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Today's News

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Student-Loan Woes Not Easily Solved, Congressional Research Report Warns

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Washington

Congress and the Bush administration have struggled this year to find the right type and amount of federal subsidy that will ensure that students have access to fairly priced government-backed loans. An analysis by the nonpartisan Congressional Research Service suggests they may be attempting a nearly impossible task.

The report by the research service, a federal agency that does policy analysis for lawmakers from both parties, asserts that the government's system of distributing money through private lenders is chronically handicapped by wide variations among participating lenders and their cost structures.

"Because the true economic costs of lenders are not easily observed, and because costs in different segments of the student-loan market differ, achieving a precise alignment of lender yields and lender costs is difficult," the Congressional Research Service says in its 35-page analysis, "Economics of Guaranteed Student Loans."

The analysis was among several newly issued reports detailing the continued turmoil in student lending, only days before the start of the 2008-9 academic year. A poll by student loan giant Sallie Mae suggested too few student borrowers are considering the costs they are incurring, and a survey by the college advisory firm Student Lending Analytics found a sharp reduction in the availability of nongovernmental private loans.

The Congressional Research Service report could embolden calls expected next year in Congress to overhaul the student-loan system. Bush-administration officials leading the Education Department have already signaled their intention to try to guide that debate by offering proposals for reshaping the government-subsidized loan system before they leave office in January.

Tough Choices

The widely recognized difficulty in setting fair subsidy rates in the government-subsidized loan program doesn't mean that reformers face an impossible task, said Kevin Bruns, executive director of America's Student Loan Providers, an industry lobby group.

It instead means that Congress has to choose between a more generous range of subsidies that would allow a larger number of participants, or leaner subsidies that would allow only a few large lenders to survive, Mr. Bruns said. The latter choice would harm both lenders and students, he said.

Loans backed by the federal government supplied students with about $74-billion of the $258-billion that they spent on college in the 2007-8 academic year, according to the Congressional Research Service report.

About four-fifths of that lending was issued by private companies that participate in the federally guaranteed student-loan program, under which the government pays the lender a subsidy and promises to repay nearly the entire loan if the student defaults. The remainder was distributed through the direct-loan program, in which students at participating colleges borrow directly from the Education Department.

Congress cut the subsidy rates paid to the private-loan companies last September, in an attempt to bring the rates closer to the actual costs incurred by lenders. Dozens of lenders then withdrew from the system this year, citing both the subsidy cuts and a growing problem with finding investors willing to purchase their debts.

The investor problem was tied to the collapse of the market in auction-rate securities, which had become increasingly popular among loan companies as a way of financing their operations. Such securities involve repeated short-term auctions of assets, a system that for a while was producing larger returns than could be obtained through longer-term investments.

The collapse of that market and the subsequent withdrawal of many lenders from the federal program prompted Congress and the Education Department to devise a rescue plan in which the department has agreed to purchase loan assets, giving the lenders more money to issue more loans.

The Education Department last week approved its first two lenders, Sallie Mae and Nelnet, for participation in the program. Additional lenders are expected to be approved in the coming days, department officials said.

Advice Against Coddling Lenders

The Congressional Research Service, in its analysis, says the withdrawal of private lenders from the government program was due both to the subsidy cuts imposed by Congress and the collapse of the market in auction-rate securities. It warned, however, against offering lenders a rescue plan that does not sufficiently punish them for their risky behavior in using the auction-rate securities.

"If such disruptions of the student-loan market are due entirely to external forces, then there is little need to impose a penalty rate on lending to ensure prudent behavior in the future," says the report, which was prepared by D. Andrew Austin, an economic policy analyst at the Congressional Research Service.

"On the other hand, if the availability of government liquidity on generous terms might encourage lender behavior that might lead to future financial disruptions, then some financial economists would argue that lending at a penalty rate would improve financial stability in the student-loan market," Mr. Austin writes.

Even with the direct-loan option available to colleges, Congress felt it needed to devise a rescue plan for private lenders to ensure that all students would find federal loans available this fall, Mr. Austin said. Congress required that the rescue plan impose no financial cost on the federal government. The plan, however, does not appear to include any actual financial penalty on the lenders, Mr. Austin said.

Such additional punishment isn't necessary, Mr. Bruns said, because lenders have already seen sharp reductions in the profitability of their business. "An economist would probably say they've already paid the penalty," he said.

Consequences for Students

Students also appear to be paying a penalty for the turmoil in the student-loan marketplace, as they find a reduced ability to obtain private loans, according to an analysis by Student Lending Analytics, which advises colleges on student-loan options.

Many students turn to private loans, which carry no government guarantees and often cost more than government-backed loans, when the cost of attending college exceeds what they can obtain through the government plans and other sources. Because of the turmoil in the credit markets, however, a number of lenders have also quit issuing private student loans.

Companies appear to have cut $2.5-billion to $3.5-billion from the private-loan market for the coming year, or about 15 percent to 20 percent of what was available last year, said Tim Ranzetta, president of Student Lending Analytics. An additional $1-billion in availability appears to have been lost by the withdrawal of a few state agencies that provided private loans, Mr. Ranzetta said.

At the same time, Sallie Mae, the nation's largest student-loan company, issued survey results on Wednesday that appeared to suggest that many students and their families might not even be paying close attention to such matters.

The survey, in which Gallup interviewed 684 college students and 720 parents of college students in May, found 70 percent of students and parents said that their expected postgraduation income did not affect their borrowing decisions.

Sallie Mae, which plans to conduct such surveys on an annual basis, said in a statement that the findings show that too many students are borrowing without considering how they will repay their loans.

The company's report, "How America Pays for College," casts doubt on concerns that the current rash of home-mortgage defaults might have a significant effect on the ability of students to pay for college this year. The survey found that only 3 percent of college students or their families expected to finance their education with the assistance of a home-equity loan.

The 3-percent statistic seems "very low," said Sandy Baum, an economics professor at Skidmore College who serves as a senior policy analyst at the College Board, which produces its own annual reports on the costs of college and the ways students pay for it.

The apparent failure among students to consider their postgraduation earnings is a cause for concern, Ms. Baum said. The need to consider potential wages should not suggest that students choose their college major based on its earnings potential, she said, but it should prompt students "to think about how much they can afford over the long run."
