CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

June 6, 2014

Honorable Elizabeth Warren
United States Senate
Washington, DC 20510

Dear Senator:

As you requested, CBO and the staff of the Joint Committee on Taxation (JCT) have analyzed S. 2432, the Bank on Students Emergency Loan Refinancing Act, as introduced on June 4, 2014. The bill would allow most individuals with student loans (both federal and private) to refinance those loans into new federal direct loans at interest rates specified in the bill. Additionally, the legislation would amend the Internal Revenue Code to impose a new minimum tax—called the Fair Share Tax—on certain high-income taxpayers.

CBO and JCT estimate that enacting the bill would increase direct spending by about $58 billion over the 2015-2024 period and increase revenues by about $72 billion over the same period. On net, CBO and JCT estimate that enacting the bill would increase deficits over the 2015-2019 period by about $26 billion but reduce deficits over the 2015-2024 period by about $14 billion. (For this estimate, CBO assumes that S. 2432 will be enacted early in fiscal year 2015. As a result, there would be no budgetary effects in fiscal year 2014.) Details of the estimate are provided below and shown in the enclosed table.

S. 2432 is quite similar to S. 2292, for which CBO transmitted a letter detailing its analysis earlier this week.[1] CBO estimates that the student loan provisions in S. 2432 would increase direct spending by about $7 billion more than the student loan provisions in S. 2292, primarily because S. 2432 would effectively lower interest rates for some loans.

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1. See Congressional Budget Office, letter to the Honorable Elizabeth Warren, providing an analysis of S. 2292, the Bank on Students Emergency Loan Refinancing Act (June 4, 2014), www.cbo.gov/publication/45417.

Student Loans

Under S. 2432, eligible individuals could apply to have the Department of Education refinance outstanding federal student loans (direct or guaranteed) or private student loans (not federally guaranteed) that were incurred before July 1, 2013, at rates specified in the legislation. The Secretary of Education would have the authority to limit refinancing to individuals based on income levels and debt-to-income ratios that would be established by the Secretary.

As required under the Federal Credit Reform Act of 1990 (FCRA), costs of the federal student loan programs (other than administrative costs) are estimated on a net-present-value basis. Under credit reform, the present value of all loan-related cash flows is calculated by discounting those expected cash flows to the year of disbursement, using the rates for comparable maturities on U.S. Treasury borrowing. The cost of modifying existing loans is shown in the year the legislation authorizing such modifications is enacted, while the cost of new loans is shown in the year the loan is disbursed.

Outstanding Loan Volume. Based on information from the Department of Education, the Federal Reserve, the Consumer Financial Protection Bureau, and private-sector reports on student loans, CBO estimates that there is about $1 trillion in outstanding federal student loans or loan guarantees, and more than $100 billion in outstanding private student loans (that are not federally guaranteed). About two-thirds of the federal student loan volume is for federal direct loans and the remainder is for federally guaranteed loans. Most of the outstanding loan volume is for loans incurred after 2003, of which about one-third is for consolidation loans.

Consolidation loans are those in which the borrower has chosen to consolidate all of his or her loans into a single loan with a fixed rate. That rate is the weighted average of the interest rates of the loans being consolidated, rounded up to the nearest one-eighth of 1 percent. Under S. 2432, the Department of Education would use the current outstanding principal from the original loans comprising each consolidation loan and the new interest rates for each loan type specified in the bill to calculate a new weighted-average interest rate for that consolidation loan (without rounding to the nearest one-eighth of 1 percent). A little less than one-half of the outstanding volume of consolidated loans was created at times when interest rates were near historical lows. For many of those loans, refinancing under S. 2432 would yield little or no savings for borrowers.

CBO estimates that less than 10 percent of federal student loan volume is currently in default. While the bill would not prohibit borrowers from refinancing federal loans that are in default, CBO expects that most federal borrowers who are in default would not refinance their loans because borrowers who have not made any payments on their loan for an extended period of time are unlikely to complete the application process for refinancing. In contrast, the bill would specifically prohibit borrowers from refinancing private loans that are in default and would further require that borrowers be current on their payments for six months. CBO estimates that for the first few years after enactment, a little less than 10 percent of private student loans will be in default or will not be current on payments for six months.

Refinancing Student Loans. All federally guaranteed loans refinanced under this program would be converted to federal direct loans, which would change the cash flows between the borrowers and the federal government. For private student loans, the government would pay off the existing private lender and issue a federal direct loan to the individual for the amount that was paid to the private lender.

Although there is no specific end date for potential refinancing under the bill, CBO expects that most of the loans that would be refinanced would go through that process over the 2015-2017 period. Because it would take several months to write and publish the necessary regulations and implement a system for refinancing loans, CBO expects that most of the refinancing would be completed in the latter part of 2015 and in 2016.

In estimating the cost of refinancing student loans, CBO accounted for the information presented above and the following factors:

- **Income limits and debt-to-income ratio.** The bill would allow the Secretary of Education to establish income limits and debt-to-income ratios to determine who would be eligible to refinance their student loans. CBO expects that such guidelines would make only about 5 percent of the outstanding loan volume ineligible for refinancing.

- **Years remaining until repayment.** The bill would allow any outstanding loan made before July 1, 2013, to be refinanced. CBO expects that the closer an individual is to paying off a loan, the less likely that person is to refinance, and the longer a person has left to repay a loan, the more likely that person is to refinance.

- **Interest rate.** The bill specifies the interest rate for each type of refinanced loan. CBO expects that the bigger the amount by which a borrower's current interest rate exceeds the rate specified in S. 2432, the more likely that the loan would be refinanced. CBO also expects that loans that have interest rates close to or lower than those specified in the bill or calculated under the bill, such as many consolidation loans, are not likely to be refinanced.

- **Income-based repayment.** Under the bill, individuals would have to apply to the Department of Education to refinance their student loans. CBO expects that the process of applying would lead more individuals to opt for the longer repayment terms and the possibility of eventual loan forgiveness that are features of the income-based repayment plans offered under current law.[2] In addition, because people could refinance private student loans into federal loans under S. 2432, they could end up with a larger amount of federal loan debt and, thus, more likely to be eligible for income-based repayment.

Estimated Costs for Student Loan Refinancing. CBO estimates that slightly more than half of the outstanding loan volume for federal student loans and loan guarantees (about $500 billion) would be refinanced under the bill. Because of the lower interest rates on the refinanced loans, the federal government would receive less interest income over the life of the new loans, which would make those loans and loan guarantees more costly for the federal government. Thus, CBO estimates that enacting S. 2432 would increase direct spending for federal loans that are currently outstanding by $62.9 billion (on a present-value basis) in 2015.

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2. By submitting income information to the Department of Education in the application to refinance, borrowers will also have completed an important part of the process to apply for income-based repayment and, thus, CBO expects more borrowers would become aware of and take advantage of that benefit.

CBO also estimates that about half of the outstanding private student loan volume (about $60 billion) would be refinanced under S. 2432. For budgetary purposes, those loans would be new federal loans. Under FCRA, new student loans generate income for the federal budget because the interest earned on new student loans is greater than the cost of financing those loans. Accordingly, CBO estimates that refinancing those private student loans would reduce direct spending by $5.0 billion over the 2015-2024 period. (Those costs are shown in the years that new federal loans are made and not in the year of enactment, because those loans would be considered new loans and not modified loans.)

Finally, there would be additional costs to administer the formerly private student loans; those costs would be recorded on a cash basis. Based on the administrative costs for existing loans, CBO estimates that those additional costs would increase direct spending by $0.2 billion over the 2015-2024 period.

Revenues

Under S. 2432, in 2015 a new minimum tax would be phased in for individuals with adjusted gross income between $1 million and $2 million; in later years, those thresholds would be indexed for inflation. Affected taxpayers would calculate the sum of their regular tax (after subtracting allowable credits except for the foreign tax credit), their alternative minimum tax, the 3.8 percent surtax on their investment income, and the employee's portion of the payroll tax. If that sum was less than 30 percent of those taxpayers' adjusted gross income (after deducting a credit for charitable contributions), they would pay an additional amount of income tax to bring their total taxes up to that level.

In total, JCT estimates that enacting this provision would increase revenues by $31.7 billion over the 2015-2019 period and $72.5 billion over the 2015-2024 period.

Difference in Estimates Between S. 2432 and S. 2292

On June 4, 2014, CBO transmitted a letter analyzing the budgetary effects of S. 2292, the Bank on Students Emergency Loan Refinancing Act, as introduced on May 6, 2014. That bill is quite similar to S. 2432, which has the same title. CBO estimates that enacting S. 2432 would increase direct spending by $7.3 billion more than S. 2292. The two primary differences between the bills are detailed below.

- S. 2292 would specify a rate of 6.41 percent for all borrowers who refinance their consolidation loans, regardless of the current rate on those loans. In contrast, under S. 2432, the Department of Education would calculate a new weighted-average interest rate based on the rates specified in the bill for each underlying loan type and the current outstanding principal from the original loans that were consolidated. CBO estimates that for most consolidation loans, the rates calculated under S. 2432 would be lower than 6.41 percent. Those lower rates would lead more borrowers to refinance their consolidation loans, and CBO expects that the volume of refinanced loans would be about $40 billion higher—about $500 billion under S. 2432 versus $460 billion under S. 2292. The combination of refinancing that additional $40 billion in loans and providing lower rates on loans that would have been refinanced under S. 2292 would increase budgetary costs by about $7.1 billion, CBO estimates.

- S. 2292 would allow the Secretary of Education to charge an origination fee of up to 0.5 percent of principal for an outstanding loan; but S. 2432 would have no such origination fee. The lack of an origination fee increases the estimated cost of S. 2432 by about $0.2 billion.

In addition, the legislative language for the proposed Fair Share Tax is slightly different between the two bills; but there is no difference in the estimated effects on revenues.

Staff Contact
I hope this information is helpful. The CBO staff contact for this analysis is Sam Papenfuss.

Sincerely,

Douglas W. Elmendorf

Douglas W. Elmendorf
Director

Enclosure

cc: Honorable Tom Harkin
Chairman
Committee on Health, Education,
Labor, and Pensions

Honorable Lamar Alexander
Ranking Member

June 6, 2014

BUDGETARY EFFECTS FOR S. 2432, THE BANK ON STUDENTS EMERGENCY LOAN REFINANCING ACT, AS INTRODUCED ON JUNE 4, 2014
Billions of dollars, by fiscal year

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-2019	2015-2024
CHANGES IN DIRECT SPENDING												
Refinance Outstanding Federal Student Loans (Loan Modifications)												
Estimated Budget Authority	62.9	0	0	0	0	0	0	0	0	0	62.9	62.9
Estimated Outlays	62.9	0	0	0	0	0	0	0	0	0	62.9	62.9
Refinance Private Student Loans (New Federal Loans)												
Estimated Budget Authority	-2.0	-2.4	-0.5	*	*	*	*	*	*	*	-5.0	-5.0
Estimated Outlays	-2.0	-2.4	-0.5	*	*	*	*	*	*	*	-5.0	-5.0
Administrative Costs												
Estimated Budget Authority	*	*	*	*	*	*	*	*	*	0.1	0.1	0.3
Estimated Outlays	*	*	*	*	*	*	*	*	*	*	*	0.2
Total Changes												
Estimated Budget Authority	60.9	-2.4	-0.5	*	*	*	*	*	*	*	58.0	58.1
Estimated Outlays	60.9	-2.4	-0.5	*	*	*	*	*	*	*	58.0	58.1
CHANGES IN REVENUES												
Fair Share Tax[a]	17.1	-4.4	5.8	6.3	6.9	7.3	7.7	8.2	8.6	9.0	31.7	72.5
NET INCREASE OR DECREASE (-) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES												
Net Changes in Deficits	43.8	2.0	-6.3	-6.3	-6.9	-7.3	-7.7	-8.2	-8.6	-9.0	26.3	-14.4

Sources: Congressional Budget Office and the staff of the Joint Committee on Taxation.

Note: Components may not sum to totals because of rounding; * = between -$50 million and $50 million.

a. Positive numbers indicate an increase in revenues and negative numbers indicate a decrease in revenues.