

COMPARISON OF RELATIVE FEDERAL GOVERNMENT COSTS FOR NDEA AND GUARANTEED STUDENT LOAN PROGRAMS, PRESENT VALUES IN DOLLARS¹

	NDEA	GSLP
Federal capital contribution.....	\$534,808	-----
Interest receipts, deduct.....	185,478	-----
Payments for institutions' administrative cost.....	115,064	-----
Cancellations, 10 percent and 15 percent.....	249,300	-----
Interest paid on behalf of borrowers.....		\$517,127
Insurance reserve matching seed money.....		25,942
Placement and conversion fees.....		56,338
Total cost.....	\$ 713,694	\$ 579,407

¹ Based on costs incurred by Federal Government for 500 students borrowing \$4,000 each with 10-year repayment cycle, 5½-percent discount rate. Present value is the standard method used for comparing 2 or more streams of receipts and payments which have different time patterns. It is based on the concept that a dollar at some time in the future is worth less than a dollar today. Neither calculation includes the cost of any defaults.

² With proposed reinsurance plan—under present funding of insurance reserves, with 50-50 matching and no reinsurance, the Federal insurance reserve cost would be \$29,710.

³ Elimination of the cancellation feature would reduce the NDEA total cost to \$464,394. Addition of a comparable cancellation feature to GSLP would increase the GSLP total cost to \$828,972.

METHOD USED IN COMPUTING COMPARATIVE COSTS

The Treasury Department's calculation was made using the discounting technique of calculating the present value of costs. The theory underlying the discounting technique is that benefits from programs to be realized in the near future are valued more highly than benefits to be realized in the more distant future and that costs which must be incurred in the near future loom larger than costs that will be incurred in the more distant future. The discounting of future benefits and costs makes them comparable to present benefits and costs, i.e., to the present value of benefits and costs. The numerical standard used in making these intertemporal comparisons is called the discount rate.

ASSUMPTIONS USED IN TREASURY'S COST COMPARISON

Our review of material supporting the cost comparison shows that the Treasury Department made certain assumptions with respect to various aspects of the two loan programs. These assumptions and related background information are shown below:

1. Each of 500 students will borrow \$1,000 a year for 4 years and loan disbursements will be made to each student semiannually.

2. Repayments of the loan, which will begin after a 9-month grace period, will be made in equal quarterly payments during each year for 10 years.

3. For the calculation of administrative costs in the comparison, 1 percent of the aggregate loan balance outstanding at the end of each fiscal year will be used for the direct loan program and placement and conversion fees of \$25 will be used for the insured loan program. Administrative expenses under the direct loan program and fees under the insured loan program will be paid annually.

For administrative expenses under the direct loan program, educational institutions are allowed 1 percent of the aggregate loan balance outstanding at the end of each fiscal year or 50 percent of the amount of administrative costs incurred whichever is lower. Proposed legislation relative to the insured loan program would allow a placement fee of not to exceed \$35 for the processing of each student's loan and a conversion fee of not to exceed \$35 for the consolidation, to a repayment status, of all loans to each student.

4. Under both programs 25 percent of the 500 borrowers, or 125 borrowers, will have all or part of their loan indebtedness plus accrued interest canceled. Ninety-five of these 125 borrowers (19 percent of the total) will have 50 percent of their loan indebtedness canceled at the rate of 10 percent a year, and 30 borrowers (6 percent of the total) will have their entire obligation canceled at the rate of 15 percent a year.

5. For borrowers under the insured loan program, interest payments by the Government will be made on their behalf at the rate of 6 percent annually while in school and during the grace period and at 3 percent during the repayment

period. For borrowers under the direct loan program, interest payments by the borrowers will be made at a rate of 3 percent during the repayment period only.

6. Present values will be computed on the basis of an estimated Treasury borrowing rate of 5½ percent.

7. Federal advances will be made to an insurance reserve fund at a rate of 1 percent of the amount of loan disbursements. These advances will be repaid to the Federal Government at a rate of 1 percent of the loan repayments by the borrower.

Federal advances, referred to as seed money, are made to insuring agencies to help establish or strengthen the reserve funds of the insured loan program. Proposed legislation now being considered by the Congress would provide in effect that Federal advances made to an insurance reserve fund after June 30, 1968, would equal 1 percent of the outstanding loans based on a 10-percent reserve that most insuring agencies maintain.

COMMENTS ON COST COMPARISON AND OTHER MATTERS FOR THE CONSIDERATION OF THE SUBCOMMITTEE

On the basis of our review, we believe that the cost comparison submitted by the Treasury Department presents fairly the relative costs of the two programs, subject to the limitations imposed by the various assumptions upon which the cost comparison was based. Certain matters concerning the presentation of the cost comparison, the assumptions used in making the cost comparison, and other material accompanying the cost comparison, are presented below for the Subcommittee's consideration.

Matters related to presentation

The cost comparison shows a lump-sum figure of \$249,300 for cancellation costs under the direct loan program. Although this amount represents the increased costs of the direct loan program when cancellation provisions are applicable, on the basis of assumptions made, the comparison does not show how the costs associated with cancellation provisions affect other cost categories presented in the comparison, such as Federal capital contribution, interest receipts, and administrative costs. The effect of distributing costs associated with cancellation provisions to other cost categories under the direct loan program is shown in the following table.

	Direct loan program with cancellations		Difference
	Cancellation costs not distributed to other cost categories	Cancellation costs distributed to other cost categories	
Estimated Treasury borrowing rate (percent).....	5½	5½	-----
Federal capital contribution.....	\$534,808	\$720,968	\$186,160
Interest receipts, deduct.....	-185,478	-142,567	42,911
Payments for institutions' administrative cost.....	115,064	114,410	-654
Cancellation costs.....	249,300	-----	-----
Principal canceled (10 percent paid to schools).....	-----	20,883	20,883
Cancellation costs.....	713,694	713,694	249,300

As shown by the above table, the distribution of cancellation costs to other cost categories has significantly affected the costs applicable to the Federal capital contribution and the interest receipts. The costs applicable to the Federal capital contribution before distribution of cancellation costs were arrived at on the basis that loans would be repaid in full. To the extent that loans are canceled, in part or in full, the anticipated repayments are thereby reduced, which results in an increase in the costs of the Federal capital contribution. Similarly, such loan cancellations have a significant effect on anticipated interest receipts.

Matters related to assumptions made and other material accompanying the cost comparison

Following are our comments on certain of the assumptions upon which the Treasury Department's cost comparison was based, which we believe would be of assistance in interpreting the results of the comparison.

DETERMINATION OF DISCOUNT RATE TO BE USED

The single, most important assumption made, in our view, was that the estimated costs should be discounted at a rate of $5\frac{1}{8}$ percent, representing the estimated costs of Government borrowings.

This Office has issued a report,¹ a copy of which is enclosed, on an earlier survey of the use by 23 selected Federal agencies of the technique of discounting in making evaluations of future programs. In that report we indicated that, with respect to the determination of the discount rate to be used under the discounting technique, one school of thought holds that such rate should be determined by, and be equal to, the rate paid by the Treasury Department in borrowing money. Another school of thought holds that the rate should be determined by what is foregone in the economy, namely, the return that could have been earned in the private sector of the economy, when the decision is made to commit resources to the public sector. Still another view, as indicated in that report, is that the rate should be the total of the interest cost to the Government and the cost of taxes foregone by the Government when resources are withdrawn from the private sector to use for Government programs.

Under the second and third views stated above, it appears that the discount rate to be used for determining the total cost to the Government would be higher than $5\frac{1}{8}$ percent and that a discount rate from 7 to 8 percent could be demonstrated.

With regard to the view that the rate should be determined by the return that could have been earned in the public sector of the economy, we noted that, in its report² relative to the question of the discount rate which should be used in evaluating public programs, the Joint Economic Committee, Congress of the United States, stated:

"According to the testimony received by the subcommittee, economists generally agree that the appropriate discount rate to use in evaluating public programs is the opportunity cost of capital in the private sector. * * * The witnesses generally agreed, however, that the opportunity cost of capital in the private sector is at least 10 percent at the present time."

Proponents of all views agree that the use of different discount rates has an effect on financial judgments.

Because of the divergence of opinion at this time with respect to the discount rate that should be used and the effect that the use of different discount rates would have on the estimated costs of a program, we have calculated the cost of the direct and insured loan programs using discount rates of 7 percent and 10 percent. Our calculations were made both with and without provisions for cancellation costs, because of the initial request by the Subcommittee Chairman that the cost comparison made by the Treasury be made in such a manner. Our calculations at the discount rates of 7 percent and 10 percent and a calculation at the $5\frac{1}{8}$ -percent discount rate used in the Treasury Department's cost comparison follow.

COMPARISON OF RELATIVE FEDERAL GOVERNMENT COSTS FOR THE DIRECT AND INSURED LOAN PROGRAMS AT VARYING DISCOUNT RATES WITH AND WITHOUT CANCELLATION COSTS

Discount rate (percent).....	Direct loan program without cancellation costs			Direct loan program with cancellation costs		
	$5\frac{1}{8}$	7	10	$5\frac{1}{8}$	7	10
Federal capital contribution.....	\$534,808	\$657,591	\$799,713	\$720,968	\$818,905	\$928,628
Interest receipts, deduct.....	-185,478	-160,967	-128,945	-142,567	-123,275	-98,211
Payments for institutions' administrative cost.....	115,064	103,876	88,816	114,410	103,356	88,446
Principal canceled (10 percent paid to schools).....				20,883	18,128	14,503
Total cost.....	464,394	600,500	759,584	713,694	817,114	933,366

¹ See report to Joint Economic Committee, Congress of the United States, entitled Survey of Use by Federal Agencies of the Discounting Technique in Evaluating Future Programs, B-162719, dated January 29, 1968.

² Report of the Subcommittee on Economy in Government, Joint Economic Committee, Congress of the United States, December 4, 1967.

Discount rate (percent).....	Insured loan program without cancellation costs			Insured loan program with cancellation costs		
	5½	7	10	5½	7	10
Placement and conversion fees.....	\$56,338	\$54,340	\$51,392	\$56,338	\$54,340	\$51,392
Interest paid on behalf of borrowers.....	517,127	474,073	415,265	557,879	510,197	445,091
Insurance reserve matching seed money.....	5,942	7,306	8,886	5,923	7,286	8,849
Principal canceled (paid to lending institutions).....				208,832	181,279	146,954
Total cost.....	579,407	535,719	475,543	828,972	753,102	652,286
Cost of insured loan program in excess of direct loan program.....	115,013			115,278		
Cost of direct loan program in excess of insured loan program.....		64,781	284,041		64,012	281,080

As shown in the above table at the 5½-percent discount rate used in the cost comparison by the Treasury Department, the direct loan program was less costly than the insured loan program both with and without cancellation costs. However, at the 7- and 10-percent discount rates, the cost comparison shows a reverse trend and the insured loan program was less costly than the direct loan program. At the 7-percent rate, costs for the insured loan program amount to \$753,102 with cancellation costs and \$535,719 without cancellation costs compared with costs for the direct loan program of \$817,114 with cancellation costs and \$600,500 without cancellation costs.

At the 10-percent rate, costs for the insured loan program amount to \$652,286 with cancellation costs and \$475,543 without cancellation costs compared with costs for the direct loan program of \$933,366 with cancellation costs and \$759,584 without cancellation costs.

Also, the above table indicates that, as the discount rate was increased, the cost of the insured loan program showed a downward trend while the cost of the direct loan program showed an upward trend and thereby widened the gap in costs between the two programs.

We believe that our cost comparisons of the two programs at the 7-percent and 10-percent discount rates indicate that the determination of total costs under those programs is particularly sensitive to the discount rate used.

ADMINISTRATIVE EXPENSES APPLICABLE TO THE DIRECT LOAN PROGRAM

A second assumption used in the cost comparison relates to the administrative expenses applicable to the direct loan program. In the cost comparison submitted to the Subcommittee by the Treasury Department, administrative expenses determined on the basis of 1 percent of the outstanding loan balances were considered appropriate. Our review of the basis upon which the 1-percent rate was determined revealed the following matters.

The 1-percent rate was computed by the Office of Education by dividing the total administrative expenses reported to it by various educational institutions for fiscal year 1966 by the institutions' total amount of outstanding loans. The result thus obtained, which was approximately nine tenths of 1 percent, was rounded to 1 percent.

In addition to increasing the rate by one tenth of 1 percent for rounding purposes, the computation did not take into account the outstanding loan balances for educational institutions which did not claim administrative costs. Accordingly, the 1-percent rate used in computing administrative costs for the direct loan program appears to be on the high side when compared with the actual costs claimed for administrative expenses by the educational institutions administering the program. However, statistics for all educational institutions were not readily available to allow us to compute a more accurate rate for use in estimating the administrative expenses to be included in the cost comparison.

Also, with respect to administrative expenses, we noted that, in part I, attachment B, of the cost comparison submitted by the Treasury Department, reference was made to administrative expenses on a per loan basis. According to the attachment, the amount of administrative expenses per loan made during the year averaged \$26 where claims for such costs were based on 1 percent of the aggregate loan balances and \$13 where claims for such costs were based on 50 percent of the amount of administrative costs incurred.

These amounts were not used in the Treasury Department's cost comparison but were provided for the information of the Subcommittee. These amounts were derived by the Office of Education from a sample of approximately 10 percent of

the educational institutions that submitted claims for administrative expenses in fiscal year 1966.

Our evaluation of the basis upon which the Office of Education determined the administrative expenses of \$26 and \$13 applicable to each loan disclosed two matters which we believe should be brought to the attention of the Subcommittee.

First, an arithmetical error was made in computing the \$26 unit cost with respect to the educational institutions claiming administrative costs under the 1-percent criteria. This unit cost should have been computed at \$20 per loan, and officials of the Office of Education acknowledged the arithmetical error.

Secondly, in its computation of the \$26 and \$13 amounts, the Office of Education divided the dollar amount of the administrative expenses reported by the educational institutions for fiscal year 1966 by the number of student loans made during that fiscal year. The figures thus derived represented an allocation of all administrative expenses claimed for the fiscal year only to those borrowers who obtained loans during the fiscal year and did not give recognition to any administrative expenses applicable to borrowers now in a repayment status.

It seems that a large percentage of an educational institution's administrative expenses may be due to costs incurred in connection with billing and collection efforts for students in a repayment status. Furthermore, since fiscal year 1966 was the 8th year for the direct loan program, a substantial number of borrowers were in a repayment status, and consideration of the outstanding balances of loans applicable to these borrowers would tend to decrease the average administrative expense per loan.

FEDERAL ADVANCES TO INSURANCE RESERVE

An additional assumption made in the cost comparison with respect to the insured loan program was that Federal advances to an insurance reserve of 1 percent of the amount of loan disbursements (referred to as "seed money") would be repaid to the Federal Government as the loan was repaid by the borrower. This assumption had the effect of reducing the cost of the insured loan program.

Approximately \$15 million in seed money (of the \$17.5 million authorized) has been advanced for insurance reserves maintained by States and nonprofit organizations. We were informed by a responsible official of the Office of Education that repayments of seed money had not been made by States and nonprofit organizations and that none were expected to be made in the near future. Additionally, one of the Higher Education Act amendments currently being considered by the Congress proposes a \$12.5 million increase in authorizations for Federal advances of seed money.

To the extent that Federal advances of seed money are increased and to the extent that Federal advances remain outstanding, the cost of the insured loan program will be increased.

Because of your request for the early submission of our report, we did not obtain the views of either the Department of Health, Education, and Welfare or the Treasury Department on the comments in this report.

We plan to make no further distribution of this report unless copies are specifically requested, and then copies will be distributed only after your approval has been obtained or public announcement has been made by you concerning the contents of this report.

We trust that the information presented above will serve the purposes of your request.

Sincerely yours,

FRANK H. WEITZEL,
Assistant Comptroller General of the United States.

AMERICAN FEDERATION OF STATE,
COUNTY, & MUNICIPAL EMPLOYEES, AFL-CIO,
Washington, D.C., February 26, 1968.

HON. EDITH GREEN,
*Chairman, Select Subcommittee of the House Education and Labor Committee,
Rayburn House Office Building, Washington, D.C.*

MY DEAR CONGRESSWOMAN: Would you be so kind as to insert this statement into the record of the hearing on H.R. 15067?

The American Federation of State, County and Municipal Employees, AFL-CIO, applauds the Education for the Public Service Act, (H.R. 15067) which you

co-introduced. The purpose of the legislation to improve the educational qualifications of public servants is good. The method by which the legislation seeks to achieve this is good.

There are two portions of the bill to which we direct your attention because of language difficulties which might impair the fulfillment of the objectives of the bill. Neither of these two points have a direct effect upon our 370,000 members, but we are effected by the quality of public service and the image of public employment. Consequently, we pass these suggestions on to you merely to improve the bill and to meet the civic responsibility with which we are charged.

Section 1213(4) (A) requires that a graduate or professional program of an institution of higher education will recommend "only persons of superior promise" (lines 14-15, p. 113). A statement suggesting positive recruitment methods to insure equal opportunity in the selection process would be desirable in overcoming the obvious problems flowing out of the contemporary utilization of certain symbols of academic or vocational "superiority." In other words, language should be employed to offset the already inherent tendency to give less than full consideration to culturally deprived individuals.

Section 1221(b) (3) provides a definition of "institution of higher education" (lines 8-11, p. 115) which would include two-year program community colleges. This is particularly noteworthy since such institutions are playing an increasingly important role in dealing with urban problems. The qualification of credits toward a degree presents problems whereby a fully accredited institution might not fall within the definition because of the treatment accorded course credits by four-year institutions. This possibility could be avoided by substituting the word "may" for "is" on line 10.

Allow me to again commend you for your leadership in recognizing the profound implications of today's public personnel mechanisms and in developing an effective means to deal with the situation.

Respectfully,

JERRY WURF,
International President.

COLLEGE OF THE VIRGIN ISLANDS,
February 13, 1968.

HON. EDITH GREEN,
*Chairman, Special Committee on Education,
House of Representatives,
Washington, D.C.*

DEAR MRS. GREEN: I am writing to you to urge consideration of a change in the Higher Education Facilities Act under Title I. The change which is being requested is to provide for a minimum amount of \$50,000 of grant money for each of the states under each of the two categories of Junior Colleges and Four Year Colleges.

The reason for proposing this change is to provide a minimum level of support on which a building program can be based. If the amounts which present formulas provide are less than is here being proposed the result may be to hold out the promise but not the actuality of strengthening a state's higher education facilities.

We are extremely pleased in the Virgin Islands to participate in this important program and request this change so that our participation can be more meaningful.

We continue to believe that the work of the Special Education Committee is of the greatest importance to higher education and to give our fullest support to the leadership which this committee is providing.

Sincerely yours,

LAWRENCE C. WANLASS,
President.