CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Phillip L. Swagel, Director

September 15, 2022

Honorable Warren Davidson
U.S. House of Representatives
Washington, DC 20515

Re: CBO's Estimates of Student Loan Costs Since 2010

Dear Congressman:

This letter responds to a request by you and your colleagues for information about the Congressional Budget Office's estimates of the cost of student loan programs and how they have changed since 2010.

CBO is currently analyzing the effects of President Biden's announcement on August 24, 2022, about executive actions affecting student loans. Estimates of the effects of those actions will be published as soon as they are completed. CBO recognizes that Members of Congress are interested in that information and is working hard to examine the issues. This letter does not address the new actions; it focuses on the questions you asked about student loans covering the period 12 years before the announcement.

How Have CBO's Estimates of the Cost of Student Loan Programs Changed Since 2010?

Overall, the estimated cost of the federal student loan program has increased since 2010. In CBO's assessment, the increases (estimated before August 24, 2022) primarily stem from the use of income-driven repayment (IDR) plans and not from the elimination of the guaranteed student loan program and its replacement with direct loans.

CBO has not attempted a full retrospective analysis of the cost of changes to IDR provisions and the switch to direct loans specified in the Health Care and Education Reconciliation Act of 2010 (HCERA), Public Law 111-152.[1] The agency has updated its estimates of the cost of student loan

[1] For the 2010 analysis, see Congressional Budget Office, cost estimate for H.R. 4872, the Reconciliation Act of 2010 (March 20, 2010), www.cbo.gov/publication/21351.

programs as part of each baseline projection, and it did so most recently in May 2022.[2] CBO estimates the effects of changes to programs—stemming from legislative, administrative, economic, and other factors—between one baseline and the next. Because many legislative and administrative changes are made over time within a given program, it is usually not possible in a retrospective analysis to identify the effects over time of a single historical legislative change separately from those subsequent actions. That is the case for HCERA. CBO has focused on baseline projections of the cost of those programs as they are specified at the time as well as analysis of changes to current law.

Growth of Income-Driven Repayment Plans. You asked specifically about changes between 2010 and 2019. During that period, the share of direct loan borrowers participating in IDR plans increased from 10 percent to 30 percent, and the volume of outstanding direct loans in IDR plans increased from $24 billion to about $450 billion.[3] Those plans are more costly to the government than fixed payment plans because the required payments depend on borrowers' income, and borrowers may be eligible to have their unpaid balances forgiven after a certain number of payments. (In some cases, borrowers may not be required to make payments at all.) Those reduced monthly payments, combined with loan forgiveness, result in lower total payments over the life of the loan, which translates to an additional cost to the government. That cost is partly offset because borrowers in IDR plans are less likely than borrowers in fixed payment plans to default on their loans. Despite having higher default rates than IDR plans, however, fixed payment plans are generally less expensive for the government than IDR plans are, on average, CBO estimates.

Projections of the Cost of Income-Driven Repayment Plans. CBO's 2010 baseline projections of the cost of student loan programs underestimated the subsequent rapid growth of IDR plans and probably also underestimated the cost of provisions related to the specific IDR plan amended by HCERA. That plan, the income-based repayment (IBR) plan, was created under the College Cost Reduction and Access Act of 2007 and

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[2] See Congressional Budget Office, "Student Loan Programs—May 2022 Baseline" (May 2022), https://tinyurl.com/yz6bvfe6.

[3] See Department of Education, Federal Student Aid, "Federal Student Loan Portfolio," https://tinyurl.com/3bdp87j4 (accessed August 17, 2022); and Congressional Budget Office, *Income-Driven Repayment Plans for Student Loans: Budgetary Costs and Policy Options* (February 2020), www.cbo.gov/publication/55968.

became available to borrowers in July 2009; it was amended in 2010 by HCERA for new borrowers who took out loans on or after July 1, 2014.

It would not be straightforward to update the estimates of amendments related to the IBR plan on the basis of current information. Any update would need to determine how much of the growth in IDR plans was attributable to those provisions, how much was attributable to the creation of other payment options (introduced through administrative actions), and whether any of the authority for those actions was derived from HCERA. Significant actions that affected student loan cost occurred after 2010. In 2012, the Obama Administration implemented the Pay as You Earn (PAYE) plan as part of the income-contingent repayment plan. Then, in 2015, the Administration created the Revised Pay as You Earn (REPAYE) plan. PAYE and REPAYE plans, rather than the IBR plan amended by HCERA, account for most of the growth in the volume of IDR plans.

The Cost of Guaranteed Loans Versus Direct Loans. The rapid growth of IDR plans does not substantially affect CBO's current assessment of the budgetary effect of eliminating guaranteed loans and replacing them with direct loans. Guaranteed loans were also eligible to be repaid through an IDR plan; thus, the growth of IDR plans since 2010 would have raised the cost of guaranteed loans, had they continued to exist.

In 2010, CBO estimated that eliminating guaranteed loans and replacing them with direct loans would result in budgetary savings, and the agency continues to have the same view of the key factors underlying that estimate. Specifically, the largest share of those savings was derived from the interest component of the program subsidies.[4] In the case of direct loans, the government would collect the interest payments. When CBO was preparing the cost estimate for HCERA, the interest rate paid by borrowers was projected to be higher than the interest rate on Treasury securities (and that rate is used in the estimation of the subsidies). As a result, CBO estimated that the government would collect more in interest from borrowers than it would pay on the Treasury securities that were used to finance student loans. By contrast, private lenders collected the interest payments on guaranteed loans. Furthermore, with direct loans, the government would not make the special allowance payments it would have paid to lenders in the guaranteed loan program.

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[4] See Congressional Budget Office, *Costs and Policy Options for Federal Student Loan Programs* (March 2010), http://www.cbo.gov/publication/21018, and *Subsidy Estimates for Guaranteed and Direct Student Loans* (November 2005), www.cbo.gov/publication/17473.

How Does CBO's 2010 Estimate Differ From CBO's 2019 Baseline Projection?

You asked about CBO's 2010 estimate of the cost of student loans, which included the elimination of guaranteed student loans, and about CBO's 2019 baseline projection. The 2010 estimate covered the 2010–2020 period.[5] The 2019 baseline covered the 2019–2029 period.[6]

There is no clear basis for comparing CBO's estimates in 2010 and 2019. They reflect different time periods with different program specifications (particularly for repayment plans), different projections of loan volume, and different forecasts for interest rates.

How Did CBO Estimate the Number of Borrowers Who Would Default on Their Loans?

For the Department of Education's student loan programs, CBO's estimates of cash flows—including scheduled and unscheduled principal payments, defaults, and recoveries—in 2010 and in 2019 were based on models that incorporated information available in those years about applicable laws and regulations and were calibrated to data on the historical performance of loans in those programs. The estimated cash flows took into account the characteristics of the loans and borrowers in each program and CBO's projections of macroeconomic variables, such as interest rates.

CBO used the same projections of default rates in two types of estimates. The Federal Credit Reform Act specifies that the present value of expected future cash flows be calculated by discounting those cash flows using the rates on Treasury securities with similar terms to maturity. Under fair-value estimating procedures, in contrast, estimates are based on market values.[7] A given projection of defaults is estimated to be more costly on a fair-value basis because defaults occur more often when the economy is weak, resources are scarce, and incomes are low.

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[5] See Congressional Budget Office, letter to the Honorable Judd Gregg about the budgetary impact of the President's proposal to alter federal student loan programs (March 15, 2010), www.cbo.gov/publication/21315.

[6] See Congressional Budget Office, "Student Loan Programs—May 2019 Baseline" (May 2019), https://tinyurl.com/yz6bvfe6.

[7] See Congressional Budget Office, *Measuring the Cost of Government Activities That Involve Financial Risk* (March 2021), www.cbo.gov/publication/56778.

I hope this information is helpful to you. Please let me know if you have any further questions.

Sincerely,

Phillip L. Swagel
Director

cc: Honorable Rick W. Allen; Honorable Jim Banks; Honorable Mo Brooks; Honorable Byron Donalds; Honorable Louie Gohmert; Honorable Garret Graves; Honorable Doug LaMalfa; Honorable Barry Loudermilk; Honorable Dan Meuser; Honorable Barry Moore; Honorable Ralph Norman; Honorable Scott Perry; Honorable Brad R. Wenstrup; Honorable Bruce Westerman