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HARD LESSONS FROM THE FEDERAL STUDENT-LOAN PROGRAM'S COMING $36 BILLION SHORTFALL

Prospect of taxpayer losses increases the chances that Congress will make major changes to the program

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U.S. officials have long maintained the federal government would make a profit on its $1.4 trillion student loan portfolio or at least break even, but two recent reports suggest just the opposite will be the case. Government lending to college and graduate students could soon become an immense drain on federal coffers, worsening an already deteriorating U.S. budget picture.

The Education Department's inspector general, an agency watchdog, in a report released last week said the profitability of the U.S. federal student lending program is being squeezed because millions of Americans who borrowed heavily in recent years–including many graduate students–are flocking into a program to have substantial portions of their debts forgiven. Students who borrowed in the fiscal year ended Sep. 30, 2015, and enrolled in such "income-driven repayment" plans, for example, are expected to pay back $11.5 billion less than they took to pay tuition and other schooling costs.

The government still earns billions of dollars every year in interest on the loans it has made to 43 million American undergraduates, graduate students, and parents of undergrads. But the losses from those not repaying are now projected to mount and could eat up all of the gains. It is hard to get precise estimates, but the Education Department's annual financial report, released in November, offered a clue. A footnote in the report projected that money coming in for government student loan and guarantee programs will be $36 billion short of what's needed to cover outstanding debt and accrued interest.

A year earlier, the department projected the shortfall would be $8.4 billion, while in prior years it projected the program would generate billions of dollars in taxpayer surpluses. The latest report explained that one reason for the sharp switch was the rise of income-driven repayment plans. These plans set monthly payments as a share of a borrower's income and then forgive any balance that remains after 10, 20 or 25 years, depending on the borrower's work status and loan size.

While that $36 billion projection doesn't quite compare to the $4 trillion federal budget, it's still an immense sum. To put it in perspective, the government ultimately paid $33 billion to bail out Wall Street banks and auto companies under the Troubled Asset Relief Program during last decade's financial crisis, according to the Congressional Budget Office.

The prospect of taxpayer losses on student loans increases the chances that Congress will make major changes to the program, such as eliminating debt-forgiveness options or placing new dollar limits on how much individuals can borrow. Congressional Republicans have proposed such changes. Moreover, the risk of a flood of red ink highlights what analysts across the political spectrum agree has become an inefficient system that for years directed funds to universities as they raised prices, with little regard for the creditworthiness of borrowers.

The government expanded lending to help students pay for college, and it consistently estimated the program would return tens of billions of dollars in profits. Budget officials from the Education Department and Congress said that while taxpayers would end up covering a big chunk of unpaid loans–including $108 billion in forgiven debt, according to a 2016 estimate by the Government Accountability Office–enough borrowers would repay their debts with interest to maintain a surplus.

Critics inside and outside the government have said faulty accounting methods overstated how much money the program would bring in. A Government Accountability Office study in 2016 called for major changes to the government's methods, including its assumptions for future interest rates, how much debt it would collect on defaulted loans, and how many students would enroll in debt-forgiveness programs. The Education Department said its November estimate of $36 billion in prospective losses reflected internal accounting changes designed to respond to the GAO concerns.

"There's been a systematic underestimate of default rates," said Douglas Holtz-Eakin, a former CBO chief who heads the conservative group American Action Forum. He said he believed costs would rise further given low student-repayment trends of recent years. "This is the financial downside of government-credit intervention, whether it's direct loans or guarantees. And it turns out these are large numbers."

Nearly five million direct-loan borrowers have defaulted, meaning they've gone at least a year without making payments. Other borrowers, particularly those with graduate degrees, are refinancing at lower interest rates through private lenders such as Social Finance Inc., reducing the money the government expected to make on interest payments. Others are getting their debt obligations waived by the Education Department because investigators concluded their schools defrauded them with deceptive recruiting.

Perhaps the biggest factor is a surge in borrowers enrolling in income-driven repayment. The plans, created by Congress in the 1990s and 2000s, are designed to help the neediest, for example those in low-paying jobs. They're also helping borrowers who went to pricey, prestigious schools and now work in white-collar jobs.

About 6.5 million Americans owing $352.5 billion in federal loans are enrolled in the programs, Education Department figures show. That is up from 1.6 million borrowers owing $72.3 billion in early 2013.