Stephen Spruiell
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Today Student Loans, Tomorrow Health Care

In student lending, "public option" is turning into "single payer."

By Stephen Spruiell

Anyone who still doubts that Obamacare would lead to a government-run health-care system should take a look at Obama's plans for student loans. Those plans got a big boost this week when Rep. George Miller, the California Democrat who chairs the House Education Committee, introduced legislation to replace federally subsidized private lending with a government-run program, leaving only a sliver of student lending to the private sector and completing a journey to nationalization that began 44 years ago. Compromisers take note: This journey also involves a detour onto the "public option" turnpike.

In 1965, Congress created what became known as the "Stafford loan" as part of the Federal Family Education Loan Program (FFELP). Almost anyone who has attended college has heard of Stafford loans, and most people know that the federal government insures these loans against default risk — that is, the government reimburses the private lender for 97 to 99 percent of the loan's value if the student defaults. What most people don't know is that the government also protects lenders from interest-rate risk. Stafford loans are provided to students at a low fixed rate set by law. Fluctuations in commercial interest rates can expose banks to losses on these loans if their borrowing costs rise too high. So to smooth out their returns, the government pays the banks a subsidy when interest rates rise. Conversely, when rates fall below the Stafford rate, lenders must remit the difference to the government. Lenders are also guaranteed a percentage to cover administrative costs.

FFELP was ostensibly designed to help students borrow money cheaply for college. For the first 25 years of its existence, conservatives complained that it led to tuition inflation by increasing demand for higher education, while liberals were more or less satisfied with it. Then, in the early 1990s, a change in federal budgeting rules forced Congress to set aside more money for the program, leaving less available to spend on other things. Lawmakers looking for a way around this problem found that, oddly enough, they could reduce FFELP's budgetary impact by putting all the loans directly on the government's books.

The Democrats argued that this would produce real savings by cutting out private-sector middlemen. In fact, the bulk of the projected savings were fictitious, resulting from the accounting change. To understand how this worked, consider the structure of the interest-rate insurance provided under FFELP. In exchange for insulation against interest-rate spikes, private lenders give up their ability to make windfall profits on student loans when their borrowing costs fall. The government doesn't have to make that trade; if interest rates drop, it can keep all the profits. This means the Congressional Budget Office can use rosy interest-rate scenarios to project large savings.

Under these projections, “Treasury can charge 6.8 percent, borrow at 2 percent, and pocket the difference all day,” says Jason Delisle, director of the Federal Education Budget Project at the New America Foundation. Sounds good, but, as Delisle points out, this scenario hides the additional risk to the taxpayer that comes with putting all those loans on the government’s books. For government accounting purposes, that risk doesn’t exist, nor does the risk that Treasury’s borrowing costs might spike.

In 1993, the Democratic Congress made its move and created the Ford Direct Loan Program (FDLP). The initial plan was to have the FDLP take over all federally guaranteed student lending, but Republicans thwarted this move when they took control of Congress in the next year’s elections. The Clinton administration saved the FDLP by arguing that the existence of a “public option” for student lending would benefit consumers. In 1999 (the fifth anniversary of the program), Deputy Education Secretary Marshall Smith said, “Guaranteed lenders have responded to the Direct Loan Program by improving their service. . . . Students and schools are served by healthy competition in student loan programs, which has created marketplace incentives for both programs to improve.” Sound familiar?

Now that the government’s borrowing costs have fallen and the deficit has swelled, the Democrats have dropped the pretense of caring about consumer choice. “Healthy competition” is now a bad thing; their argument is that the FFELP should be eliminated and the “savings” spent elsewhere. Obama is brandishing the figure of $87 billion in savings over ten years, which he would use to expand the Pell Grant program. But, as noted above, the bulk of these savings will not materialize unless the CBO has accurately projected Treasury’s borrowing costs for the next ten years. The new plan “saves” the money FFELP spent to insure private lenders against risks — by assuming that those risks don’t exist.

There are small but real administrative-cost differences between the guaranteed-lending and direct-lending programs, but, as Delisle points out, this is true mostly because the reimbursement for those costs is settled in back rooms on Capitol Hill, not in the marketplace. Indeed, the “private” market for student loans is inefficient in dozens of ways precisely because of the government’s involvement. That is a reason to fully privatize student lending, not to increase the government’s role.

As for the government’s lower administrative costs, the CBO doesn’t account for what might happen once the government has a quasi-monopoly. The FDLP’s share of new federally backed loan originations peaked at 30 percent right after it was created and has fallen steadily to 20 percent since then. About this statistic there are two things to say.

One, the steady decline in loan originations indicates that the government is not offering a great product. Private lenders have an incentive to provide students with good customer service: They want them to buy other financial products and become lifelong customers. A recent study published by the National Bureau of Economic Research attributes at least some of their higher administrative costs to “marketing activities, and higher service levels” — two things the government won’t need to worry about once it has eliminated its competition. It might mean lower overhead, but it’s not good for students; the Democrats’ plan would take an unpopular program and essentially make it mandatory.

Two, the government’s cost structure is certain to change as it expands to fill the other 80 percent of the market. The government initially plans to contract out loan-servicing operations to private lenders, but Rep. Mark Souder, an Indiana Republican who sits on the Education Committee, says that could change. “AFSCME [the government employees’ union] is going to want those servicing jobs,” he says. That would lead to a big increase in the government’s costs.

From a simple loan-guarantee program to a "public option" to a union-staffed, government-run monopoly in 44 years: "This is sort of a long progression that shows you how the federal government can take over an economy," says Neal McCluskey, associate director of the Cato Institute's Center for Educational Freedom. "We've pushed out private lenders who had a legitimate interest in making sure someone has the ability to succeed in college, graduate, and pay back the loan, and we've made this just pure welfare."

Now the Democrats are taking the health-care industry down the same road. They are even using the same language to sell the "public option," arguing, as Obama has, that "one of the best ways to bring down costs, provide more choices, and assure quality is a public option that will force the insurance companies to compete and keep them honest." (Question: Once the government has pushed private lenders out of the student-loan market, who will force it to compete and keep it honest?)

A public option in medical insurance will not bring down health-care costs any more than the public option in student loans has brought down college tuition. Instead, just like the FDLP, the public option in health care is a stalking horse for full nationalization. The subsidies for private insurance companies created by the Democrats' health-care plan will prove just as costly and inefficient as the subsidies for private student lenders did. And ten or 20 years down the line, some future Democratic president will justify his single-payer plan with these remarks:

> And let me be clear: we pay for this plan by ending the wasteful subsidies we currently provide to [private insurance companies] for [health insurance], which will save tens of billions of dollars over the next ten years. Instead of lining the pockets of special interests, it's time this money went toward the interest of [health care] in America.

It doesn't take an overpriced college education to see that much.

— *Stephen Spruiell is an* NRO *staff reporter.*