CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

September 11, 2009

Honorable George Miller
Chairman
Committee on Education and Labor
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

As you requested, the Congressional Budget Office has reviewed the Student Loan Community Proposal (the Community Proposal), draft legislation put forth on behalf of several organizations in the lending community that would modify the federal student loan programs. While the Community Proposal includes several provisions that would affect federal spending, the following analysis focuses only on those related to eliminating the existing guaranteed loan program. As in H.R. 3221, the Student Aid and Fiscal Responsibility Act of 2009, as reported by the House Committee on Education and Labor, the Community Proposal would reduce federal outlays by eliminating new lending from the guaranteed student loan program (known as the Federal Family Education Loan [FFEL] program). Unlike H.R. 3221, however, the Community Proposal would permit new loans to be originated by federally designated private lenders and then transferred to the federal government.

In addition to providing an estimate for the proposal as drafted, CBO was asked to estimate the costs of the Community Proposal assuming that two loan-related provisions authorizing spending subject to appropriation (that is, discretionary spending) in the draft Community Proposal would be changed into direct (or mandatory) spending provisions. As a result, this letter presents CBO analyses of two alternatives: for the legislation as transmitted to CBO, and for a potential change of two loan provisions from authorizing discretionary appropriations to providing mandatory funding.

CBO's Estimate of H.R. 3221

In its cost estimate for H.R. 3221, transmitted on July 24, 2009, CBO estimated that replacing new loans in the existing guaranteed loan program with new direct loans originated by the Department of Education would yield gross federal savings in mandatory spending of about $87 billion over the 2010-2019 period. About $7 billion of such savings would represent a shift of administrative costs from mandatory spending (in the guaranteed student loan program) to discretionary spending (in the Direct Student Loan Program). Thus, the $87 billion reduction in direct spending would be offset by an increase in future appropriations needed to administer the increase in the volume of direct loans, for an estimated net reduction in federal costs of about $80 billion over the 2010-2019 period.

CBO's Estimate of the Student Loan Community Proposal

The CBO estimates presented below are based on a version of the draft legislation that was transmitted to CBO on September 9, 2009.

Loan Participation Agreements with Private Lenders. As in H.R. 3221, the Community Proposal would prohibit new federal guarantees of student loans while maintaining the current Direct Loan Program. Unlike H.R. 3221, the Community Proposal would permit federally designated private lenders to originate new student loans using capital derived mainly from the sale of student loans to the Department of Education.

Within 15 days of the origination of a loan, a private lender would enter into a loan participation agreement with the Department of Education, requiring that the department pay to the lender:

- 100 percent of the principal balance, within one day of signing the agreement;

- A loan administration fee equal to 0.69 percentage points per annum times the principal balance of the fully disbursed loan for the number of days between the date of first disbursement and the legal transfer of the title to the department; and

- An origination fee of $20 when the lender signs the participation agreement and $55 when the lender transfers title to the department.

Lenders would be required to transfer the title of the loan to the department no later than 120 days after the loan is fully disbursed.

As the draft legislation is currently written, payment of both the loan administration and origination fees would be subject to future appropriation action and the resulting outlays would be classified as discretionary spending. However, appropriation of such funds would be necessary to encourage lenders to participate in the program, and CBO expects that uncertainty about future appropriations might discourage lenders' participation in the new program. As a result, private lenders might be reluctant to participate in the direct loan origination process envisioned in the proposal unless the funds are provided in advance in appropriation acts. Nevertheless, for the purpose of this estimate, CBO assumes that all loans that would be made through the FFEL program under current law would be made through private lenders and sold to the government under the Community Proposal.

As shown in Table 1, assuming the fee payments are made from discretionary funding, CBO estimates that the draft proposal would reduce direct spending by about $87 billion over the 2010-2019 period. As in H.R. 3221, those savings would stem from eliminating the existing guaranteed loan program.

Assuming future appropriation of funding for the fees paid to lenders, some of the savings in direct spending would be offset by increases in discretionary spending. CBO estimates that appropriations for those payments would increase discretionary spending by about $13 billion over the 2010-2019 period. In addition, the Department of Education would incur about $7 billion in costs to administer those loans. As a result, CBO estimates the net reduction in federal costs from the above provision of the Community Proposal would be about $67 billion over the 2010–2019 period—in contrast to the net impact of $80 billion in 10-year savings for H.R. 3221, as reported by the Committee on Education and Labor.

Estimate of Costs Assuming Fees Paid to Private Lenders are Mandatory. CBO also was asked to estimate the budgetary impact of shifting away from the existing guaranteed loan program under the Community Proposal assuming that both of the fees identified above are funded through direct spending (that is, the payments to private lenders would not be subject to annual appropriation action). As shown in Table 2, the overall budgetary effect would be the same as in the above case (a net savings of about $67 billion), but the mix of direct spending and discretionary spending would differ. CBO estimates that this alternative proposal would reduce direct spending by about $74 billion over the 2010-2019 period: about $87 billion in savings from eliminating the guaranteed loan program would be offset by an approximately $13 billion increase in direct spending for the new payments to lenders. The Department of Education would incur an additional $7 billion in discretionary administrative costs.

Summary Comparison of Proposals

Federal spending falls into two broad categories: mandatory (or direct) spending and discretionary spending (which is subject to appropriation). CBO generally estimates the impact of legislation on these two types of spending separately. However, to facilitate comparison among differing proposals, the combined impact on direct and discretionary spending of the three proposals related to the proposed shift away from the student loan guarantee program is summarized below:

- H.R. 3221—CBO estimates that H.R. 3221 would reduce direct spending by about $87 billion and increase discretionary spending by $7 billion over the 2010-2019 period by eliminating new guarantees of federal loans. As a result, CBO estimates the net impact on federal spending would be a reduction of about $80 billion over the 2010-2019 period.

- Student Loan Community Proposal (as drafted)—CBO estimates that eliminating new guarantees of federal loans under the Community Proposal also would reduce direct spending by about $87 billion and that payments to federally designated private loan originators and outlays for loan administrative costs would increase discretionary spending by about $20 billion over the 2010-2019 period. As a result, CBO estimates the net federal savings would be about $67 billion over the 2010-2019 period. That estimate assumes that sufficient appropriations are provided in advance to ensure lenders' participation.

- Student Loan Community Proposal, assuming payments to lenders are mandatory—CBO estimates that eliminating new guarantees of federal loans and making mandatory payments to lenders would reduce net direct spending by about $74 billion and that appropriations for the government's administrative costs would increase discretionary spending by about $7 billion over the 2010-2019 period. As a result, CBO estimates the net federal savings also would be about $67 billion over the 2010-2019 period.

Other Provisions

Both H.R. 3221 and the Community Proposal would make several other changes to direct spending. As shown in Memorandum lines in Tables 1 and 2, CBO estimates those other provisions in the Community Proposal, taking into account interactions between the different provisions, would increase direct spending by about $4 billion over the 2010-2019 period. (That additional cost is not included in the summary presented above in order to keep that comparison restricted to the proposed shift away from guaranteed loans.)

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Deborah Kalcevic.

Sincerely,

for Robert A. Sunshine

Douglas W. Elmendorf
Director

Enclosure:

cc: Honorable John Kline
Senior Republican Member

Honorable John M. Spratt Jr.
Chairman
Committee on the Budget

Honorable Paul Ryan
Ranking Member

Identical letters sent to the Honorable Allen Boyd, the Honorable Jason Altmire, the Honorable Robert P. Casey Jr., and the Honorable Tom Carper.

TABLE 1. ESTIMATED COST OF THE STUDENT LOAN COMMUNITY PROPOSAL AS TRANSMITTED ON SEPTEMBER 9, 2009

	By Fiscal Year, in Billions of Dollars												
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009-2014	2009-2019
CHANGES IN DIRECT SPENDING													
Eliminate new lending in FFELP[a]													
Estimated Budget Authority	0	-4.8	-13.3	-12.2	-11.2	-10.5	-10.2	-10.2	-10.1	-10.3	-10.7	-52.1	-103.5
Estimated Outlays	0	-2.6	-8.9	-11.0	-10.0	-9.4	-9.0	-8.9	-8.9	-9.0	-9.3	-41.8	-86.8
CHANGES IN SPENDING SUBJECT TO APPROPRIATION													
Administration of direct loans[b]													
Estimated Authorization Level	0	0.1	0.3	0.4	0.5	0.6	0.8	1.0	1.1	1.3	1.4	2.0	7.5
Estimated Outlays	0	0.1	0.3	0.4	0.5	0.6	0.8	0.9	1.1	1.2	1.4	1.8	7.2
Administration and origination fees paid to private lenders													
Estimated Authorization Level	0	0.6	1.5	1.5	1.6	1.6	1.6	1.7	1.7	1.7	1.7	6.8	15.2
Estimated Outlays	0	0.3	1.0	1.4	1.4	1.4	1.4	1.4	1.5	1.5	1.5	5.5	12.9
Total, discretionary spending changes													
Estimated Authorization Level	0	0.7	1.8	1.9	2.1	2.2	2.4	2.6	2.8	3.0	3.2	8.7	22.7
Estimated Outlays	0	0.4	1.3	1.7	1.9	2.0	2.2	2.4	2.6	2.7	2.9	7.3	20.1

Memorandum:
The Community Proposal contains other provisions that would affect direct spending:

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009-2014	2009-2019
Other programmatic and interactive changes													
Estimated Budget Authority	*	0.1	0.1	0.2	0.2	0.3	0.6	0.6	0.7	0.7	0.7	0.9	4.0
Estimated Outlays	*	-0.1	0.5	0.2	0.2	0.3	0.5	0.6	0.7	0.7	0.7	1.0	4.1

Notes: FFELP = Federal Family Education Program; Components may not sum to totals because of rounding; * = between -$50 million and $50 million.

a. CBO estimates that H.R. 3221 also would decrease direct spending by $86.8 billion over the 2010-2019 period by eliminating new lending in FFELP.

b. CBO estimates that H.R. 3221 also would increase discretionary spending by $7.2 billion over the 2010-2019 period.

TABLE 2. ESTIMATED COST OF THE STUDENT LOAN COMMUNITY PROPOSAL, ASSUMING FEES PAID TO PRIVATE LENDERS ARE PROVIDED AS DIRECT SPENDING

	By Fiscal Year, in Billions of Dollars												
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009-2014	2009-2019
CHANGES IN DIRECT SPENDING													
Eliminate new lending in FFELP[a]													
Estimated Budget Authority	0	-4.8	-13.3	-12.2	-11.2	-10.5	-10.2	-10.2	-10.1	-10.3	-10.7	-52.1	-103.5
Estimated Outlays	0	-2.6	-8.9	-11.0	-10.0	-9.4	-9.0	-8.9	-8.9	-9.0	-9.3	-41.8	-86.8
Administration and origination fees Paid to private lenders													
Estimated Budget Authority	0	0.6	1.5	1.5	1.6	1.6	1.6	1.7	1.7	1.7	1.7	6.8	15.2
Estimated Outlays	0	0.3	1.0	1.4	1.4	1.4	1.4	1.4	1.5	1.5	1.5	5.5	12.9
Total, direct spending changes													
Estimated Budget Authority	0	-4.2	-11.8	-10.7	-9.6	-8.9	-8.6	-8.5	-8.4	-8.6	-8.9	-45.3	-88.3
Estimated Outlays	0	-2.2	-7.8	-9.6	-8.6	-7.9	-7.6	-7.5	-7.4	-7.5	-7.7	-36.3	-73.9
CHANGES IN SPENDING SUBJECT TO APPROPRIATION													
Administration of direct loans[b]													
Estimated Authorization Level	0	0.1	0.3	0.4	0.5	0.6	0.8	1.0	1.1	1.3	1.4	2.0	7.5
Estimated Outlays	0	0.1	0.3	0.4	0.5	0.6	0.8	0.9	1.1	1.2	1.4	1.8	7.2

Memorandum:
The Community Proposal contains other provisions that would affect direct spending:

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009-2014	2009-2019
Other programmatic and interactive changes													
Estimated Budget Authority	*	0.1	0.1	0.2	0.2	0.3	0.6	0.6	0.7	0.7	0.7	0.9	4.0
Estimated Outlays	*	-0.1	0.5	0.2	0.2	0.3	0.5	0.6	0.7	0.7	0.7	1.0	4.1

Notes: FFELP = Federal Family Education Loan Program; Components may not sum to totals because of rounding; * = between -$50 million and $50 million.

a. CBO estimates that H.R. 3221 also would decrease direct spending by $86.8 billion over the 2010-2019 period by eliminating new lending in FFELP.

b. CBO estimates that H.R. 3221 also would increase discretionary spending by $7.2 billion over the 2010-2019 period.