Insight

Blissful Ignorance

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It's often said that ignorance is bliss. That's certainly true for the Department of Education and their congressional allies who support direct lending. When Congress abolished private participation in student lending and replaced it with 100 percent government financed student lending, they anticipated $75 billion in savings as a result of the switch.

AAF has already noted the flaws in this approach, and believes it's high time the federal government took to a more honest accounting. But the private sector apparently agrees that direct lending is overhyped, to the tune of $225 billion. Those are the findings of Barclays Economics Research unit, in a report issued over the summer, entitled "Student Loans: The Dark Side of Good Debt."

In the report, the researchers conclude that direct lending will miss estimates by $65 billion, just on credit reestimates, but that the pressure to move more borrowers into income-based repayment (IBR) will create an additional $160 billion in unaccounted for costs.

Assume for a moment that Barclays is only half right, and that direct lending estimates are only off by half of what they say. That still puts the direct lending program almost $40 billion under water against original estimates. However, if Barclays is right, the direct loan program will end up costing taxpayers over $150 billion by 2020, instead of the substantial savings we were promised. A $225 billion swing is hard to swallow, even in a country that's used to printing money.

However, it's an important footnote that while Barclay's findings show considerable undeclared costs to the direct lending program, they are based on scoring methods closer to the Department of Education's discounting of Treasury rates. Proponents of fair-value accounting have already weighed in critically of the Barclay's report, indicating that if one were to use a fair value accounting method, the picture only gets worse.

The bottom line is that smart people are looking at the direct loan portfolio and suggesting it's a lot more expensive than the taxpayer was told. In the mean time, of the $75 billion in assumed savings, those have already been committed elsewhere, so however far off the estimates are for the direct loan program, there's nowhere else to go but down.