3:00 PM UPDATE, July 21, 2005

Higher Education Act Committee Mark-Up: Justification for the Petri/Miller STAR Act Amendment

Rep. Tom Petri (R-WI) and Rep. George Miller (D-CA) today offered an amendment in the Education and Workforce Committee to reward schools of higher education that use the lowest cost lending program, whether it is the Direct Loan Program or the private market FFEL program. Schools that switch to the cheaper of the two alternatives, as determined by the secretary of education, will be given half of the savings caused by the switch, money that must be provided in additional grant aid to students receiving Pell Grants or graduate students with financial need. Here's background on why this amendment is a win-win for states, colleges and students. A roll call vote on this amendment is expected later this afternoon.

The Petri-Miller Amendment
The Student Aid Reward Act (H.R. 1425)

- Schools using the least expensive student loan program receive half of the savings the program generates (about 5% of their total annual loan volume).

- The amendment does not say which program is cheaper; it lets the Secretary of Education decide. If FFEL is cheaper for taxpayers, then it qualifies too.

- The Congressional Budget Office says student grant aid under the Student Aid Reward Act would increase by at least $17 billion over 10 years, at no cost to taxpayers. That's assuming Direct Loan volume grows from 25 percent to 44 percent. If all schools switched to Direct Loans, more than $60 billion would go to aid.

- Savings come from subsidies that would have gone to lenders if the school had used FFEL instead. Schools must use the new money to provide additional grant aid to students receiving Pell Grants or graduate students with financial need.

- The bill could provide roughly $1,000 a year in additional grant aid, making the max Pell Grant more than $5,000, at no new cost to taxpayers.

- Students at both new and current direct loan schools would be eligible for the additional aid.

- Because the bill uses savings only from new Direct Loan enrollees (switchers), it doesn't cost taxpayers any new money.

- The amendment levels the playing field and enhances competition between the two loan programs by equalizing the subsidies paid under each program. Under the amendment, schools choosing FFEL direct subsidies to banks; schools choosing Direct Loans direct subsidies to grant aid.

BACKFGROUND: Direct Loans vs. FFEL

BUDGET NUMBERS

President's FY2006 Budget

- According to the President's 2006 budget, loans under FFEL will cost $12 for every $100 lent over the life of the loan. Direct Loans cost $ 0.92 for the same $100 loan. Administrative costs are included.

Loan Program	Loans Made in FY2005
FFEL (guaranteed):	$12 / $100 lent
Direct Loans:	92¢ / $100 lent

- According the President's budget, taxpayers would save $9 billion this year if all FFEL loans were made as Direct Loans instead.

- FFEL will issue $78 billion in net new loans in 2005 costing taxpayers $9.8 billion over the life of the loans — a 12% subsidy.

- The Direct Loan program will make $23 billion in new loans at taxpayer cost of $211 million over the life of the loans — a 1% subsidy.

STUDENT LOAN PROGRAM COSTS

Why Direct Loans Cost Taxpayers Less

- In the FFEL (guaranteed loan) program, the government subsidizes banks to lend and lets banks make a profit through interest payments from students.

- In Direct Loans, there is no subsidy to banks and the government collects the interest on the loans.

- CBO director Holtz-Eakin: "In the FFEL program there is a subsidy to the student and the bank. Under Direct Loans, only the student gets a subsidy.

FFEL Costs

- There is *no* market competition in the FFEL program. All lenders are guaranteed the exact same subsidies, regardless of their costs, efficiency, etc. Lenders compete among themselves for market share, but not to the benefit of taxpayers.

- The main costs of the FFEL program are interest rate subsidies for private lenders**.** Direct Loans have no similar subsidy. The federal government guarantees private lenders a minimum quarterly rate of return on a FFEL loan. Borrowers pay a fixed rate for the whole year. Anytime rates rise in a quarter, lenders receive payments. In 2005 these subsidies will cost $3 billion.

- FFEL loans also include taxpayer funded fees paid to subsidize 33 guarantee agencies. Direct Loans have no similar costs.

BANKS USE TACTICS TO CONFUSE

"Big Government" vs. "Private Sector"

- Many have tried to characterize direct loans as big government and FFEL as a private sector program. THIS IS A FALSE COMPARISON. Keep in mind:

- Both programs are *government programs.* Both rely on government subsidies *and private contractors.*

- Direct loans are administered by private contractors who must compete to win the contract. This competition drives down the cost of the program.

- FFEL loans are backed 100% with taxpayer money and all interest rate risk is shouldered by the government through additional subsidies.

- In FFEL, all banks receive the same subsidy rates, regardless of cost or efficiency. This is akin to a no-bid contract. It is not free-market competition.

One-sided Comparisons

- Lenders and other critics of direct loans don't want to compare the program costs, instead they focus *only* on Direct Loan costs.

- Lenders cite reports saying Direct Loans lose money. But these critics don't point out that *FFEL loans lose even more money for the government*. It is a straw man approach: argue Direct Loans are supposed to break even, and cry foul if they don't. Neither program is intended to "break even."

- Lenders argue that Direct Loan costs have been *re-estimated* upward. They don't tell you, however, that Direct Loans are still much cheaper than FFEL, even after upward cost revisions.

- A 2004 GAO study looks at Direct Loan *cash flow*. Lenders say the report shows Direct Loans are losing money because the program has a negative cash flow. Under this approach, direct loans look like grants. What's more, FFEL has a much larger negative cash flow than Direct Loans because the government pays banks.

False Competition Arguments

- Critics argue that loan programs should compete on a level playing field for business from schools.

- The playing field is already slanted to favor lenders, because they receive generous subsidies. Under current law, lenders can use their subsidies to pay off schools for using FFEL instead of Direct Loans.

- It's a double standard, then, to say that the STAR Act gives Direct Loans unfair advantage. The additional grant aid provided by the bill is funded entirely from what would have been spent on lender subsidies.

Bogus Studies

- No government report has even refuted Direct Loan savings over FFEL. Most studies touted by lenders only look at Direct Loans, not a comparison of two programs. Others use cash accounting.

Price Waterhouse Coopers Study

- <u>The recent report commissioned by the student loan industry only looks at the direct loan program and never claims that direct loans are not cheaper.</u> Nor does it provide the dollar figure by which it believes federal cost estimates are biased in favor of direct loans, it just says costs could be biased and subject to change.

- Worst of all, the study argues that estimates of FFEL program costs are not offset by tax revenue paid by banks making student loans -- about $600 million a year. That's nothing compared to the $9 billion wasted on higher costs in the FFEL program.

- <u>The study also says that in the past, direct loan cost estimates have been revised upward. True, but even with the re-estimates, loans through FFEL still cost about 10 times as much.</u>

Chairman Boehner's GAO Study Request on Direct Loan "Hidden Costs"

- Last year Mr. Boehner and other Republican members asked the GAO to look for hidden costs in the Direct Loan program. <u>The report does not ask for a comparison of the two program costs -- even if there are hidden costs, Congress will have no meaningful way to compare them with FFEL costs.</u> The questions asked of GAO are very similar to those in the PriceWaterhouse study. The report is still pending.