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[Student Loans] [loose]

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FILE: STUDENT LOANS

November 30, 1995

MEMORANDUM FOR LAURA TYSON

FROM: PAUL DIMOND

SUBJECT: STUDENT LOANS

CC: GENE SPERLING

Attachments. Attached are (1) OMB's side-by-side (with a suggested position), (2) OMB's summary of the two sides to date, and (3) a copy of Madeline Kunin's remarks at the press conference to day blasting the Republican's scandalous complicity with special interests (banks and student loan guarantee agencies) at the expense of students and taxpayers.

Scope of $$ at issue. There is some real change at issue here: First, $6.0 billion in the baseline by simply reversing the directed scoring to CBO (and returning to scoring like other credit programs under the credit reform act). Second, another $6.0 billion from other student loan reductions (including over a billion in subsidies still left with the banks and guarantee agencies, even after the unmerciful hammering the R's took on the special interest complicity charge in the media). Ken Apfel has the complete list of the $6.0 billion in additional savings that could be put on the table.

Republican Weak-Links. There are two weak-links in the Republican armor on all of this. First, their directed scoring was merely the beginning of the complicity with the special interests of banks and the guarantee agencies. After directing the special scoring rules, R's proceeded to provide another several billion in subsidies to the banks and guarantee agencies. The press got wind of all this and a series of articles just blasted away. All but a billion in the direct subsidies were eliminated as a result, but the directed scoring still sits there as a special interest anomaly just begging to be remedied. Second, the assault on Direct Lending by seeking to cap the program at 10% absolutely flies in the face of (a) the demonstrated support for greater convenience of the Direct Loan programs to schools and students, (b) the political and administrative nightmare of removing Directing Lending from scores of schools (tens of thousands of students) that are already enjoying its benefits, and (c) the support of now some 500 college presidents for a "free market choice between" FFEL and Direct Lending (because the Direct Lending program has required the FFEL lenders to become much more responsive and efficient). [I always like to think about Direct Lending as more convenient and affordable loans made directly to the student, rather than as a structural argument about colleges rather than bank intermediaries making the loans to students.]

Potential Weak Points in Administration Position. We have two potential weak links in our armor as well. First, the cash accounting basis of the uniform credit reform scoring rules probably understates the "true" costs of the Direct Loan Program (by not counting some of the costs that may be pushed out beyond the 7-year scoring window). The "truth" is that the actual costs of Direct Loans are less than the costs of FFEL loans, but not by the amount provided by the uniform scoring rules of credit reform. My own view on this is "so what?" Unless CBO is going to review all credit reform scoring rules generally for all programs, we should score student loans under the generally applicable rule -- especially when both sides should be looking for easy ways to close the $$ gap. [There is a rumor that CBO is restoring the student loan program because of the 1% reduction in long-term interest rates; but I don't know whether this is being done on the directed basis demanded by the R's or some independent review of scoring by CBO.] Second, our original proposal to go to 100% Direct Lending in retrospect probably was an "overreach" to implement a key POTUS priority under the guise of a budget scoring "quirk." We have at least eliminated the continuing weakness of this link by agreeing to the "free choice market" approach: let every college choose whether they want to use Direct Lending or FFEL student loans with the banks and guarantee agencies. Settling on this "free market choice" will not affect the over $10 billion to close the gap by going back to scoring under credit reform and the additional savings proposed by Ken.

Conclusion. Hope this background helps. I think a very aggressive line is warranted here; and there are ways to close the gap between R's and the POTUS by over $10 billion -- if R's will accept credit reform scoring, free market choice on direct lending, and additional savings that don't reduce the benefits to students. This is one of the few "win-wins," if you can pull it off. The only downside risk that I see in an aggressive attack on the R's here is that it could well set a precedent for not being concerned about policy proposals that push costs outside of the 7-year budget scoring window. But, as you know, my view on that, is that we ought to be willing to accede to that approach as a part of reaching agreement: what better place to start than student loans, where it is only a return to the terms of the Credit Reform Act that we are seeking. Finally, as a matter of tactics, you won't get the full $10 billion unless you resolve the credit reform scoring issue before putting any additional proposals for savings on the table.

STUDENT LOANS

Administration

Accelerates the phase-in of the federal direct student loan program, eliminates guaranteed lending by academic year 1997-98, and recovers $1.1 billion in federal reserves held by guaranty agencies, which are not needed under a direct loan program. Current law specifies the goal of 40 percent of total federal student loan volume in direct lending in academic year 1995-96, 50 percent in 1996-97 and 1997-98, and 60 percent in 1998, plus free choice for schools starting in mid 96. Under current scoring, the proposal saves $6 billion. To advantage banks and other intermediaries, the Budget Resolution directs CBO to change scoring for this loan program only, raising the baseline by $6 billion and reducing savings from the Administration's proposal to $1 billion.

Recently, the Administration has publicly endorsed "free choice" for schools. Any school should be able to elect direct lending or guaranteed lending. In addition, the Administration proposes deleting the Reconciliation bill's directed scoring, thus reducing the baseline by $6 billion. Also, if additional savings are needed, the Administration could propose approximately $6 billion in savings from other student loan reductions which include no reductions in student benefits.

(Original Administration proposal: OMB -$6 billion; CBO -$1 billion plus increase in budget baseline by $6 billion for a net increase of $5 billion.

Current Administration proposal: OMB -$6 billion; CBO similar if directed scoring is eliminated)

Conference

Virtually eliminates direct lending, by capping the program at 10 percent of total student loan volume. This would force out of the program 1,300 schools that entered July 1, 1995, allowing only about 100 to continue. (Under Congressional Budget Resolution scoring rules, capping direct lending saves $.6 billion.) Makes it harder for students to convert guaranteed student loans into direct loans, thereby limiting their access to income-contingent repayment. Reduces some subsidies to lenders, but also reduces Secretary's authority and resources to manage the guaranteed program. In addition, the tax title permits non-profit secondary markets to move the benefits of non-profit status into for-profit entities resulting in substantial windfall.

(Directed Scoring + $6 billion
Program Savings - 4.9 billion
Net 1.1 billion)

Coalition

No change to current law, thereby continuing current expansion in direct loan program.

Reconciliation: Student Loans

	(Seven Year Outlay Savings in billions of dollars) Administration scoring	CBO scoring
Conference Agreement on Reconciliation	+1.3	-4.9
Administration's Balanced Budget Proposal		
Accelerate Phase-In of Direct Lending to 100%	*-6.2*	*-1.2*

Conference Agreement on Reconciliation

The Conference agreement would: virtually terminate direct lending by capping it at 10% of total loan volume; direct CBO to score student loan programs in a manner that masks the benefits of direct lending and adds $6 billion to baseline spending; and make some reductions in excess profits of the guaranteed loan program industry while providing new benefits to secondary markets.

Capping Direct Lending. The Conference bill caps direct lending at 10% of loan volume beginning July 1, 1996, terminating participation of 1,300 schools and ending access to direct loans and easy access to income contingent repayment to 2.5 million students in FY 1996 alone. Under current law, direct lending is now at 40% of loan volume and would rise to 50% on July 1, 1996 (plus however many more schools chose to participate) and to 60% July 1, 1998 (plus school choice).

Directed Scoring. The Conference bill requires CBO to ignore the government-wide scoring rules of the Federal Credit Reform Act as it applies to administrative costs of credit programs. The directive shifts administrative costs of direct lending from a cash accounting basis to a net present value basis, but does not do the same for guaranteed loans. The effect is to raise the CBO spending baseline by $6 billion over 7 years, and permit capping direct lending to be scored as a savings of $800 million.

Other Provisions. The Conference bill acknowledges the excess profits of the guaranteed student loan industry (lenders, guaranty agencies, secondary markets like Sallie Mae) by imposing fees and reducing subsidies. The net effect is to achieve some savings and still make guaranteed lending profitable. Banks are directed to have income contingent repayment plans, but as a practical matter they cannot administer such plans and will not make them easily available to the majority of borrowers. In addition, the tax title of the Conference bill permits non-profit secondary markets to move the benefits of non-profit status into for-profit entities, resulting in substantial windfalls.

Administration's Balanced Budget Proposal

The Administration's FY96 Budget proposed to accelerate the phase-in of direct lending from the current law path that reaches 60% of all loan volume by July 1, 1997. This would save $5.1 billion. The proposal saves another $1.1 billion by recalling Federal funds held in reserve by guaranty agencies and no longer needed. Regardless of scoring rules, the direct student loan program is less expensive than the guaranteed loan program because there are no payments to financial intermediaries as in the guaranteed loan program, and in direct lending, borrower payments of principal and interest during the repayment period cover the Federal government's cost of funds plus the government's administrative expenses. Under the Federal Credit Reform Act, Federal administrative expenses for the direct and guaranteed student loan programs are budgeted by law on a cash basis.

James J. Jukes

10/02/98 01:20:16 PM

Record Type: Record

To: Robert M. Shireman/OPD/EOP
cc: See the distribution list at the bottom of this message
bcc:
Subject: Re: Discussion of Net PAYGO Costs in Higher Ed Act (HR 6) enrolled bill memo and signing statement

My attempted answers to your questions are in bold. I've copied my OMB colleagues so they and correct me or elaborate as appropriate.
Robert M. Shireman

Robert M. Shireman
10/02/98 12:33:17 PM

Record Type: Record

To: James J. Jukes/OMB/EOP@EOP
cc:
Subject: Re: Discussion of Net PAYGO Costs in Higher Ed Act (HR 6) enrolled bill memo and signing statement

How much money are we talking about, in which years, and how much in comparison to what's already on the scorecard? **I understand it's a net coster in the neighborhood of $723M over FYs 1999-2003 (although a net saver in FY 1999). I have not seen year-by-year numbers. The scorecard is currently in the hole for FYs 2001-2003.**

When would the first sequester occur? (how long do we have to fix it) **I believe it would likely occur in FY 2000, but this may not be nailed down yet.**

Is this routinely included in signing statements (any recent examples? what about last year?). **It is not routinely included in signing statements, and I believe that this bill presents only the second significant instance of the occurrence of this problem. (The first one was the IRS reform bill enacted in July, which put the outyears in the hole. No signing statement was issued for that bill.)**

Additional background: Jack Lew today requested that the HEA signing statement -- and future signing statements with similar problems -- take note of the possible sequester problem. He asked us to coordinate the language with NEC

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