Research

The Department of Education's $22 Billion Blowout – And Why It's a Drop in the Bucket

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EXECUTIVE SUMMARY

- The federal direct student loan program will cost taxpayers an additional $21.8 billion in FY2016 according to the president's budget proposal. This is reported to be the largest estimate adjustment for any federal credit program in budget history.
- $90 billion has been borrowed by the U.S. Treasury to keep the student loan program afloat since 2009. When the Department of Education can't cover its loans, it borrows from the Treasury.
- The program was initially projected to save $87 billion between 2010 and 2019.

INTRODUCTION

Included in President Obama's $4 trillion FY 2016 budget are a number of changes for higher education –fiscally, and policy-wise. The budget acknowledged the federal government would be on the hook for $21.8 billion more than expected for direct student loans in fiscal year 2016. That's been reported as the largest adjustment for any federal credit program anywhere in federal budget history. Sadly, for the taxpayer, it's indicative of a larger, very expensive, but mostly hidden problem with the federal direct loan program. Suffering from a chronic cash flow shortage, the federal direct loan program has resulted in nearly $90 billion of Treasury borrowing (deficit spending) to keep the program afloat.

REESTIMATES

Every year, the federal government estimates the cost of credit programs – programs where the federal government acts as a lender or guarantor of loans. These programs are estimated on a net present value basis, as required by the Federal Credit Reform Act, legislation that replaced the previous method of cash flow accounting with a more credit-oriented method of accounting for federal loan programs. The government estimates the costs for new cohorts of loans for the coming fiscal year, and re-estimates the cost of prior year. In other words, in 2015, the government provides a cost estimate for new loans in the coming fiscal year, but also reviews the originally estimated cost of a group of student loans issued in say, 2005, to see what the current cost estimate looks like. If the estimated cost has changed, the government makes a statement to the revised cost estimate as part of the federal budget. If the cost is higher than anticipated, the budget will show a shortfall. If negative, then the budget will show a surplus for that year's worth of loans or loan guarantees.

SHORTFALLS

This year, however, the sheer size of the shortfall in the federal direct student loan program was sufficient to attract national media attention, and for good reason. Even in a $4 trillion budget, $21.8 billion is a lot of money. As a reference point, the $21.8 billion that the Department of Education (ED) is estimated to spend to cover up the shortfall in direct lending is:

•$6 billion more than the president proposed spending on low-income K-12 education programs (Title I);

•$10 billion more than the president proposed spending on special education (IDEA, Part B);

•70 times more than the president proposed spending on charter schools; and

•Nearly 7 times more than the president’s annual request for universal preschool, his signature education initiative.

Given the size of the shortfall, it seems the ED would do a better job anticipating the costs of the federal direct student loan program. After all, any program that’s reported to save $87 billion over 10 years at its inception only to have the savings reduced to $67 billion less than one year later, and then to have a third of that evaporate in a single budget year, should be on a budget watch list.

Federal law requires estimates of federal credit programs to be calculated under very specific standards, stipulating that credit programs are scored on the basis of net present value, excluding administrative costs. In other words, once an estimate has been calculated, it’s basically set in stone. All any Secretary of Education can do when the costs are re-estimated and show a shortfall is to point to the law – even when those estimates are off by $21.8 billion.

In fact, the estimates are often off. Of the 21 annual cohorts of loans issued by the Department of Education, only three didn’t cost more than expected. The remaining 18 cohorts racked up over $41.2 billion in extra costs to the taxpayer, an error rate of 85 percent. As the federal government now issues more student loans than any financial institution (or possibly all financial institutions combined), errors like this are especially profound. Every minor error in the original estimate will be compounded given the tremendous volume of loans issued every year by Uncle Sam.

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An extra prize is that these estimates are done annually; this year’s $21.8 billion shortfall is just part of the additional budget pain that’s coming as the cost estimate is continually revised throughout the life of each cohort of loans. It might be a $21.8 billion hole this year, but new loans aren’t expected to be paid off for at least 10 years at a minimum. With the administration’s pay as you earn (PAYE) initiatives, it could be 20 or 25 years until pay-off, or never, for some students. It’s a gift that keeps on giving, draining taxpayer money for decades.

BORROWING FROM TREASURY

Still, that's not even the whole picture. To see the true damage being done by the direct lending program, observers would have to dust off the monthly borrowing statement issued by the Department of the Treasury. These statements tell the story of how the government pays its debts. Some debts are owed between agencies, with Treasury footing the bill if programs run over budget or if agencies operating credit programs don't recover what they expect to. In the case of direct lending, the Treasury has borrowed nearly $90 billion since 2009 to keep the direct loan program afloat. The program generated nearly $800 billion of student debt for the Treasury books.

Fiscal Year	Agency Borrowing attributed to FDLP ($billions)	FDLP Issuances	Over borrowing attributed to FDLP ($billion)
2009	61.6	41.4	20.2
2010	103.3	97.9	5.4
2011	153.8	133.9	19.9
2012	155.4	140.7	14.7
2013	145.3	129.3	16.0
2014	118.3	105.6	12.7
Total	737.7	648.8	**88.9**

Note: figures are taken from the Monthly Treasury Statement (MTS) and Credit Supplement stating annual FDLP loan volumes.

What's happening is that for each year the FDLP returns less in principal and interest earnings than expected. The Treasury Department then has to issue debt to the ED to repay debts it owed to the Treasury. Catch that? Since the ED is short on its IOU to Treasury, it has to come up with the money somewhere, and that somewhere is another IOU from the taxpayer in the form of additional Treasury debt. Outside of Washington, this process would seem comical, as it looks a lot like asking a bank for a second loan to pay off an initial loan.

Compounding the issue is that Treasury debt is not interest free. When the ED comes up short, the Treasury still has to pay interest on the unpaid debt. That's also true for the new debt, which means a double whammy for taxpayers who are propping up Treasury's borrowing with their tax dollars. According to Congressional Budget

Office estimates, interest payments on the national debt are expected to hit $227 billion this year alone. The interest payments will then more than double to $480 billion by 2019 and more than triple to $722 billion by 2024. Given the sheer volume of federal student loans and the fact that the government borrows to make those loans –the interest payments resulting from the government's operation of the FDLP are not inconsequential.

CONCLUSION

All told, the direct loan program is creating a chronic cash flow shortage within the U.S. ED that is impacting taxpayers in the form of increased deficits and associated Treasury borrowing. This is an extraordinary loss given that the program was originally estimated to save $87 billion. Just as troubling is the lack of transparency around the program's poor performance. Other than a handful of lines tucked into thousands of pages of budget documents, there is no real accountability for the program's lack of performance.

Taxpayers should be concerned about the $21.8 billion shortfall, but they should be even more troubled by the nonchalance with which billions of dollars in additional debt are being swept under the rug by the direct loan program and its administrators.