BUDGET BULLETIN

SENATE COMMITTEE ON THE BUDGET

CHAIRMAN MIKE ENZI | @BUDGETBULLETIN

114th Congress, 1st Session: No. 10 October 27, 2015

How Back-End Agency Spending Impacts the Budget

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What Is Back-End Spending?

Article I of the U.S. Constitution gives Congress "the power of the purse" authority to tax and spend so that Americans can hold government accountable. But in practice, the legislative branch alone does not determine outlay and revenue levels—executive branch agencies play a role.

The basis for agency discretionary authority is congressional statutes that require or allow federal agencies to exercise professional judgment in carrying out programs. Particularly when programs are entitlements, agency decisions can have significant budgetary consequences.

Congress acts on the "front end" when it authorizes or amends entitlement legislation, i.e., laws consisting of direct spending with formula-driven benefits for individuals who meet specific eligibility criteria. The cost of such programs is typically uncapped, and although it can be estimated in advance, is not known until after the fact. Therefore, agencies empowered to administer entitlement programs often impact that ultimate program cost on the "back end."

Federal agencies not only act to implement new laws but also on their own initiative to exercise previously reserved authority. Agencies frequently reinterpret existing legislative language and invoke discretionary authority not previously exercised or exercised in a different manner.

In its annual report to Congress, the White House Office of Management and Budget refers to formal rules that have a substantial, direct impact on the federal budget as "transfer rules" for producing income transfers "usually from taxpayers to program beneficiaries."

Case Study: Post-Secondary Student Aid

The Department of Education implements the federal student aid programs authorized under the Higher Education Act of 1965 (HEA), including the two greatest sources of federal aid to individual students: direct student loans and Pell Grants. The department issued 19.6 million loans totaling $100.8 billion to students in fiscal 2014. During the 2014-15 academic year, the department awarded Pell grants totaling $31 billion to 8.2 million students, with the neediest eligible for a maximum individual award of $5,730.

Under discretionary authority granted by the HEA, the Education Department recently took steps to alter the repayment terms on millions of loans and to revamp the federal aid application process used by more than 20 million individuals annually. Most recently, the department initiated a regulatory process to clarify which student loan debtors qualify to have their debt discharged by the secretary. A discussion of these administrative actions and their budgetary implications follows.

Income-Based Loan Repayment

A 2007 reconciliation statute created a new, income-based repayment plan (IBR) for student loan borrowers, which limited the required monthly loan repayments for IBR enrollees to 15 percent of borrowers' discretionary income, forgiving any remaining principal after 25 years.

To reduce the cost in the budget window, the 2007 law limited IBR eligibility to those borrowers first receiving a loan after July 1, 2009. A subsequent 2010 reconciliation law made IBR more generous for those borrowers first taking out loans after July 1, 2014, lowering required payments to 10 percent of discretionary income and forgiving principal in 20 years.

But those more generous IBR terms actually became available sooner than Congress had planned. In November 2012, the Education Department issued a final rule creating a technically new repayment plan (Pay As You Earn, or PAYE). PAYE required the same terms as IBR, but with eligibility extended to those who first took out loans after October 1, 2007, and had new loan disbursements after October 1, 2011. The department estimated this modification would raise the cost of outstanding student loans by $2.1 billion.

Significantly, the Education Department cited as statutory authority for PAYE not the aforementioned IBR statutes, which clearly define an eligible borrower pool, but broad, long-standing language in the HEA allowing the secretary to administer "an income contingent repayment plan, with varying annual repayment amounts based on the income of the borrower, paid over an extended period of time prescribed by the Secretary, not to exceed 25 years. . . ."

In later expanding IBR more dramatically, again without action by Congress, the administration relied on this same language. On June 9, 2014, President Barack Obama directed that PAYE be expanded, now as REPAYE, to those who first took out loans prior to October 1, 2007.

This executive action effectively made the generous IBR terms Congress had extended to recent borrowers available to millions of older borrowers, at a cost of $15.3 billion, according to an Education Department estimate in its July 9, 2015, Notice of Proposed Rulemaking. The notice projected an $8.3 billion increase in the cost of outstanding loans and an additional $7 billion increase in the anticipated cost of new loans to be issued over the budget window. The final REPAYE rule is expected by December 31, 2015.

Revised Aid Application Process

Federal student aid applications will be processed earlier and applicants can more easily use previously filed tax data under a policy the president announced on September 14, 2015. Beginning with the 2017-18 academic year, the Education Department will begin processing applications three months earlier than it has in the past. Thus, students will be able to submit an aid form for 2017-18 as early as October 1, 2016, instead of January 1, 2017.

Also, the department will use “prior-prior” year income data to determine aid eligibility. That means a family’s calendar year 2015 income will be used to determine its aid eligibility for the 2017-18 academic year. The HEA authorizes this action by stipulating that prior-year income is to be used in calculating the federal aid for which a student is eligible, except that “the Secretary may provide for the use of data from the second preceding tax year when and to the extent necessary to carry out the simplification of applications.”

These changes to the application process were not subject to a formal rulemaking process, so no administration cost estimate was issued. The Congressional Budget Office, however, preliminarily projected that the department’s invocation of its dormant authority to alter the aid application process would increase the number and size of Pell awards, raising Pell spending over the next decade by $1.8 billion on the mandatory side and by $7.4 billion on the discretionary side.

Defense to Repayment

Facing scrutiny from regulators for violations that included misleading students about job-placement rates, Corinthian Colleges, Inc., recently sold most of its schools, closed the remainder, and then filed for bankruptcy. The 15,000 students attending the Corinthian schools that closed their doors became eligible for cancellation of their student loan obligations under a long-standing “closed schools” provision of the HEA.

But this limited redress granted no relief to students attending schools sold by Corinthian or to students who collectively borrowed billions of dollars in recent years to attend Corinthian schools, not to mention all the individuals with outstanding student loan debt who believe they were defrauded by their post-secondary institutions.

In this context, the Education Department is revisiting a 22-year-old provision in the HEA that states "the Secretary shall specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a loan made under this part." A department regulation issued under this mandate states that a student victimized by a school in a manner that "would give rise to an action under applicable state law" can request a discharge.

The regulation is seldom invoked since it sets no clear standard and provides no procedure or form to apply for a discharge, but that is due to change. On October 20, the department initiated a rulemaking process to overhaul the regulation, creating a procedure for borrowers to establish a defense to repayment, while establishing department criteria to identify acts or omissions of an institution that constitute defenses to repayment, "including the creation of a Federal standard."

In a recent blog post, David Wessel, president of the Brookings Institution's Hutchins Center on Fiscal and Monetary Policy, notes that at least 28 colleges are under investigation, according to Securities and Exchange Commission filings or state and local government authorities, and students attending the 28 colleges borrowed more than $57 billion over the past five school years. Wessel writes:

> Until recently, this clause had been invoked only five times–ever. . . . As the department ponders its standard for forgiving loans, potentially tens of thousands of borrowers could seek relief from repaying tens of billions of dollars. . . . Forgiving student loans in this fashion doesn't require an act of Congress or formal approval from the Treasury or the Office of Management and Budget—even if forgiveness means that future government receipts will be lower and budget deficits larger than projected. The Education Department has no reliable way of estimating the cost of its actions because there is so little history to go by.