Insight

Biden Administration Turns Direct Student Loan Program Into a Permanent Big Spender

TOM LEE | MAY 16, 2023

Executive Summary

- The Federal Direct Loan program, designed as part of the "pay for" for the Affordable Care Act, was projected by the Congressional Budget Office to save taxpayers $62 billion over a decade; this assumed, of course, that student loan borrowers would pay back their loans.
- Under the Biden Administration's proposed blanket student loan forgiveness, these borrowers would pay back much less than they owe, if anything at all.
- The administration's blanket forgiveness under the Federal Direct Loan program would cost taxpayers from $230 billion–$1 trillion over the next decade, far surpassing in costs the program's projected savings.

Introduction

As a "pay for" for the Affordable Care Act (ACA), in 2010, Congress passed a law to have all federal student loans issued directly by the Department of Education (ED), an arrangement known today as the Federal Direct Loan program, or Direct Loan program for short.[1] Prior to this reform, student loans were issued by banks and private lenders and guaranteed by the federal government and were known as Federal Family Education Loans (FFEL). Transitioning from the FFEL program to the Direct Loan program was projected to lower the costs of federal student loans to taxpayers.[2] Specifically, the savings from the new program were intended to help fund the new Affordable Care Act, as well as increase funding for Pell Grants.[3], [4] When the Direct Loan program began, the Congressional Budget Office (CBO) estimated it would save taxpayers about $62 billion over the next 10 years.[5], [6] This was, of course, under the assumption that borrowers would pay back their federal student loans. While repayment rates historically fell short of projections, the payment rates fell to just 1 percent following the payment pauses associated with the COVID-19 public health emergency.[7], [8]

Enter the Biden Administration's plan to forgive the outstanding balances of student loan borrowers. The administration's one-time blanket student loan forgiveness plan – which is currently on hold at the Supreme Court – would forgive $10,000–$20,000 of student loans for up to 43 million borrowers.[9] ED has also created a new income driven repayment (IDR) plan called Revised Pay As You Earn (REPAYE), which offers what is essentially the option for the administration to provide indefinite blanket loan forgiveness. Through these policies, current and future student loan borrowers would pay back much less than what they owe, if anything at all. Depending on the specific cost estimate, these two actions combined will cost federal taxpayers anywhere from $230 billion to nearly $1 trillion. [10], [11] As noted, the Direct Loan program, which was supposed to be a cost saver has already become a taxpayer liability. The administration's blanket forgiveness proposals would dramatically exacerbate this liability.

The Original Purpose of the Federal Direct Loan Program

Prior to 2010, most federal student loans were made through FFEL. These loans were issued by banks and private lenders and guaranteed by the federal government. In 2010, Congress closed the FFEL program and subsequently new federal loans were issued directly by ED. These new loans, officially called the William D. Ford Direct Loan Program, represent about 87 percent ($1.4 trillion) of the $1.6 trillion in outstanding federal student loan debt today.[12]

Originally intended as a partial "pay for" for the ACA, CBO estimated the Direct Loan program would save taxpayers $62 billion over the next decade, under the rationale that cost saving "arises because the interest rates on most direct loans exceed the rates on Treasury securities of comparable maturity, so discounting future interest payments at Treasury rates produces an estimated net gain for the government."[13] This projection, however, was predicated under the assumption that federal student loan borrowers would pay back their loans.

As noted, the Direct Loan program had already become a taxpayer liability, adding hundreds of billions in red ink. While the pandemic-related payment pauses were the main driver of non-payment, student borrowers were already repaying their loans at lower-than-projected rates.[14]

$10,000–$20,000 Blanket Forgiveness and New Income-driven Repayment Plan

In August 2022, President Biden announced his $10,000 blanket forgiveness plan for borrowers of federal student loans making less than $125,000 per year and for married borrowers whose combined income is less than $250,000 per year. The amount of forgiveness would increase to $20,000 for Pell Grant recipients. The Penn Wharton Budget Model has projected the blanket loan forgiveness plan would cost about $469–$519 billion over the next decade.[15] CBO has estimated blanket forgiveness would cost about $400 billion over the next decade.[16] The blanket forgiveness plan is currently on hold as the Supreme Court debates its legality.

In January 2023, ED proposed new regulatory changes through negotiated rulemaking to IDR plans for federal student loans. The changes will go into effect in July 2023 and will create a new IDR plan called REPAYE that will effectively halve the monthly payments currently required under IDR, and in some cases lower the number of payments a borrower must make before receiving automatic forgiveness. Under these changes, IDR effectively becomes a form of blanket loan forgiveness, as it now dramatically reduces or eliminates the amount federal loan student borrowers will have to pay back. The Penn Wharton Budget Model has projected the new REPAYE plan will cost $333–$361 billion over the next decade.[17] CBO estimates it will cost about $230 billion over the next decade.[18]

The Direct Loan program was projected to be a cost saver, under the assumption that borrowers would pay back their federal student loans. Blanket forgiveness negates that assumption. While estimates vary, at the lower bound the combined cost of the blanket forgiveness plan and the new REPAYE plan program together would amount to at least $630 billion. Even if the blanket forgiveness plan is denied by the Supreme Court, the REPAYE plan will go into effect in July 2023. The Direct Loan program, projected to save taxpayers $62 billion compared to the prior FFEL program, will now cost taxpayers at least $230 billion over the next decade, a figure that could grow to over $1 trillion.[19], [20]

[1] "PUBL152.PS (govinfo.gov)

[2] Education Policy: Topics (newamerica.org)

[3] Pell Grants are made to lower-income borrowers to pay for their undergraduate tuition. Because they are grants, they do not need to be paid back like loans.

[4] Education Policy: Topics (newamerica.org)

[5] Student loan letter.fm (cbo.gov)

[6] Education Policy: Topics (newamerica.org)

[7] Student Loans: Education Has Increased Federal Cost Estimates of Direct Loans by Billions Due to Programmatic and Other Changes | U.S. GAO

[8] https://studentaid.gov/data-center/student/portfolio

[9] FACT SHEET: President Biden Announces Student Loan Relief for Borrowers Who Need It Most | The White House

[10] Budgetary Cost of Newly Proposed Income-Driven Repayment Plan — Penn Wharton Budget Model (upenn.edu)

[11] Estimated Costs of the Proposed Rule on Income-Driven Repayment (cbo.gov)

[12] Federal Student Loan Portfolio | Federal Student Aid

[13] Student loan letter.fm (cbo.gov)

[14] GAO-22-105365, Accessible Version, STUDENT LOANS: Education Has Increased Federal Cost Estimates of Direct Loans by Billions Due to Programmatic and Other Changes

[15] The Biden Student Loan Forgiveness Plan: Budgetary Costs and Distributional Impact — Penn Wharton Budget Model (upenn.edu)

[16] Costs of Suspending Student Loan Payments and Canceling Debt (cbo.gov)

[17] Budgetary Cost of Newly Proposed Income-Driven Repayment Plan — Penn Wharton Budget Model (upenn.edu)

[18] Costs of the Proposed Income-Driven Repayment Plan for Student Loans | Congressional Budget Office (cbo.gov)

[19] The ultimate cost associated with blanket forgiveness depends on whether the administration’s one-time blanket forgiveness plan is approved by the Supreme Court. Also the cost estimates use different assumptions about how many more loans will be disbursed due to borrowers expecting future forgiveness.

[20] The Biden Student Loan Forgiveness Plan: Budgetary Costs and Distributional Impact — Penn Wharton Budget Model (upenn.edu)