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Student Loans

Uncle Sam Saves College

Maurna Desmond, 09.09.09, 2:56 PM ET

Remember last year when a wave of college-bound students worried they wouldn't be headed to school due to a lack of loan availability? Not to worry. Thanks to Uncle Sam, the kids are all right this fall.

Despite pullbacks in lending and borrowing by consumers, the amount of government-backed student loans originated as of early August surpassed the full-year total for 2007/2008 by 21% at a record \$95 billion, according to data provided by the Department of Education. "As far as the federal student loan program, the bulk of student loans, there ended up being some minor disruptions," says Robert Shireman, Deputy Undersecretary of the Department of Education, "but no one went without loans."

What saved student lending? Rescue legislation passed in May 2008 called the Ensuring Continued Access to Student Loans Act (ECASLA), which, along with increasing limits on government education loans, gave the DOE the authority to buy up taxpayer-backed student debt so that lenders would have the funds they need to issue new loans.

At the time, markets had seized up and many lenders were withdrawing from the student loan market for fear that they wouldn't be able to sell them to credit-crunched investors. "People across the political spectrum realized it was necessary. It was not contentious. It was needed, and it was fast," says Shireman.

The gambit worked. Roughly nine out of 10 government loans originated in the 2008/2009 school year were funded under ECASLA, with some \$51 billion in student debt purchased by the government.

Not only did the government effort help students in need, it also met the needs of a growing crowd. The number of students applying for federal financial aid grew by 12% in the 2008/2009 school year to 16.4 million from the year before. The trend continues to pick up. So far this year, 15 million students have applied for aid, and the Department of Education expects to receive 20 million applications in all, a 25% jump year-over-year and double last year's increase.

While a funding crisis has been averted in higher education, some warn that using taxpayer money to keep funds cheap perpetuates a tuition bubble that comes at a great price for students. (See "[The Coming College Bubble](#).") "The question is: Would you have seen schools increasing their tuition the way they did if the government hadn't backstopped loans?" says Neal P. McCluskey, an associate director at the Cato Institute. "Of course costs always go up. There's no bottom line for colleges."

Even with student aid and student loans up significantly, colleges have seemed to curbed costs a bit. According to a study by the Commonfund Institute, the research arm of Commonfund, an investment manager for nonprofit institutions, costs at colleges and universities like faculty salaries, administrative salaries and utilities rose by 2.3% during fiscal 2008, half the rate of the prior year. While some say this is laudable, the easing compares with an annualized consumer price index, a measure of the change in the price of goods or inflation, increasing by 1.4% for the same period.

While others worry about a continued era of cheap money, Deputy Undersecretary Shireman says the "major trend" now is that students and families are paying more attention to price when it comes to colleges. "We're seeing indications of a lot more shopping, and it will cause institutions to scale back some of the frills," he says. But only time will tell if a consumer-led pullback in borrowing will curb the federal government's central role funding higher education. For now, Uncle Sam is shouldering most of the market and his share is growing.