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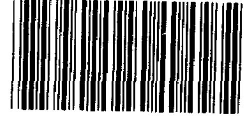
United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-249663



July 15, 1993

The Honorable Paul Simon
United States Senate

Dear Senator Simon:

In November 1992 we reported that the federal government could save $4.7 billion in the first 5 years by replacing the Federal Family Education Loan (FFEL) program with a direct student loan program.[1] A principal assumption in our analysis was that the government would finance direct loans with securities that had an average yield equal to the rate on 10-year Treasury notes, an assumption consistent with the Congressional Budget Office's (CBO) interpretation of the Federal Credit Reform Act of 1990 (P.L. 101-508). In a February 1993 letter to Chairman William Ford of the House Education and Labor Committee, we demonstrated what the estimated savings could be by assuming that the government would use Treasury bills (T-bills) to finance direct loans.[2] Under this scenario, the possible savings increase from $4.7 billion to about $11 billion over 5 years.

You requested that we update our analysis to reflect the more recent estimates for (1) inflation, which affects the costs of future loan servicing and origination; (2) interest rates, which affect borrowers' interest payments, the cost of federal borrowing, and the rate at which future costs and income are discounted to derive a present value estimate; and (3) future FFEL volumes for subsidized and unsubsidized Stafford loans, Supplemental Loans for Students (SLS), and Parent Loans for Undergraduate Students (PLUS). Unsubsidized Stafford loans, first authorized by the Higher Education Amendments of 1992 (P.L. 102-325), were not included in our prior analyses.

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[1] Student Loans: Direct Loans Could Save Billions in First 5 Years With Proper Implementation (GAO/HRD-93-27, Nov. 25, 1992).

[2] Direct loan debate (GAO/HRD-93-15R, Feb. 8, 1993).

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You also asked us to compute separate present value savings estimates for a direct loan program fully implemented in fiscal year 1994 and for one phased-in during fiscal years 1994-98. For each of these scenarios we estimated savings for three rates of Treasury financing: (1) 10-year Treasury notes, (2) 52-week T-bills, and (3) a combination of 52-week T-bills for SLS and PLUS loans and 91-day T-bills for Stafford loans.

Using CBO's 1993 forecasts for inflation and interest rates (see table I.1) and the Department of Education's April 1993 estimates for loan volumes (see table I.2), we estimated that the present value saving of a direct loan program for fiscal years 1994-98 would range from $2.1 billion to $10.4 billion, depending on the assumptions used. (See table 1.)

Table 1: Estimated Savings From Direct Lending

Dollars in Billions

Analysis[a]		Estimated present value savings for fiscal years 1994-98 loan commitments	
		Full implementation	Phased-in full implementation
1	GAO's November 1992 analysis (using 10-year Treasury note rates)	$4.7	No estimate
Updated analysis with federal borrowing at...			
2	10-year Treasury note rates	$3.3	$2.1
3	52-week T-bill rates	$9.5	$5.0
4	91-day T-bill rates for Stafford loans; and 52-week T-bill rates for SLS and PLUS loans	$10.4	$5.4

[a]See tables I.1 and I.2 for assumptions and estimates used.

As was the case in our November 1992 analysis, all savings estimates are expressed in present value terms as of the beginning of fiscal year 1994. The estimates shown reflect the impact of the 1992 amendments and present value calculations for the program's administrative costs including loan origination, servicing, and collection. The scope of our analysis excluded loan prepayments, proposed reductions in borrower interest rates, income contingent repayments, and loan forgiveness for national service.

As shown in table 1, the revised analysis with funding at the 10-year Treasury note rates indicates lower savings than we indicated in our November 1992 analysis. This occurs primarily because CBO now forecasts that 10-year Treasury note rates will exceed T-bill rates by a wider margin than in CBO's earlier forecast used in our previous analysis.

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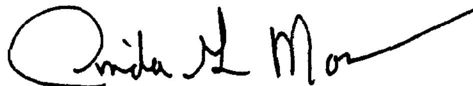
Copies of this letter will be provided to the Secretary of Education; the Director, Office of Management and Budget; relevant congressional committees; and other interested parties. If you have any questions or would like to discuss this material further, please call me at (202) 512-7014.

Sincerely yours,



Linda G. Morra
Director, Education and
Employment Program

Enclosure

CERTAIN ASSUMPTIONS USED IN GAO ANALYSES

Table I.1: Economic Assumptions Used in Revised Analyses

Assumption	Fiscal year				
	1994	1995	1996	1997	1998
Inflation (annual rate)	2.7%	2.7%	2.7%	2.7%	2.7%
91-day T-bill rate[a]	3.5%	4.2%	4.6%	4.8%	4.9%
52-week T-bill rate[a]	3.7%	4.4%	4.8%	4.9%	5.0%
10-year Treasury note rate	6.6%	6.6%	6.5%	6.5%	6.4%

Source: Congressional Budget Office, January 1993 assumptions.

[a]Our analyses with financing at the 91-day and 52-week T-bill rates assumed that the government's cost of borrowing would be the bond equivalent yield on the highest of CBO's forecasted T-bill discount rates during fiscal years 1994-98, that is, 4.9 percent for 91-day T-bills, and 5.0 percent for 52-week T-bills.

Table I.2: Loan Volume Assumptions--Loan Commitments, Net of Cancellations

Dollars in Billions

	Fiscal year					
	1994	1995	1996	1997	1998	Total
All FFEL program loans (either guaranteed or direct)	$20.1	$22.1	$22.9	$24.2	$25.2	$114.5
Amount of direct loans assumed for a phased-in program	$0.4	$3.2	$9.7	$19.3	$25.2	$57.7

Source: Department of Education, April 1993 estimates.

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