

AMERICA'S STUDENT LOAN PROVIDERS

www.studentloanfacts.org

**Years of Study Shows Claims
of Direct Loan Savings are
Wrong at Best**

Over a decade ago, the budgeting of credit programs was dramatically changed through enactment of the Credit Reform Act of 1990. The Credit Reform Act improved the federal budget process by accounting for all the estimated costs associated with extending credit over the full life of a guaranteed loan commitment during the same fiscal year the decision to extend credit is made. However, administration of the Act introduced at least two biases into the budget process that favor direct loans over guaranteed loans. These biases are widely recognized by budget experts, although they are usually ignored by direct loan advocates.

Although some have tried for more than a decade to prove that Direct Loans cost taxpayers less than FFEL loans, the fact is that no definitive budget analysis has been produced. House Budget Committee Chairman Jim Nussle: "Your claim that direct lending saves money is at best premature, since such savings are contingent on projected performance benchmarks and interest rate scenarios that may or may not come to pass."

Here's why the credit reform rules force biased scoring:

- While administrative costs in the FFELP are built into the cost of making a loan, those same costs in the Direct Loan Program are excluded.
- As a result, under credit reform, the budget significantly underestimates the cost of the Direct Loan Program.

Second, the budget "cost" of the student loan programs in each fiscal year is based on estimates of payments expected to come in over the life of the loans.

- The net present values of these decades of estimated payments are recorded in the budget as actual payments. However, the forecasting models used by CBO and OMB - as required by Credit Reform -- do not reflect the actual performance of the loan programs.
- The GAO has found that the budget continues to forecast Direct Loan Program receipts far more optimistically than justified by past performance.
- The opposite has occurred in the FFELP, where budget estimates have failed to keep up with the significant improvements in default prevention and collections.
- As a result, the Department of Education was forced to make repeated upward re-estimates of the cost of the Direct Loan Program -- \$481 million in 2001, \$4.6 billion in 2003, and \$2.6 billion in 2004, while making downward re-estimates of costs in the FFELP of \$4.7 billion in 2001, \$3 billion in 2003, and \$3.6 billion in 2004.

A Dozen Years of Quotes on Direct Loan Scoring: It Doesn't Save

- "From fiscal years 1995 through 2003, total cash outflows exceeded total cash inflows by about \$10.7 billion.... Over the same period, FDLP's actual cash flows (principal receipts, interest receipts, origination fees, and collections on defaults) were \$4.2 billion less than estimated, primarily because Education overestimated interest receipts." General Accounting Office, *Department of Education's Federal Direct Loan Program, Status of Recommendations to Improve Cost Estimates and Presentation of Updated Cash Flow Information*, Feb. 2004.

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- On student loans, experts seem to agree that the scorekeeping conventions required under the law bias decision towards direct loans because of the differential treatment of administrative costs." Former CBO Director Dr. Rudy Penner, *"Policy and Scorekeeping, A meeting of Budget Experts and other interested Parties,"* a symposium of The Committee for a Responsible Federal Budget, December 4, 1996.
- "The exclusion of administrative costs from credit reform calculations gives an unfair advantage to direct federal lending compared with loan guarantees. When administrative costs are included, as recent budget resolutions have provided, the relative budgetary cost of direct loans and guarantees depends on the vagaries of CBO's assumptions about short- and long-term interest rates over the next several decades." CBO Assistant Director Paul Van de Water at the same 1996 symposium.
- "We reached two principal conclusions. First, in any given year either FFELP or FDLP total costs (administrative and subsidy) may be greater, given the impact of prevailing economic conditions on subsidy costs. Since costs may be higher or lower at any one point in time, a total cost figure for any one year does not definitively answer the question of whether the FFELP or FDLP is more expensive." Study by the Department of Education Inspector General: *Study of Cost Issues, Federal Family Education Loan Program, Federal Direct Loan Program* March 1999.
- "Abandonment of the current public/private lending system in favor of direct lending could actually increase budget outlays [federal debt] and reduce national income if the program is unable to duplicate administrative cost efficiencies achieved by private lenders." Barbara Miles and Dennis Zimmerman, *Federal Family Education Loans: Reduced Costs, Direct Lending and National Income*, Congressional Research Service, February 22, 1993.
- "To allow for improved budgetary comparability, the Congress, in the budget resolution for fiscal year 1996, conformed the treatment of the administrative costs of direct student loans with that for guaranteed loans... The (resulting) baseline modification essentially makes the subsidy costs about the same for direct student loans and guaranteed student loans." Letter from CBO Director June E. O'Neill to Sen. John Ashcroft, May 3, 1996.
- "The Credit Reform Act of 1990, which governs budget scorekeeping for federal credit programs and other federal budget scorekeeping conventions, create a clear scoring bias against guaranteed loans and in favor of direct loans." *Comparing the Federal Budget Costs of Direct and Guaranteed Student Loan*, White Paper prepared for Education Finance Council by KPMG Consulting Barents Group, January 2001.
- "Exclusion of Department of Education administrative costs from the subsidy estimates of both programs is a major problem that needs to be remedied." *Ibid.*
- "To be complete, budget cost estimates for direct loans should account for the federal tax revenue lost due to the crowding out of private, for-profit lending activity by government lending. Finally, a full comparison of the direct and guaranteed loan delivery mechanisms for student aid should consider broader economic costs rather than narrowly focusing on budget accounting." *Ibid.*

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- "The primary way in which direct lending could reduce costs is if the Government should succeed in lowering administrative and servicing costs relative to the private sector's performance with guaranteed loans. In fact this is not expected, and ED is contracting these functions back out to the private sector. There may be a logical rationale for direct lending, but lower cost is not it." *Critique of the Administration's estimated savings from direct lending for student loans*, Barbara Miles and Dennis Zimmerman, Congressional Research Service, April 1995.

For more information, contact America's Student Loan Providers www.studentloanfacts.org