increased administrative costs on the discretionary side, CBO estimates net budgetary cost savings of about $62 billion over the budget window.

[3] Private lenders often package the FFEL loans they originate with higher-cost private loans, leading students to take out private student loans when they would be eligible for further federal loans, which are safer and more affordable. For example, in its 2004 10-k filing with the SEC, Sallie Mae wrote that "[O]ur largest Private Education Loan program is the Signature Loan offered to undergraduates and graduates through the financial aid offices of colleges and universities and packaged with the traditional FFELP and PLUS loan products." See The Institute for College Access & Success Project on Student Debt, "Private Loans: Facts and Trends," August 2009, http://ticas.org/files/pub/private_loan_facts_trends_09.pdf.

Previously, investigators found abuses in the processes by which some university financial aid offices select lenders. On a number of occasions, lack of strong oversight allowed improper arrangements to flourish between lenders and schools. See Government Accountability Office, "Federal Family Education Loan Program: Increased Department of Education Oversight of Lender and School Activities Needed to Help Ensure Program Compliance," p. 26, July 2007, http://www.gao.gov/new.items/d07750.pdf.

[4] While the student loan reform legislation would generally improve efficiency in the loan servicing market, a provision would award a certain number of contracts for loan servicing to eligible non-profit servicers. This would shrink the pool of loans subject to the competitive bidding process and thereby somewhat diminish efficiency.

critics, such as Sen. Lamar Alexander (R-TN),[5] have made the rhetorical argument that the proposal represents a "government takeover" of the student loan system.

This claim has no foundation. As noted above, the loans are already subsidized by public funds under terms set in federal statute, and taxpayers already bear virtually all of the risk of default. Moreover, under the reform legislation, private firms would continue to service loans (e.g., collect monthly payments).

Others, including a group of six Democratic senators, have expressed concern that the proposal could cost jobs.[6] In macroeconomic terms, this concern is misplaced. First, the number of jobs tied to student loans originating with banks is tiny compared with the normal amount of job turnover that takes place every month in the U.S. labor market. Second, many of the 35,000 workers in the FFEL part of the student loan industry work in the loan servicing part of the business, a task that private-sector entities would continue to perform.

Third, by using the savings from reforming the student loan program to increase funding for Pell Grants, the legislation would enable more students to attend college than could otherwise afford it. When the increase in jobs associated with this greater college enrollment is taken into account, the net impact of the legislation on jobs is likely to be a wash. And, in the longer run, investments to help students afford college would strengthen the economy.

Investing in Educational Opportunity Would Benefit Nation as a Whole

The reform proposal would take a majority of the budget savings from eliminating FFEL and channel them into Pell Grants, which make college more affordable for low- and moderate-income students. The number of students who qualify for Pell Grants has risen because the recession has limited job opportunities and caused many families' incomes to fall — and has consequently impelled many adults to return to school. This has made the program more costly. The reform proposal includes $13.5 billion to help meet the added budgetary obligations of providing Pell Grants to the increased number of students who are qualifying for and using them during the economic downturn. This would help to ensure that Pell Grants do not have to be cut back at a time when the need for them is so acute.

In addition, the reform proposal would index the maximum Pell Grant to inflation from the 2014-2015 academic year through the 2017-2018 academic year, and would provide mandatory funding to cover the costs of this indexation. In recent years, as tuition costs have increased, the average financial need remaining after Pell Grants and other aid are taken into account has risen for low- and moderate-income students. If insufficient funding is provided to enable Pell Grants even to keep pace with inflation, unmet financial need will rise much higher.

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[5] Sen. Lamar Alexander, "Why make government the prime source for student loans?" *Washington Post,* March 7, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/03/05/AR2010030502972_pf.html.

[6] Letter to Senate Majority Leader Harry Reid, March 9, 2010.

The increased funding for Pell Grants represents a sound investment for both students and taxpayers. For many students, access to college means an opportunity for a better life. Extensive data show that people with more education do better at securing and retaining jobs and have greater earnings capacity. According to the College Board, the median income for families where at least one adult has at least a four-year college degree is more than $50,000 higher than for those with only a high school education.[7] A recent Rand study found that a person's earnings capacity increases 7 to 10 percent for each additional year of educational attainment.[8]

From a taxpayer standpoint, the Rand study found that college graduates pay substantially more in taxes and receive substantially less in government services over their lifetime than other individuals.[9]

Helping Americans afford to go to college also is beneficial for the economy in the long run. Better-educated workers have higher productivity rates. While most of the benefits from attending college accrue to students in the form of higher wages, such investments in human capital also have historically been an important contributor to raising the overall standard of living in the U.S. economy.

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[7] Trends in College Pricing 2009, College Board, http://www.trends-collegeboard.com/college_pricing.

[8] Stephen J. Carroll and Emre Erkut, "The Benefits to Taxpayers from Increases in Students' Educational Attainment," p. 15, the RAND Corporation, http://www.rand.org/pubs/monographs/2009/RAND_MG686.pdf.

[9] The study estimated that the total net present-value benefit for taxpayers of having a person go from some college to a college degree was over $100,000 (in 2002 dollars).