

CRS Report for Congress

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Student Loans and FY2006 Budget Reconciliation

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Summary

The FY2006 budget resolution (H.Con.Res 95, H.Rept. 109-62) contains reconciliation instructions that require authorizing committees to report legislation to reduce mandatory spending by \$34.7 billion over a five-year period. The House Committee on Education and the Workforce is responsible for a reduction of \$12.7 billion for FY2006 through FY2010. The Senate Committee on Health, Education, Labor, and Pensions is responsible for a reduction of \$13.7 billion over that period. Authorizing committees were initially required to report to the budget committees by September 16, 2005. However, reconciliation action has been postponed until October. The Higher Education Act (HEA) reauthorization and budget reconciliation processes have become intertwined. Each of the aforementioned authorizing committees has marked up a comprehensive HEA reauthorization bill containing provisions that generate substantial net savings in mandatory spending on the student loan programs. This report will be updated.

Budget Resolution

The House and Senate approved the conference report (H.Rept. 109-62) on H.Con.Res. 95, the Concurrent Resolution on the FY2006 Budget on April 28 and April 29, 2005, respectively. The annual concurrent resolution on the budget sets forth the Congressional budget. When the federal deficit is expected to be large, budget resolutions often require reductions in mandatory spending. In such instances, the budget resolution issues reconciliation instructions that require authorizing committees to report changes to legislation to reduce spending on mandatory programs under their jurisdiction.

The FY2006 budget resolution includes reconciliation instructions that direct authorizing committees to report legislation to reduce mandatory spending for the period FY2006-FY2010. Subsequently, these proposals are to be combined in a single reconciliation bill by the budget committees. The House Committee on Education and the Workforce is responsible for a reduction of \$1.0 billion specifically for FY2006 and \$12.7 billion overall for FY2006 through FY2010; the Senate Committee on Health,

Education, Labor, and Pensions is responsible for \$1.2 billion for FY2006 and \$13.7 billion for FY2006-FY2010.

The Federal Family Education Loan (FFEL) program and the William D. Ford Direct Loan (DL) program are two of the major mandatory programs under each committee's jurisdiction. Each committee is looking to reduce mandatory spending on these federal student loan programs.

Federal Student Loan Programs

The federal government operates two major student loan programs: the Federal Family Education Loan program, authorized by Part B of Title IV of the HEA, and the William D. Ford Direct Loan program, authorized by Part D of Title IV of the HEA.¹ These programs provide loans to undergraduate and graduate students and the parents of undergraduate students to help them meet the costs of postsecondary education.

Under the FFEL program, loan capital is provided by private lenders, and the federal government guarantees lenders against loss through borrower default, death, permanent disability, or, in limited instances, bankruptcy. Under the DL program, operated through the U.S. Department of Education (ED), the federal government provides the loans to students and their families, using federal capital (i.e., funds from the U.S. Treasury). The two programs rely on different sources of capital and different administrative structures, but essentially disburse the same set of loans.²

The DL program, established in 1993, was intended to streamline the student loan delivery system and achieve cost savings. While the DL program was originally introduced to gradually expand and replace the long-standing FFEL program, the 1998 HEA amendments removed the provisions of the law that referred to a "phase in" of the DL program. Currently both programs are authorized and the two programs compete for student loan business. In FY2004, these programs provided \$52.1 billion in new loans to students and their parents. In that year the FFEL program provided 9,550,000 new loans averaging approximately \$4,111 each and the DL program provided 3,001,000 new loans averaging approximately \$4,279 each.

Mandatory Spending on Student Loans

The FFEL and DL programs are entitlements; funding is provided for these programs on a permanent indefinite basis, not subject to appropriations. The fiscal year cost estimates for both programs, under terms of the Credit Reform Act of 1990, are calculated by determining the net present value of the costs to the government over the lifetime of

¹ There is a smaller, separate, campus-based student loan program (the Federal Perkins Loan Program) that is also authorized by the HEA which will not be discussed here. For information on Perkins loan reauthorization issues see CRS Report RL31618, *Campus-Based Student Financial Aid Programs Under the Higher Education Act*, by David Smole.

² For detailed information on the array of FFEL and DL program loans, see CRS Report RL30655, *Federal Student Loans: Terms and Conditions for Borrowers*, by Adam Stoll. For a thorough discussion of how the loan programs operate, see CRS Report RL30656, *The Administration of Federal Student Loan Programs: Background and Provisions*, by Adam Stoll.

new loans disbursed in the given fiscal year. Under credit reform, an effort is made to capture, in the year in which credit is provided, the multi-year net cash flows associated with a new cohort of direct or guaranteed loans. This calculation establishes a “subsidy cost,” which is the estimated long-term cost to the government of a direct or guaranteed loan.

In calculating the subsidy costs for the two programs, the main cost components are the interest benefits to students in the subsidized Stafford program, the special allowance payments to lenders,³ and defaults. Subsidy cost calculations are highly dependent on interest rate forecasts over the life of the loans, and therefore can vary significantly depending on these forecasts.

In order to achieve savings in mandatory spending on the loan programs, Congress has often cut loan subsidies, or introduced fees to generate funds that offset mandatory spending.

Each year the Congressional Budget Office issues a baseline budget forecasting estimated spending over 10-year period under current law, assuming no policy changes are enacted over that time period. The CBO baseline serves as a benchmark for budgetary analyses. When legislation that would affect mandatory spending is introduced, its budgetary impact is measured against the CBO baseline. The current CBO baseline projects that over the 2006-2010 period the federal student loan programs would guarantee or disburse about \$360 billion in new loans — costing about \$37 billion.⁴

Reconciliation Provisions

The FFEL and DL programs are scheduled to be reauthorized as part of HEA reauthorization during the 109th Congress. As has been noted, these programs are being relied upon to produce much of the savings in mandatory spending required by the FY2006 budget reconciliation instructions to the House Committee on Education and the Workforce and the Senate Health, Education, Labor, and Pensions Committee.

In recent months, the House Committee on Education and the Workforce reported an HEA reauthorization bill and the Senate Health, Education, Labor, and Pensions Committee ordered reported an HEA reauthorization bill. Reconciliation provisions were included as a part of each of these HEA reauthorization bills. The House bill, H.R. 609, contains \$8.7 billion in net savings in mandatory spending on student loans;⁵ and the Senate bill, S. 1614, contains a reported \$7 billion in net savings.

³ The special allowance payment amount is determined on a quarterly basis by a statutory formula which is tied to a financial index and ensures lenders receive, at a minimum, a specified level of interest income on loans. The special allowance is designed to compensate lenders for the difference between the below-market, statutorily set interest rate charged to borrowers and a market set interest rate that is intended as fair market compensation on the loan asset.

⁴ Congressional Budget Office Cost Estimate, *H.R. 609 College Access and Opportunities Act of 2005*, Sept. 16, 2005.

⁵ *Ibid.*

The principal savings provisions included in the House bill would: change the formulas used to calculate borrower interest rates and lender yields on student loans;⁶ eliminate a separate formula for lender yields for loans (known as 9.5% floor loans) which are supported with certain tax exempt financing; and reduce the level of insurance provided to lenders from 98% to 96% for new loans made on or after July 1, 2006.⁷

The Senate bill relies on many of the same mechanisms to achieve savings. However, several of the savings proposals are structured differently in the Senate bill. The principal savings provisions included in the Senate bill would: change the formulas used to calculate lender yields on student loans;⁸ place limitations on (but not fully eliminate) a separate formula for lender yields for loans (known as 9.5% floor loans) which are supported with certain tax exempt financing; reduce the level of insurance provided to lenders from 98% to 97% for new loans made on or after January 1, 2006; and increase the lender origination fee on consolidation loans for all loans made on or after April 1, 2006.

Issues

The FY2006 budget resolution contains reconciliation instructions that require authorizing committees to report legislation to reduce mandatory spending by \$34.7 billion over a five-year period. Recently, it has been widely reported that House leadership may wish to consider an amendment requiring increased mandatory savings in order to offset costs associated with Hurricane Katrina and Rita relief and recovery efforts.⁹ If such an effort is successful, it is likely that the House Education and the Workforce Committee would be called upon to generate additional savings, with the student loan programs becoming a possible target for additional cuts. It is not evident that any similar effort to increase cuts in mandatory spending is receiving consideration in the Senate. It is already the case that the House bill generates more student loan savings targeted for use in reconciliation than does the Senate bill. Efforts to generate additional savings in the House may make compromise between the chambers more complicated.

⁶ Under the provisions of H.R. 609, new “excess interest” provisions would be adopted. In essence, a new formula would be in effect for new loans made on or after 7/1/06, which would annually calculate the amount a borrower rate was above the Special Allowance Payment (SAP) rate, and the difference will be credited to the federal government. This in effect would reduce lender yields by insuring they do not receive interest income exceeding the SAP rate. In addition, H.R. 609 would make changes to various student loan rate-setting formulas. For a detailed depiction of these changes see CRS Report RL33040, *The Higher Education Act Reauthorization: Status and Issues*, by Adam Stoll.

⁷ The insurance percentage paid to lenders and loan servicers receiving “exceptional performer” designations would be reduced from 100% to 98%.

⁸ While in principal the excess interest provisions included in the Senate bill parallel those in the House bill, the borrower interest rates (with one exception) are not changed in the Senate bill as they are in the House bill. Since the borrower rate is a central facet of the excess interest calculations this constitutes a significant difference in the two approaches.

⁹ See, for example, “CBO Finds More Cash; Education Panel Quickly Finds New Places to Spend It,” *Congressional Quarterly*, Oct. 18, 2005; or “Senate Panel Puts Higher-Education Legislation on Fast Track as It Approves Deficit-Reduction Bill,” *The Chronicle of Higher Education*, Oct. 19, 2005.

The HEA reauthorization and budget reconciliation processes have become intertwined in the 109th Congress. H.R. 609 and S. 1614 are comprehensive HEA reauthorization bills that each contain provisions that would generate substantial savings in mandatory spending on the student loan programs. Some of these savings would be used to support enhanced student aid benefits (e.g., new grant programs, adjustments to need analysis, expanded loan limits) and some are generated to meet the requirements of reconciliation instructions. The Senate bill has a separate Title for reconciliation provisions. On October 18, the Senate Health, Education, Labor, and Pensions Committee approved another bill containing these provisions to meet the requirements of reconciliation. The Committee attached the other components of S. 1614 (the HEA reauthorization bill) to this reconciliation bill in an apparent attempt to place HEA reauthorization on a fast track. It is unclear whether the House will follow suit and attempt to link a comprehensive HEA reauthorization bill to a reconciliation measure in this manner.

Additionally, the reconciliation provisions contained in H.R. 609 and S. 1614 differ from one another in some fairly fundamental ways. For instance, the major savings proposal included in each bill is the excess interest provisions that insure that lender yields do not exceed the SAP rate. The Senate proposal calculates the SAP based upon fixed borrower rates whereas the House proposal enacts variable borrower interest rates. Either proposal generates substantial savings. However, arriving at a compromise on borrower interest rates may prove challenging in a short time frame.