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ABSTRACT

Title of Dissertation: ACCIDENTAL EFFICIENCY: INTER-PROGRAM COMPETITION AND THE HIGHER EDUCATION ACT

Hoke James Wilson, Doctor of Philosophy, 2001

Dissertation directed by: Professor Stephen Elkin
Department of Government and Politics

When government is directed to provide a good or service, it usually does so by establishing a single program to accomplish its goal. The provision of loans to students at U.S. postsecondary institutions is a notable exception, however. Since 1994, the U.S. Department of Education has administered both the Federal Family Education Loan program and the William D. Ford Federal Direct Student Loan Program. Though the former provides loans by outsourcing to private lenders for financial capital, and the latter finds the necessary capital in-house by borrowing from the U.S. Treasury, both programs provide loan products to an identical population of students at the same price and with the same terms of repayment.

Strictly as an accident of politics, the Federal government has eliminated monopoly aspects from the provision of student loans. This thesis asserts that, as a result of competition between the two programs, students and the institutions they attend are better served while the government saves roughly $685 million per year.

Chapter One reviews academic inquiries into privatization generally, and the injection of competition to the provision of goods and services by government specifically. Chapter two is divided into three main sections. The first reviews the political history of the student loan programs. The second uses budget data from 1966 to 2001 to estimate the cost savings associated with the introduction of competition via time-series regression with moving average error correction. The third traces improvements in the quality of the loan product since competition with nonparametric tests, as seen through the eyes of students and the financial aid directors at over 2,300 U.S. postsecondary institutions. Chapter Three addresses why inter-program competition has been a success in the instance of student loans, the degree to which such a model can be generalized to the provision of services in other scenarios, and the political ecology necessary to the sustenance of a competitive environment.

ACCIDENTAL EFFICIENCY: INTER-PROGRAM COMPETITION AND THE HIGHER EDUCATION ACT

By

Hoke James Wilson

Dissertation submitted to the Faculty of the Graduate School of the
University of Maryland at College Park in partial fulfillment
of the requirements for the degree of
Doctor of Philosophy
2001

Advisory Committee:

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DEDICATION

For Trish, Jonas, Samantha, Penny, ... and Jean. Far more than mine, this is your accomplishment.

PREFACE

This thesis asserts that the introduction of competitive elements to the provision by government of services can result in a more efficient provision. That is, from the perspective of the collective consumers of these services, the direct beneficiaries, as well as the taxpayers, cheaper and, possibly, better services can be produced than under traditional arrangements.

However, efficiency as I define it is not the only criterion by which the success of competitive government service provision can be judged. If I were to use Pareto efficiency as a yardstick, I would have to conclude that competitive government service provision is a failure. While taxpayers and beneficiaries might be rendered better off, the producers of such services, be they bureaucrats or private contractors, might not be. The gains to consumers in such circumstance come, in part, from the diminuition of producer profit margins.

Additionally, whether competitve government service provision results in efficiency gains, under any criterion, is dependent upon a clear definition of the goals of the service provision. The goals of a government program, en toto, are frequently ambiguous. While a government program may be designed with the intent of providing a tangible service, or good, it may also be directed toward an end that is left unstated, for example, wealth redistribution.

This thesis uses the case of competition between two Federal student loan programs as evidence of the benefits of competitive service provision. Our hearts may not be broken if we find that the profit ledgers of banks, servicers, guarantee agencies, and insurance companies are adversely affected in this instance. Yet, in others, we could be less inclined to accept such a result. In the first chapter, I argue that the characteristics of a good or service determine the structure of the market in which it should be provided. If that is so, then homogeneous, non-public goods without significant positive externalities, etc., should be left to private, competitive markets as liberalization advocates declare. There would seem to be no good argument for the provision, by government, of janitorial services, say. Yet, if an unstated goal of such a provision is to lift the incomes of janitors above the poverty line, then we should rethink our position on the issue.

In short, as readers proceed through this thesis, they should keep in the back of their minds that advocacy for liberalization g enerally, and competitive government service provision, in particular, should be tempered by an understanding. An understanding, not only of the criteria used to judge success or failure, but also of the goals - transparent and opaque - of the program to be reformed.

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Chapter One

Folk wisdom has it that as government expands it necessarily gets more expensive. The logic is simple enough: We all know that in our personal lives as we expand our roles we require more resources to fulfill them and these resources only come at a price. The same logic applies to government when it expands its functions, we believe. A source of popular aggravation, though, is that, unlike the supreme efficiency by which each of us conduct our daily lives, the more government tries to do, the less well it seems to do it. Give an agency a new task and it suddenly seems unable to meet its existing responsibilities. Augment its budget in order to expand an existing function and it appears that it is no longer able to provide the level of services that it did before it obtained the additional resources.

The conclusion is obvious. Government should govern and, to the greatest extent possible, refrain from entering the domain of supply and demand. Government should act as a collective purchaser of goods and services - and then, only in extreme cases - and not as a collective provider. Markets, even less than competitive markets, are more efficient and thus they, not government, should be the ultimate source of provision. A legitimate justification for expanding the scope of government to include the production of goods and services is rare.

As a review of the existing literature will demonstrate, the conclusion derived from this popular wisdom is often correct. Depending on the nature of the market, and

thus in the end on the nature of the good or service itself, the government that governs best may be that which produces the least. "Liberalization" is the battle cry of academic adherents to this simple thought process. Liberalization, as commonly used, is a mandate to move government out of, and private suppliers into, the provision of collectively consumed goods and services. More properly, it should be defined as the introduction of market forces to the provision of goods and services traditionally supplied by governments. Of more importance than this elementary matter of diction, though, liberalization advocates do not discriminate with regard to market structure or the nature of the good/service when waging their jihad. They take note that the overwhelming majority of academic studies have offered convincing evidence that significant efficiencies can be realized by removing government from the provision of collectively consumed goods. Then, prescribing the broadest possible application, they let God tally the results.

There are situations, however, in which government does have a valid reason for assuming productive responsibilities. Moreover, in the interests of the most efficient and least costly provision, public welfare may best be served, not only by maintaining a government's current productive facilities, but also in some scenarios by duplicating them.

When government is charged with a duty, we might hope that it would endeavor to do its job once and do it well. However, in certain cases it may be difficult to provide goods and services efficiently without duplicating efforts. Specifically, I

argue in the pages to follow that competition between government programs may inject cost efficiencies, spur improvements in service delivery, and stimulate innovation much as competition between firms in private markets does. Therefore, government frequently has a role to play in the provision of publicly consumed goods and services - even if that role is merely to inject competition into a market that otherwise would have none.

In order to support my claims, I offer evidence that is both unique and timely. I examine two nearly identical Federally sponsored student aid programs and demonstrate that, in terms of cost efficiency as well as product value, together these programs are greater than the sum of their parts. Since 1994, the future of these programs has been the subject of intense political controversy, in part precisely because their simultaneous existence not only contradicts the bulk of the academic evidence on liberalization, but flies in the face of the anti-big government folk wisdom.

The competition between these two programs, the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Student Loan Program (DLP), is almost unique in the annals of Federal government. The data I present demonstrate that perhaps that is unfortunate. Competition can be an effective elixir against inefficiency, yet contrary to the conclusions of numerous students of liberalization, I prove that increasing competition in the provision of goods and

services traditionally provided by government does not imply the indiscriminate adoption of laissez faire philosophies.

At least since Adam Smith, economists, in particular, have derided the efficacy of government in providing goods and services. With good reason, I might add. As William Niskanen [1971] pointed out under traditional arrangements, bureaucrats, the managers of government's productive efforts, have every incentive to provide budget appropriators with the choice of "all or nothing." Either the bureaucrat's budget is maximized to the point where the consumer surplus associated with the particular good is eradicated, or nothing at all is supplied. The result is an over supply (or, in some cases, no supply) of the good and therefore a misallocation of resources.

Even if Congressional appropriators could dictate to bureaucrats precisely what level of output will be produced - and assuming that Congress could not be swayed by political interests who might like to misdirect output to their own, special advantage - setting that output at an optimal level, one which matches real demand for the product, would be strictly a matter of guess work. How could appropriators do otherwise than guess? Congress's constituents either have no idea how much of a particular good or service they require, or they intentionally overstate their needs.

It is well known that ignorance in matters of public policy is an entirely logical course of action. The perceived benefits to any voter of staying fully informed on

every issue are nil to negative. Most of us simply do not have the time to come to informed conclusions concerning what level of inspection is necessary to insure our health before chickens go to market, for example. Rather, we would prefer to leave such calculations to the experts and the obsessed.

In the rare instances in which we fall into one of these two categories, it is equally rational to misrepresent our preferences. Practically speaking, no matter how high the marginal cost of an extra chicken inspection, it will be in our interests to approve the extra inspection. After all, it is not as if we, by ourselves, will bear the full cost of the extra inspection. Instead, we get to share it with 250 million other individuals regardless of the extent to which they may benefit.

Finally, there is the esoteric notion of the assignment of property rights. Theoretically, at least, we are all granted an equal share in the outcomes of government. Unlike private equity markets, however, we cannot divest ourselves of our interests in government should it not perform to our satisfaction. The result is a lack of incentive on the part of the managers of government to please their customers and "stockholders," and an entropy which precludes innovation.

Bureaucratic inertia and budget maximization, special interest politics, rational ignorance, misrepresented preferences, and the inability of the individual to divest oneself of the outcomes of government. These are all intractable problems. The good news, though, is that we may be able to deal with the single biggest issue

negatively associated with the provision of goods and services in any setting - monopoly supply.

We certainly do not trust private entities to provide us with goods and services in a monopoly market. The propensities of monopolies to under produce and overcharge are infamous and, usually, at the first rumor of the genesis of a monopoly - natural or otherwise - a clamor arises to regulate it, or nationalize it. In either event, the monopoly remains so we should not be too terribly surprised if it continues to behave inefficiently. In the latter case, only the ownership has changed; in the former, we have dictated in static terms the procedures the monopoly is to follow and leave it unable to respond to market dynamics. In both cases, we usually insure the perpetuation of the monopoly by proscribing entry into the market by potential competitors.

Perhaps as a result of our tendency to think of governments as political monopolies, we seem to insist that when we ask government to provide us with a public good, one associated with positive or negative externalities, and/or one produced by a monopoly, it does so in a monolithic fashion. Yet, such an insistence is counter-productive to efficient supply. Just because governments operate as monopolists - at least in terms of the brokerage of power - in the realm of politics, there is no reason to believe that they must, of necessity, act as monopolists when we ask them to venture into the domain of economics.

An Accident of Politics

I offer as evidence the case of the delivery of federally sponsored student loans. In 1993, the Student Loan Reform Act (SLRA) authorized the creation of the William D. Ford Federal Direct Student Loan program. What makes the Federal Direct Loan program (DLP) noteworthy is that, when it was instituted, another Federally directed student loan program, the Federal Family Education Loan program (FFELP), was already in existence. The FFELP was considered an unnecessarily expensive program that had wrested itself from control by the Federal government and, as originally conceived the DLP was to replace the FFELP within four years. Nevertheless, due to the political muscle of the FFELP's supporters - principally the banking industry, the Student Loan Marketing Association (Sallie Mae), and the state guarantee agencies - both programs continue to function today. Purely through an accident of politics, the Federal government stumbled upon an arrangement by which it can deliver better student loan services, from the perspectives of the consumers of those services, at less expense. This naturally occurring experiment demonstrates that, under certain circumstances, by dispensing with the notion that government goods and services must originate from a single source, we can improve not only the efficiency with which the goods and services are produced, but also their quality and thus their value to the consumer/taxpayer. Irrespective of the mode of supply, though, we do not want government to become entangled in the trivial. Arguably, no endeavor is more important to the long-term health of a state than the promotion of educational attainment.

The Importance of the Federal Student Loan Programs

John Adams once wrote that "education is more indispensable, and must be more general, under a free government than any other" (quoted in Arnold, 1982, p.54). By this, he meant that not only is an educated citizenry essential to the present and future economic well being of a nation, but it is also requisite to the sustenance of republican democracy. A democracy requires that its electorate be, to the greatest extent possible, informed and intelligent decision-makers.

Unfortunately, an education, especially a higher education, is acquired only at a considerable cost - a cost that is incurred over a relatively brief period of time. Its benefits, however, disperse over a lifetime and accrue not only to the student, but also to those who may not contribute to the student's education in any manner whatsoever. An almost ideal way in which to spread costs over a time span somewhat equivalent to that over which benefits are distributed is through the use of credit markets. If, in addition, we require those who benefit peripherally from the education of another to share in the expense by subsidizing that credit market, then we have a fairly good facsimile of the Federally sponsored student loan market.

Today the DLP and the FFELP provide more assistance to students enrolled in post secondary institutions than all other sources, public and private, combined. The OMB estimates that in 1999 the Direct Loan program will award 3,251,000 loans at

an average of $3,291 per award.[1] In the same year, the FFELP will issue 5,843,000 loans at an average of $3,391 per award[2] [Source: Appendix to the U.S. Budget for Fiscal Year 1999, pp. 331-349]. Together the FFELP and DLP account for the vast majority of all student aid originating with the Federal government, far outstripping the assistance rendered by Pell Grants, Supplemental Educational Opportunity Grants (SEOG), College Work-Study assistance, and Perkins Loans. Relative to these other programs, but omitting the DLP, according to figures from the U.S. Department of Education [unpublished data], the FFELP provided better than 70% of the Federal aid granted to students at post secondary institutions in 1995. Similarly, and in only its second year of existence the DLP, relative to all other aid programs excluding the FFELP, provided 39% of all aid to post secondary students. Taken together, they provided $24.3 billion in financial assistance and accounted for almost 76% of the aid granted by the Federal government. Not even private sources of financial aid can match these loan programs in terms of volume as this is a figure roughly twice that of all aid emanating from the private sector.[3] See the figures below.

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[1] Average is for interest-subsidized Stafford loans only. Unsubsidized Direct Loans will average approximately $3,310 and Direct PLUS loans (Parental Loans for Undergraduate Students) will average $5,865.

[2] Again, this figure is for subsidized Stafford loans only. Unsubsidized FFELs will average $3,869 and FFEL Plus loans will average $6,458.

[3] $12.35 billion emanating from individuals, alumni, foundations, private corporations, religious organizations and other sources. [Source: Council for Aid to Education, New York, NY, *Voluntary Support for Education*, 1995]

Figure 1.1 - Financial Assistance Excluding DLP, 1995

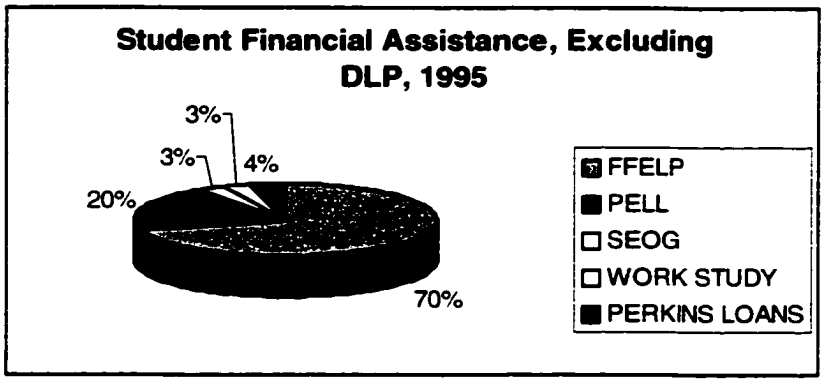


Figure 1.2 - Financial Assistance Excluding FFELP, 1995

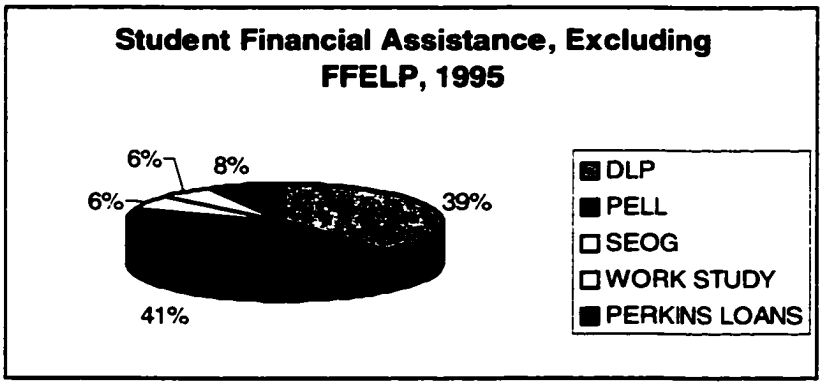
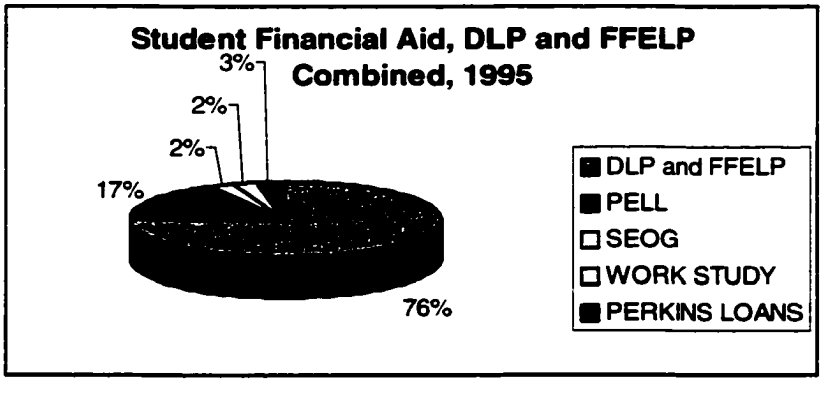


Figure 1.3 - Financial Aid, DLP and FFELP Combined, 1995



Clearly, then, the FFELP and the DLP are essential, not only to the fulfillment of Adams' dictates, not only to the ability of the nation's electorate to attend post secondary institutions, but also to assuring that they will have some choice in the institution they attend. In 1995, roughly 14.3 million students at all institutions of

higher learning, public and private, paid $13,260 in tuition and fees, to say nothing of room, board, textbooks and other supplies. That represented an increase of 5.6% over the previous year [Source: U.S. National Center for Education Statistics, *Digest of Education Statistics*, annuals]. While most students (58%) attended public institutions where tuition and fees averaged only $2,057 for schools of all types, and $2,997 for traditional four-year programs, it is apparent that enrollment at all institutions, public, yet especially private, would have been significantly curtailed if theses programs had not existed.

Addressing the question of access more generally, consider that in 1995-1996 the FFELP alone provided 37% of all tuition and fee remittances to American institutions of higher learning. In that same year, from a population of 8,138,000 full-time students, 5,757,000 promissory notes to lenders participating in the FFELP were signed. If we assume that each student took two loans - one for each semester - then we can conservatively estimate that 35% of all full-time students came to rely on the FFELP in the 1995/96 academic year.[4] Without the Federal Family Education Loan Program, there can be little doubt, many students would have found attending any institution, public or private, extremely difficult. More than the personal ambitions of U.S. students might have been dashed without the FFELP, to say nothing of the DLP, however.

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[4] Sources: U.S. National Center for Education Statistics, *Digest of Education Statistics*, annual; *Projections of Education Statistics*, annual; appearing as table 306 in U. S. Census Bureau, *Statistical Abstract of the United States, 1998.*

Given the importance of higher education to the growth of a service economy, such as that of the U.S., the long term, positive benefits of these programs cannot be overstated. In constant 1997 dollars, median family income has grown since 1990 by 2.6%.[5] Can it be a complete coincidence that, over the same period, the number of persons age 25 years and older with a college education grew by precisely the same rate? As well, college enrollment has risen by 4.3% since 1980. While we should expect some lag between the formation of the human capital associated with post secondary education and its inevitable contributions to GDP, there must certainly be a link between the present accessibility of higher education and the future economic (to say nothing of the political) well-being of the nation as a whole.

Moreover, the FFELP and the DLP may be almost as important to the present health of the economy as they are to its future. In 1995, American colleges and universities employed over 2.6 million faculty, staff, and non-professional personnel and balanced their books at roughly $189 billion, or 2.6% of GDP.[6] The $24 billion contributed by the FFELP and DLP represent about 13% of that total. Without the FFEL and DL programs, an important and dynamic sector of the U.S. economy, American academia might be significantly endangered.

While not indistinguishable, the FFELP and the DLP are similar in terms of the contributions they make toward the accessibility of post secondary education, the

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[5] Source: U.S. Census Bureau, *USA Statistics in Brief*, 12/98.
[6] Source: U.S. Census Bureau, *USA Statistics in Brief*, 1/10/99 (GDP); U.S. National Center for Educational Statistics, *Digest of Education Statistics*, annual, appearing

promotion of institutional choice among post secondary students, and the maintenance of a large and important sector of the economy. Further, they perform these services for identical populations. Whether a student decides to participate in the FFELP or the DLP is largely a matter of whichprogram his or her institution decides to enroll in. Should the institution decide to participate in both programs - roughly one third do - then the student does have a choice to make but, practically speaking, that choice is of little consequence.

While it was not always the case, as of 1999 the FFELP and DLP have come to be virtually identical, at least to the borrower, in terms of repayment options, interest rates, repayment grace periods and deferments, etc. In fact, it is now possible for students and graduates who never participated in the DLP to consolidate their FFELP loans into the Direct Loan program. What differences there are between the two programs arise from their loan origination sources.

Ostensibly, under the DLP loan funds originate from the student's eligible post secondary institution. Closer to the fact, however, is that these loans are issued directly by the Federal government. On the other hand, the FFEL program uses private banks and lenders as its source of financial capital. Participating private lenders are insured against default by state and private guarantee agencies although guarantee agencies are paid for their services by the government and compensated for almost all of their losses due to default.

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as table 309 in U. S. Census Bureau, *Statistical Abstract of the United States, 1998.* (Higher Education Expenditures and Revenues)

In essence then, and aside from the similarities already outlined, under both student loan programs the Federal government is the ultimate source of loan capital and assumes all risks associated with granting student loans. This is obviously the case under the Direct Loan program, yet it is equally true for the Federal Family Education Loan program. The difference between the latter and the former is that under the DLP, the Federal government provides loan funds "up front." One could say that it directly "produces" the loans. Under the FFELP, the government contracts with outside sources to produce the service and then covers all expenses associated with said provision. These are probably the two most commonly employed modes of production when it comes to providing governmentally produced goods and services. Rarely are they used, though, to simultaneously provide identical goods/services to identical constituencies.

Liberalization and Government Service Delivery Reform

When government chooses to deliver a good or service it can either produce it "in-house", as John C. Hilke [1992] would say, or contract out - "out source" - to private firms, with government retaining oversight and directive functions. The former is the approach taken under the DLP while the latter represents the delivery system employed under the FFELP. The question arises, however, as to why the U.S. government decided to employ two different modes of production to produce the same service. Further, why two programs at all? Total obligations for the Direct Loan Program including loan subsidies and administrative expenses will ring

up at roughly $1,104,000,000 in 1999. For the Federal Family Education Loan Program, total obligations of $4,933,000,000 will need to be met, the OMB estimates.[7] One might expect that economies of scale could be exploited under one consolidated program. The creation of the DLP surely represents wasteful duplication of efforts and resources. Or does it?

A Government That Works Better and Costs Less

Shortly after taking office, President Bill Clinton launched a series of initiatives and executive orders designed to "reinvent government" in such a fashion that it "works better and costs less"[8]. The keystone of this effort is undoubtedly the Government Performance and Results Act (GPRA) of 1993. It directs Federal agencies to develop performance goals, establish by what criteria their performance is measured, and annually submit a public accounting of the extent to which these goals have been met. However, the real importance of the GPRA is that is that it, along with a number of OMB circulars that find their genesis in the National

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[7] Be aware that the Department of Education's (ED) Office of Inspector General (OIG) released a "Study of Cost Issues" associated with the two programs in March of 1999 (CN S13-70001). The study suggests that ED's cost accounting procedures may not be accurate, attributing many costs to the DL when they are actually associated with the FFELP. As I am not privy to the information and sources available to the OIG, I cannot make the judgements that they have and must necessarily restrict myself to the analysis of publicly available cost data. However, because the OIG's findings imply that the Direct Loan program is cheaper (and the FFELP more expensive) than previously, publicly stated, adjusting for such biases - if I could - would only serve to strengthen my arguments.

[8] "Reinventing government" and "works better and costs less" became something of catch phrases in the Clinton Administration. They can be found in almost every

Performance Review (NPR), creates an audience for the recommendations of the NPR. The NPR is strictly an advisory council, but its advice concerns compliance with the GPRA and OMB directives and, therefore, when the NPR speaks, Federal agencies listen.

The NPR, which now likes to refer to itself as the National Partnership for Reinventing Government, was created in March 1993 and placed under the direction of Vice President Al Gore. Then as now, its goals were to promote cost efficiency in the provision of government services while improving the quality of the services provided. Further, it searched for ways to improve the relationships between government agencies and their "customers" by making the former more responsive to the latter. Borrowing heavily from David Osborne's and Ted Gaebler's bestseller, **Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector** (1992), the NPR sought to achieve its goals through the use of three often conflicting strategies. Donald Kettl refers to these strategies as downsizing, reengineering, and continuous improvement [Kettl, 1995, pp.37-50].

Downsizing is the all too familiar dull ax frequently used, since the early 1980s, by private enterprises to reduce costs through the elimination of ample portions of the workforce. The idea, of course, is to make the enterprise leaner and meaner. In microeconomic terms, by adjusting the capital/labor ratio to the point where equivalence with the relative productivity of the two factors is established the firm

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speech and/or white paper released on the subject of government reform in the last seven years.

can operate more efficiently. Put another way, fewer employees are asked to work harder for the same compensations. Downsizing can certainly prompt short-term savings in both private and public endeavors. The long-term effects of this strategy, however, are unclear as it may endanger the capacity of government to perform its appointed functions in the future. Worker disenchantment, disillusionment and, ultimately, attrition are not uncommon in enterprises, public and private, which have adopted the strategy of downsizing.

Reengineering employs the methods of organizational gurus Michael Hammer and James Champy. Their popular work, **Reengineering the Corporation** [1993], urges corporate executives to "think outside of the box". In order for an enterprise to thrive, Hammer and Champy argue, executive leadership must seek out cutting edge technologies and reorganize corporate structures in such a manner that communication with, and service to, customers is maximized. Often this requires a radical restructuring of the managerial hierarchy. Reengineering is the strategic impetus behind the NPR's "E-Gov" initiative, an effort to make interfacing with the Federal government simpler by using the Internet. By utilizing "virtual government" it is now possible for individuals to complete their tax returns on the web, stay abreast of the latest EPA requirements for small businesses, or obtain a student loan by filling out the Free Application for Federal Student Aid (FAFSA) online. Such technological innovations have lead to improved customer satisfaction, yet the management reorganization aspects may, again, threaten future government capacity by eliminating middle management. Because reengineering is

a top-down process, initiated by those at the highest echelons of the organizational structure, and because it values customer service and the lower level employees who most frequently interact with customers, process restructuring usually comes at the expense of middle management.

What Kettl calls "continuous improvement" is not as disjoint as reengineering or downsizing and is most closely related to W. Edward Deming's Total Quality Management (TQM) [1982]. It does not call for the one-shot, radical restructuring that downsizing and reengineering do, but instead prescribes an ongoing effort. The theory holds that if a firm focuses on the quality of its product, improvements in efficiency will follow. In order to continuously improve the quality of product and, therefore, its value to the consumer, management must empower those who are most intimately acquainted with the desires of the consumer and the day-to-day processes associated with production. By giving lower level employees a voice in the determination of what is produced, and how it is produced, labor productivity rises. Deming asserts that this is the result, not only of improvements in the productive process and the marginal value of the product associated with the quality upturn, but also to an enhancement of employee commitment. Thus, TQM is a bottom-up process that can find its methods in direct conflict with those of reengineering and downsizing.

That the Direct Loan program should be authorized under the Student Loan Reform Act in the same year that the NPR began its crusade to reduce government

inefficiencies is somewhat ironic. Prima facie, it would seem that few government programs are better candidates for reform than the Department of Education's student loan programs. Downsizing calls for a reduction of the labor force associated with the delivery of a service, not an increase. However, the Direct Loan program required 140 full-time employees in 1994, its demonstration year. By 1999, that number had quadrupled[9]. Reengineering proposes that management processes be streamlined, not virtually duplicated as was required when the DLP was inaugurated. And TQM, while it may have nothing to say about the existence of parallel service provision, simply is not applicable to government, critics contend. Citizens are not the customers of government, they are its owners.

The present continued co-existence of the DLP and the FFELP rests on the precept that service has improved and that cost has been contained through the introduction of pseudo-market forces. Yet, government should provide goods and services only when private markets fails, or so goes the standard, knee-jerk critique. If that is the case, it is obvious that the applications of methods relying on market incentives are not germane to government. Further, even if incentive structures could be applied in a public setting, they cannot take the place of the rule of law. Bureaucrats are obligated to follow the will of the people as that will expresses itself through Congress. Allowing bureaucrats to decide the means and methods of public service provision is to allow them to subvert that will to their own. In other words, the adoption of TQM represents a rollback of the reforms that were won under the banner of the Progresives in the decades surrounding the turn of the 20th century

[9] Source: Appendices to the U.S. Budget, 1996 - 1999.

[see, e.g. Fredrickson (1992), Moe (1993) and Lynn (1994), all cited in Kettl]. For reasons of efficiency, as well as the promotion of responsive government, the elimination of one of the Federal student loan programs could have been high on the list of the NPR's recommendations for reform. Nevertheless, it was not.

Five years after its creation, the NPR remains immature as it continues to search for a unified theory of government reform. Its present recommendations are still derivative of the pop-management techniques outlined above, but fortunately, it has never been rigid in its directives [see, e.g. NPRG, "Balancing Measures: Best Practices in Performance Management", August 1999]. Its overarching mission was to inject competitive forces into the provision of government services as proselytized by its high priest, David Osborne. Osborne and his co-author, Ted Gaebler, dedicate the bulk of their efforts in **Reinventing Government** to expounding upon the management techniques they believe to be necessary to transforming a dormant bureaucracy into a set of dynamic, customer oriented, service enterprises. However, the crux of their message is that in order to reap the benefits of a private market, government must foster competition wherever, and however, possible. Once quasi-markets are established, the policy making organs of government must relegate themselves to "steering" (dictating the ultimate outcomes and overseeing that they, in fact, come to pass) rather than "rowing" (micromanaging the production process) [Osborne and Gaebler, 1992, pp.1-25]. Fortunately, this most important aspect of Osborne's and Gaebler's thesis was not lost on the NPR.

According to Osborne and Gaebler, three different types of competition can be used in the delivery of publicly supplied goods and services (see table 1.1). It is left up to the policy maker to create the quasi-market appropriate to the particular good or service.

Table 1.1- Types of Competition

	Public	Private
Public	- Interagency - Inter-municipality (Lakewood Plan)	e.g.: Tennessee prisons, U.S. Dept. of Transportation, NYC Dept of Sanitation
Private	----------	- load shedding
	----------	- procurement
	----------	- competitive contracting

Private vs. Private: By far the most commonly used method, government relies exclusively on competing private entities to supply the good/service or, at least, the necessary inputs.

- Load shedding: Government simply abandons provision of the good/service. In order for this strategy to be successful, a number of private suppliers must already exist, or barriers to market entry must be low enough to attract and sustain an adequate number of suppliers. Government must use its regulatory capabilities to insure that public interests are met.

- Procurement: Here government does not abandon the provision of the good or service. It does require private enterprises to compete with one another in order to supply it with the inputs it needs to do the job, though.
- Contracting: Also very common, government decides what is to be supplied, how it is to be supplied, and to whom. It then - usually - grants an exclusive franchise for service delivery for a limited period to the private entity that can reasonably demonstrate that it can perform the function for the lowest possible cost.

Public vs. Private: In this scenario, government does not give up "in-house" production of the good or service. It does not grant itself an exclusive monopoly, however. Ideally, it encourages entry into the market by private competitors. Examples, the first three of which are cited in Osborne and Gaebler (pp.84-85), include ...

- The State of Tennessee's decision to allow one of its three new prison facilities to be run by a private firm so that cost and quality comparisons can be made.
- The New York City Department of Sanitation's entry into the market for municipal motor vehicle maintenance in competition with private contractors.
- The Department of Transportation's requirement that transit authorities seeking Federal funds allow private firms to bid for routes alongside public providers.
- Congress' repeal of the U.S. Postal Service's monopoly on parcel post delivery.

Public vs. Public: Government agencies, departments and municipalities continue to produce the good or service, but compete with one another either for a larger market share, or for the right to supply the service to other agencies or municipalities.

- Interagency competition: Presently a hypothetical quasi-market, interagency competition could be viewed as a formalization of agency "turf battles" for influence and budget. In essence, the bureaucratic incentive structure that Niskanen described is used to restore consumer surplus by pitting one agency against another. Perhaps the closest example of interagency competition that history can present is that of the Air Force/Army efforts to simultaneously develop an intercontinental ballistic missile. This competition will be discussed at greater length later.
- Inter-municipality competition: Often called "The Lakewood Plan" in honor of the California community which seems to be responsible for it, this quasi-market allows smaller municipalities to take advantage of the economies of scale its larger brethren can generate. Larger municipalities must provide services at the lowest possible cost - to their own residents, as well as to those of the smaller communities - lest today's customers decide to produce the service themselves and become tomorrow's competitors. The most well known example is that of the Los Angeles County Sheriff's Department, which supplies capital intensive services to other, unincorporated municipalities.

Perhaps because the contemporaneous existence of the DLP and the FFELP quite closely mirrors the public vs. public, interagency competition genre[10], the NPR has seen fit not to interfere. In fact, it has been remarkably quiet on the subject - remarkable because the DLP/FFELP seems to represent just the sort of experiment that Osborne, one of the NPR's leading forces, would recommend. Perhaps the NPR's silence is the result of a keen political acumen that deters it from throwing itself into the conflagration that has engulfed the Direct Loan program since its inception. Whatever the reason, the on-going cage match between the FFELP and the DLP[11] provides a unique opportunity to test the hypothesis that the introduction of competitive forces can improve the delivery of goods and services by government.

Liberalization Strategies

Privatization (Private vs. Private Competition)

Exposing the government supply of goods and services to market forces, be it through the use of private vs. private, private vs. public, or public vs. public competition, has been labeled "liberalization". Under the heading of liberalization we can also find the sub-rubric of "privatization", a term reserved for describing liberalization when it uses competing private entities to increase efficiency.

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[10] The student loan programs only mirror this quasi-market because, truth be told, it can really be described more accurately as an intradepartmental competition - or even intraoffice. Both programs are administered in the Department of Education's Office of Postsecondary Education.

[11] More on this in Chapter 2.

Privatization has been well studied and, under certain fairly specific circumstances, it has proven efficacious.

Since the late 1960s when he served as a deputy city administrator under New York Mayor John V. Lindsey, E. S. Savas has been one of privatization's foremost promoters. Lindsey espoused himself to a theory which holds that bigger government is better government. The creator of numerous "Super Agencies", his administration reflected the notion that consolidation of the decision making process, as well as production, assured efficient service delivery. Savas learned otherwise.

While Savas would be the first to admit that when it comes to government service delivery there can be more than one legitimate approach [e.g. Savas, 1977a, pp. 1-5], the bulk of his investigations have focused on the efficiency gains which can accompany privatization. In particular, he has closely examined refuse collection. For Mayor Lindsey, he found that New York City's refuse collection service was almost three times as expensive as private collection [Osborne and Gaebler, 1992, pp.80-81.]. Other Savas studies of sanitation services suggest competitive contracting between private suppliers save governments between 40% to 60% of the cost of public supply [e.g.: Savas, 1974, 1977b, 1977c, 1980, 1981, Stevens and Savas, 1978].

Whereas Savas' studies advocate privatization at the state and local level, James T. Bennett and Thomas J. DiLorenzo [1983] do the same for programs at the Federal level. Using data from various GAO studies, they contend that government provision of goods and services can be up to four times as expensive as competitive contracting. Specifically, Bennett and DiLorenzo compare private vs. in-house maintenance of Navy supply and support ships; the costs of rail maintenance for Amtrak vs. private, freight railroads; publicly vs. privately administered day care centers; and private vs. public military base support services, including motor vehicle maintenance, laundry and dry cleaning, custodial services; and food services. Like Savas, Bennett and DiLorenzo believe that cost efficiencies accrue as a result of the diminution of the political influence of rent-seeking, public employee labor unions.

John C. Hilke (1992) attempted to look at all manner of competition in order to find cost savings, including inter-agency competition, at both the Federal and State levels. Most of his data and the literature he reviews describe contracting arrangements, however. One cited study, what Hilke refers to as the "Stevens Study", conducted for the OMB in 1984, finds cost savings ranging from 22% to 49% for municipalities which use outside contractors to provide services that are often produced in-house. Usually, these are labor intensive services. Street cleaning, janitorial services, tree trimming, highway and road maintenance, and the ever popular refuse collection were all subjects of the Stevens Study. Other cited works touting the effectiveness of privatization include those for bus services

(Morlok and Moseley, 1986, Morlok and Viton, 1985, and Perry and Babitsky, 1986), cleaning services (Hamburg Senat, 1974, Kaiser, 1977, GAO, 1981, 1982, Fixler and Poole, 1987), fire fighting (Poole, 1976, Smith, 1983), forestry (Pfister, 1976) and highways (Deacon, 1979), to name just a few. For his part, Hilke estimates that $14 billion could have been saved in 1987 if privatization had been more fully instituted. His estimate of total cost savings is an aggregate of 16 categories of services. By Hilke's accounting, the greatest improvements in cost efficiency would have been realized in highway construction and maintenance, parks and recreation, sewage, and general public building maintenance. No savings could have been had by applying privatization techniques to financial administration, hospitals, public welfare, and utilities.

Simon Domberger and John Piggott (1986) bring an Australian perspective to the issue of privatization. While they are interested in the topic of liberalization more generally, they report that "in Australia private bus services have co-existed with public sector operations for over a century. Sectoral cost comparisons have found private operators to have significantly lower unit costs" (p.158).

Steve H. Henke edited a series of articles that, with few exceptions, fall four square in favor of privatization. In **Prospects for Privatization** (1987), privatization is not defined as merely private vs. private competition, but refers specifically to the more radical concept of loadshedding. The efforts reviewed are successful in terms of

productive efficiency but are, like every other study cited so far, labor intensive endeavors in industries with numerous existing or potential vendors.

Not every experiment with privatization, let alone liberalization, has been successful, though. Schlesinger, Dorwart, and Pulice [1986] review the awarding of competitively bid contracts to private suppliers for otherwise governmentally produced mental health services. This practice, they note, is intended to reduce the costs and improve the quality of services. Yet in the state of Massachusetts at least, these ideals are rarely achieved. Instead, they believe that competitive contracting fosters the creation of a small set of cartel-like vendors who ultimately find themselves in a position to set prices, and "cream" the most profitable service scenarios, leaving to the state the business of servicing more difficult and expensive clientele. According to the authors, once a company receives a contract it, quite naturally, gains an expertise in administering the required services. This precludes further competition from potential suppliers who lack their experience. In addition, the limited ability of contract officers to gauge the merits of proposals submitted by potential new providers further limits competition. Contract officers, the government's liaison to private service providers, are familiar with the approach and methods of the incumbent supplier. On "re-compete" - that is, once the initial contract has expired and provision is opened to competitive bidding - the incumbent enjoys a distinct advantage over other bidders. As time progresses, potential suppliers drop from the competition, and possibly the market, rather than devote considerable expense and effort to a losing cause.

From the studies reviewed so far, we might conclude that when activities are reasonably menial and labor intensive, privatization is preferable to government, in-house production. Garbage pickup, janitorial services, rail and road maintenance, laundry services, and landscaping, for example, are all likely candidates for out-source contracting, if not outright load shedding. None require particularly specialized labor skills, or insurmountable capital investments should a firm decide to enter the market. In these cases, something close to competitive markets can be readily constructed, if they do not already exist. If the comparisons the authors have made are valid, it is a wonder that government ever perceived the need to produce these services itself.

All things being equal, there is no reason to believe that government must establish an agency to see to it that windows at the local post office are clean. Yet things are not always equal. For obvious reasons, the Central Intelligence Agency might prefer that individuals it can trust wash its windows. In other words, it might require itself to be a bit more selective in determining who should administer the service than the post office need be. If so, the CIA will want to pay a premium for this special, if not specialized, workforce. Productive efficiency comparisons, especially to the private sector, cannot be made, as one is not simply comparing windows washed per dollar. Bennett and DiLorenzo, for example, found that in 1976 an unnamed Federal agency spent $8.72 per account to pursue debt collection whereas an unspecified private collection agency spent only $3.50 per account. Should we conclude from their findings that critics of the DL program must be

right? Because the FFELP uses private loan servicers under contract, it must be more cost efficient than the DLP could hope to be.

Not necessarily. Collecting delinquent student debt is not the same as automobile repossession, for instance. In conventional credit markets, the threat of foreclosure or forfeiture of collateral surely helps to convince delinquent debtors that it is in their interests to fulfill their obligations. While the Federal government does have a few options - it can garnish wages, withhold income tax refunds, and lay claim to lottery winnings, to name a few - an education can not be repossessed and so the incentive to repay is simply not as strong. It is, therefore, more difficult to avoid defaults. As we know, it was not profit that inspired the Federal government to become involved in student credit markets. Clearly it had ulterior motives that could not be satisfied conventionally. Comparisons to private markets are invalid.

To judge the Direct Loan program against the FFEL program, we must do so in context. To understand whether or not one is superior to the other, or whether combined their value is greater in sum than it is in parts, we must evaluate their merits in the venue of the market for student loans. That is precisely what will be undertaken in the following chapter.

When valid comparisons can be made, however, indications are that cost savings and productive efficiency can be realized through privatization to the degree that:

- The good or service potentially supplied by government is identical, or nearly so, to goods and services already traded in private markets.
- The good or service predominantly entails the use of unspecialized labor and capital with no barriers to the mobility of productive factors across markets.
- Markets are - and remain - contestable by potential providers. This means that ...
  - ✓ Expenses associated with capital - initial "sunk costs" and depreciation - must not be so large as to preclude market entry by potential competitors, or encourage exit from the market by existing firms.
  - ✓ The good or service provided to government must not be so differentiated from what might be required by private sector purchasers that, as Schlesinger, Dorwart, and Pulice point out, failure to win a contract means failure to remain in the market.
  - ✓ Economies of scale must not be so great as to provide an advantage to providers who enter the market early and are lucky enough to benefit from initial success.

Essentially, when attempting to describe the conditions under which privatization can be successful, we end up listing the characteristics of a competitive market. Numerous suppliers and purchasers (in addition to government), easy entry and exit from the market, unspecialized labor and capital that is readily transferable from one market to another, and no economies of scale or other advantages that might accrue to early entrants, are all necessary to successful privatization efforts. The choice of

method employed - load shedding, contracting, or procurement - seems strictly a function of the degree to which government has ulterior motives in providing the good or service. If the good or service is identical to that which can already be purchased in a reasonably competitive market, then load shedding would be ideal. If it is nearly identical, but encompasses some quality that is marginally different from that which can be purchased in competitive markets, then contracting is the way to go.[12] If the good or service cannot be purchased from reasonably competitive markets - if, for example, the good or service has a public goods aspect to it -, but if inputs can be competitively purchased, then competitive procurement might be preferable.

Privatization, then, can be effective in increasing productive efficiency only to the extent that competitive markets - either for the good itself, or for its inputs - exist. Unfortunately, the necessary conditions for the existence and sustenance of a competitive market are rather difficult to meet. What should be done when we cannot meet these conditions? Should we choose government, or a private entity to be our supplier? Alternatively, perhaps, some combination of the two?

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[12] In reference to a hypothetical example given earlier, the use of window washers who have, and can maintain, a high security clearance is not marginally different from the cohort of potential window cleaners who could otherwise be had in an open labor market. Not only must they be able to initially obtain a high security clearance, but continuing security must be assured through constant monitoring and with remuneration higher than might otherwise be obtain to mitigate potential temptations.

Fortunately, a number of authors have examined the cost/productive efficiencies of public suppliers relative to private firms in markets that are inescapably non-competitive. Due to the availability of data, most of these concern themselves with electric utilities and while results are often contradictory, *en toto*, some patterns do emerge.

Bennett and DiLorenzo looked at the relative efficiencies of hydroelectric power supply by public and private sources and found that government provision is 21% more costly. Consonant with their overall thesis of the evils of public employee unions, they suggest that the source of this extra expense is the 48% greater average employment per plant at government facilities from 1973 to 1975. Given the time period over which the analysis was conducted, and because the authors give no indication to the contrary[13], we can assume that their entire sample consisted of monopolists. Competition between suppliers was not an issue.

Using an earlier, but similar sample, Robert A. Meyer [1975], more elaborately controlling for economies of scale, also attempted to determine whether or not publicly owned utilities are less cost efficient than privately owned facilities. He found no evidence to support the hypothesis and further suggested that, with respect to production and maintenance costs, public suppliers are more efficient.

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[13] They controlled only for plant scale "as much as possible" (see pp. 38-39).

Additionally, no significant differences between ownership modes could be found with regard to transmission and distribution costs. The prices charged by private utilities, except on large commercial accounts, were also significantly higher. Meyer was rightly guarded concerning his results, offering that they could be due to regulatory practices, differences in production techniques and capital deployment, etc.

Atkinson and Halverson revisited the question in 1986, attempting to separate the joint effects of ownership type and regulation. Compared to a theoretical, idealized, utility maximizing electric Power Company, they found that publicly and privately controlled utilities were equally inefficient. Moreover, of nine preceding studies of utilities they reviewed, Atkinson and Halverson reported that two found private firms to be 5% to 22% more efficient, four concluded that public firms are up to 33% more efficient, and three found no significant differences whatsoever.

Because of their contradictions, these studies are not at all conclusive on the subject of whether public or private provision is preferable in the absence of competition. Atkinson's and Halverson's conclusion is probably closest to the mark: both are inefficient. As Borcherding, Pommerehne, and Schneider wrote, "it is not so much the difference in the transferability of ownership, but the lack of competition which

leads to the often observed less efficient production in public firms"[14] [quoted in Domberger and Piggott, 1986, p.152].

Public vs. Private

If it is monopoly that is the true evil in the battle to supply collectively consumed goods and services, what can be done when we are faced with the problem of the provision of a good that inherently lends itself to monopoly production? Because something similar to competitive markets does not exist, or cannot be reasonably created, privatization efforts must be doomed to failure. Are we left only with a choice between public supply and regulation of a private supplier? Perhaps not.

A number of authors have examined the effects of competition in markets that, under normal circumstances, might devolve to monopoly. In most cases, the competition arises between a private, potential monopolist and a public entity and these studies overwhelmingly demonstrate that the introduction of competition improves the efficiency of both public and private providers. The authors make no claim that productive efficiency is increased to a level associated with competitive markets. It would be unreasonable to do so because what is spawned is a duopoly situation and not a competitive one.

[14] Recall that the "transferability of ownership, i.e. the ability to sell off one's stock if one is unhappy with outcomes, is one of the defining differences between public and private endeavors. For some, it is the defining difference.

Walter J. Primeaux, jr. examined the cost efficiencies of electric utility firms competing to provide service to the same city. In almost all of the 49 cases studied competition was between a public utility and a private supplier. While deficiencies in the data did not allow Primeaux to analyze the effects of competition on private firms, he found that public utilities that must compete have lower cost structures (11%, on average) and, therefore, prices. He concluded "that if viable competition can exist in a public utility market, its downward pressure on prices could generate significant favorable effects" [1975, p.194]. Bellamy [1981] confirms Primeaux's findings, suggesting that competing utilities had 20% lower prices.

In a study of another industry that tends to be rather highly concentrated, Finsinger [1981, cited in Hilke] investigated the effects of competition between five publicly owned insurance and liability providers and seventy-five private firms. He discovered that competition between public and private firms promoted equivalent efficiencies.

Domberger and Piggott [1986] surveyed a dozen studies of the relative cost efficiency of the two major, domestic, Australian airlines in the early to mid-1970s. One was publicly owned, while the other was privately controlled[15] The industry itself was government regulated. Four of these studies found the privately owned airline to be marginally more efficient, while the others concluded that there were no perceivable differences in efficiency. This latter group did generally add,

[15] The authors do not name these carriers and my attempts to discover their identities have been futile.

however, that, when compared to U.S. carriers, both Australian firms were inefficient. All of the studies attributed the lack of efficiency to the presence of a higher level of regulation, when compared to the U.S. Three of them acknowledge that a higher level of competition in the U.S. may also contribute to the relative lack of efficiency on the part of the Australians.

By far, the most intriguing study of public vs. private competition in an environment that might otherwise breed monopoly concerns the contests between the Canadian National, and the Canadian Pacific railroads. Douglas W. Caves and Laurits R. Christensen [1980] relate that by the end of World War I the Canadian rail system had become so concentrated that only one carrier, the Canadian Pacific (CP), remained. In 1923 the Canadian National (CN), a wholly government owned corporation, was created to maintain rail service to remote parts of Canada that, due to profit considerations, the CP had largely abandoned. The market remained a heavily regulated one until the early 1950s. By 1967, though, the industry was almost completely deregulated and the CN was mandated to compete on an equal footing, not only with the CP, but also with all other forms of passenger and freight transportation. Using a measure of total factor productivity, Caves and Christensen estimate that the CP was 13% more productive than the CN in 1957, the first year of the study. Ten years later, however, the CP had caught up to the CN in terms of productivity and surpassed it for the next seven years. By 1975, the two firms roughly converged in productivity.

What makes Caves' and Christensen's effort so special is that it allows us a glimpse into the effects of competition on both the public and private suppliers. Other studies have demonstrated that the efficiency of public suppliers is spurred by the presence of a private competitor. Yet Caves and Christensen provide important evidence for the contention that private suppliers can be equally motivated by the presence of a public competitor. For example, between 1956 and 1963, the authors point out that the CP's average annual rate of productivity growth was 1.7%. For the period of 1963 to 1974, though, it increased to 3.3% in response to the competition offered by the CN.

Public vs. Public

So far, we have seen that the introduction of competition to the production of publicly supplied goods and services can have favorable consequences in terms of productive efficiency regardless of market structure. The studies reviewed above seem to imply an important caveat, though. Is it a necessary and sufficient condition that the success of any liberalization effort must hinge on the existence of at least one potential private supplier? While this may be a sufficient condition, as we shall see, it is by no means necessary.

Aside from that between the FFEL and the DL programs, cases of public vs. public supplier competition are extremely rare. However, the few cases that have been studied unanimously return a verdict in favor of the introduction of competition into

the provision of collectively provided goods wherever feasible. An instance in which competition proved infeasible was that of what Thomas L. McNaugher calls the "Thor-Jupiter controversy" [1989, pp.79-84].

Competition between the armed forces is legendary and, during the Eisenhower administration, pitting one branch against another in contest over the development of similar weapons, with nearly identical missions, catalyzed it further. McNaugher relates that the Air Force and Army were set against one another by the Defense Department to develop an air defense missile; the Air Force and Navy developed similar tactical aircraft; and all three service competed to provide a long range ballistic missile. The most well known competition, however, was that between the Air Force's Thor intermediate range ballistic missile program, and the Army's Jupiter delivery system. The Thor-Jupiter competition, like the other procurement rivalries, was designed to give the defense secretary a choice between programs, in terms of both quality and cost. Though the Thor proved inferior in early tests its development continued because the Air Force had already constructed concurrent production facilities. Cancellation of Thor would have represented a sizable loss of sunk, fixed costs. Similarly, Jupiter could not be eliminated due to traditional Congressional Pork barrel considerations. McNaugher's contention is that, although it was a valiant effort at cost containment, the introduction of a competitive incentive structure was infeasible not because competition between two public entities is impractical, but because of the nature of the product.

The development of a new weapons system usually pushes the technological envelope. When a request for proposals is issued to potential contractors, a statement of previously unrealized objectives is given with little or no insight into how those objectives might be attained. It is left to the contractor to propose the appropriate technology with the understanding that it may not presently exist. Research and development costs, therefore, can be staggering. The process is complicated by the fact that it is unrealistic not to develop the production system contemporaneously and production design must continuously be altered to match new developments in research. Further, as the parameters of the battlefield change, so do project objectives, often requiring radical redesign in midstream of development. These expensive realities dictate that the Defense Department can not simply request an interceptor that performs in a particular manner, for example, and then review the cost and quality of the finished product from potential suppliers. What seems clear is that requisite to any successful liberalization effort, the product must already exist. At the very least, it must require the application of existing, widely used technologies.

Public vs. public competition has proven effective when these conditions have been met, and in the absence of a potential private supplier. The so-called "Lakewood Plan" is the most well studied example. Put briefly, it proposes that smaller communities contract for services with larger ones, allowing them to take advantage of the economies of scale the larger communities enjoy. In turn, larger communities benefit due to lower unit costs resulting from the increase in service demand. The

larger communities must offer services at the lowest possible cost due to the presence of other, large communities that can provide the service and/or the possibility that higher prices might induce smaller communities to produce the good or service themselves. Having done so, they may potentially enter the market as a competitor.

Stephen Mehay and Rodolfo Gonzalez [1985] examined the incentives municipalities which supply services to other local governments have to produce these services efficiently. The authors contend that the supplying municipality, for the reasons stated above, must set price equal to unit cost and must offer their services at a uniform price to all potential purchasers. This allows purchasers to set price/marginal cost equal to their perceived marginal benefit. This behavior, in theory at least, precisely mimics that of producers and consumers in a competitive market. Running regressions on a sample of 53 of California's 58 sheriff's departments, the authors find that, in practice, those departments which supply services to other municipalities experience an $18 to $45 reduction, per capita, in the cost of supplying the services, not only to other municipalities, but to their own constituents as well. They conclude that competitive, inter-municipality contracting puts pressure on bureaucracies to reduce managerial inefficiencies and counters the Niskanen effect.

Robert T. Deacon [1979] also examines the benefits of the Lakewood plan, but does so from the vantage point of the local government that contracts for services.

Deacon's dependent variables are total expenditures on police protection and street maintenance, comparing costs under the Lakewood plan with those accrued through in-house supply. In all cases he finds statistically significant lower costs associated with municipalities that contract out to other governments for services. Specifically, "estimated expenditure differences between the two types of cities ... [suggests that] purchasing municipalities spend about 86% as much on all services as do their producing counterparts"[p.388]. These cities are able to tap economies of scale they otherwise would not be able to use.

Summary

Using the term's proper definition, the introduction of competitive forces to the supply of collectively consumed goods, we can conclude that advocates for liberalization are probably correct. In order to improve the efficiency of the provision of such goods and services, it is advisable to liberalize wherever possible. However, we have to be very careful not to misuse the term. If we define it as radical load shedding only (the abandonment by government of the production of collectively consumed goods) then we may be disappointed with the results of liberalization efforts. While the problems classically related to public provision - bureaucratic and special interest politics, rational ignorance, misrepresented preferences, and the inability to divest oneself of the outcomes of government - are not to be ignored, they may be trivial in comparison to the inefficiencies associated with monopolies. Liberalization, judiciously applied, may help us to overcome these inefficiencies.

A number of authors have demonstrated that, in the absence of competition, private suppliers are more efficient in supplying goods and services. Just as many, though, have shown that in the same situation public suppliers can be less costly and more productive. No doubt, the issue is clouded by the presence of regulation in monopoly markets, but when this factor is controlled for, it appears probable that both public and private monopoly suppliers are equally inefficient. When competition in otherwise monopolistic settings is realized, past studies, especially Caves' and Christensen's examination of the Canadian railroads, declare that both public and private suppliers drive one another to higher levels of efficiency with the consumer the final beneficiary. The true evil, then, is monopoly. To proscribe government involvement in the provision of collectively consumed goods and services is to forbid entry into a market by the only entity with the potential to offer competition.[16]

When liberalization is used to inject competitive forces into the supply of a good or service that might otherwise be supplied by a publicly controlled monopolist, it is done by deregulating the environment, or perhaps subsidizing a private firm to the point where entry is feasible. Studies of monopoly markets provide no rationale, however, for deeming it ill advised to introduce a public competitor to a private monopolist. In fact, they imply the opposite.

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[16] That is, government may be the only entity with the financial wherewithal to meet the high capital investments necessary to achieve the economies of scale that characterize monopoly. Under what conditions the return in efficiency is offset by the high, initial capital outlays and other costs is a question left for another time.

Depending on the nature of the market for the good and, therefore, the nature of the good itself, liberalization need not be restricted to the "public vs. private" genera of competition. Public vs. private seems best suited to the promotion of efficiency in markets that might devolve to monopoly in the absence of such competition. On the other hand, privatization, or private vs. private competition, is preferable when the good or service to be collectively consumed, or at least the inputs required for its production, is already available in private markets. Thus load shedding - complete divestiture by government from the production process - is recommended to the extent that the good/service is a competitively supplied one. However, if the good is marginally different from what can be purchased in competitive markets, including instances where government may have ulterior motives for supplying the good, then competitive contracting may be advisable.

I have repeatedly stated that the choice of liberalization strategy depends on the market for the good and, thus, ultimately on the nature of the good itself. Some goods, chiefly those deemed "public goods" and those endowed with significant positive externalities, do not easily lend themselves to supply by private firms simply because their full value cannot be captured by the supplier. Consequently, private markets that can match true demand do not exist. When dealing with such goods, because of the lack of a potential private supplier, are we left to conclude that liberalization efforts must fail? Fortunately, no.

While there are precious few examples of "public vs. public" competition, its theoretical existence has been hypothesized by Savas, Hilke, and Osborne and Gaebler, to name a few. Public goods, and those with positive externalities, are rather rare and for that reason alone we should not be surprised at the paucity of examples. Still, the scarcity of examples may be even greater than it should be for two additional reasons. First, by far the largest number of liberalization studies examine the relative efficiencies of public and private provision of goods that can generally be obtained in existing, reasonably competitive markets. This is understandable because cost and price data are more readily obtainable from markets of this type. Second, as we know, these studies usually find that private production is superior. Based on their findings, the authors most frequently conclude that government has no business in the business of supply. It would be a policy maker of uncommon valor who could initiate an apparently redundant public program given the weight of "expert opinion" against him. Therefore, the number of experiments in public vs. public provision is even less than the ratio of public goods to all others might indicate.

My study of the competition between the FFELP and the DLP aims to assist the courageous policy maker by providing him or her with powerful evidence that competition, even in the absence of a potential private supplier, can aid in the efficient provision of those goods and services traditionally associated with production by government - public goods, and those associated with positive externalities.

If, as Gerald Garvey has asserted, the 1990s represent the third great wave of government reform in the US, then an examination of the potential for "public vs. public" competition is long past overdue. The NPR/NPRG openly seeks to lead government into a millennium in which the presence of competitive incentives in the provision of goods and services supplied by government is the norm. Regrettably, to date most of the NPR's initiatives - "laboratories," it likes to call them - involve the application of pop management techniques. While the introduction of competitive incentive structures to the management of public projects is surely important to improvements in efficiency, the NPR's efforts represents a form of gradualism often associated with republican democracy. It is now time, however, to take the next step. It is now time to inject true competition - between agencies, between departments within agencies, and between offices within departments - to the production of goods and services provided by government. In order to do so, we must have evidence that such endeavors can be successful and not expensive, duplicative fiascoes, though. The study of the Federal Family Education Loan Program and the William D. Ford Federal Direct Student Loan Program, presented in the next chapter, provides exactly the sort of ammunition needed.

Chapter Two

Competition between private entities, in the absence of collusion, invariably results in more product, at a lower price, with better quality. We would hope that competition in public markets might render the same benefits. An examination of the federal government's two middle-class student loan programs reveals that this just may be the case.

As a result of the advent of the Federal Direct Student Loan Program, not only did the cost per loan to the peripheral beneficiaries of higher education, taxpayers, decrease, but the number and quality of student-loan products increased. In other words, the flexibility afforded students in choosing repayment options increased without a concomitant increase in cost. While students did not perceive a change in the quality of student loan products in terms of service, financial aid directors at postsecondary institutions most definitely did. After the introduction of the DLP, financial aid directors noticed a marked improvement in services from lenders, loan servicers and guarantee agencies

To support these claims, this chapter is divided into three parts. Part one is a reasonably short narrative describing the history of student loan programs under Title IV of the HEA. The second part addresses the cost benefits accruing from competition between the FFELP and the DLP. Part two is further subdivided into sections which describe the data used in the analysis, the methodology employed,

the model itself and, finally, the conclusions we can derive from the model. Part three examines changes in customer satisfaction that came about as a result of program competition. Like part two, part three is also divided into data and methodology subsections, followed by summary conclusions.

History

In order to claim that improvements in the federal government's provision of student loans to middle class families is a result of direct competition between the DLP and the Federal Family Education Loan program, it is important to understand what, if anything, was wrong with the FFELP. How did the situation get so dire that federal government felt the need to eradicate it? How did the FFELP grow so powerful that it was able to resist the efforts of several presidents to terminate it? These are related questions that shed light not only on the root causes of inefficiencies associated with the government goods and services, but also upon possible amelioration. The source of this light emanates not simply from budget figures and customer surveys, but also from the history of federal efforts to make postsecondary education more accessible to the American middle class. As will become evident, until the accidental advent of competition between the FFELP and the DLP, the federal, middle-class, student loan program was, for postsecondary student, institutions of higher learning, and the American taxpayer, a difficult situation that grew more burdensome by the day. It started out innocently enough, however.

Nascence of the Student Loan Industry

When Congress passed the Higher Education Act (HEA) in 1965, President Lyndon Johnson envisioned its Title IV, part b, as a cornerstone to the Great Society he intended to build. Unlike most of the other social programs he initiated or endorsed, though, the Guaranteed Student Loan program was not designed to assist the severely deprived exclusively. Instead, it attempted to reach the middle-class as well. Johnson, a former community college public-speaking instructor who liked to refer to himself as "the teacher in the White House", was a graduate of modest Southwest Texas State Teachers College. Surely, as well as anyone, he understood the extent to which financial considerations could influence a young person's decision as to what institution they might attend, if they could afford to attend at all. Moreover, he understood that if America's society was to be a great, it had to be educated.

Though the middle-class cannot be characterized as severely deprived, with regard to attaining a higher education, it was handicapped. With 1965 median family income at $6,882, and the average annual cost of tuition, room and board at public four-year institutions at $1,051 ($2,202 for private four-year schools), it is easy to understand why financing the education of even one child could be a serious challenge for most families. With such financial barriers in place, the possibilities for the maintenance of a middle-class, not to speak of upward social mobility, were limited. Additionally, if only the wealthy could afford to educate their sons and daughters, then the concept of a social meritocracy was at risk. As an example, in

1970, the first year for which comparable data exist, median family income for freshman was $12,000. Median family income for the population at large in 1970 ($9,867), however, was only 82% of that. The decision to obtain a higher education, these figures infer, was influenced not only by ambition and ability, but by financial wherewithal as well. As the table on the next page indicates, this percentage has remained remarkably constant over the years, but at least it has not deteriorated. It is interesting to note that the disparity is smallest in 1980, the year following President Carter's decision to end all "means tests" - income qualifications - from determinations of GSL eligibility. By 1985, President Reagan had largely re-instituted income caps. By 1995, the Direct Loan program was in full swing and a barely perceptible close in the income gap can be observed. What contributions the DLP may have brought to this narrowing will be discussed later.

Table 2.1 - Disparity between Median Freshman and U.S. Family Income for Selected Years[17]

Year	Median Freshman Family Income	Median U.S. Family Income	Percent U.S. Family Income to Freshman Income
1970	$12,000	$9,867	82.2%
1980	$23,000	$21,071	91.6%
1985	$34,000	$27,843	81.9%
1990	$43,000	$35,353	82.2%
1995	$49,000	$40,611	82.9%
1997	$53,000	$44,568	84.1%

When LBJ searched for methods to ease this inequity, he heeded the advice of John W. Gardner and the Carnegie Commission on Higher Education. In a task-force report delivered in 1964, "the Gardner Commission" recommended a broader use of student loans. The Gardner Commission presented LBJ with two options by which student loans could be provided. Chiefly, the commission advocated the creation of

[17] Figures for median, freshman, family-income are from **The American Freshman: National Norms**, annual; The Higher Education Research Institute, UCLA. Figures for median, U.S. family-income are from the U.S. Bureau of the Census, Income Statistics Branch/HHES Division, March Current Population Surveys. Tuition and cost figures are from U.S. Department of Education, National Center for Education Statistics, Higher Education General Information Survey (HEGIS), "Institutional Characteristics of Colleges and Universities" and "Fall Enrollment in Institutions of Higher Education" surveys; Integrated Postsecondary Education Data System (IPEDS), "Fall Enrollment" and "Institutional Characteristics" surveys.

a National Student Loan Bank that would raise capital, market, package, and then resell student loans. Later known as the Educational Opportunity Bank (EOB), or the "Zacharias Plan" in honor of Jerrold R. Zacharias, the M.I.T. physicist and commission member who originally proposed it, the National Student Loan Bank represented what was referred to in the last chapter as an "in-house" option. The government was to act not only as collective consumer of the good, but also as collective producer. Students would repay these loans over the course of thirty to forty years and, like contemporary student loan programs, contained an income contingent component which allowed borrowing students to pay 1% of their future income for each $3,000 borrowed.

The higher education lobby, particularly the National Association of State Colleges and Land Grant Universities (NASCLGU), an association of public institutions, let their opposition to the plan be known. To them, the Student Loan Bank represented a lifetime of indenture for their future students. They preferred a program of direct federal grants the disposition of which they, naturally, would control [McNett, 1966].

President Johnson did not need to hear NASCLGU's arguments against the National Student Loan Bank, though. The government was already in the business of producing student loans and Johnson did not like the results [McNett, 1965a]. Created in the wake of the Sputnik hysteria, the National Defense Education Act of 1958 authorized the existence of the National Defense Student Loan Program

(NDSLP). Later termed the National Direct Student Loan Program and now known as the Perkins Student Loan Program, the NDSLP provided low interest loans to students focusing on math, physical sciences, modern, foreign languages, and other areas of study that might close the perceived "missile gap" between the U.S. and the U.S.S.R. By 1965, 314,000 students at 1,560 institutions were receiving NDSLs at an annual cost to the government of $136.4 million. Because the 3% interest rate associated with these loans was paltry compared to the cost of providing them[18], because a large percentage of them were routinely cancelled ($400,000 in 1965), and because, like loans of any type, a fraction of borrowers could be expected to default, the NDSLP represented less of a loan program and more of an outright grant. Fiscally speaking, LBJ already had a lot on his plate. His administration did not need another expensive transfer program. Johnson's idea of a student loan program was one that would replace the NDSLP.

The Gardner Commission's alternate recommendation was for "a program of federally insured commercial loans to encourage banks and other credit institutions to lend funds for educational purposes, and to supplement the existing private credit programs, many of which [were] charging rates of interest amounting to usury. " [Quoted in Fields, 1972 (a) (Vol. 6, #18)]

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[18] In 1965, the return to new U.S. 91-day Treasury Bills was 3.95%. The prime rate for private banks was 4.54% while the Federal Reserve Discount Rate was 4.04%. Therefore, depending on the rate one chooses for comparison, the differential between what was charged on NDSLs and the true market cost was anything between -0.95% and -1.54%.

Private lending institutions had been making student loans long before the advent of the GSLP or, for that matter, the NDSLP. As long as a student, or more likely the student's parents, had the resources, banks were more than happy to issue what amounted to little more than a traditional consumer loan. A consumer loan with a significant interest premium, however. Yet, to characterize these loans as "usurious," as the Gardner Commission did might be a bit harsh. Rates on student loans were higher than traditional consumer loans, but they needed to be. The terms of a student loan typically included a repayment period of ten years and, unlike other long-term loans such as a home mortgage, there was nothing for a bank to lay claim to if the borrower defaulted. The long repayment period meant that a lender's funds were tied up for a long time, constraining his or her flexibility to pursue more lucrative opportunities should they arise. Given these facts it is a wonder that private lenders ever consented to grant a student loan, but they did. Aside from charging high interest rates, lenders initiated two innovations that made student loans more appealing to them.

First, in conjunction with the States, they instituted a guarantee system. Chartered and financially seeded by individual States, guarantee agencies were created to underwrite the risks associated with lending to students. In return for an insurance fee charged to the borrower of as much as 5% of the loan principle, guarantee agencies agreed to assume the collateral risk endemic to student loans. So long as the lender agreed to exercise "due diligence" as prescribed by the guarantee agency in attempting to collect on loans falling into arrears, then the agency would fully

compensate the lender for principal and interest should the borrower default. The risk associated with a student's lack of collateral was ameliorated. The first guaranteed student loan was made in Massachusetts in 1957 and, by the time the HEA was passed in 1965, twenty-one guarantee agencies were already fully functional [National Council of Higher Education Loan Programs, 1994].

Second, some lenders found that they could use student loans to solicit new business and solidify relationships with existing customers. If students, or more likely their parents, were willing to maintain specified balances in a bank's accounts, then that bank would be willing to issue a guaranteed loan. In this way, the lack of liquidity that accompanied the issuance of a student loan was at least partially offset by the borrower.

Still, a number of problems remained which limited the accessibility of student loans. Guarantee agencies, for example, existed in less than half the States. Students residing in States that did not have such an agency found it difficult, if not impossible, to secure a guaranteed student loan[19]. Additionally, guarantee agency funds were exhaustible. In order to remain financially solvent, they had to limit the number of loans they would insure. Lenders' practices of issuing loans only to customers with other accounts at their banks also presented problems.

[19] Guarantee agencies in some States did make provisions for out-of-state students. Massachusetts, home to several large, expensive, private, and politically powerful institutions of higher learning, was one.

If a potential student-borrower - or the student-borrower's parents - had a bank account then the borrower probably had some discretionary income. If that was the case then it was likely that the income of the borrower attained or approachesd middle-class status. In 1965, even more so than today, if an individual was middle-class and sought a higher education, then the probability was high that they were also white and male. As late as 1970, a report conducted for the Department of Health, Education and Welfare's (HEW) United States Office of Education (USOE) entitled "Survey of Guaranteed Student Loan Accessibility" concluded that the major reason loans were refused was due to the lack of such a relationship. The report also stated that although relatively few students listed sex or race as the reason for being refused loans, "the proportion of females and non-whites not receiving loans was significantly higher than could be explained by random chance" [quoted in McNett, 1970]. However inadvertent it may have been, in terms of educational opportunity, minorities and women were discriminated against. As the date of the report indicates, this problem persisted for many years after the passage of the HEA.

Obviously, President Johnson chose the second of the Gardner Commission's recommendations. Rather than create another in-house program for the production of student loans, he decided to out-source the effort. Yet LBJ, and the 89th Congress, attempted to engineer provision in the cheapest and most politically unobtrusive fashion possible. It was also the most naïve fashion possible.

It was politically unobtrusive in that it did not intrude on States' rights. Since the earliest days of the Union education has been the domain of the States. George Washington's attempts to establish a national university were sharply rebuffed for parochial reasons, for example. The thought of good, Catholic boys being schooled in Virginia by heathen Anglicans was a repugnant one for most Marylanders [Arnold, 1982]. Thus, the method, as well as the finance, of higher education remained an exclusive prerogative of the States until passage of the HEA[20]. The HEA introduced a permanent federal presence to higher education, promoting as it does improvements in library physical structures and resources, the preservation of historically African-American universities and, under the HEA's most famous title (IX), equality of opportunity. Yet, it did so reluctantly. Virtually the HEA's last words in Title I (General Provisions) explicitly prohibit the use of the Act by the federal government to direct the content of higher education:

> Sec. 804. (a) Nothing contained in the Act shall be construed to authorize any department, agency, officer, or employee of the United States to exercise any direction, supervision, or control over the curriculum, program of instruction, administration, or personnel of

[20] Yes, the Morrill (land Grant) Act preceded the HEA by one hundred and three years, but it did not have the permanent character of the HEA. Congress granted the resources for the creation of public institutions and then stepped back. By 1887 the Hatch Act was passed which provided some funds to land grant institutions, yet its primary purposes were to bolster a waning agricultural sector and promote the "separate but equal" doctrine [Parsons, 1997, pp.26-38]. In any event, the Hatch Act pales in size and scope beside the HEA. By 1989 Title IV of the HEA reached a cost to the Federal government of $10 billion, with its total value in student assistance approaching twice that [Finifter, Baldwin and Thelin, 1991, p.114].

> any educational institution, or over the selection of library resources by any educational institution.

Given the political climate of the 1960s, with opinions raging viscerally for and against busing, forced integration and desegregation generally, it is understandable that such a paragraph had to be included in the HEA were it to have a prayer of passage. As necessary as it may have been, however, its inclusion was a serious mistake from the perspective of the success of the GSL. A mistake because, as we shall see, it allowed State parochialism to fragment the collective purchasers of student loans (students, postsecondary institutions, and the public at large, i.e. the federal government), thereby providing individual suppliers - lenders with no such constraints - greater leverage in the political/economic market.

It was the cheapest method of providing student loans because, as envisioned by President Johnson, it was to be a breakeven proposition for bankers. What made the proposal the most naïve proposal imaginable is that it relied on lenders' farsightedness and sense of community service to make it work.

Under Title IV, part b, of the HEA the federal government pledged that if bankers made loans to students, these loans would be fully guaranteed against default and would yield a return of 6%. The loans would be insured by the State guarantee agencies. In States where such agencies did not exist, Congress attempted to create them, allocating $45 million for seeding. Failing the existence of a guarantee

agency or the ability to create one, HEW/USOE would guarantee the loans directly. Students eligible for GSLs would be from families with incomes of less than $15,000 per year[21], and the government would pay all interest accruals while students were in school. Upon leaving school, the government would continue to pay the interest for a "grace period" of six months and during periods of temporary disability. After that, the student became responsible for principal and interest and had ten years to pay off the loan at a fixed rate.

Even though the loans were fully guaranteed - lenders could not lose principal or interest - and paid a rate of return higher than all other low risk financial instruments (see table 2.2 below), not even the President believed GSLs would be a bonanza for the banking industry. These loans to a notoriously transient population c adre had to be serviced, and servicing costs money. Additionally, due diligence requirements - at least in theory - had to be met and that represented a drain on resources.

Table 2.2 - Selected Average Calendar Year Interest Rates for 1965 [22]

3-Month Treasury Bills	High-grade Municipal Bonds (Standard & Poor's)	Triple A Corporate Bonds	New Home Mortgage Yields	Bank Prime Rate	Federal Reserve Discount Rate	Guaranteed Student Loans
3.95%	3.27%	4.49%	5.81%	4.54%	4.04%	6.00%

[21] The reader will recall that median family income was $6,882 in 1965 - considerably below the GSL income cap.

[22] Source: Moody, Scott, ed. **Facts and Figures on Government Finance** (Washington, D.C.: Tax Foundation, 1998, table B25)

LBJ believed, however, that an educated populace made for an expanding economy, which was in the long-term best interests of the banking community.

The American Bankers' Association (ABA) did not agree. Long-term best interests, or not, they contended that 6% was too low in the tight money market of 1965. At that rate, they could not break even. They would lose money. Moreover, notwithstanding Title I, section 804, paragraph (a), the ABA questioned the authority granted by Congress allowing the federal government to guarantee loans [Jacobson, 1966]. Not only did GSLs represent a potential incursion upon States' rights, but also a public intrusion into the private sphere of banking. A glance at the opinion pages of the Wall Street Journal will quickly underscore the fact that when government intervenes in private markets financiers are suspicious. When those markets are financial markets, they are rabidly in opposition.

The ABA could not balk in this instance, though. To do so would invite the enmity of the President, the higher education community, and the public. Worse still, it might drag the federal government into direct competition with the banking industry. The Educational Opportunity Bank (the in-house option) had been well publicized and was, therefore, known to lenders. If the ABA openly refused to participate in the GSL program, the government might have had to adopt "plan A" - the EOB. While the prospects for turning a profit, or even breaking even, under the

GSLP may have been problematic, one thing was certain. The banking industry was making money on student loans prior to 1965. Their voluntary involvement in the student loan market proves that. Should the President be forced to embrace the EOB option, especially at 6%, then their share of that market would surely erode. Somewhat reluctantly, lenders agreed to participate.

The GSL did not get off to a fast start, though. The Office of Education predicted that it would subsidize the loans of 300,000 students in 1966. As it turned out, USOE was very slow in publishing the necessary forms, and in distributing them to lenders such that the GSLP did not really get off the ground until 1967. In 1966, only 48,500 students actually did receive GSLs. USOE snafus were not the only reason the GSLP did not meet its stated goals, however. By 1967, the requisite administrative apparatus was in place yet still participation was well below projections. In that year USOE estimated that 775,000 students would be assisted under the program, when in fact only about 330,00 were helped.[23] The principal reason for the shortfall in 1967, and another in 1968, was a lack of lender cooperation [McNett, 1968, vol. 3, #1]. Bankers may have agreed to the plan for strategic reasons, but their deeds did not follow their words.

Put succinctly, the banking industry was holding out for more money, and who could blame them. Despite recommendations to the contrary, the Federal government seemed bound and determined to rely on their voluntary cooperation

and not become further involved in the issuance of student loans. With the Federal government out of the picture, there was no serious competition. Because the guarantee agency system was segmented by state, banks did not have to compete with their opposite numbers in other states and were thereby granted far more market power than they might otherwise have had. In the words of the previous chapter, they were "regional monopolists." While they could not use this power to set prices (interest rates), they could limit their participation. They could continue to do business as they had before 1965 with the added flexibility that they could pass the risk of less secure loans to guarantee agencies or the Federal government.

Although the HEA was not scheduled for reauthorization for another two years, in 1968 it was felt that the Act had to be amended if it was to be successful. Concessions had to be made to lenders. Lenders did not get the $35 per loan administration fee they requested, but interest rates were raised by a percentage point. Just as importantly, Congress authorized the government to re-insure guarantee agencies for up to 80% of their defaults. This latter step was taken to free more money from guarantee agency ledgers for student loans, as well as to make the creation of these agencies fiscally more feasible in states that did not have one [McNett, 1968b]. This reauthorization, though, still could not jump-start the GSLP.

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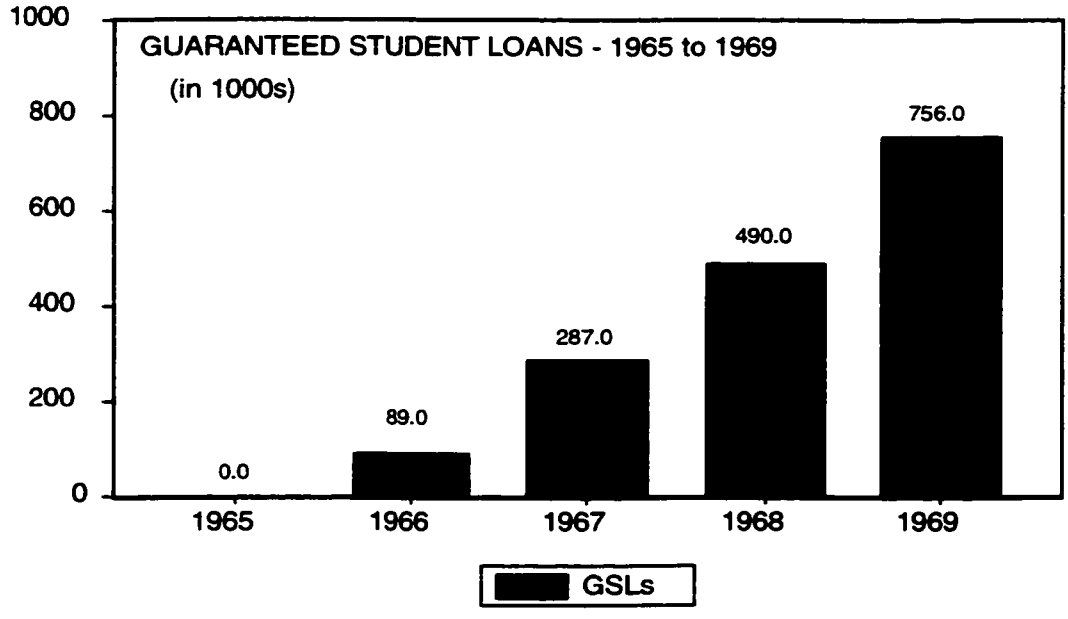
[23] Estimates are from the Appendix to the U.S. Budget for the Fiscal Year 1967, p. 424. Actual values are from the Appendix to the U.S. Budget for the Fiscal Year 1969, p.399.

Figure 2.1 - Number of Federally Guaranteed Student Loans in 1,000s, 1965 to 1969.



Only a year later Congress found it necessary to act again. It ratified an "emergency" student loan bill that authorized HEW to pay as much as an additional three- percent above the seven- percent stipulated in the reauthorization of 1968[24]. This marked the beginning of the practice of granting lenders a variable "special allowance." Special allowances were created to allow returns to lenders to fluctuate with market conditions in a manner that might make participation attractive. Also, it was at this time that HEW was directed to determine whether or not lenders were discriminating against borrowers who did not have accounts with them [Scully, 1969].

[24] As it turned out, the special allowance granted for 1970 was 2 percent, bringing the return to lenders up to 9% on a fully guaranteed loan. For purposes of comparison, note that the prime rate, the interest rate that banks charge their best

With the advent of special allowances and the reinsurance and propagation of guarantee agencies, the program began to blossom. In 1970, the number of loans issued increased by over 100,000 to 863,000. By 1971 that number had swelled to 1,171,000, a 55% increase over 1969. Yet as the program bloomed, so did its costs and critiques. In 1968, total obligations[25] for the GSLP approached $40 million. By 1969, they nearly doubled to $71.2 million. In the year following passage of the emergency student loan bill, obligations came to more than $114 million. And these figures do not include costs associated with the Student Loan Insurance Fund (SLIF). As already mentioned, when a lender/guarantee agency was not reasonably available to insure a GSL, the Federal government assumed the responsibility. The SLIF represents the separate ledgers associated with these activiti es. The SLIF cost the government $1.3 million in 1968, a figure that increased to almost $2 million in 1969. In 1970, however, it shot up more than three-fold to approximately $6 million. This was a rate of increase significantly greater than that associated with conventional GSLs. Like it or not, the Federal government was in the business of directly insuring student loans. More than this, the loans the government insured were the riskiest and the most costly to service. Many of these were to students from low-income backgrounds enrolled in proprietary schools[26], and often these

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customers, was 7.91 percent. Best customers, or not, commercial loans made at the prime rate entail at least some risk as they are not guaranteed.

[25] For the purposes of U.S. budgets, total obligations represent all costs incurred in a particular year whether or not payment is actually made in that year. Thus, personnel expenses are part of total obligations, but so too are costs associated with contracts - loan servicing, for example - payment for which is not due until sometime in the future. All cost and loan volume figures are from appendices to the U.S. budget, various years.

[26] A proprietary school is a trade school. Beauty academies, truck driving schools, computer schools, etc. are all proprietary schools.

students were mislead into believing the loan was not a loan, but a grant. By design, or otherwise, guarantee agencies were "creaming" off the most secure and, therefore, profitable loans and leaving the dregs for the Federal government.

Critics took note. If the Federal government was going to insure student loans, it might as well insure itself, thus allowing it to take the good with the bad. A number of papers prepared in 1969 for the Joint Economic Committee of Congress again recommended the creation of a federally financed direct loan bank. As envisioned by its advocates, it would allow borrowers to repay at a fixed percent of income over a thirty to forty year period. Chief among its advocates included Alice M. Rivlin of the Brookings Institute and former HEW assistant secretary for program planning and evaluation under Johnson; Jeffery H. Weiss, Jerrold R. Zacharias of the Carnegie Commission; Clark Kerr, former president of the University of California; and Howard R. Brown, past president of the University of Iowa [McNett, 1969]. Brown and Kerr are particularly noteworthy due to their associations with public universities.

Generally, the proponents of federal direct lending came from private, not public, universities. Throughout the 1970s, private colleges and universities repeatedly raised the idea of an income-contingent federal loan bank. Harvard, Yale, Princeton, MIT, Brown, Dartmouth, and Amherst, among others, saw direct lending as a mechanism that would allow them to raise tuition to meet escalating costs. At the same time, cheap, manageable loans for prospective students would allow these

schools to maintain acceptable enrollment levels [Winkler, 1974]. Harvard, well-endowed as it is, actually initiated such a program on its own [Jacobson, 1973], but until the 1990s these proposals could not gain the requisite support in Congress for public funding.

Public institutions, on the other hand, were not so enamored with the idea. Initially taking the moral high-ground, they contended that such plans represented little more than student indenture and a divestiture of the public responsibility to educate succeeding generations [See the editorial by Michigan State President, Clifton R. Wharton, 1971]. Private schools recognized their position as camouflage for a strategy designed to ensure that public institutions could continue to undercut private schools in terms of their cost to students, however. If a student's tuition was determined by his or her future income, then there would be no reason to choose a public school over a private one on the basis of expense alone. By 1976 all pretenses were dropped when, at the November meeting of the American Association of State Colleges and Universities, the association's secretary, Allen W. Ostar, expressed the opinion that "[a] state's first commitment must be to its public institutions, and it is time to emphasize this to state officials". In response, Donald A. Holden, executive director of the Council of Independent Colleges in Virginia, said: "Their [public institutions'] general philosophy of life and their attitude toward us can be summed up in a statement the make every now and then. They say, 'We recognize the private sector, we think it very valuable and should be preserved, but don't give them a nickel'" [Quotes from Scully, 1976].

As the 1972 HEA reauthorization loomed on the horizon, no one seemed to care about the GSLP's primary objective - making higher education accessible to all. Consistent with the point made in the introductory chapter - that it is typical for individuals to place their own well-being above the common good - lenders, guarantee agencies, and institutions of higher learning sought to advance their own interests with seemingly little concern for students and taxpayers. Lenders wanted higher interest rates and administrative cost allowances. Guarantee agencies wanted such allowances, as well as high rates of reinsurance and their coffers replenished with no-cost federal seed money. Academia squabbled over whose students and, thus, whose treasuries should get the largest share of the GSLP's proceeds. Put bluntly, everyone wanted more money. If it came at the expense of another program participant, so be it. With three self-interested actors already on the stage, perhaps all that was needed to help the program meet its goals was another. Enter the Student Loan Marketing Association, or as it is more commonly known, Sallie Mae.

As has already been stated, in 1970 the GSL began to approach its student loan targets. It continued its expansion through 1972. From 1970 to 1972, the number of new loans issued annually increased by 39%, from 863 thousand to 1.2 million. Consequently, in some parts of the country funds available for new loans were drying up quickly. The situation became so dire that universities considered purchasing student loans from lenders in order to free up funds for more loans. The

University of Minnesota bought $700,000 in GSLs precisely for this purpose [McNett, 1969].

Like his predecessor, President Richard Nixon was not a big fan of the NDSLP, urging as he did that the program be terminated in 1972. Unlike LBJ, though, Nixon did not care for the GSLP either. Nixon's proposal that income caps under the GSLP be lowered to $10,000 drew intense fire not only from democrats in Congress, but also, as might be expected, from educational associations and lobbies. Chief among those making public their opposition included the American Council on Education (ACE), NASCLGU, the American Association of State Colleges and Universities, the Association of American Universities (AAU), and the American Association of Junior Colleges (AAJC). Most of these associations represent public institutions, but the AAU is an exception. An "invitation only" fraternity of America's elite institutions, the AAU represents predominantly, but not exclusively, private institutions. The AAUs presence on this list infers that all educational institutions, public and private, could agree on one thing. The GSL pie must be preserved. They would rejoin the discussion as to who should get the largest slice later.

Better than preserving the pie, of course, would be to enlarge it. It is no surprise, therefore, that President Nixon's suggestion for creating a national secondary market for student loans found universal support. Sallie Mae was a government sponsored enterprise (GSE) charged with the responsibility of increasing the number of student

loans by accelerating their velocity[27]. Like her older sister in the home mortgage market, Fannie Mae, Sallie Mae was to accomplish this by either purchasing or warehousing outstanding student loans. In the former case, the original lender sells part of its student loan portfolio to Sallie Mae at a discount. While the lender grosses less revenue on the loan than if it held it to term, the lender is relieved of the burden and expense of servicing and collecting on the loan. Further, the lender gains flexibility in its portfolio management, choosing to sell student loans and, with the revenues received from Sallie Mae, expand its presence in the student loan market when rates on other financial instruments decline. When better opportunities present themselves, financiers may choose not to increase their exposure by selling and using the (guaranteed) loans they presently possess as a tool for reducing the overall risk associated with their portfolio. In the case of warehousing, lenders secure low interest loans from Sallie Mae using their student loans as collateral. In either case, funds received from Sallie Mae can only be used to grant additional student loans.

Like all GSEs, Sallie Mae was chartered by the government to perform its function in a profit-oriented fashion. At the very least, it was not to lose money. While it was initially given "at cost" access to the U.S. Treasury, Sallie Mae was to raise the bulk of the funds it needed through its purchasing and warehousing operations, as

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[27] Velocity is an economic term that refers to the extent to which a financial instrument changes hands. In the case of student loans, the faster the velocity, the greater the availability of funds to make loans. If a banker can make a loan, and then sell it to another financier interested in either holding the loan long-term, or in further speculation, the banker can make a profit and replenish his or her reserves in order to make more loans.

well as by selling shares of common stock. Until the end of the 1970s, Sallie Mae required its business partners to purchase at least 100 shares of its common stock.[28]

As a business enterprise, Sallie Mae succeeded admirably. Acting "more like a Wall Street Bank than a government service agency" [Anonymous, high-ranking H.E.W. official, quoted in Roark, 1979], Sallie Mae quickly became one of the most profitable organizations - public, or private - in the United States. Starting with an initial seeding of only $400 million [Fields, 1971], by 1993 it was turning a profit of $394 million, making it one of the nation's 100 largest corporations [Parsons, 1997, p.197]. Reorganized as the Student Loan Marketing Holding Corporation (SLM), a wholly privately-owned entity, by July of 1998 its common stock was trading on the New York Stock Exchange at $50 per share - a price equal to that of the Chase Manhattan Corporation. By the summer of 2000, SLM had acquired the New England Education Loan Marketing Corporation and was in the process of gaining control over the USA Group[29]. SLM and its seven subsidiaries provided its investors with a 16% return as it seeped into every conceivable niche of the student loan industry[30] [SLM Annual Report, 1999].

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[28] By 1979, Sallie Mae began to make rare exceptions to this rule. While Sallie Mae remains a GSE and will remain so until 2008 at the latest, as a division of the privately held SLM Holding corporation, it no longer needs to enforce this requirement.

[29] The New England Education Loan Marketing Corporation (Nellie Mae) is one of the oldest Guarantee Agencies and secondary marketers in the country. During the summer of 2000 it ranked as the nation's seventh largest educational loan originator. National in scope, the USA Group is the largest educational loan guarantor and servicer in the country.

[30] Specifically, SLM's subsidiaries are: Sallie Mae, Inc.; the Student Loan Marketing Association (the original, federally chartered Sallie Mae); Sallie Mae Servicing Corp.; Nellie Mae; SLM Financial Corp.; Sallie Mae Solutions; and the Sallie Mae

Growing Pains

With the reauthorization of 1972, the scene was set and the actors had found their marks. While the playwright and its audience - Congress and the voting public - applauded the main plot line, each of the *dramatis personae* revealed their motivations to be more specific than a simple extension of educational opportunities.

Institutions of higher learning wanted to see the GSL program prosper so that, in effect, their students' disposable income would rise. This would allow them to raise tuition to meet projected cost increases without incurring a decrease in enrollment. Their character was further complicated by two additional issues, one which has already been mentioned, and the other new to the scene as of 1972. Both addressed the relative abilities of public and private institutions to attract the best and the brightest students.

Private colleges and universities were the most adamant supporters of student loan programs and were staunch proponents of proposals to launch federal direct lending through a national student-loan bank. Their public counterparts were less enthusiastic about student borrowing. Because of the variability associated with

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Trust for Education. Besides its involvement in the student loan market, SLM provides home mortgages and home equity loans, as well as traditional consumer

lending - within limits, a student borrowed as much as he or she needed based on income[31] - the price gap between public and private institutions was narrowed. This enabled talented students who, because of cost considerations, might not be able to contemplate a private education to do so. Public schools, for their part, preferred an outright grant program that would increase the ability of present and prospective students to pay higher tuition while maintaining the price gap. The Congress gave them just that in 1972. In addition to chartering Sallie Mae, Congress indirectly impacted the student loan program by authorizing Basic Educational Opportunity Grants (BEOG). Now known as Pell Grants, BEOGs potentially provided students with up to $1,400 per year less expected family contributions, or up to 60% of the students' needs, whichever was less[32]. Both forms of assistance - grants and loans - were evermore in competition for funding, mirroring the struggle between private and public institutions.

Guarantee agencies, on the other hand, were able to avoid such family squabbles. Because, until the last half of the 1970s, guarantee agencies were state agencies or foundations, they were separated geographically and, thus, were able to avoid conflict. Like the utilities discussed in the last chapter, they were regional monopolists and their wish list was uniform. From the federal government, they

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loans. Since the late 1970s, it has been actively acquiring small to medium-sized banks, and savings and loan associations.

[31] As of 1972, a student could borrow up to $2,500 annually - up from $1,500 before reauthorization.

[32] Students rarely received the full amount for which they qualify due to shortfalls in Congress' appropriations for the grants.

wanted higher administrative allowances[33], continued access to federal reserve funds[34], higher reinsurance rates, and the ability to issue tax-free bonds.

Lenders, especially large banks, were also isolated from competition with one another. This was due, in part, to the regional nature of the guarantee agency system, but was also a result of the fact that, at this time, the banking system was more localized than it is today. Throughout the 1970s, it was much less likely that the customers of a West Coast bank - say Wells Fargo - would overlap much with those of a bank centered in the east, for example, Citibank. Their isolation allowed them to deal with the guarantee agency and borrowers in a given State in a monolithic fashion.

Moreover, there were not that many lenders deeply involved in the student loan market. Because the management of student loans in accordance with federal and state guidelines required an expertise acquired with experience and vast administrative resources, entry to the market was restricted. This is similar to the case of the Massachusetts mental health care market referenced in the previous chapter. In addition, the long-term nature of student loans served as another barrier to market entry that was further exacerbated by Sallie Mae's requirement that its financial customers also become investors. As a result of all of these factors, the student-loan industry became so dense that, by 1997, just ten financial corporations

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[33] Reiterating, an administrative allowance is a fixed percentage of loan volume paid to a guarantee agency to meet administrative expenses. In 1972, the U.S. government paid out almost $6.8 million for this purpose [source: Appendix to the Budget for Fiscal Year 1974, p.430].

issued ("originated") 44.5% of all FFEL/GSL loans. The top 25 originated 66.1% and only 50 institutions originated 78% of all FFELP loans. Similarly and in the same year, 10 corporations held 57.5% of all outstanding FFELP loans and 25 held 75.3%. See tables 2.3, 2.4, 2.5, and 2.6, below[35].

Table 2.3 - Loan Origination

	FY 1997	FY 1998	FY 1999
Top 10 as a Percent of Nation	44.5	51.8	52.2
Top 25 as a Percent of Nation	66.1	69.1	70.1
Top 50 as a Percent of Nation	78.0	79.3	81.3
Top 75 as a Percent of Nation	83.7	85.3	86.4
Top 100 as a Percent of Nation	87.1	88.5	89.5

[34] Again in 1972, reserve fund advances amounted to $662,000 [ibid.].

[35] The reader should be aware that not only banks issue and hold student loans. For example, in 1998 the Pennsylvania Higher Education Assistance Authority (PHEAA), a guarantee agency, originated $359.3 million in student loans, ranking it fifteenth in the nation. In the same year, the University of Chicago lent $45.3 million to students and Northwestern issued $43.9 million

As should be expected, entities holding loans are just as likely to be guarantee agencies, loan servicers, secondary marketers, and insurance funds as traditional banks. With a portfolio of $38.4 billion in student loans, Sallie Mae dwarfed number two Citicorp ($8.2 billion) and number three Chase Manhattan ($5.4 billion). Harvard University held $128.3 million in student loans, but Harvard is unique among universities in its propensity to hold federally insured student loans. Most institutions of higher education sell the student loans they may issue under the FFEL/GSL program. Data is unpublished, but available from the U.S. Department of Education, Office of Postsecondary Education, website.

Table 2.4 - Top 10 Loan Originators (Volume in $ millions)

	FY 1997	FY 1998	FY 1999
1	Chase Manhattan (1727.4)	Bank One (1768.4)	Bank One (1902)
2	Citicorp (1603.6)	Citicorp (1748)	Citicorp (1820.5)
3	Bank One (1186.5)	Chase Manhattan (1653.5)	Chase Manhattan (1728.5)
4	Norwest Bank ((932)	Norwest Bank (1571.1)	Bank of America (1501.3)
5	Key Corp. (801.5)	Bank of America (1560.9)	Norwest Bank (1501.3)
6	Nations Bank (759.5)	First Union National Bank (1324.4)	First Union National Bank (1269.8)
7	Wells Fargo (699.9)	National City Bank (763.3)	National City Bank (824.2)
8	Bank of America (693.1)	Pittsburgh National Corp. (558)	Education Finance Group (568.1)
9	Educaid, Trans World Insurance Co. (627.1)	Key Corp (410.6)	Pittsburgh National Corp (459.4)
10	First Union National Bank (533.7)	U S Bank (406.1)	Union Bank and Trust Co. (452.4)

Because of the high level of market concentration and due to their regional isolation, lenders - through their lobby, the Consumer Bankers' Association (CBA) - were able to present a united front to Congress and HEW. Perpetually, they demanded higher interest rate subsidies ("Special Allowances"), faster payments from HEW, and administrative allowances similar to those guarantee agencies enjoyed.

Table 2.5 - Loans Held

	As of 9/3/98	As of 9/30/99
Top 10 as a Percent of Nation	57.5	62.3
Top 25 as a Percent of Nation	75.3	78.6
Top 50 as a Percent of Nation	87.4	89.1
Top 75 as a Percent of Nation	92.5	93.4
Top 100 as a Percent of Nation	94.7	95.3

Table 2.6 - Top 10 Holders of Student Loans (Volume in $ millions)

	As of 9/3/98	As of 9/30/99
1	Sallie Mae	Sallie Mae
	(38,351.1)	(45,090.5)
2	Citicorp	Citicorp
	(8175.5)	(9465.8)
3	Chase Manhattan	Secondary Market Services
	(5356.4)	(5236.8)
4	Key Corp	First Union National Bank
	(2962.8)	(4629.6)
5	Secondary Market Services	Norwest Bank
	(2894.4)	(4157)
6	Bank One	Nellie Mae
	(2778.5)	(3576.9)
7	Norwest Bank	Key Corp
	(2655.4)	(2926.8)
8	Nations Bank	Bank of America
	(2361.4)	(2642.9)
9	Student Loan Funding Corp	Student Loan Funding Corp
	(2230.2)	(2629.1)
10	Nellie Mae	National City Bank
	(2198.5)	(2310.3)

Sallie Mae, though newly minted in 1972, expressed throughout its existence a desire to be left alone. Established by the government to fulfill a public purpose, Sallie Mae's fondest wish was that it be allowed to follow the conservative financial practices that would fill its coffers, supply its employees with lavish offices and

perquisites, generously compensate its officers, and bring closer the day on which it might cut the umbilicus to the U.S. Treasury and openly seek profit. If the public purpose for which it was established be somewhat subverted, so be it.

What has been written over the past four pages should not be taken to imply that the principal actors in the student-loan drama cared not one whit if higher education was made more accessible to students from the middle-class and below. Surely they did. It is just that they had secondary agendas and the political voices necessary to make their particular wants known. Lenders could see the long-term benefit of a student loan program, but they wished it to achieve its goals without threatening their short-term profits. Colleges and universities valued anything that assisted students in meeting tuition, yet the rivalry between public and private institutions undermined the degree to which they might otherwise serve as advocates. Guarantee agencies knew that loans for students was their raison d'être. However, they still wanted to see the industry thrive in an environment that was, for them, as risk-less and cost-free as possible. Similarly, Sallie Mae would not exist without the student-loan industry, yet its idea of fostering the market was one that would see it net the highest possible returns for its partners, principals, and stockholders. Typical of the provision of most collectively consumed good, the ability of the federal, guaranteed student-loan program to reach its goals was sabotaged by the ascension of individual over collective interests.

The most important set of actors in this little stage play was relatively mute, though. Although the GSLP was designed with them in mind, students at postsecondary institutions carried little political clout. That being the case students, along with HEW, became a convenient lightening rod for the criticisms of the GSLP that arose following its maturity.

The 1972 reauthorization of the HEA, along with its amendment in 1976 and the Middle Income Assistance Act (MIAA) of 1978, made certain that the GSL program would meet its goals in terms of loan volume and students assisted. In addition to the creation of Sallie Mae, Congress overcame stern resistance from President Nixon in 1972 to increase maximum annual loans per student to $2,500. The 1976 amendments mandated HEW to pay debts to lenders within 30 days instead of quarterly, and raised the family income ceiling under which students could qualify for loans to $25,000. President Carter's MIAA removed income caps entirely, allowing all students, regardless of family income, to become eligible for federally subsidized and guaranteed student loans.

Consequently, the GSL program matured. From 1972 until 1980, the number of loans issued under the GSL more than doubled, from 1,017,000 to 2,314,000. This being the case, it should come as no surprise that the costs associated with the program mushroomed. It is startling to learn, however, that total obligations did a lot more than double. They increased almost seven-fold, from approximately $235 million in 1972 to nearly $1.6 billion in 1980. [See figures 2.2 and 2.3, below]

Figure 2.2 - GSL Loans in 1000s, 1972 to 1980

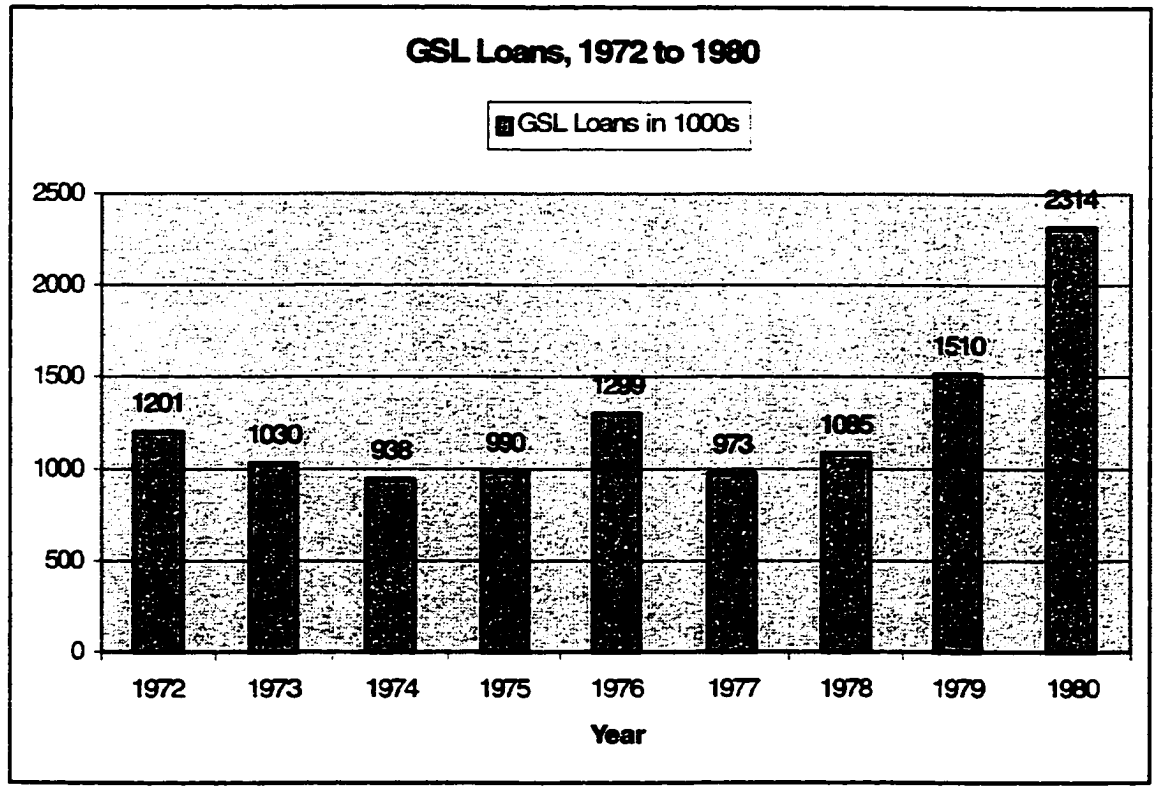
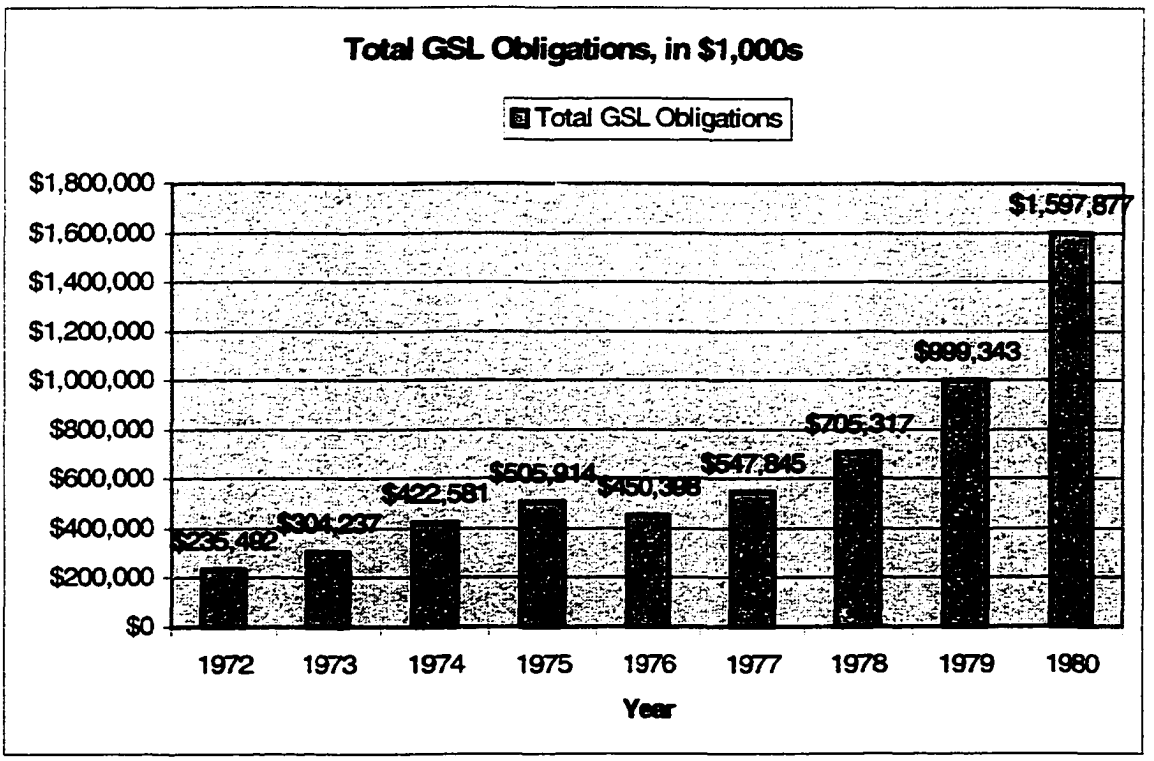


Figure 2.3 - Total GSL Obligations (including Student Loan Insurance Fund) in $1,000, 1972 to 1980



Throughout the 1970s, Congress searched for a reason and, therefore, a remedy for the GSLP's skyrocketing costs and initially focused their criticisms upon students and HEW. Later, they added proprietary schools to their list of likely suspects. In particular, they charged HEW with inefficiency, if not incompetence in administering the program, and students and trade schools with out and out fraud.

There was some merit to their allegations. Many students, for example, clearly misunderstood (or chose not to understand) that the GSLP was not a grant program. From 1972 until 1980 net default costs[36] rose 430% on an annual basis, from $49.6

[36] Net default costs are the total value of loans declared in default by the federal government plus collection costs less defaults recovered.

million in 1972 to $214.5 million by 1980. However, on a per loan basis this worked out to a cost of $41.32 for every loan issued in 1972 and $92.68 in 1980. The per loan calculation roughly doubled over the time span, more closely mirroring the growth in the program. The rise in default expenses, therefore, was in part a function of the expansion of the program and should have been expected. Still, 200 million is no pittance, the cost per loan did double, and Congress was right to take issue.

By 1977, according to the Government Accounting Office (GAO), one in six GSLs were in default. Worse still, the GAO held a grim outlook for collection. Its estimates for September of that year indicated that the government had paid $436 million in claims to lenders over the life of the program, but had revived only $33.8 million of those debts [Roark, 1977 (a)]. The popular perception of the default problem was that students and former students were entirely to blame.

During the first few years of the decade, declaring bankruptcy in order to avoid one's student loan obligations became very fashionable. In 1972, HEW paid $29,000 to lenders to cover the bankruptcy claims of college graduates. By 1973 that figure had risen to $4.01 million, a level it roughly maintained until 1976 when it reached a high of $5.4 million. Within the reauthorization of 1976, Congress finally took action and forbade GSL recipients from declaring bankruptcy within 5 years of leaving school [Roark, 1976]. The effect was to bring bankruptcy claims down to realistic levels. In 1977, bankruptcy claims were actually negative (due to

collections on inappropriate past claims) and ranged between $9 thousand and $128 thousand from 1978 until 1980.[37] Clearly, many students felt no compunction about neglecting their end of the GSL bargain, if they could, once they had completed their education.

After the bankruptcy loophole was closed, other former students chose a less formal method of reneging on their debts. They simply ignored them. In 1972, GSL default costs approached $5.2 million. They remained relatively constant through 1977. In 1978, however, only two years after Congress proscribed bankruptcy as a way out, default costs spiked to over $1 billion and increased to $1.2 billion in 1979. Not until the effects of a HEW crackdown were felt, in December of 1977, did default costs become more manageable, plummeting to $280 million in 1980.

Many students, it seems, were just as self-serving as any other participant in the student-loan program. If there was a way to ignore one's financial and moral responsibilities in favor of personal profit, they would take advantage of it. ED found, in 1982, that about 47,000 federal employees - some working for ED - had defaulted on $68 million in student loans [Chronicle of Higher Education, 1982 (a)]. These were individuals who surely should have known better, their irresponsibility underscoring a notion, popular with many, that student loans were not really loans - they were grants.

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[37] This is not to imply that bankruptcy defaults were no longer a problem. Though the bankruptcy fad ended in 1977, because the lender's principal and interest were insured, borrower practices of the first half of the 1970s continued to be an expense

Moreover, many people on Capitol Hill and within the general public felt that the GSL program, available as it was to the middle-class, was a money machine for individuals who really did not need financial assistance. Again, that perception had some merit. Indiana's Commissioner of Higher Education, George Weathersby, was sharply rebuked in 1979 for publicly explaining to students how they could reap a windfall of several thousand dollars by taking GSLs they did not need and investing them [Rubinton, 1979]]. At least one individual heeded Mr. Weathersby's advice as, in 1980, a member of Senator Claiborne Pell's staff admitted to having used student loan proceeds to invest in a money market fund [Hook, 1980 (a)].[38]

Proprietary schools were also considered a leading source of program abuse in the 1970s. As noted earlier, proprietary schools are for-profit institutions that offer trade skills, usually acquired over the course of only a few months, to prospective students. Charges that they were "rip-off artists" [Fouts, 1988] and "FISL (Federally Insured Student Loan) Factories" [Van Dyne, 1975] may have been harsh, but not unfounded.

In 1975, an HEW investigation revealed that proprietary schools were claiming about 45% of all GSL program funds and their students were responsible for 57% of all defaults [Van Dyne, 1975]. Because proprietary schools are attractive to low-

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for the rest of the decade and then some. Interest payments on these defaults cost the government between $8.2 and $11 million from 1977 through 1980.

income and unemployed individuals, these figures are not dreadfully out of line. Certainly most trade school students qualified for loans under any income ceiling. Additionally, because of their low incomes, many had few experiences with credit. The concept of regular, yet deferred payments is rather foreign to most students, but particularly to those likely to be enrolled in trade schools. The problem was exacerbated by the fact that proprietary school officials were not inclined to inform students of their obligations.

As Jay W. Evans, president of NCHELP in 1974 pointed out, "It is unrealistic to assume that a person responsible for recruiting students could at the same time impress on a [prospective] borrower the seriousness of the loan obligation he is undertaking, especially when stressing this point could result in the loss of a sale" [quoted in Winkler, 1974 (b)]. The revenues for a truck driving school, say, do not come from foundations, endowments, and alumni. Ultimately, revenues emanate entirely from tuition. The GSLP was a bonanza for proprietary schools as it allowed them to increase their enrollment without any concern for the possibility that their new students might not pay their fees. This being the case, they also had to give little thought to the quality of training they offered, or even if the student completed the course of studies. Whether the student acquired the skills to become employable was not germane. Once the student signed on the dotted line for his or her loan, the proprietary school had been paid and any repercussions from default were the student's problem and not theirs.

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[38] This is particularly ironic because Senator Pell was arguably the leading advocate for assistance to students pursuing a postsecondary education. Basic Educational

As an example, consider Bay College in Baltimore, Maryland. This small, private business college offered secretarial and entry level administrative skills to low-income, minority students. In 1976, it obtained 95% of its budget from various student aid programs. Receiving $1.4 million in federal funds, it was second only to the state's public flagship, the University of Maryland at College Park, in student-aid dollars. With an enrollment of only 535, this was quite an accomplishment.

As to the quality of the education received, an investigation by Maryland's Board of Education found Bay College's library resources to be minimal, and only 50% of its faculty possessed so much as a bachelor's degree. Students who had failed to submit a high school transcript, had failed the entrance exam, or who had flunked out were allowed to register anyway. Class attendance hovered around 25%, prompting one Board member to declare that "Students are coming for the money, not the classes" [Winkler, 1976 (a)].[39]

Until 1975, however, Bay College and proprietary schools like it could not be accused of doing anything wrong - at least not from the vantage point of the guaranteed student loan program. They were merely taking advantage of the system as it existed, just as everyone else was. In March of that year HEW's Office of Education published guidelines that aimed to weed out such undesirable institutions. Specifically, HEW declared that institutions could not enroll students receiving

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Opportunity Grants were renamed in honor of Senator Pell upon his retirement.

GSLs if the default rate of its students exceeded 10 percent; if more that 20 percent of its students withdrew during an academic year; or if more than 60 percent of the institution's students received GSLs in a given academic year. As well, HEW required all schools to institute "fair and equitable" refund policies [Fields, 1975]. This later requirement was designed to dam the rising tide of complaints from former trade school students. They contended that, upon discovering how worthless the training they had signed up to receive really was and withdrawing, they could not obtain fee remittances and, therefore, could not pay off their loans. The trade school industry argued with some force that such regulations were discriminatory as they were clearly designed to keep trade schools and their low-income, significantly minority students out of the program. As a result, the precise parameters of these guidelines varied from year to year.

The extent to which such regulations improved trade school education and lowered default rates in the GSLP is unclear, though their effect was probably minimal.[40] One thing is certain. They did little to discourage the unmitigated fraud that some proprietary schools seemed bent on perpetuating.

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[39] Interestingly, B. Herbert Brown, Chairman of the University of Maryland's Board of Regents, founded Bay College in 1976.

[40] More than ten years later, in 1987, ED found that 600 proprietary schools had default rates of 50% or more [Wilson, 1987], so it is difficult to assert that regulation had much impact.

Excerpts from a long list of indiscretions include the following:

- In 1975, investigators for the Senate Permanent Investigations Subcommittee revealed that the operator of a proprietary school in Los Angeles had defrauded the government of $300,000. He obtained GSLs directly from the government, sold them on the secondary market, and then closed the trade school. An employee at HEW's San Francisco regional office was implicated [Winkler, 1975].

- In 1978, the House Committee on Standards of Official Conduct began its investigations into the activities of Representative Daniel J. Flood (D-Penn.). Among other charges, Flood was accused of accepting $100,000 from a chain of California trade schools in return for his influence with HEW and in Congress. Flood was alleged to have used his political savvy to assure that HEW made GSLs available to the trade school and to direct the course of legislation in a manner favorable to trade schools [Roark, 1978 (a)].

- Three proprietary schools, including two of the largest chains - Advance Schools and Bell and Howell Schools - were found guilty, in 1980, by HEW auditors of billing the government for loan subsidies they were not entitled to and misusing federal funds.

- In 1981, Bell and Howell Schools agreed to return $3.75 million it improperly received in payments for defaulted loans. It was fined a mere $31,000 after

pleading guilty to having made false claims under the GSL program [Hook, 1981 (a)].

As popularly perceived in the 1970s, the last member of the unholy trinity responsible for exaggerated expenses in the GSLP was the government itself. Specifically, HEW and its successor, the Department of Education. Whenever there is inefficiency in the provision of a collectively consumed good, the government is always a likely suspect.

The fact is that, from the program's inception through the 1970s, the government did a very poor job of administering and policing the GSLP. I have already stated that HEW's failure to distribute the proper forms helped to keep the program on the ground for at least a year. This tendency to react to problems instead of anticipating needs was a administrative propensity that was perpetuated over the history of the program.

Closing the bankruptcy loophole merely spurred higher default rates and a greater need to police the program. Unfortunately, HEW did not foresee this and was ill-equipped to deal with the default problem. In 1978, HEW Secretary Joseph Califano finally got serious about defaults and ordered the Bureau of Student Financial Assistance to begin notifying defaulters that they could be subjected to prosecution from the Justice Department and/or have their loans turned over to private collection agencies. Consequently, it was discovered that many delinquent

borrowers had not been billed in over five years [Roark, 1978 (b)]. Why? Because until late 1977 - a dozen years after the program ostensibly began - HEW had no facilities with which to notify borrowers that they were in arrears [Roark, 1977 (b)]. Not until the creation of the National Student Loan Data System (NSLDS) in 1978 did HEW possess a database capable of keeping track of beneficiaries. One would think that such a database would be a prerequisite to the establishment of such an expensive and extensive program. Without it, some "students" found that they could register at one school and take out loans, drop out, and then register at another school, again taking loans they had no intention of repaying.

And whenever the government did react to a problem, it frequently did so by increasing the number of forms students and financial aid advisors at postsecondary institutions needed to complete. The upshot of this increase in paperwork was that students began to feel that they were being asked to jump through hoops unnecessarily. In the best of cases, they were only asked to dedicate days on end to standing in lines at financial aid offices. In the worst of cases, some students, particularly low-income and minority students, were so intimidated by the mass of paperwork that they did not take advantage of the assistance available to them and, as a result, chose to forego a higher education [Roark, 1977 (c)]. For financial aid officers, the ever mounting stack of papers that needed to be processed meant that, more often than not, students could not receive their loan proceeds until the semester following that in which they had initiated the process.

The labyrinth that was the student loan process extended to HEW, too. Given the size of the program and the lack of tools at the disposal of HEW, it is a wonder that the department was ever able to fulfill its obligations. Sometimes, it did not. In 1976, the government fell 90-days delinquent in paying a debt of $570,000 (out of $1.3 million outstanding) to the Security Pacific National Bank. Security Pacific, the tenth largest bank in the country at the time and the largest source of student loans in California, threatened to withdraw from the GSLP as a result. The bank's announcement inspired near panic at every postsecondary institution in the State. Financial aid directors felt that they would "lose the entire program in California [Lillian Morales, financial aid specialist for the California Community Colleges, quoted in Winkler, 1976 (b)][41]. The program was saved in California when, just weeks after the bank's declaration, the Senate took up the task of amending the HEA to mandate that the Commissioner of Education make payments within 30 days of the receipt of a proper voucher.

The effect of the HEA amendment was to give HEW even less time to assess the validity of claims, a task with which it was already challenged. A year earlier, in 1975, the GAO charged that the Office of Education had failed to enforce the due diligence requirements for lenders in collecting loans before assigning them default status. GAO's Deputy Director for its Manpower and Welfare Division, James Martin, related that in a random sample of 245 claims for government reimbursements of defaults - most of which were paid by HEW - the GAO found

[41] Pacific National carried $30 million in student loan paper with nearly $3 million of it in default. With a default rate of 10% one is led to wonder, which institution

that 235, or 96% should not have been approved. Failure to oversee lender due diligence, was not the only problem. Mr. Martin pointed out that, as far back as 1973, an audit of HEW records found, in a sample of 108 lending institutions, that 96 had made errors in their favor when billing the Office of Education for interest charges [Winkler, 1975].

These problems persisted and, in 1978, HEW's Office of the Inspector General (OIG)[42] disclosed that the department lost $7 billion, or 5% of its budget due to "fraud, abuse, and waste" that was permitted, and even "encouraged", by HEW's faulty management practices and systems. Chief among abuses was the expenditure of $183 million on defaulted loans never collected and "unlawful and improper" activities by colleges and schools. These less than kosher activities included the habit of approving loans for ineligible students at a cost to the government of $53 million [Roark, 1978 (c)]. As has been noted, the database necessary to keep track of students involved with the program was not authorized until 1978. The NSLDS is just one more example, therefore, of the government reacting to a problem instead of anticipating it.

In fairness to HEW, however, one must question to what extent they should have anticipated these problems. Yes, the contemporary mantra for the efficient provision of collectively consumed goods requires government to "steer" policy (oversee it) and not "row." The caveat emptor always applies and to the extent that

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had the greatest right to show impatience with the other - the bank, or HEW.

government abandoned its oversight responsibilities, we must find it guilty, as charged, of bad management and inefficiency. Yet, the government was doling out millions of dollars a year to financial institutions and guarantee agencies to manage professionally the student loan program. Just what was it getting for its money? As we know, it was not the money itself. Ultimately, all funds emanated from the U.S. treasury. While banks were the *de jure* originators of student loans, because all risks were - in the end - assumed by the government the effect on bank reserves was nil.[43] Magic money! Financial institutions could make student loans and not impact their more traditional business affairs. By the end of the decade the Congressional Budget Office (CBO) estimated that by eradicating the present system and providing all loan capital from funds directly from the U.S. Treasury, the GSLP could save more than $4.8 billion over five years [Hook, 1980 (b)]. As it was, the GSLP was not much of a loan program. One state student-aid official estimated that the total cost of the program to the government was about 79.5 cents for every dollar lent [Jacobson, 1981]. At that cost, the GSLP might be more properly referred to as a grant, rather than a loan program. In short, the federal government contracted for professional administration and oversight. The Treasury could dole out money, no questions asked, just as well as the private sector. The government was not getting what it paid for.

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[42] OIG was HEW's internal auditor. HEW's successor, the Department of Education, also has an OIG.

[43] Obviously, banks cannot lend all of their depositor's money. It is prudent to keep a certain percentage in reserve to cover withdrawals, hedge against risk and, generally, to maintain liquidity. If a bank can make a risk-free loan, however, what it needs to keep in reserve is largely not affected.

One of the primary arguments used by lenders and guarantee agencies when soliciting for higher compensations was the high costs associated with administering student loans. We can assume, therefore, that they understood that managing GSLs was an expected duty, yet it was not one they seemed to take seriously. Not until 1980, when Congress required them to do so, did lenders deem it necessary to provide student borrowers with complete loan information, including the terms of repayment [Hook, 1980 (a)]. Even after 1980, Richard J. Innocenzi, director of the New Jersey Higher Education Assistance Authority, argued that lenders still were not explaining to students the terms of their loans - often going so far as to imply that they were not loans at all [Chronicle of Higher Education, 1985 (a)]. With such indifference, if not fraud; on the part of lenders it is no wonder that default rates were so high. If banks disseminated little information, or misinformation, how could students be expected to understand their obligations?

The problem of bank indifference toward the administration of student loans was particularly acute after a student graduated. While a student was in school, administration was a snap. All a bank had to do was sit back and collect the interest. However, upon graduation, it was the lender's responsibility to keep track of a borrower's location and repayment status, and bill them accordingly. Or, at least it should have been. At this stage, though, even the most responsible graduates had a difficult time repaying through no fault of their own. To many lenders, student loans were a guaranteed source of income and objects for speculation. These loans frequently traded hands on the secondary market three or more times

and only the most diligent borrowers could keep track of to whom they owed payments. If, through perseverance, they did manage to discover who held their loans, they often also found that the holder displayed little interest in collecting [Chronicle of Higher Education, 1980 (a)]. Advocates for privatization argue that, due to incentives built into free markets, the private sector is far more efficient at reducing costs than the public sector can ever be. Apparently, this is especially true if the private sector can ignore the obligations associated with those costs.

Guarantee agencies were not much better at upholding their end of the bargain, either. In 1974, the federal government owed $60 million to state guarantee agencies to cover defaults. Compared to the $136 million in defaults the government incurred by insuring loans directly through the Student Loan Insurance Fund, $60 million might not seem excessive. One could conclude from these figures that guarantee agencies were more effective at managing po rtfolios, and enforcing lender due diligence requirements, than the federal government. Yet as Kenneth A. Kohl, Associate Commissioner of Education for Guaranteed Student Loans pointed out, one must recall the function of the SLIF in order to explain the difference. The SLIF was created to insure the loans of borrowers at "eligible institutions who do not have reasonable access to State or private programs of student loan insurance." [Appendix to the Budget for Fiscal Year 1972, p.454]. Most of these loans - and 58% of the SLIF defaults - were for students enrolled in proprietary schools. The difference in default volume, then, might be attributed to differences in the risk-level associated with each cache of loans as easily as it can be

to differences in administrative efficiency [Winkler, 1974 (c)]. Because of the sliding scale used to calculate reinsurance rates, State guarantee agencies wanted nothing to do with risky loans. If they could maintain default rates within their agencies at no more than 5% then they were reinsured, by the government, at a rate of 100%. By "creaming off" the most secure loans, they assumed no risk. Yet, if guarantee agencies failed to fulfill the function of risk assumption, for what did the government owe them compensation? In 1974, the default rate for the wholly government managed National Direct Student Loan Program was 14.2%. However, for the GSLP, managed with the assistance of professional financiers and guarantee agencies, the default rate in the same year was 24.3% [Fields, 1974]. Not until later in the decade, when the government more actively accepted the role of policing the GSLP did the program's default rates fall in line with the NDSLP [Roark, 1978 (d)]. Apparently, the federal government could do as good - or, as bad - a job of administering the GSLP without help from well-compensated professionals.

By the end of the Carter Administration, it became clear that the profligacy associated with the GSLP could be attributed to sources other than the government, students, and proprietary schools. Lenders, guarantee agencies, and secondary marketers were as willing as any other party to accept the benefits of the program without shouldering any of its burdens. This finally became public knowledge when HEW secretary Joseph Califano testified before Congress, in 1979, regarding HEA reauthorization. Lobbing a salvo across the bow of the lending community, Califano summed up many of the points made in this text so far. Lenders, he said,

were unwilling to make loans to low-income and other high-risk students, despite government guarantees. Those who did manage to secure a loan were forced to fill out complicated forms and faced inflexible repayment schedules that encouraged default, he related. As for Sallie Mae, the enterprise had been created in order to generate loan capital, yet it had "unfortunately not fulfilled its promise". Perhaps it was time to scrap the whole deal. Maybe, the Secretary acknowledged, it would be wiser to redirect Sallie Mae into a role as linchpin of "a single, federally operated loan agency that would not only develop capital, but collect loan repayments and deal with defaults as well." [Roark, 1979].

The Gang that Couldn't Shoot Straight Hits the Bull's Eye

President Reagan's administration has sometimes been referred to as "the gang that couldn't shoot straight." Policies promoted by the administration often failed to hit their intended mark. If Reagan intended to dismantle the newly created Department of Education, as he had promised during his campaign, or decimate federal aid to students, as the Heritage Foundation had advised just before his inauguration [Chronicle of Higher Education, 1981 (a)], then he missed. However, if he wanted to reform student-aid, especially the GSLP, by publicly identifying sources of waste, then he was right on target. This was not his original intention, though. While Carter, toward the end of his term, began to consider the feasibility of replacing the GSLP with a centralized, federally managed program, Reagan was more inclined to do away with the program in any guise.

From the standpoint of expense, when Reagan took office the GSLP was in terrible shape. Thanks to Carter's Middle-Income Assistance Act and Higher Education Extension and Technical Amendments Act of 1979, any student, regardless of family income and assets, was eligible for a student loan. As a result, the number of loans more than tripled, rising from 1,085,000 in 1978 to 3,539,000 in 1981, Reagan's first year in office[44]. Total obligations increased at a slightly faster rate over the same period, from $705.3 million to $2.72 billion. Given the exorbitant expense of the program, it is not surprising that, in February of 1981, new OMB Director David Stockman publicly targeted the GSLP as a principal victim for the budget ax [Jacobson, 1981]. Yet how deeply would the ax cut?

Given Reagan's *laissez faire* philosophies and his history as a chief executive, the smart bettor would have wagered that, under Reagan's watch, the GSLP would not last long. As governor of California, he called for cuts - frequently drastic cuts - to the State's education budget. He instituted tuition in the State system, slashed faculty salaries, reduced student/teacher ratios, argued that professors should do less research and more instructing, participated in the firing of Clark Kerr[45] as University of California President, and did not hesitate to use the National Guard to squelch student unrest [Hook, 1979]. Unlike LBJ, Reagan did not even pretend to

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[44] In fairness to Carter, rapidly deteriorating economic conditions as a result of the second OPEC oil shock may have had a lot to do with this increase.

[45] Recall that Clark Kerr later became Secretary of HEW under Johnson and was a leading advocate for student assistance generally and a national student loan bank, in particular.

be a big fan of students, their professors, or the institutions they were associated with. No subsidies for eggheads, thank you.

However, after taking office, Reagan's attitudes, or at least those of his lieutenants, began to change. For example, Terrell H. Bell, Reagan's first Education Secretary, stated upon his ascension that he would be the Department's last. His goals were to dismantle ED and the student loan program. Yet upon leaving, in 1985, he expressed his respect for the Department, its personnel, and its mission. Toward the end of his tenure, Bell became a leading advocate for student aid of all kinds.[46] Bells' successor, William Bennet, followed a similar course. Establishing himself as something of a loose cannon, Bennet quickly aroused the enmity of education leaders and students alike when he asserted that student loans were going to no better purpose than the finance of stereos and exotic, spring-break vacations. To Bennet, students seemed to be undeserving recipients of federal largesse[47]. While Bennet never retracted his statement, in later years he was just as likely to assault the behavior of lenders and guarantee agencies as students and postsecondary institutions.

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[46] It is interesting that Bell should have began his reign as Secretary advocating a curtailing of the GSLP. In 1976, he resigned as HEW Commissioner of Education under Ford because he could not afford to send his three sons to college on the $37,000 salary he was making. He, as well as anyone, should have understood the importance of assistance to the middle-class in obtaining a higher education [Chronicle of Higher Education, 1981 (b)].

[47] Bennet may have been partially correct when he asserted that students misused their loan funds. Such behavior may not have been all together their idea, though. In 1984, ED justifiably took offense when McDonald Motors of Lincoln, Nebraska ran an ad reading as follows: "Volkswagen Scirocco puts a handle on excitement. $12,000. Take advantage of your student loans now!" [Chronicle of Higher Education, 1984] (a)].

The Reagan administration did change their attitudes concerning the merits of student aid, and they did alter the objects of their scorn. These changes, however, may not have been the result of some sort of philosophical epiphany. More likely, they were the result of changes in the structure of the student-loan marketplace that made the source of some abuses more apparent.

During the 1970s, the student-loan market was regionally segmented by State. Each State had, at most, one guarantee agency that attended to affairs within its jurisdiction. Additionally, lenders rarely competed with one another across geographic divides. Guarantee agencies and lenders alike, therefore, were able to maintain a unity of interests. For a number of reasons, this situation metamorphosed radically as the new decade dawned.

For one, the nature of financial markets was altered. While the industry, per se, became progressively more concentrated with the acquisition of smaller institutions by larger ones becoming a routine affair, those that did survive were no longer confined by geographical or political borders. The big players, either directly or through subsidiaries, could just as easily issue loans in New York as in California. Even if a financial institution was not involved with origination, it could still find its assets entangled in the secondary market for student loans. When, in 1989, ED decided not to reimburse California based United Education and Software for $575 million in defaults, charging the company with gross mismanagement, ripples were

sent clear across the Pacific basin. ED's decision threatened the profit ledgers of the Bank of Tokyo, Fuji Bank and the Industrial Bank of Japan which, along with Citibank and the Bank of America, had served as underwriters for bonds issued by United Education. As a result, not only did Representative Augustus F. Hawkins (Dem., Ca.) and Senator Pete Wilson (Rep., Ca.) lodge protests, but Whitehouse Chief-of-Staff John Sununu was called upon to broker a deal between ED Secretary Lauro F. Cavazos and Bank of America Chairman A. W. Clausen. The latter acted as spokesperson for the five underwriters [Wilson, 1989 (a)].

As the case of United Education demonstrates, when they shared a singularity of interest financial institutions could maintain a unified front. Thrust into contest with one another on a national, sometimes international, level, however, they more frequently found that their interests were at odds. Unconstrained by boundaries, their intra-industry competition for profits led them to aggressive marketing and cost-cutting practices that had the unintended consequence of exposing to the public eye how lucrative the student-loan market really was. Tactics used by banks to bolster their student-loan volume included:

- Offering premiums such as cameras and radios to students as an incentive to take out GSLs.
- Reminding customers on their credit card statements that they were eligible for GSLs
- Sending letters to students already receiving GSLs asking why they had not applied for the following term - even if they already had.

- Distributing football tickets, and even cash payments, to student aid administrators in return for referring students to the lender.

As Deborah L. Tabbot, vice-president of the student loan division for Chase Manhattan, explained, such practices were legitimate and necessary. A large volume of loans was required, from a lender's standpoint, to make the endeavor profitable. Be that as it may, the "zealous pursuit" of student borrowers sent signals to Congress and the Republican administrations that "lenders are making too much money" [Wilson, 1985 (a). Quotes, from the same article, attributed to Sherry A. Ward, Director of the Virginia State Education Assistance Authority].

In order to cut costs, bankers generally withdrew their offers of funds to students at proprietary schools and community colleges. Lenders did this not to avoid the high default rates associated with students at such institutions, but to decrease administrative costs further. Afterall, their loans were fully insured by guarantee agencies and/or the federal government, so defaults were not a concern.[48] What was a concern was the size and tenure of the loan. Students at schools offering other than traditional four-year programs took out smaller loans and were in repayment status sooner. This meant that the costs associated with servicing - even lip servicing - such loans escalated faster and, because the loans were smaller, loan

[48] Actually, by 1980 the Student Loan Insurance Fund had met its demise. The federal government no longer directly insured loans for students without access to a guarantee agency. Instead, it authorized Sallie Mae to do so. However, the guarantees Sallie Mae made as part of this new responsibility were 100% re-insured by the federal government without exception. In reality, therefore, nothing had changed.

service expenses claimed a larger proportion of revenues.[49] Due to increased competition at the national level in the 1980s, more so than in the past, bankers were spurred to cream off the most profitable student loans. They distanced themselves even further from President Johnson's hope of a program in which lenders would find their incentives in the long-term health of the economy and the nation rather than their own self-interests.

The competition between lenders grew fierce because of more than just the advent of inter-state banking. Like chum in the water, the high profits to lenders in the GSL program attracted more big fish to the pond. Specifically, large insurance companies entered the fray and they were just as aggressive as bankers in attempting to secure a large volume of lucrative student loans. Possibly more so as they sought to bind GSLs to insurance policies.[50] One company contacted Thomas G. Hood, student-aid director at the University of Mississippi, and offered him $200 for every student he referred for a combination insurance policy and guaranteed student loan.[51] In many cases insurance companies targeting families with high school aged children did not make clear to prospective borrowers that they could still receive a GSL without buying life insurance. According to the Colorado

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[49] Recall that virtually no expense is associated with a student while he, or she, is in school. However, once the student leaves school and enters repayment the lender, theoretically, must monitor the graduate and remind him or her of their responsibilities. Further, it costs just as much to keep tabs on a loan recipient who borrows $1,000 as it does one who borrows $100,000. As the administrative costs are pretty much fixed per loan, a $100,000 loan is more profitable than a $1,000 loan, *ceteris paribus.*

[50] A practice not unlike bankers' attempts to offer GSLs in return for deposits.

[51] Until the HEA reauthorization of 1986 proscribed such inducements, this was quite legal.

Insurance Division, the practices of one company, Occidental Life, were flat-out "deceptive and misleading" [Peebles, 1985]. With the competition for student loans becoming ruthless, it was difficult for lenders to plead to Congress that the GSLP was not a "lender's pork barrel" [Peter H. Pundt, manager of education lending for Chase Lincoln First Bank, quoted in Wilson, 1985 (a)].

As a consequence of inter-state banking and heightened competition between banks and insurance companies, the topography for guarantee agencies also changed. In 1976 there was a total of 25 guarantee agencies in the United States, almost all of them directly associated with the government of the State in which they operated. By 1987, this number swelled to 58 with an ever-increasing proportion having no formal ties to any government - State or Federal [Wilson, 1987 (b)]. By 1990, almost half of all guarantee agencies were privately controlled [DeLoughry, 1990].[52] Initially, the two largest private guarantee agencies, the Higher Education Assistance Foundation (HEAF) and the United Student Aid Fund (USAF), were the principal guarantors for the large insurance companies entering the market [Peebles, 1985]. Following their primary customers across State lines, they treaded upon the turf of more traditional State agencies and helped to catalyze disunity among guarantee agencies. Hostility openly erupted among guarantee agencies in 1983 when HEAF announced that it would guarantee, nationwide, $300 million in GSLs for law school students. This upset other guarantee agencies because law students

[52] By 1990, though, the number of guarantee agencies decreased to 45.

took out large loans for at least three years[53]. "They're taking the cream of the crop of loans out of the state agencies," said Paul P. Borden, head of Kentucky's state guarantee agency [Chronicle of Higher Education, 1983]. This genesis of large, national guarantee agencies provided traditional guarantors with more to worry about than the loss of a particular cache of loans. They were losing control over their default rates. Guarantee agencies had to keep default rates at or below 5% in order to remain 100% re-insured by the federal government. They did this by refusing to insure risky loans. However, with new, private, inter-state guarantee agencies on the scene a lender refused guarantees by a state agency could simply take its entire portfolio - risky and riskless loans - elsewhere. Regional agencies faced a choice. They could actually perform the function for which they were created - assume risk - or see their portfolios diminished. These options were not palatable and so the state agencies lobbied Congress for an amendment to the HEA. The "Goodling Amendment"[54] allowed state agencies to police lenders and private guarantors operating in their jurisdiction. By providing state agencies with the power to proscribe a lender (regardless of who guaranteed their loans) from operating within their state, Congress returned to them a measure of their past abilities to operate as regional monopolists [Wilson, 1985 (b)]. In the process, though, the state agencies turned "State's evidence," inadvertently revealing to Congress, the Reagan and Bush administrations, and the public the extent to which they, as well as lenders and private guarantors, were profiting.

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[53] Medical students might also appear to be lucrative targets. However, medical students are eligible for very low-interest and federally administered HEAL loans. With such an attractive alternative, medical students usually do not become deeply involved in the GSLP.

Being non-profit enterprises, it is difficult to understand why guarantee agencies, especially state guarantee agencies would care about the volume of loans they insured. So long as lenders were protected, allowing students to receive the funds they needed to complete their education, did it matter who insured the loans? To individual guarantee agencies, obviously it did. One practice that became popular in the early 1980s was that of using agency reserves and loan portfolios to back the issuance of bonds. Because these bonds were tax-exempt, guarantee agencies could offer them at lower interest rates than the returns garnered from student loans.[55] A 1980 CBO report estimated that the federal government was losing hundreds of millions of dollars a year in tax revenues as a result. The next reauthorization of HEA tightened this loophole, but did not close it. Profits to guarantee agencies on the issuance of these bonds were limited to 2.5 to 3-percent (depending on the ratio of students to state population) [Chronicle of Higher Education, 1980 (b)]. By 1984, though, guarantee agencies learned that they could use Sallie Mae as an intermediary to get around these limits [Chronicle of Higher Education, 1984 (b)].

Guarantee agencies received funds from other sources as well, including the 5% insurance fee they were authorized to charge students for their loans. In fiscal 1981,

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[54] In honor of sponsor, Representative William F. Goodling (Rep., Pa.).

[55] To understand how profits could be made, consider it this way: Suppose you buy a bond with a 10% interest rate. At the end of the year, though, you have to pay, say, a 10% capital gains tax. That would mean that the effective yield on the bond is only 9%. By purchasing a tax-free bond returning 9% (or better), then you would be at least as well off. If the bond issuer does not have to pay taxes on the instruments backing the bonds then, in this instance, the issuer can realize as much

state loan guarantee agencies reaped $426 million in revenues - 42% more than their expenses of $300 million [Hook, 1982]. In 1982, at least, $260 million of their revenues emanated from the insurance fees charged to students. These funds were used to build up agency reserves, allowing them to hedge against future defaults. In the same year, though, only two agencies, New York and Maryland, incurred default rates higher than 5%. Therefore, only these two states encountered any default expenses whatsoever. The fight among guarantee agencies for higher reserves and revenues raised the question of precisely what they were doing with all this money. As chief of ED's student loan branch, David C. Boyer, wrote to state guarantee agencies in 1982, "It was never the intent of Congress that guarantee agencies should get rich [as a result of the GSLP]" [Quoted in Hook, 1982].

Some of the money was used to enhance the salaries[56], perquisites, and the work environment of guarantee agency officers and staff. It also went to cover administrative expenses such as office supplies, loan servicing and collection efforts purchased from private, for-profit suppliers[57]. Curiously, many of these suppliers were owned, in whole or in part, by guarantee agency officers, occasionally with their revenues improperly coming from guarantee agency reserve funds and default reimbursements [Wilson, 1986]. In reply to GAO accusations that state-agency reserves totaled $1 billion in 1985 and were used chiefly to gather dust and interest,

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as a 1% profit. The figures used in this example were chosen for ease of math. Guarantee agencies garnered much more than 1%!

[56] The executive director of the Vermont Student Assistance Corporation - the state's guarantee agency - received a salary $72,000 higher than the governors in 1989 [Wilson, 1989 (b)]

the executive director of one of the largest such agencies, the Pennsylvania Higher Education Assistance Agency (PHEAA), Kenneth R. Reiher contended that "Nobody can take [that] money and buy an airplane with it. ... It is there to run the loan program" [quoted in Wilson, 1986]. Perhaps Mr. Reiher never did buy an airplane, but several years later federal and state investigators described as "rather lucrative" the kickbacks he received from the Gabler Educational Management Corporation. Gabler was under contract for $1.7 million to PHEAA to help collect student loans [see Janchik, 1988 and Wilson, 1989 (b)].

When Reagan took office, in 1981, such abuses on the part of lenders and guarantee agencies had not yet become apparent. Reagan, his administrators, and the Republican Congress saved their wrath for students, proprietary schools and, of course, the Department of Education that they intended to dismantle. In fact, they were quite receptive to agency and lender demands. When, in his first year, Reagan moved to end interest subsidies for students, it was only intervention by NCHELP and lenders that kept him from being successful. They testified that doing so would cause the GSL to come to an "abrupt halt" [NCHELP President, Douglas R. Seipelt, quoted in Hook, 1981 (c)]. By ending subsidies[58] student loans would have become much more expensive to the borrower and - if the simplest laws of supply and demand came into play - would have reduced loan volume. This was ironically unattractive to an industry that frequently decried the GSLP as an unprofitable drain

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[57] Recall that guarantee agencies are paid an "administrative allowance" by the federal government - almost $35 million in 1982.

on their resources. Also in 1981, Reagan approved the collection from students of 5% origination fees by banks [Hook, 1981 (d)].[59] In the autumn of 1982, bowing to pressure from lenders, Congress approved a bill that made federally insured loan to students exempt from the Truth in Lending Act. Bankers had contended that the act's disclosure and reporting requirements were more detailed than need be and placed an unnecessary administrative burden on them [Chronicle of Higher Education, 1982 (b)].

As Reagan began his second term, however, it became clear that, for lenders and guarantee agencies, the jig was up. Even though the number of GSLs issued remained reasonably constant over his first term, rising from 3.5 million in 1981 to 3.8 million in 1985, the cost of the program did not. Nominally, the total cost of the program swelled from $2.7 billion in 1981 to $4.1 billion in 1985, an increase of almost 52%. In real terms (constant 1992 dollars), the increase was only 26%. On a per loan basis, real total obligations rose by only 16%, but considering the short time period, this was considerable. Reagan paid more for each student loan and students, at least, got less in return. The origination fee that banks could now charge students was meant to assist them in meeting the costs of responsibly administering GSLs. The default situation only got worse, however, with defaults costing the government $256 million in 1981 and $1.08 billion by 1985. On a per loan basis,

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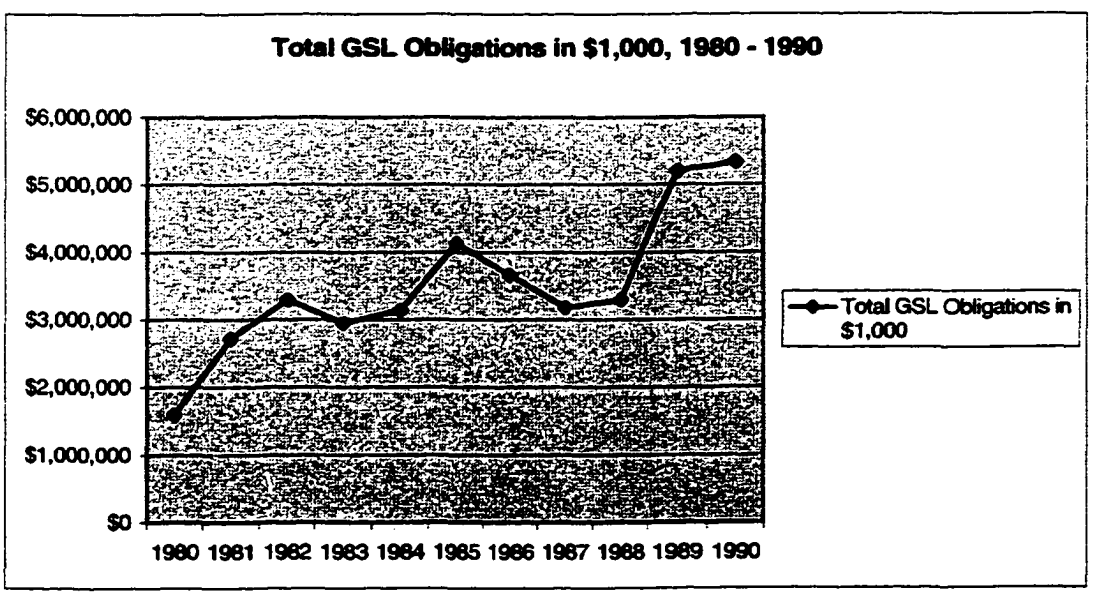
[58] The plan was for the government to stop paying the subsidies. Instead, interest would accrue to the principal. When the student began repayment after graduation he, or she, would have a larger debt to pay off.

[59] Recall that guarantee agencies were charging students as much as 5% in insurance fees. Additionally, many colleges and universities deducted a percentage of loan

net default costs grew six-fold, from $49.90 per loan issued in 1981 to $300.86 in 1985. And the administrative costs associated with the program, including administrative allowances paid to guarantee agencies, also rose 87% - from $60 million in 1981 to $112 million in 1985. Interest benefits - the subsidies paid by the government on behalf of students, but not including special allowances - similarly mushroomed. The government doled out $73.6 million to cover interest payments while students were in school in 1981, and more than $1.8 billion in 1985 [See the figures, below]. To even the most casual observer, it was obvious that the situation had gotten out of hand. The federal government was spending billions of dollars and, for this expense, it was saddled with the unenviable duty of having to keep a watchful eye, not only on the program's beneficiaries, but also on its vendors.

Figure 2.4 - Total GSL Obligations in $1,000, 1980 - 1990



principal in return for processing the loan. A student could easily sign for a loan of $1,000 and receive a check for less than $900.

Figure 2.5 - Total GSL Obligation ($1,000) in Constant, 1992 Dollars, 1980 - 1990

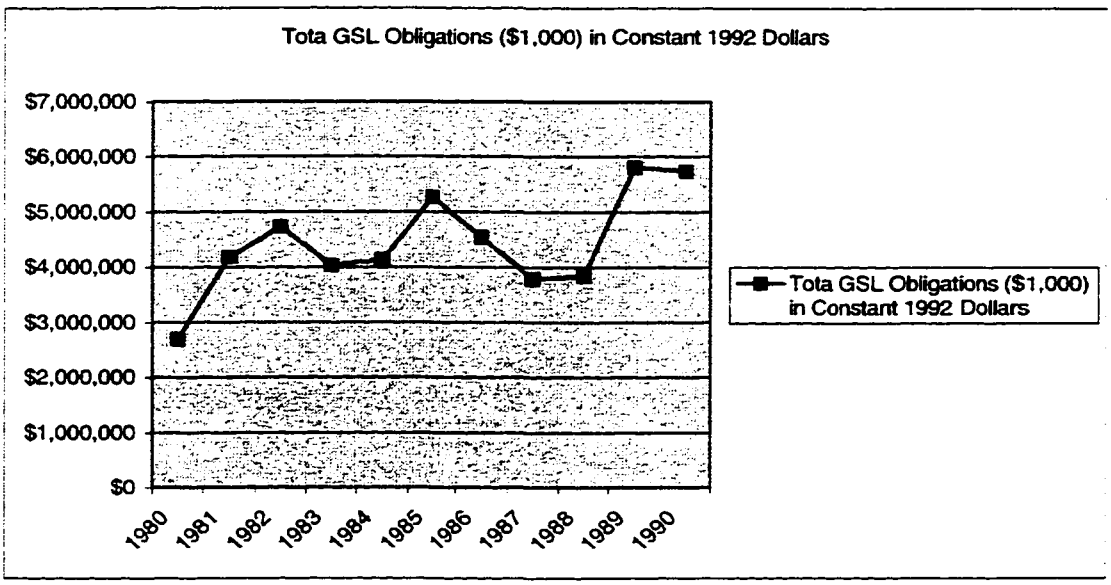


Figure 2.6 - Total GSL Obligations ($1,000) Per Loan in Constant, 1992 Dollars, 1980 - 1990

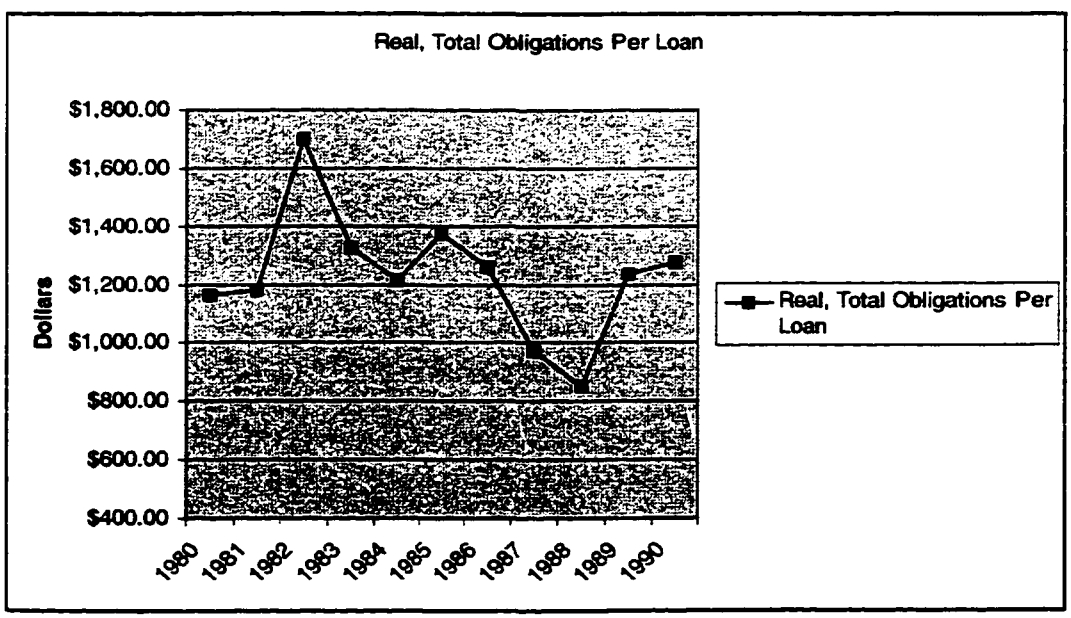


Figure 2.7 - GSL Default Costs ($1,000), 1980 - 1990

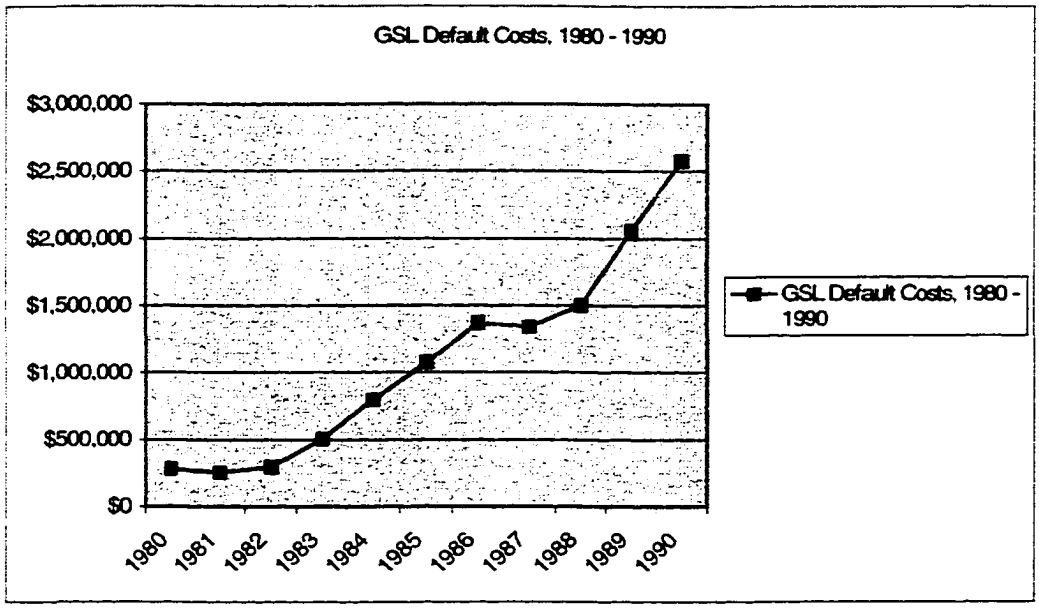


Figure 2.8 - GSL Net Default Costs Per Loan, 1980 - 1990

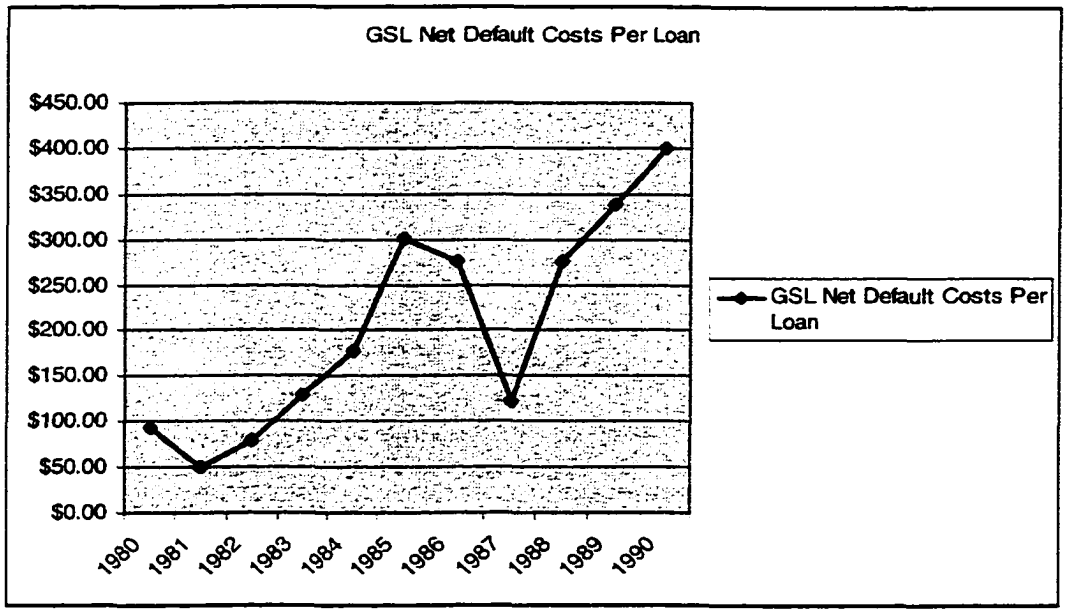


Figure 2.9 - GSL Administrative Costs ($1,000), 1980 -1990

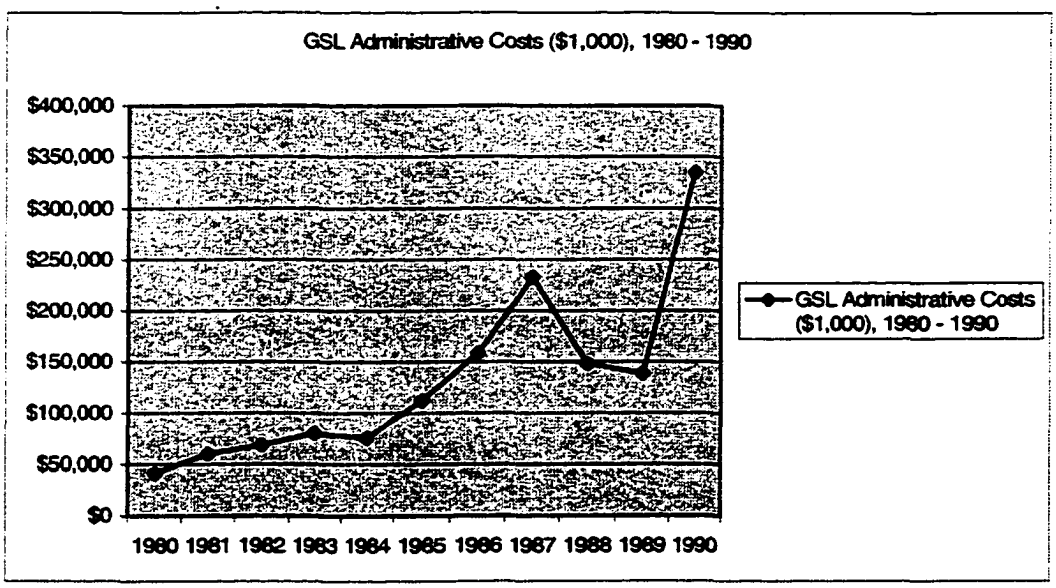
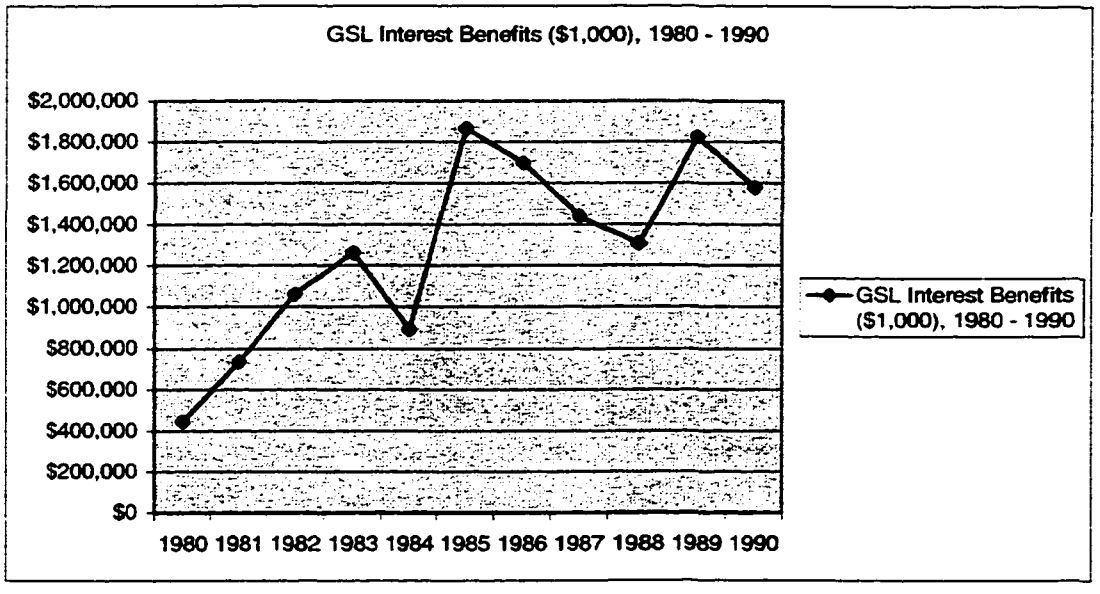


Figure 2.10 - GSL Interest Benefits ($1,000), 1980 - 1990. Does not include special allowances.



The public perception now was that the GSLP had become a "500-pound gorilla" that pandered to the interests of a "vast number of lenders and guarantee agencies" [Wilson, 1988 (a)]. As it was obvious that the threats of lenders and guarantee agencies to leave the program were hollow, Reagan moved to reduce fe deral expenses by cutting their revenues. Over their vociferous protests that such actions would "shut the whole program down" [Muriel Johnson, executive director of the Virginia State Educational Assistance Authority, quoted in Engelgau, 1985], Reagan attempted to reduce the special allowances paid to lenders from 3.5% to 3%. More drastically, he wanted to slash them to 1.5% while students were in school and lenders had little to do but collect the proceeds. Further, he wanted to require lenders to disburse funds twice a year, instead of just once. Special allowances and other interest charges would then be paid on a semi-annual basis and not on the entire, annual amount as was previously the case. As popular as Reagan was, he

was only able to reduce special allowances to 3.25 percent. He was successful in obtaining multiple disbursements from lenders, but not in an attempt to reduce the maximum re-insurance rate paid to guarantee agencies to 90% from 100%. He also wanted to end the payment of administrative allowances to guarantee agencies, but here, again, he was unsuccessful [Engelgau, 1985]. Against the politically less powerful, Reagan was able to secure a few more significant reforms. With the passage of the 1986 HEA reauthorization a needs analysis was reinstated for students whose families earned more than $30,000 a year and, after the fourth year of repayment, the interest rate students were responsible for was raised to 10% from 8% [Wilson, 1986 (e)].

Also in 1985, the Reagan administration initiated efforts to reclaim excess guarantee agency reserves. William J. Gainer, a GAO associate director, testified before the House Subcommittee on Postsecondary Education that guarantee agencies should not be permitted to "generate unnecessary income or reserves at the expense of either the student-borrower, or the federal government." Allowing them to accumulate $841.9 million in surplus reserves accomplished precisely that end, Gainer explained. As could be expected, NCHELP responded that they had no "surplus" reserves, with every nickel necessary to guard against future defaults [Wilson, 1985 (c)]. Nevertheless, by 1988, the government did attempt to rein in excess reserves, collecting almost $25.6 million that year. As further evidence that Reagan no longer believed guarantee agency beseechments, ED flatly withheld $55 million in administrative allowances in 1985. The Department's rationalization was

that, due to an unexpected upturn in default claims, ED could not afford to distribute the administrative allowances [See Chronicle of Higher Education, 1985 (b) and (c)]. Intentionally or not, as figures 2.7 and 2.8 imply, ED sent a message to guarantee agencies that, at least for a couple of years, they heeded: "Do your jobs, or you will not get paid.[60]"

Generally, though, Reagan could not put a leash on the GSL beast. While it was now apparent that lenders and guarantors were as much to blame for expenses and abuses associated with the program as any other participant, they proved themselves to be much too powerful to control. On the one hand, the GSLP served over 3,000,000 students in 1987 and secured employment for literally thousands of people at banks and guarantee agencies so legislators could not simply shut it down. On the other, few legislators knew enough about the program to feel comfortable making radical changes [Wilson, 1988 (a)][61].

That being the case, the program proceeded through the rest of Reagan's final term, and George Bush's as well, pretty much as it had before 1985. The only real difference was that the government was in open contest with the private sector

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[60] ED resumed the payment of administrative cost allowances in July of 1986.

[61] And the banking industry, at least, seemed quite willing to keep them in the dark. CBA "studies" of the student loan industry consistently predicted doom and gloom should cost-saving measures be enacted. When asked about the profits accruing to lenders from student loans, the CBA was most likely to throw up its hands and state that, because different banks calculate profits in different ways, there was no way to tell. When pushed to provide a figure in 1986, the CBA suggested that lenders earn an average of about 0.75% on each loan as compared to 1.0% on traditional consumer loans. The CBA would not, however, reveal how it derived the figure,

agents it had once hoped it could hire to run the program efficiently. Numerous investigations and court battles in the latter half of the 1980s demonstrated that the glare of the public eye was not a sufficient deterrent for fraud

Highlights for 1987 included OIG findings that Pennsylvania's state guarantee agency, PHEAA, had defrauded the federal government of $17.8 million by billing ED for default reimbursements before lenders had even attempted to collect on the loans, and for inappropriate administrative costs [Wilson, 1987 (c)]. In the same year, a GAO study determined that ED had reimbursed lenders for at least $83 million in defaulted loans for which they had not exercised sufficient due diligence in attempting to collect. The GAO revealed that half of all reimbursement claims it examined should have been rejected.[62] [Wilson, 1987 (d)]. In another study, conducted in 1987, the GAO perused the records of 16 of the largest lenders in the program and found that 18% of the bills submitted for interest subsidy payments contained errors. These errors led to the overpayment of at least $1.8 million. That such errors could slip past ED, charged as they were with auditing the records of roughly 14,000 lenders in the program, is not surprising [Wilson, 1988 (b)].

Even when ordered by ED to comply with its mandates, guarantee agencies put up a stiff battle. A series of court cases in 1989 pitted ED against 22 state guarantee

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stating that "most lenders are reluctant to reveal their profits on student loans" [Wilson, 1986 (c). Also see Wilson, 1986 (d)].

[62] Note that this implies negligence, if not fraud, on the parts of both lenders and guarantee agencies: The lenders for submitting the reimbursement claims to the guarantee agencies, and the guarantee agencies for approving them and submitting them to ED for re-insurance claims.

agencies that refused to turn over control of $200 million in reserves[63]. As usual, the agencies argued that the interest from the reserves was needed to meet operating expenses. Moreover, they were being unfairly singled out because, unlike other agencies that had chosen to put their reserves into real estate and other less liquid assets, they had opted to hold theirs in cash [DeLoughry, 1990 (a)]. Another court case brought forth allegations by two former managers at Sallie Mae's Lawrence, Kansas, processing center that the GSE routinely defrauded the government. They alleged that Sallie Mae was in the habit of accepting canceled loans from banks (loans that had never been dispersed) and then failing to report them as canceled to ED. By doing so, Sallie Mae could collect interest benefit payments from the government for loans that, in effect, had never been made. They alleged, as well, that Sallie Mae regularly misled borrowers by informing them that their accounts were delinquent when, in fact, they were up to date. Such a tactic could cause borrowers to pay more than they should on their loans[64] [DeLoughry, 1990 (b)].

With reauthorization again looming on the horizon, in 1990, the Senate Permanent Subcommittee on Investigations conducted well-publicized hearings. "The Nunn Commission," as it was called, charged that lenders, processors and guarantee agencies had wasted millions of taxpayer dollars through "abuse and outright fraud." Said the commission's chairman, Sam Nunn (Dem., Ga.), "[I]n our investigation we have yet to hear of even a single part of the student-loan program that is working

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[63] Guarantee agency reserves totaled roughly $1 billion in 1989.
[64] The plaintiffs, Diana Crossfield and Brenda Albright, claimed that they were wrongfully terminated when they brought these matters to the attention of their superiors.

efficiently or effectively" [Quoted in Myers, 1990]. Something had to be done. But, what?

The "In-House" Option

The point was made, at the beginning of this history, that when the Gardner Commission suggested to President Johnson a broader use of student loans to help make higher education more accessible, they offered two methods for instituting the madness that later became known as the GSLP. LBJ could "out-source" the program, in essence hiring private firms to provide loan funds and services. Or, as the commission preferred, he could have selected the "in-house" option by which the government would provide the loan capital and administrative functions itself. Hoping that the former would be cheaper, Johnson chose to out-source. Almost every year thereafter one advisory panel or another recommended scrapping the GSLP in favor of a national student-loan bank, or some other permutation of in-house, direct lending. By the early 1990s, President Bush began to take such recommendations seriously. In January of 1991, a spokesperson for the Bush administration floated the idea of cutting banks and guarantee agencies out of the picture. Instead, perhaps it might be better to allow colleges to originate and administer the loan program with funds borrowed from the U.S. treasury. The lenders and guarantee agencies that only a decade earlier had bemoaned how unprofitable the GSLP was, rabidly opposed the plan [DeLoughry, 1991]. Shortly thereafter, Bush's Education Secretary, Lamar Alexander, announced the

administration's adamant opposition to the plan and threatened the upcoming HEA reauthorization with a presidential veto should it include provisions for direct lending.

The ball had been fumbled, however, and the Democratically controlled Congress picked it up and ran. With the conviction - and votes - to override a presidential veto, Democrats pushed through a Direct Loan pilot program. As originally conceived, the pilot program would offer direct lending to 500 postsecondary schools whose loan volume did not exceed $500 million in the most recent year [Student Aid News, 1992]. This was not enough for Bush's successor, Bill Clinton, though.

Just a few months later, Clinton seized on the Direct Loan initiative, labeling it a focal point for his "reinventing government" project headed by Vice President Gore [Pitsch, 1994]. Bolstered by Congressional Budget Office estimates that Direct Lending could save the government between $3 billion and $6 billion over the next five years [Student Aid News, 1993 (a)], Clinton proposed to scrap the pilot and immediately begin direct lending. The President hoped to phase in the DLP gradually until it could replace the GSLP/FFELP[65] by the 1997/98 academic year. In advancing the DL, Clinton set off what was arguably to become the most partisan firestorm in the last decade.

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[65] The Guaranteed Student Loan program was renamed the "Federal Family Education Loan Program" by Republican supporters with the 1992 reauthorization. What was formerly referred to as the "GSLP" will, from here on, be designated the "FFELP".

In conjunction with other techniques, the student loan industry attempted to derail the DSLP by seeding a grass roots opposition movement. Plastering campuses all over the state with unprofessionally scrawled posters, the "Ohio Students for Loan Reform" declared the new DSLP to be "kind of like pass-fail with your future on the line." The posters included tear-off cards addressed to Ohio's senators, urging them to vote "no" on the DL proposal, and a toll-free telephone number by which students might "register [their] concerns by phone." What the posters did not make clear was that the Ohio Students for Loan Reform was actually a front for the Student Loan Funding Corporation, a secondary marketer that feared it would be swept away by the DSLP. This deception[66], said Senator Paul Simon (Dem., Ill), was only "the latest outrage in an all-out lobbying campaign orchestrated by Sallie Mae and its allies." Simon related that Sallie Mae was backing a similar endeavor in Wisconsin and was further engaging some of the most expensive and well-positioned lobbying firms in Washington to defeat Direct Lending [All quotes in Weisskopf, 1993]. An industry which had repeatedly declared itself to be on the brink of financial collapse suddenly seemed willing to go to almost any length to remain in business.

Their efforts and expense largely went for naught, obviously. While the student loan industry continued to publicly denounce the DSLP as a disaster waiting to happen, they had to concede that "The best way to handle the situation is to come out with a strong [FFEL] program and not wait for a fumble in the direct loan

program " [Director of student financial services at UC, San Diego, William Hansen, quoted in Student Aid News, 1994]. What this really meant was that, if the student loan industry hoped to survive, it had to match the DSLP innovation for innovation.

Indeed, the credit for student loan innovations should go to the Department of Education. The Clinton administration and ED invested a lot of political capital[67] in the DSLP and, therefore, they were determined to make the program as attractive to borrowers and college financial aid administrators as possible. Customer service, something not normally associated with the provision by government of collectively consumed goods, was driven by ED and mimicked by private industry. The DSLP was to provide "one-stop shopping" for students, said ED Secretary Richard Riley. Previously, students seeking a loan had to gain approval from their school and then take the resulting paperwork to a lender and begin the process again. Loan terms were inflexible - take it, or leave it. If they did take the loan, they were lucky to receive the proceeds (less 8%[68] in origination and insurance fees) within several weeks. Once the student entered repayment, given the speculative nature of the student-loan industry, finding out to whom they should send payments often

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[66] Student Loan Funding Corp. chief financial officer, Mark Weadick, called it an "oversight." He claimed that it was never the companies "intent to mislead anyone in anyway."

[67] The investment was so high, in fact, that by 1994 the stakes were no less than the survival of the Department of Education itself. The Gingritch led 104th Congress, as part of its "Contract with America", revived Reagan's notion of dismantling ED. Make no mistake. The proposed demise of the department had everything to do with the counterattack Republicans waged against the DSLP in 1995. One way to get rid of the DSLP, clearly, was to do away with ED.

[68] But, legally, as much as 10%.

presented a problem. In contrast, under the DSLP students could fill out a paperless application, on-line, or at their student aid office. Once approved by their postsecondary institution, the student's financial aid office had merely to electronically draw down an account established for the school by ED and cut a check for proceeds in excess of tuition and fees. The turn-around time? Seventy-two hours, start to finish [Goodman, 1993]. Once in repayment, there could be little confusion over to whom they owed money. In addition, students could choose from a variety of repayment plans. Besides the aforementioned income-contingent plan, students could stick with the standard (10-year) plan, opt for an extended (20-year) repayment plan, or choose a graduated repayment plan in which payments increase over the course of the repayment period [Quinn, 1994]. ED also offered to cut the fees students paid under the FFELP in half - from 8% to 4%

Backed by the CBA, NCHELP and Sallie Mae, Republican congressional leaders attempted to muster support for a reformed FFELP as an alternative to direct lending by offering the same services ED including in its DSLP. Lenders, guarantors, servicers and secondary marketers, under the auspices of the Coalition for Student Loan Reform (CSLR), brought to their predominantly Republican supporters on Capitol Hill proposals that they hoped would circumnavigate their "total obliteration" [Quote attributed to NCHELP president Jean Frohlicher in Student Aid News, 1993 (b)]. Even the threat of competition, it seemed, was enough to inspire the student loan industry to make proposals that, only a few years previously, would have motivated declarations of hardship. "Darned concerned"

about losing their jobs [Sam Kipp, executive director of the California Student Aid Commission (Guarantee agency), quoted in Student Aid News, 1993 (c)], the impossible suddenly became feasible. The CSLR offered to reduce defaults by allowing income-sensitive repayment[69] and doubling the repayment period from ten to twenty years. Additionally, the CSLR proposed that lenders hold loans for nine months, instead of six, before declaring them in default. They also offered to decrease re-insurance rates, and reduce federal administrative payments. Most striking of all was the CSLR suggestion that $1.3 billion could be saved by reducing lender special allowances (interest subsidies) from 3.1% to 2.45% while students were in school [Student Aid News, 1993 (d)]. Lenders actually engaged in price and service competition with the federal government!

While the CSLR could not defeat the DSLP[70], it did win some important rearguard actions. Arguing that a level playing field was necessary to effectively compete, it was able to see to it that the FFELP was amended in such a fashion that the industry could adopt the same practices that ED had instituted for the DSLP. Most importantly, they were able to secure a cap on the growth of the DSLP, guaranteeing themselves significant market share through 1998. This not only short-circuited Clinton's plan to do away with the FFELP by 1998, but gave them the time to prove

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[69] Income-sensitive repayment differs subtly from income-contingent with both providing advantages and disadvantages for borrowers. Under the DSLP's income-contingent plan, payments are strictly calculated as a percentage of the borrower's income. With income-sensitive repayment, payments are also calculated as a percentage of income, however, the minimum payment must equal the interest accrued over the repayment period. Interest never compounds principle. Under the income-contingent plan payments can be lower, but because interest can be added to principle, the length of the loan can be extended.

that the FFELP could be a viable alternative to the DSLP. Specifically, some of the highlights of the direct lending compromise provided for the following:

- For both programs, during in-school, grace and deferment periods, the interest rate charged borrowers was reduced from that of the 91-day T-bill plus 3.1% to the 91-day T-bill plus 2.5%. This meant that special allowances paid to lenders under the FFELP were reduced 60 basis points.
- Fees paid by students in the FFELP were cut in half to 4%, matching those charged under the DSLP. Lenders were allowed to charge 3% (down from 4%) in origination fees, while guarantee agencies could charge 1% (down from 4%) in insurance fees.
- Regardless of the T-bill rate, borrower interest rates were not to exceed a ceiling of 8.25%.
- Guarantee agency retention allowances for collections on loans in default reduced from 30% to 27%
- The maximum reinsurance rate paid by the federal government decreased from 100% to 98%. All other reinsurance tiers were also reduced by 2%.
- Sallie Mae charged 0.3% on its outstanding loan volume annually, rising to 1% if it fails to act as a "lender of last resort" when called upon by ED to do so.
- Limit DSLP volume to 5% of industry total in the program's first year (1994), rising to 60% by 1998/99.

[Student Aid News, 1993 (e)]

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[70] Created as part of a 1993, five-year, deficit reduction plan.

Because of these changes to the FFELP, the student-loan industry won time to reconstitute itself into a form reminiscent of a competitive market. The entities the industry served - students, schools and taxpayers - were the biggest winners, however.

Although it is presently agreed that both programs will co-exist, side-by-side, competition, both political and economic, is still keen. As any economist can tell you, this means that the collective and individual consumers of student loans have benefited, and will continue to do so as long as real competition is maintained. For example, in 1994, Maine Educational Services announced that it would fund "Super Loans" to Maine residents and out-of-state students attending institutions in the state, at a full percentage point lower than the FFELP/DSLP rate [Ornstein, 1994]. In 1995, Sallie Mae successfully lured the University of Maryland at College Park out of the DSLP and back to the FFELP exclusively. The University of Maryland, one of the largest of the first-year direct loan program participants, left the program, according to the school's financial aid director, William Leith, because it was concerned that the 104th Congress might eviscerate the DSLP. Given that Sallie Mae agreed to institute a loan delivery system similar to that used in the DSLP, it seemed rational to abandon the program before it sank [Student Aid News, 1995]. Direct lending did not founder, of course. It withstood various political volleys and, for good or ill, continues to sail along. One thing is certain, though. In the twenty-five years previous to the creation of the DSLP a lender, of its own volition, would never have offered student loans for less than the maximum rate allowable. Further,

a servicer/marketer would never have gone to the trouble to tailor its product to the needs of a customer.

The history of the federal, guaranteed student-loan program superficially demonstrates the merits of competition. The GSLP began as a program with the laudable aim of making postsecondary education attainable for the middle-class and below. It grew into a system of regional fiefdoms in which local lords - lenders, marketers, and guarantee agencies situated in particular states - sought to increase their tributes while shirking responsibilities. When something went wrong, they quietly let the finger of blame rest on the lowly peasants (students), or upon the shoulder of the distant king (the federal government).

Eventually, the nature of the financial services market changed such that formerly localized lenders, servicers, marketers, and guarantors began to tread upon one another's turf. This led to conflicts between segments of the industry which exposed them for what they were - rational actors in typically self-interested pursuit of personal gain. It became apparent that students and the government were not the only parties responsible for the extreme cost that had associated itself with the public goal of making education affordable. .

With this knowledge in hand, the federal government moved to replace the GSLP. Yet, because the program had grown so large, assisting hundreds of thousands of

students at thousands of postsecondary schools, and employing thousands of individuals at various financial institutions, the government could not simply pull its plug. Instead, the new Direct Student Loan program had to be phased in gradually. This gave supporters of the FFELP/GSLP time to counter-attack politically and otherwise reform their program. FFELP supporters successfully directed their efforts toward making the FFELP more attractive to those it served, an effort they would have considered impossible (or, at least, distasteful) only a few years before. Like participants in a truly competitive market, they sought their economic survival by lowering their prices and improving the level of service to their customers - students, postsecondary institutions, and the taxpayer as well.

By 1999, a political equilibrium had been achieved. All disputants acknowledged that both programs should remain as competition had served well the interests of the parties for whom the program was intended to benefit. Unique within the catalog of goods and services provided by government, the consumers of student loans had a choice of providers.

Whether or not an economic equilibrium has been achieved is another question; one which I will not attempt to answer at this time. What is clear is that the taxpayer expense associated with the student loan programs has declined. The existence of competition the FFELP and the GSLP may be associated with these cost savings and, in the next section, I attempt to confirm, or deny, this in a quantitative fashion.

Cost Analysis

There is anecdotal evidence that student borrowers benefited financially from the onset of competition between the direct and guaranteed student loan programs. As was pointed out above, some lenders saw fit to offer student loans at interest rates below the maximum that could be charged under the FFELP. However, tracking the effective interest rates charged by over 13,000 lenders over a four-year period would be problematic, to say the least. This section, therefore, will not address borrower cost benefits, but instead will turn attention to the cost savings realized by the peripheral beneficiaries of student loans, the general public.

As argued in chapter one, the general public benefits, politically and economically, from a student's attainment of a postsecondary education. Economically, he or she benefits due to the higher productivity and associated spillover effects of the increase to the national stock of human capital that the student's education represents. Politically, the taxpayer benefits by the addition to the polity of an individual with a larger stake in political outcomes, inducing a greater propensity on the part of that individual to take the democratic process seriously. If one does not accept such arguments, then one must also endorse the notion that government, at any level, has no business providing student aid of any kind. There is not point in reading further. If, on the other hand, the reader believes that government, representing the interests of the public, does have an interest in promoting postsecondary education, then read further.

Having proceeded to this paragraph, I will assume that the reader concurs with me concerning government's interests in promoting postsecondary education. I will also assume that the reader agrees that, whatever the good or service government endeavors to provide, it should do so in the most cost efficient manner possible. This section examines cost data across the history of the guaranteed student loan program and concludes that savings were realized as a result of competition between the FFELP and the DSLP.

Cost Analysis Data

With a few notable exceptions, all of the data used in this cost analysis were derived from appendices to the U.S. budget for fiscal years 1965 through 1999. They can be found under entries listed for the Office of Education, U.S. Department of Health, Education and Welfare, or for the Office of Postsecondary Education, U.S. Department of Education, HEW's successor. With the exception of fiscal years 2000 and 20001, all data represent actual, and not estimated, expenditures.

In any given budget, OMB dues not provide actual figures for that particular year. Instead, it must provide estimates of costs and revenues. Similarly, estimates of the previous year's expenditures and revenues are also included. With a two-year lag, however, actual figures are reported and it is for this reason that estimates must be used for the years 2000 and 20001. Although the estimates are quite good, it is always preferable to use actual over estimated data and, whenever possible, this has

been done. This does mean, however, that the party interested in verifying or replicating this analysis should look for, say, 1994 data within the 1994 U.S. budget. To obtain total obligations incurred by the direct loan program in 1994, for example, one would need to look at program data listed under Department of Education, Office of Postsecondary Education, Federal Direct Student Loan Program Account, Appendix to the U.S. Budget for fiscal year 1996.[71]

The variables used in the analysis at one point or another include:

Total Obligations: As stated in footnote number 9, total obligations represent all of the expenditures incurred by a program in a given fiscal year[72], whether or not payment is actually made in that year. Therefore, the government can award a five-year contract in a particular year and specify that payment to the contractor be spread over the course of the contract. The total cost of the contract over the span of its lifetime, however, is credited to the year in which the contract was awarded.

DLCOST - Total obligations for the DSLP derived from the Federal Direct Student Loan Program Accounts. Values for years prior to 1994, the year in which the DSLP began operating, are set to zero.

FFELCOST - Total obligations associated with the GSLP/FFELP. FFELCOST includes total expenditures listed under Program and Financing

[71] Alternately, I would be happy to provide the data in Excel format.

accounts for the GSLP, or the FFELP, as applicable. Additionally, for 1992 and later, FFELCOST includes total obligations listed under the "liquidating account" ledger. For these years, Program and Financing accounts only specify costs and offsets for loans financed in 1992 on. The Liquidating accounts list obligations associated with loans committed to in 1991 and before. To assure that total obligations for the FFEL program for 1992 and later are comparable to earlier entries, total obligations for both accounts must be added. The change in the accounting procedure was a product of the Credit Reform Act of 1990.

SLIF - Total obligations associated with the Student Loan Insurance Fund. The SLIF was created to enable HEW to act as insurer of last resort in case where a guarantor was not available, or willing, to insure the loans of qualified students.

Costs and Offsets: The following variables relate to costs and revenues subsumed within a program's total obligations.

GSLIBEN - GSL/FFEL interest benefits paid by the Federal government on behalf of students. These figures do not include special allowances distributed to lenders to encourage their participation. These benefits include interest charges paid by the federal government while the student is still in school, during the post-graduation grace period, and other deferments.

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[72] Note that the government fiscal year runs from October 1st through September 30th.

DLIBEN - Interest benefits paid by the Federal government on behalf of student participating in the Direct Loan program.

SPA - Special Allowances paid to lenders in order to encourage their participation in the GSL/FFEL. Calculated as a fixed percentage of loan volume, this fixed percentage, plus the interest rate associated with the 91-day Treasury bond, is equal to the lender's rate of return.

GSLDEFCT - Gross GSL/FFEL default costs. Where appropriate, GSLDEFCT includes figures from Program and Liquidating accounts. This includes all default claims paid to guarantee agencies.

DLDEFCT - Gross default costs associated with the DSLP. Includes contract collection costs and reflects "non-repayment" as opposed to guarantee agency reinsurance claims.

GSLDEFCL - Total GSL/FFEL collections on defaulted loans, program and liquidating accounts.

DLDEFCL - Total DSLP collections on defaulted loans net of the expenses associated with the collection of these loans.

GSLDDB - GSL/FFEL death, disability and bankruptcy costs. From summary of Program Costs and Offsets, program and liquidating accounts.

DLDDB - DSLP death, disability and bankruptcy costs. From the summary of Program Costs and Offsets.

GSLCOLCT - Represents the cost associated with collection of defaulted GSL/FFEL loans. Includes contract collection costs and guarantee agency retentions.

GSLADCT - GSL/FFEL administrative costs. This includes Administrative Cost Allowances paid to guarantee agencies, federal administrative expenses, and Supplemental Preclaims Assistance. Gross Student Aid Management is not included and no administrative expenses are reported in the liquidating accounts.

DLADCT - DSLP administrative costs. Generally listed as "Student Loan Administrative Expenses" under the program account for the Federal Direct Student Loan Program.

GSLFEES - An offset. Fees received from participants in the GSL/FFEL by the Federal government in payment for its services. GSLFEES include borrower and lender origination fees, Sallie Mae Offset fee (a charge for the use of Federal

funds), and consolidation loan holders' origination fees. As these fees are paid "upfront", the liquidating account does not apply.

DLFEES - DSLP borrower origination fees only.

GSLNTDEF - GSL/FFEL net default costs from the summary of Program Costs and Offsets, program and liquidating. "Net default costs equal default claims minus net collections (gross collections minus contract collection costs and guaranty agency retention)." For the liquidating account, this is equal to default claims.

DLNTDEF - DSLP net default costs. From the summary of Program Costs and Offsets.

Because accounting procedures do change from year to year - sometimes subtly and sometimes dramatically - a precise log was kept to record data keying procedures. This log is available upon request.

Other Variables:

FFELLNS - GSL/FFEL loans in thousands.

DLLNS - DSLP loans in thousands.

TBILL90 - The 91-day Treasury Bill rate, entry for 2001 is calculated as the monthly average over the first quarter. Source: Federal Reserve Board

GDPDEF - GDP price deflator used to convert nominal figures to constant, 1994 dollars. Source: Budget of the United States Government, Fiscal Year 2001, Historical Table #10.1.

DLDUMMY - A dummy variable set to equal one for years in which the DSLP was in operation (1994 to present) and zero otherwise.

REAUTH - Another dummy variable set to equal one for years in which the HEA was authorized, reauthorized, or significantly altered, and zero otherwise.

Overview

Tracking the components of costs associated with the GSLP/FFELP can be a little tricky because federal accounting procedures have changed over the years. Usually, procedural changes accompany program growth and reflect attempts to gauge more accurately the costs of an increasingly expensive program. Sometimes, however, they are the by-products of other legislative goals. For example, the Federal Credit Reform Act of 1990, which created a separate ledger of accounts for pre- and post-1992, was designed to assist efforts to diminish the U.S. budget deficit.

Data for the GSLP did not reach a high level of detail until 1978. Previously, GSLP expenses were lumped with those of the Office of Education's (HEW) "Higher Educational Activities," expressed as separate accounts under the SLIF, or more often, both. Figures for 1967[73] are simply listed as "Insured Loans: $15,632,000. No breakdown concerning how much of this expense was associated with interest benefits, administrative costs, etc. is given. Some information concerning default costs and fees received is related under separate SLIF accounts, but not much. The SLIF, the reader will recall, was the separate ledger for loans the federal government insured directly, without using a guarantee agency as an intermediary. By 1970, a better accounting for the program was given, with separate entries for interest benefits, guarantee agency reserve fund advances, and program administration cost. This level of detail rises until 1978, when all program accounts were incorporated into the SLIF ledgers. By 1980, the SLIF had been eliminated yet, fortunately, accounts separate from the rest of the new Department of Education's postsecondary endeavors were maintained. In 1992, detailed accounts of expenses associated with student loans originated in 1991 or before (liquidating accounts), and those issued in 1992 and later, are presented. Adding the separate entries derives FFELP totals.

Dependent variables

[73] Remember that figures are derived from budgets for fiscal years two years later. Thus, figures for 1967 are taken from the 1969 budget.

Because total obligations for the program, per se, do not appear until 1978, total obligations for years previous to this are calculated as the sum of interest benefits, special allowances, administrative costs, net default expenses, and death, disability and bankruptcy benefits.[74] Additionally, by deducting fees received by the federal government, we can come to a figure reflective of net costs associated with the program. Over the life of the FFEL program these fees can include: Borrower origination fees, lender origination fees, consolidation loan holder fees and Sallie Mae offset fees[75]. In 1999, these fees totaled $965,000,000, so they are consequential. Expressed in constant 1996 dollars I refer to this calculation of net FFEL program cost as RFFELCT (real, FFEL, net cost)..

As table 2.7 demonstrates, there is some disparity between total obligations given for 1979 and beyond, and the calculation used to approximate them in earlier years. This is as it should be because total obligations represent total expenditures and do not take into account fees received. The approximation covers in the vicinity of 90% of listed total obligations for the years 1978 through 1991, but fall precipitously to 78% in 1992. The difference is largely due to ambiguous entries such as "Noncontractual modifications" ($2,177,788,000 in 1992). Similar ambiguities arise in later years, and can be either positive or negative. Generally, though, the difference between the approximation and listed total obligations is

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[74] Net default costs are calculated as gross defaults plus collection costs, less default collections. Know that gross defaults equal net defaults for years prior to 1970. Considering that the GSLP barely got off the ground until 1968, it is reasonable to expect that the Office of Education had made little headway toward collection on loans that had only recently gone into arrears.

[75] Sallie Mae offset fees are a recently instituted tax on Sallie Mae's excess reserves.

close enough to inspire confidence in the former variable. The simple correlation between total obligations and the net cost variable, from 1979 to 2001, is 0.948.

Table 2.7 - Net FFELP Cost as a Percentage of Reported Total Obligations, 1979 - 1980

1979	999,343	901,607	90.22%
1980	1,597,877	1,488,015	93.12%
1981	2,721,115	2,614,563	96.08%
1982	3,297,776	2,925,560	88.71%
1983	2,942,072	2,531,598	86.05%
1984	3,130,939	2,967,753	94.79%
1985	4,130,920	4,259,245	103.11%
1986	3,658,502	3,355,711	91.72%
1987	3,179,160	2,442,750	76.84%
1988	3,297,305	3,111,744	94.37%
1989	5,203,843	4,836,578	92.94%
1990	5,341,039	4,890,222	91.56%
1991	5,733,353	5,264,114	91.82%
1992	5,051,751	3,881,314	76.83%
1993	5,600,382	4,176,049	74.57%
1994	5,074,846	4,912,538	96.80%
1995	5,030,000	5,207,462	103.53%
1996	4,628,000	4,378,026	94.60%
1997	4,650,000	4,128,066	88.78%
1998	3,320,000	3,288,539	99.05%
1999	4,068,000	3,851,719	94.68%
2000	3,852,000	3,894,797	101.11%
2001	3,387,000	3,658,934	108.03%

A similar variable, RDLCT (real DL net cost), is created for the Direct Loan program. However, due to fundamental differences between the FFEL and DL programs, the components to RDLCT are not identical to those of RFFELCT. For example, special interest allowances are benefits paid to lenders in order to encourage their participation in the FFEL. Because the government is its own

source of capital in the DLP, special allowances are not a factor in Direct Loan costs. This does not mean, though, that the Federal government bears no burden when it distributes capital under the DLP. To finance Direct Loans, ED borrows money from the U.S. treasury at the prevailing 91-day Treasury Bill rate. As a result, ED paid almost $3.5 billion to the Treasury for the funds it used to provide student loans in 1999. The OMB estimates that this figure will rise to just less than $4.1 billion in fiscal 2001[76]. To get an accurate read on the cost of the DLP, interest payments to the Treasury must be added to RDLCT, but so must interest received from borrowers be subtracted (giving us net interest costs). Specifically, RFFELCT and RDLCT comprise figures from the following budget lines:

INTEREST BENEFITS:

- RFFELCT Interest on student loans paid by the government, to lenders, while students attend school, during the grace period immediately following school attendance, and during other specified deferment periods.
- RDLCT: Interest on Direct loans that the government does not collect while students attend school, during the grace period immediately following school attendance, and during other specified deferment periods.

[76] It might seem a little odd that the Federal government must pay itself for the use of its own funds but, actually, this is reasonable. Interest payments represent, at least, the opportunity costs (losses related to foregoing the use of the funds for other purposes) of using the capital to make Direct loans. Also, adverse macroeconomic consequences could ensue if the Treasury was not paid for its funds. Briefly, this might require the Treasury to raise its T-bill rates, forcing up the price of financial capital emanating from other sources.

SPECIAL ALLOWANCES:

- RFFELCT: Interest on principal in the FFEL program paid by the Federal government to encourage participation by private lenders. Historically, special allowances have ranged from 2.45 to 3.5 percent. Special allowances paid by State governments are not included.
- RDLCT: Not applicable.

NET DEFAULT COSTS:

- RFFELCT: Net default costs equal loan defaults plus costs associated with the collection of defaulted loans, less defaulted loans collected. The cost of collecting on defaulted loans includes "Contract Collection Costs" and "Guarantee Agency Retentions." The former includes payments to private collection firms while the latter consists of funds retained by guarantee agencies as an incentive for following up on loans declared in default and, for which, they have already been reimbursed.
- RDLCT: Net default costs equal loan defaults plus costs associated with the collection of defaulted loans, less defaulted loans collected. The cost of collecting on defaulted loans includes administrative costs and private, collection agency fees.

DEATH, DISABILITY AND BANKRUPTCY BENEFITS:

- RFFELCT: As implied, these are operational losses due to the death, disability, or bankruptcy of the FFEL borrower.
- RDLCT: Losses due to the death, disability, or bankruptcy of the DL borrower.

ADMINISTRATIVE COSTS:

- RFFELCT: Includes Federal administrative costs and administrative payments to guarantee agencies. Payments to guarantee agencies include Account Maintenance Fees, Loan Insurance and Processing Fees, and Supplemental Preclaims Assistance. Student Aid Management fees, which may go to administering either the FFELP or the DLP, are not included.
- RDLCT: Federal administrative costs only. Like Federal administrative costs under RFFELCT, these include civilian and Federal personnel compensations; travel and transportation; rental payments to GSA; communications, utilities and "miscellaneous charges"; printing and reproduction; advisory and assistance services; equipment; operation and maintenance of equipment; purchases of goods and services from government accounts; and land and structures.

FEES:

- RFFELCT: Includes borrower origination fees, lender origination fees, Sallie Mae offset fees, consolidation loan holder fees, reinsurance and insurance fees. These fees are deducted from the above to arrive at a net cost figure.
- RDLCT: Borrower origination fees only.

INTEREST

- RFFELCT: Does not apply
- RDLCT: Interest payments for funds borrowed from the Treasury are included, while interest payments received from DL borrowers are deducted as an offset.

The purpose of this analysis is to determine whether the introduction of competition to the provision of student loans reduced costs. Therefore, RDLCT is added to RFFELCT to get RTOTCT (real, total, net cost). RTOTCT is, thus, the main dependent variable. We should also like to determine if competition improved the cost efficiencies of the FFEL program and, for that reason, a parallel analysis is conducted on RFFELCT[77].

Inspection of figures 2.11 and 2.13 (below) reveal a number of things. First, it is apparent that the real, net expenditures on student loans have increased steadily since 1966. The presence of an upward trend is very clear. The same is true for the FFELP singularly until 1984, when associated costs seem to level off or, perhaps, decline slightly. Also, beginning in 1984, there is a marked increase in the variability of expenditures[78]. Naturally, we would like to explain the trend and the variability to the greatest extent possible.

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[77] An analysis of *RDLCT* is not conducted as, after all, the introduction of the DL is the "treatment" and not the subject of the "experiment".

[78] This is true for both graphs, of course, because they are identical until 1994, when the DLP was introduced.

Figure 2.11 - Real, Total, Net Cost for the Combined FFELP and DLP (*RTOTCT*). In thousands of constant, 1996 dollars.

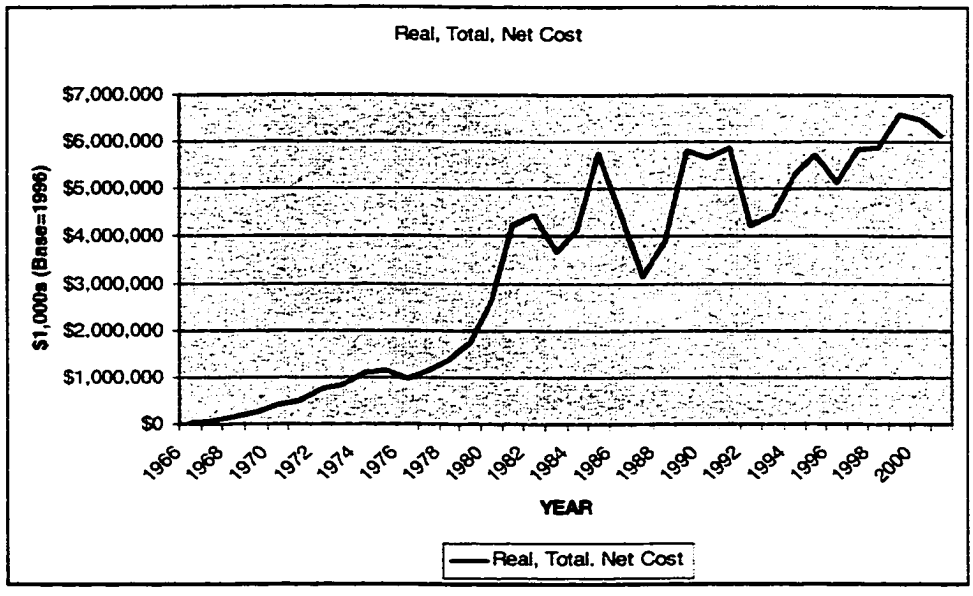


Figure 2.12 - Number of Loans Combined FFELP and DLP (*TOTALLNS*) by Year of Origination. Displayed in thousands of loans.

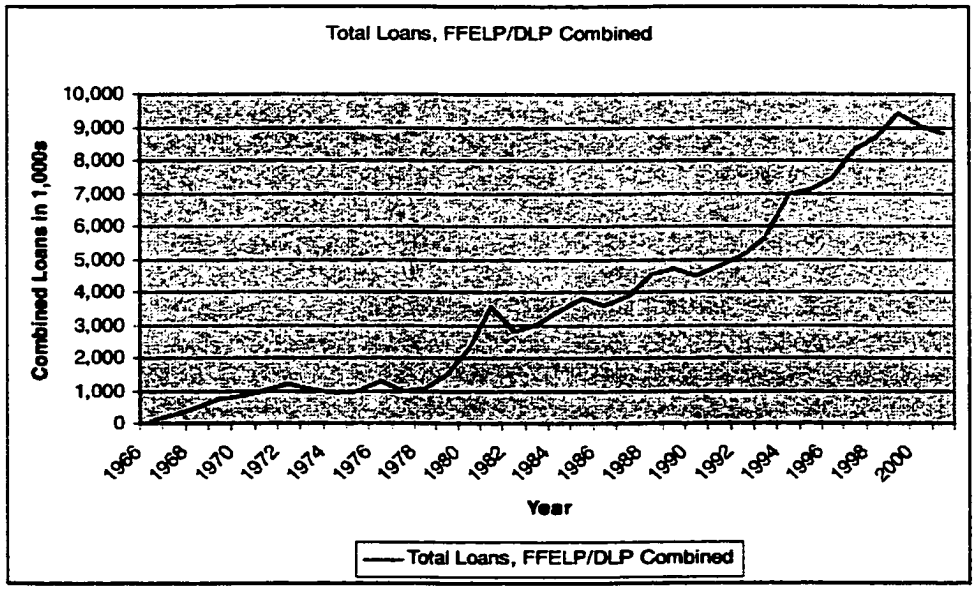


Figure 2.13 - Real, Net Cost for the GSLP/FFELP Only (*RFFELCT*). Expressed in thousands of constant, 1996 dollars.

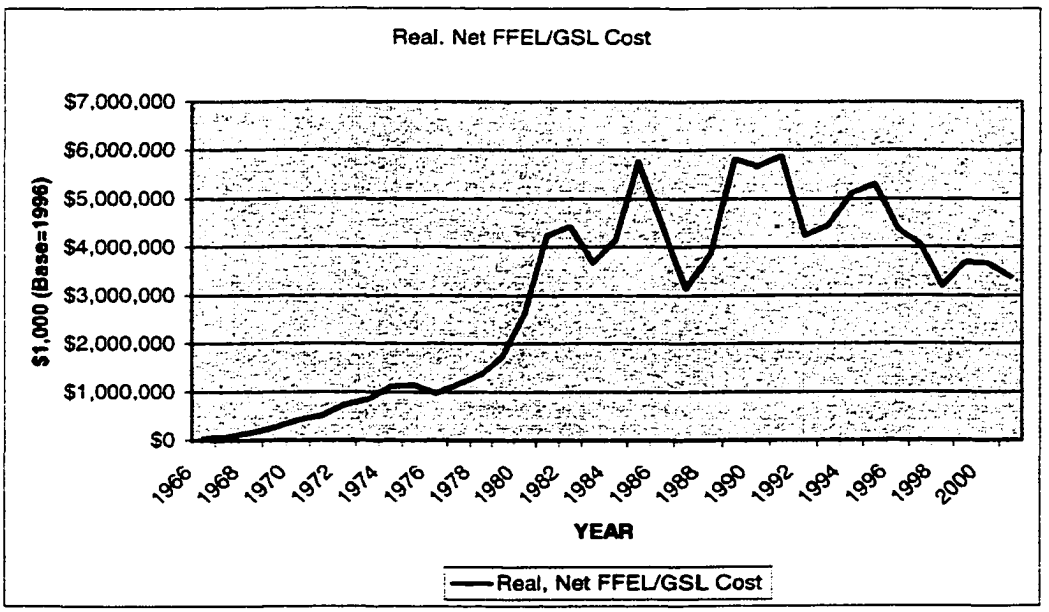
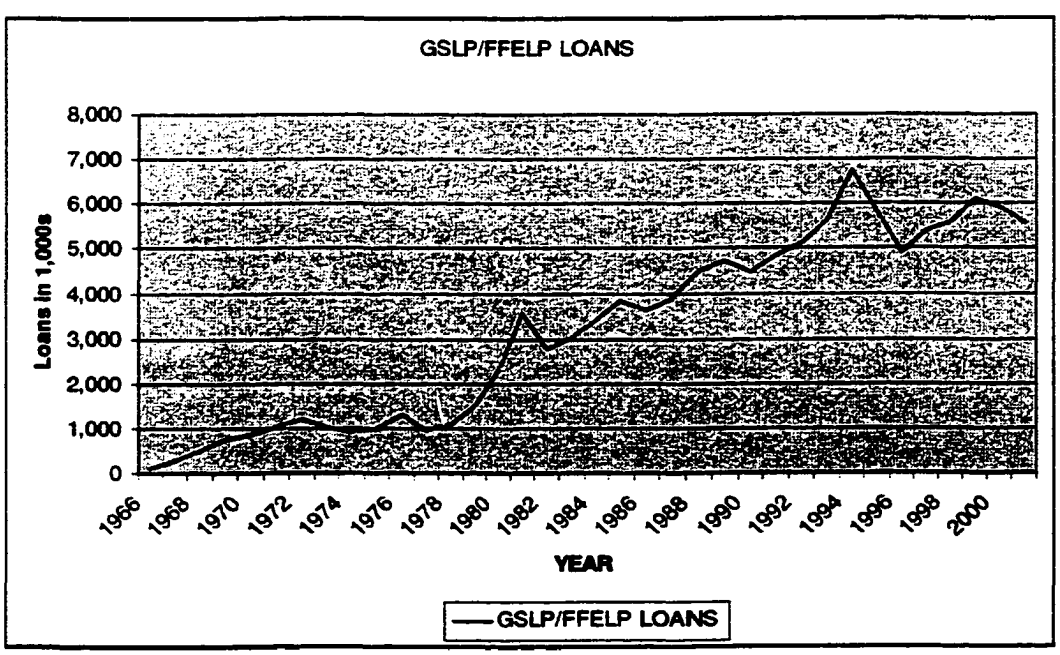


Figure 2.14 - Number of GSLP/FFELP (*FFELLNS*) Loans by Year of Origination. Displayed in thousands of loans.



A look at figures 2.12 and 2.14 suggest an obvious explanation for the increasing cost trend. The provision of student loans has steadily expanded since 1966. With more loans comes greater total cost, and a comparison of figures 2.11 and 2.12 reveals a rather similar rate of ascent. Figures for the FFEL program alone - 2.13 and 2.14 - demonstrate a slightly different pattern, however. FFELP costs rise with the number of FFELP loans through 1985 where they roughly plateau - although, again, there is a great deal of variation through the 1980s - until 1993 whence they seem to take on a downward trend. Until the onset of the DLP in 1994, though, the number of FFELP loans rises steadily. On a per loan basis, it would appear that FFELP costs began to fall in 1985 and took an especially sharp plummet beginning in 1993.

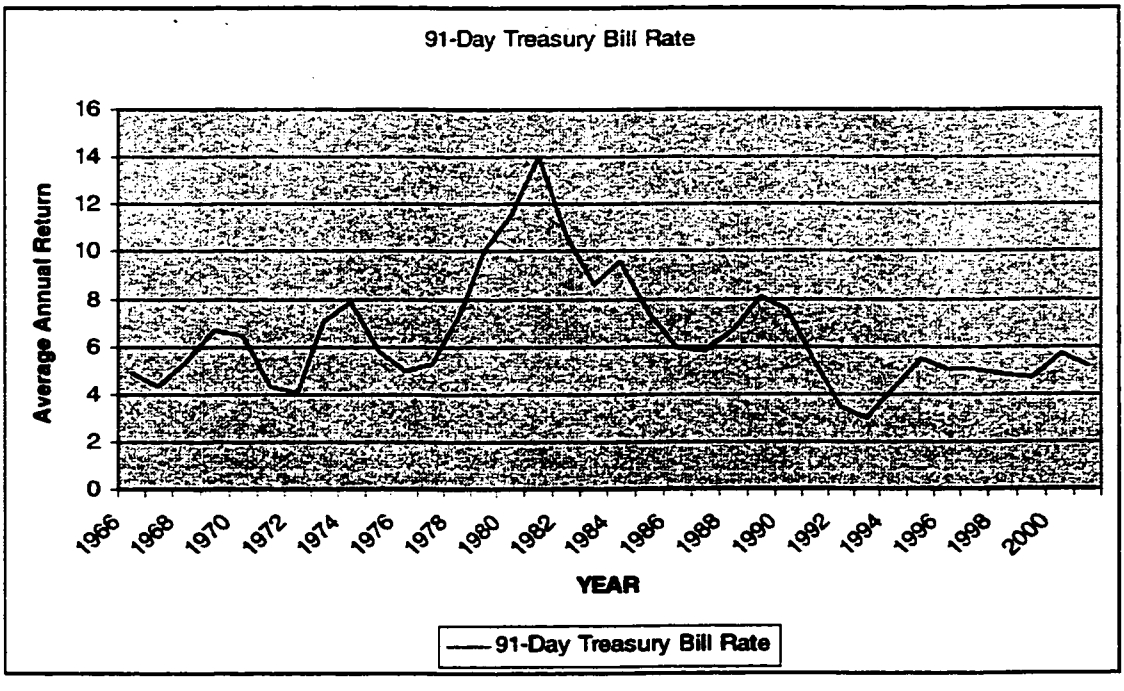
What we know about the politics of the GSLP/FFELP can help to explain the downward trend in per loan costs seemingly initiated in 1985. While it was Carter's ED secretary, Joseph Califano, who launched the first assault against the abuses of FFEL lenders, guarantee agencies and servicers in 1979, it was Reagan's secretaries, particularly Bell and Bennett, who declared all-out war. Further, it took a few years for the Reagan administrations to recognize that students and proprietary schools were not the sole source of problems in the program. Pressures that Reagan brought to bear may not have produced results until 1985. The political struggles that ensued in attempting to bring costs under controls while simultaneously placating what might be thought of as traditional Republican constituencies - the banking industry, individual States as represented by guarantee agencies, and middle-class,

voting parents - also explain the variation we see in this period. Similarly, though it was Carter who initiated efforts to rein in default expenses, it was Reagan who fully utilized the resources of the Internal Revenue Service and private, collection agencies to revive defaulted loans. These efforts may be a source of the diminishing expenses associated with the decline in GSLP/FFELP expenses on a per loan basis. Additionally, the glare of the spotlight turned upon the program by investigations conducted at this time by the GAO, the OIG, and the Nunn Commission, may have inhibited the behavior of some actors for short periods of time.

An effort to capture the influence of politics through the use of a dummy variable (*REAUTH*) set to one for years in which the HEA was either reauthorized or significantly amended, and zero otherwise was instituted. This effort was a dismal failure, and we should not be surprised. Political policy is rarely monotonic. Carter's Middle-Income Assistance Act, for example, made any student - regardless of family income - eligible for GSLs and, to insure lender cooperation, removed caps on special allowances. Just two years later, the reauthorization of 1981 reinstituted "means testing" and again capped special allowances. The point is that policy, over time, is unlikely to exert a strictly positive or negative influence upon program cost. As such, the influence of politics cannot be captured without adopting a rather subjective coding practice. The variable *REAUTH* was found to be wildly insignificant in any model formulated and no further mention of it will be made of it.

Another source of variation during the 1980s is the uncertainty surrounding the economic conditions that prevailed. The country suffered through a deep recession during Reagan's first term, a situation that was exacerbated by the Federal Reserve Board's attempts to get a rope around inflation. Figure 2.15 depicts the interest rate for 91-day Treasury Bills over the life of the GSLP/FFELP. Although the overall trend is relatively flat, the most variability is evident in the 1980s. The rate spikes sharply at 14.03% in 1981 and remains above the apparent trend until 1987. Ambiguity over how long interest rates would remain high, in conjunction with the changing nature of the student loan market[79], may have caused lenders to over adjust to short-term conditions.

Figure 2.15 - 91-Day Treasury Bill Rates



[79] Increased competition and the prevalence of inter-state banking

Be that as it may, the use of a "per loan" cost variable is not ideal. While it would capture some of the relationship between the scale of the program and its costs, barely a fraction of the total cost of a student loan is incurred in the year the loan is issued. As table 2.8[80], below, indicates, expenditures on a loan in the year it is issued can actually be negative. This is due to the fact that fees received may exceed the cost of the loan for that year. Generally, though, first year expenditures seem to hover around 7%, rise markedly over the next year or two, and then begin to decline.

Table 2.8 - OMB Estimates for Loan Expenditures by Year of Origination over a Seven-Year Time Span

1985	216	1028	614	564	390	265	87	???	???	???	???	6.83%
1986	0	-184	653	705	674	406	355	55	???	???	???	-6.91%
1987	0	0	165	800	570	425	273	170	49	???	???	6.73%
1988	0	0	0	175	1025	647	433	302	212	69	???	6.11%
1989	0	0	0	0	271	1156	653	470	323	212	66	8.60%

However, while the OMB estimates make a lot of sense intuitively, they do not square with data for the history of the program. Figures 2.16 and 2.17, displayed on page 151, which graphically display the correlations between real, total costs for the combined programs, and those for the FFELP alone, do not reveal the concave

[80] Table 2.8 is an amalgamation of OMB estimates appearing as separate tables in Budget Appendices for the years 1987 through 1991 (pp. I-119, I-117, I-117, I-115, and A-649 respectively). These are the only budgets in which such estimates are presented

pattern implied by table 2.8. Instead, contemporary values (lag 0) of TOTALLNS and FFELLNS exhibit a strong correlation with RTOTCT and RFFELCT respectively. They subsequently die off at a smooth, geometric fashion until, after ten years, TOTALLNS and RFFELLNS fail to influence cost variables. Given that, until relatively recently, the maximum length of a student loan (barring extenuating circumstances such as temporary disability) was ten years, this result has some appeal.

The OMB estimates would imply that the relationship between cost and loan volume could most effectively be captured through the use of a second-order (quadratic) distributed lag model, possibly with fixed end point conditions. Such models were examined and proved to be unsatisfactory. The geometric pattern we see in figures 2.16 and 2.17 on the next page, implies a different technique, and is a function of an amalgamation of costs. The OMB figures in table 2.8 are a seven-year distribution of costs for loans originating in a given year. RTOTCT and RFFELCT reflect costs for all student loans, regardless of year of origination. Additionally, because loan volume is highly correlated with its most recent past values - this is why we see such a prevalent trend in figures 2.12 and 2.14 - amalgamated costs should reveal a similar, though declining trend. Therefore, it does seem reasonable to model cost relationships by using the first order lag of cost as an independent variable. The use of further lags, however, results in colinearity with the first order lag of cost. Incorporating a first order lag also is beneficial in that it helps to control for first order autocorrelation between error terms.

Figure 2.16 - Relationship between Values of Real, Total, Net Cost and Lagged Values of Total Loans

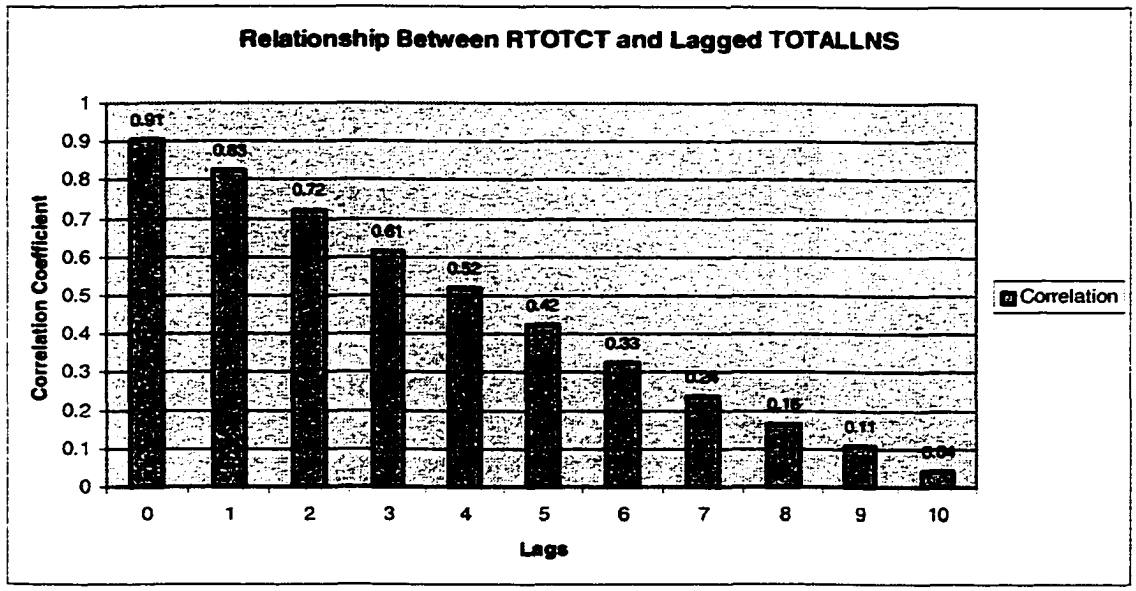
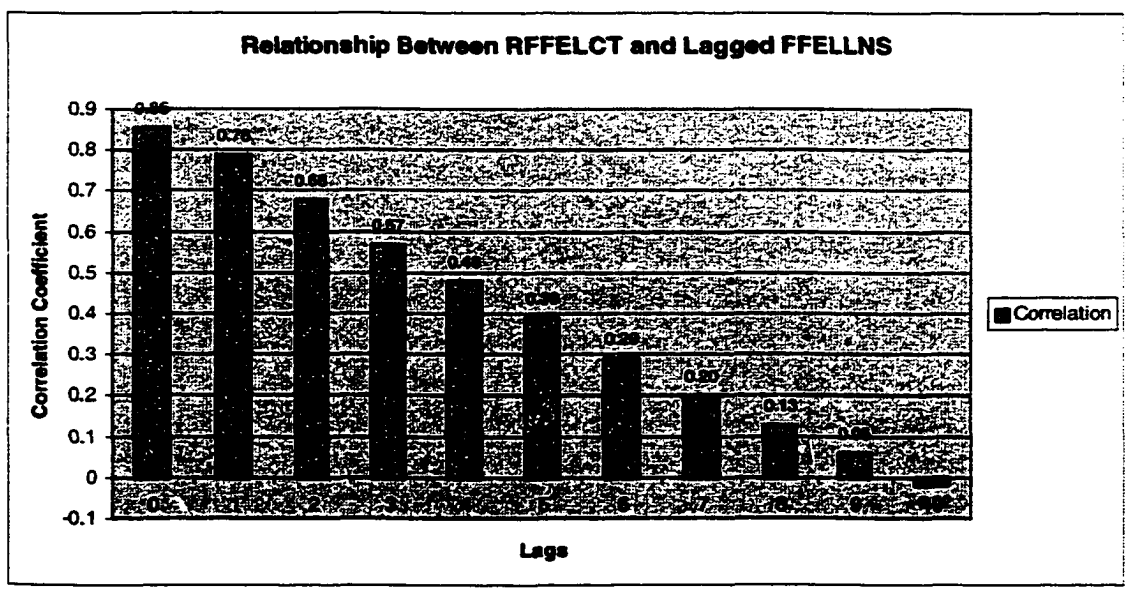


Figure 2.17 - Relationship between Values of Real, Total, Net FFELP Cost and Lagged Values of Total FFELP Loans



Because interest related payments such as student interest benefits and special allowances are a major cost component for the student loan programs, and because

these costs are directly linked to the 91-day Treasury Bill rate,[81] it is important to include the variable *TBILL90* in any proposed regression. Since 1980, interest related payments, including net interest payments for borrowed capital under the DLP, have averaged almost 59% of total expenses.

Figure 2.18 demonstrates that the T-bill rate is highly correlated with itself from year to year. A one-year lag on the T-bill rate is highly correlated (.784) with contemporary values. The correlation dies off gradually until, after seven years, lagged values display almost not relationship with present values. The small values for the partial correlation coefficients after one lag, in conjunction with their frequent reversal of sign, indicate that the T-bill's relationship with its past values is best modeled as first-order, autoregressive. The reader will recall that autocorrelation coefficients are the "betas" of the simple regression of the variable on its past values. The partial autocorrelations are similar, but take into account the effect of previous lags. Explicitly, the first order (one lag) autocorrelation coefficient is identical to the "B" in the regression Y = a + BY(lag one). Similarly, the second-order autocorrelation coefficient is precisely "B" in Y = a + BY(lag two). On the other hand, the second-order partial autocorrelation coefficient is equal to "C" in Y= a + BY(lag one) + CY(lag two). Clearly, for first-order lags, the autocorrelation and partial autocorrelation coefficients are identical.

[81] For fiscal 2001, lender returns in the student loan programs will be linked to the commercial paper rate. This will be the first year in which the 91-day treasury bill rate will not be used as a base. The commercial paper rate is somewhat higher than that of the T-bill, but is highly correlated with it.

Figure 2.18 - Correlations for the Treasury Bill Rate with its Past Values.

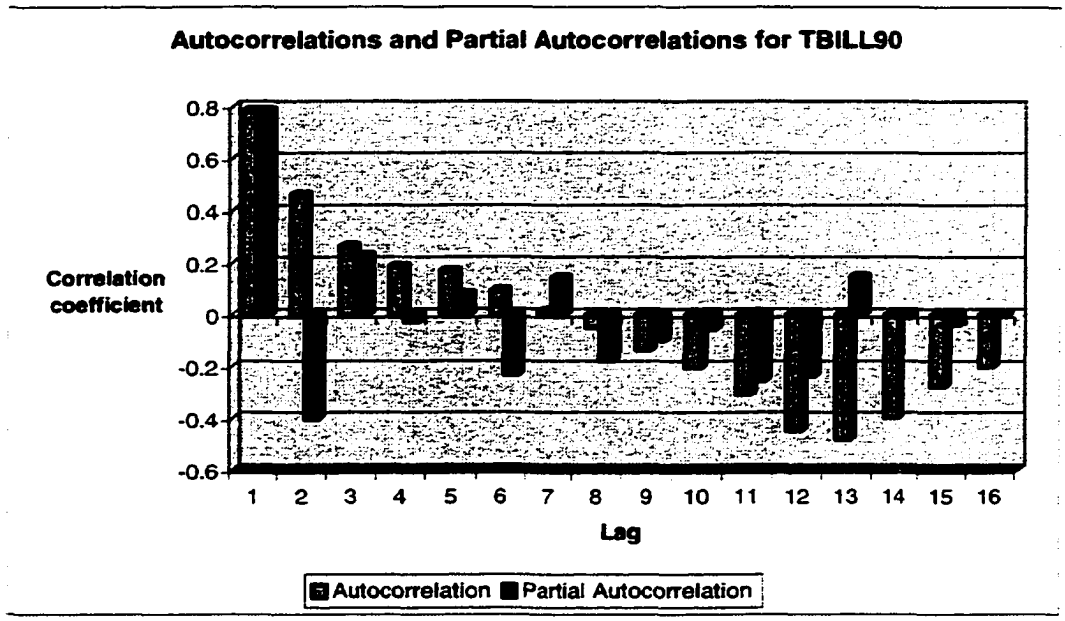
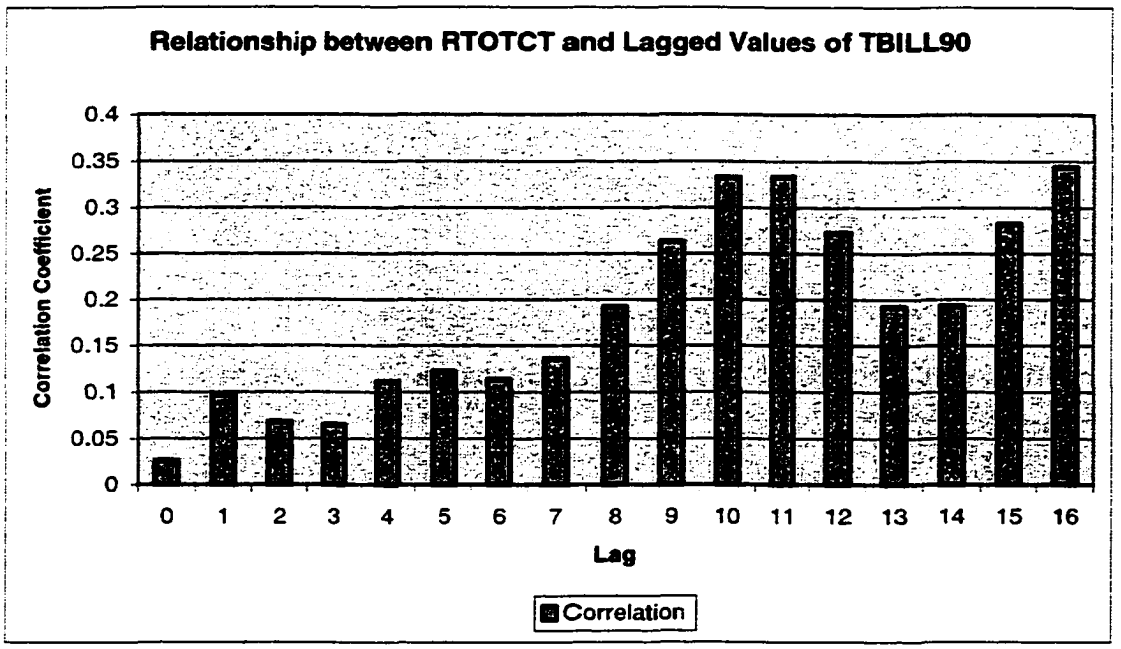


Figure 2.19 displays the relationship between RTOTCT and lagged values of TBILL90. From the figure, it is apparent that in the same year values for RTOTCT and TBILL90 are not related (the coefficient is 0.026). The correlation between RTOTCT and TBILL90 does rise to 0.096 for a one-year lag of the T-bill rate and remains at approximately this level for seven years. The correlation reaches a high of 0.333 after 10 years. This is somewhat disturbing because it is difficult to explain intuitively. While we can understand a low correlation at lag zero, the apex after 10 years is difficult to comprehend. As we know from table 2.8, only a small fraction of the net cost to the government of a student loan is incurred in the first year. The distributions of interest benefits to lenders[82] represent a significant expenditure beginning in the second year of the loan. However, after ten years all, or most of the loan should be paid off. The relatively high correlation after ten

Figure 2.19 - Relationship Between Real, Net Costs for both Programs and the 91-day Treasury bill Rate.



years may be a function of the growth of the student loan programs. In any event, given what we know about the first-order autoregressive structure of TBILL90 , the inclusion of lagged values greater than, and in addition to, one year will result in collinearity. That is to say, any regression including more than one lagged value of TBILL90 will render the coefficients statistically insignificant due to inflated standard errors. Because lagged values of TBILL90 are so tightly related with one another, their individual effects cannot be separated. Figures 2.18 and 2.19 indicate that the proper choice of value for the Treasury bill as predictive variable is with a one year lag (TBILL90(-1)).

[82] And, in the case of the DLP, to itself.

Methodology

Time-Series Errors: Ideally, every statistical analysis should be based on a randomly drawn sampled. If the sample is not random, then the analysis could be "misspecified" and misleading. Perhaps the most famous example of a misspecified analysis was that behind the *Chicago Daily Tribune's* prediction that Thomas E. Dewey would defeat incumbent Harry Truman by a landslide in the presidential election of 1948. While I am not privy to the specifics behind the sampling and analysis that led to this erroneous conclusion, I do know that sampling was conducted by telephone. Because only reasonably wealthy individuals owned telephones in 1948, the sample was biased. However, if interviewers had asked respondents, in addition to who they favored and in what Congressional district they resided, what their annual income was, then conclusions may have been different. The presence of an income variable surely would have alerted analysts to the problems surrounding their sample, and probably would have led to the incorporation of an income-dependent weighting scheme that might have produced results that were more accurate.

The example above is meant to illustrate the fact that misspecification, frequently revealed through error correlations between adjacent observations, can be a problem in cross-sectional analysis. Correlated errors, however, are pandemic to time-series analysis. This is because observations ordered over time are most definitely not randomly drawn. We do not expect, for example, that ED might assist millions of students with student loans in one year and then none in the next. Just as the

respondents to the *Tribune* survey were related by their high incomes, loan volume in one year is related to that in the following year by their proximity in time. If we did not acknowledge this, we would be, in effect, misspecifying our model. We would not be taking into account variables that might account for correlations between observations. Correlations in loan volume - and, thus, in predictive errors - might be related to growing awareness about the availability of student loans, or political sentiments in Congress concerning the desirability of such programs. Fortunately, we do not need to know what underlies correlations, and we do posses techniques at our disposal to deal with the correlated errors.

The presence of correlated errors in an analysis means that systematic mistakes are being made in the prediction of the dependent variable. Still, if we can identify the pattern to the errors, we can correct for them and derive a more effective model. A moving average error correction is a commonly used technique to account for such patterns[83].

In a regression, such as $Y_t = X_t + u_t$, it is assumed that, on average, the error term u_t will equal zero and will not covary across time. That is, $E(u_t, u_{t-i}) = 0$ for all i not equal to t. However, if we are truly dealing with a stochastic process, rarely will u_t actually take the value of zero. Moreover, because a shock occurring at a particular point of time is likely to have persistent, if not systematic, effects, the covariance

[83] Another common and related technique is autoregressive correction. Together these are known as ARMA processes

$E(u_t, u_{t-i})$ may not be negligible for i not equal to zero. As an example, consider the following example:[84]

Suppose that at any given point in time, t, we observe errors u_t. Also assume that we know that the observed errors are correlated with their past values such that $u_t = e_t + be_{t-1}$, where $-1 < b < 1$[85]. In other words, the errors we observe are actually a linear combination of the actual error, e_t, and some fraction of the true error realized in the recent past. Further assume that we know that b = .75. Both the actual and observed errors are presented in columns two and four of the table below. The actual errors, e_t, were randomly generated by the author from a normal distribution with mean zero and a variance of one and are uncorrelated. Note that the values of e_t exhibit more variation than does U_t. If we were to graph and compare, we would realize that the latter are smoother than the former. To see this, compare the values of e_t and u_t for t= 2,3 and 4. In period t = 2, e_t takes a value of around -1. It then jumps to +1.5 and then back down to almost -1. Conversely, u_t starts at about -1.5 and then also shoots up, but only to +.6. When e_t drops down again, so too does u_t, but only to + .2.

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[84] This example is based upon that of C.W.J. Granger, Forecasting in Business and Economics, pp.49 - 85. The errors were generated by me randomly and from a normal distribution with mean zero and a standard deviation equal to one. For readers comfortable with spectral analysis, see E. Malinvaud, Statistical Methods of Economics for a more rigorous proof. The definitive work on the subject is George E. P. Box's and Gwilym M. Jenkin's Time Series Analysis: Forecasting and Control (1976), however.

[85] Do not make the mistake of assuming that b is the correlation coefficient of e_t with e_{t-1}. It is not. I will describe b in a moment.

t	e_t	$.75e_{t-1}$	$u_t = e_t + .75(e_{t-1})$	e^*_t	$f_t = .75(u_t - f_{t-1})$
1	-0.340	-----	----	----	0.000
2	-1.160	-0.255	-1.415	-1.415	-1.061
3	1.430	-0.870	0.560	1.621	1.216
4	-0.870	1.073	0.203	-1.013	-0.760
5	-0.450	-0.653	-1.103	-0.342	-0.257
6	-1.790	-0.338	-2.128	-1.871	-1.403
7	-1.520	-1.343	-2.863	-1.459	-1.095
8	1.010	-1.140	-0.130	0.965	0.723
9	0.740	0.758	1.498	0.774	0.581
10	0.580	0.555	1.135	0.554	0.416
11	0.010	0.435	0.445	0.029	0.022
12	-0.880	0.008	-0.873	-0.894	-0.671
13	1.520	-0.660	0.860	1.531	1.148
14	-0.270	1.140	0.870	-0.278	-0.209
15	-0.01	-0.203	-0.213	-0.004	-0.003
16	1.36	-0.008	1.353	1.355	1.017
17	-0.21	1.020	0.810	-0.207	-0.155
18	-0.32	-0.158	-0.478	-0.323	-0.242
19	0.7	-0.240	0.460	0.702	0.526
20	-0.98	0.525	-0.455	-0.981	-0.736

In practice, we do not know the values of e_t so we must estimate them. We do know that $u_{t+1} = e_{t+1} + .75e_t$. Unfortunately, at period t we know the value of neither e_{t+1} or u_{t+1}. Thus, our best guess of u_{t+1} is that it equals be_t or, in this case, $.75e_t$. Call this forecast made at time t $f_t = be_t$. The error that we make when we use this guess - called the forecast error and denoted FE - to estimate u_t is equal to the actual value of u_{t+1} less the estimate of the value of u_{t+1} we made during the previous period, f_t. More formally, the forecast error based on the forecast of u_{t+1} made during the previous period, FE, is equal to

$FE = u_{t+1} - be_t$.

$= u_{t+1} - f_t$. Updating u_t from the process $u_t = e_t + be_{t-1}$ and substituting its value in place of u_t, we get

$FE = e_{t+1} + be_t - be_t$

$FE = e_{t+1}$

So the forecast error of the observed error, u_t, is equal to the actual error term, e_t. Thus we can write

$e_t = u_t - f_{t-1} = e^*_t$, an estimate of e_t. Substituting e^*_t into our forecast, $f_t = be_t$, we derive

$f_t = b(u_t - f_{t-1})$. So the best forecast of u_{t+1} we can make is based upon the present realization of u_t and the forecast we made of it during the previous period. Iteratively using these forecasts, we develop estimates of the actual, as opposed to the observed, error terms. Looking back at columns two and five in the table we see that after eight iterations the estimated values of the unkown error terms begin to converge to their actual values.

Most statistical software packages adept at time series analysis routinely calculate moving average corrections using the value of zero as the first estimate of u_t. This is as I have done in the preceeding example and is reasonable given that in the first period the only information available is that the expectation of e_t (its mean), and thus of u_t, is zero. It is reasonable, therefore, to "seed" the process of estimation with zero. Unlike my example, though, software packages readjust the seed based upon the results of previous iteratative estimations resulting in a faster and more accurate convergence.

In the above example it was given that b = 0.75. In reality, the value of b is known only implicitly. It is implied by the values of the correlations between u_t and u_{t-i}. In the case of the above example of a first order moving average process, the correlation between u_t and u_{t-1} is equal to

$Corr(u_t, u_{t-1}) = Cov(u_t, u_{t-1})/Var(u_t)$. Yet

$Cov(u_t, u_{t-1}) = E[U_tU_{t-1}]$

$E[U_tU_{t-1}] = E[(e_t + be_{t-1})(e_{t-1} + be_{t-2})]$

$= E[e_te_{t-1}] + bE[e_te_{t-2}] + bE[e_{t-1}e_{t-1}] + b^2E[e_{t-1}e_{t-2}]$

Because e_t has a constant variance over all time periods and does not covary with its past values, the $Cov(u_t, u_{t-1})$ reduces to

$Cov(u_t, u_{t-1}) = bE[e_{t-1}e_{t-1}] = bVar(e_{t-1}) = bVar(e_t)$

Similarly, the variance of u_t is equal to

$Var(u_t) = E[U_tU_t]$

$= E[(e_t + b\, e_{t-1})(e_t + b\, e_{t-1})]$

$$= E[e_t e_t] + bE[e_t e_{t-1}] + bE[e_t e_{t-1}] + b^2E[e_{t-1}e_{t-1}]$$

$$= Var(e_t) + b^2Var(e_t)$$

$$= (1 + b^2)Var(e_t)$$

Thus the correlation of u_t and u_{t-1} is equal to

$$Corr(u_t u_{t-1}) = bVar(e_t)/(1+b^2)Var(e_t)$$

$$= b/(1+b^2)$$

So if we know the correlation between u_t and u_{t-1} we can determine the value of b by placing the above quadratic equation in standard form and solving for its characteristic roots. For a moving average process there will be one, and only one, real root that is less than one. If the real root of the equation should be greater than one, then the process is termed explosive[86] and the presence of a moving average process is rejected.

Model One - The Influence of the Direct Loan Program on Real, Net, Total Cost Since 1966.

Model One is a regression of the net cost of the combined DSL and GSL/FFEL programs, in constant 1996 dollars (RTOTCT), on its value lagged one year (RTOTCT(-1)), the total number of loans originating in that year (TOTALLNS), a one year lag of the average return to the 91-day Treasury Bill (TBILL90(-1)), and a dummy variable (DLDUMMY) set to one for years in which the DSLP was in

[86] An explosive process is one in which the value of the random shock does not diminish, but increases through successive time periods.

operation and zero otherwise. The lagged value of real net cost for the programs is included in order to handle first-order autocorrelation[87].

Table 2.9 - Model One

LS // Dependent Variable is RTOTCT
Sample: 1966 2001
Included observations: 36
Convergence achieved after 12 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-676674	242583.7	-2.789447	0.0092
TOTALLNS	512.1328	54.97326	9.316036	0
RTOTCT(-1)	0.410368	0.066798	6.143414	0
TBILL90(-1)	140918.1	28270.55	4.984625	0
DLDUMMY	-684835	244366.6	-2.80249	0.0089
MA(2)	-0.32323	0.075528	-4.279631	0.0002
MA(4)	0.922154	0.073337	12.57412	0

R-squared	0.974922	Mean dependent var	3333863
Adjusted R-squared	0.969734	S.D. dependent var	2280051
S.E. of regression	396664.3	Akaike info criterion	25.95436
Sum squared resid	4.56E+12	Schwarz criterion	26.26226
Log likelihood	-511.26	F-statistic	187.9012
Durbin-Watson stat	1.794212	Prob(F-statistic)	0

Inverted MA Roots	.75+.63i	.75 -.63i	-.75+.63i	-.75 -.63i

Table 2.9 indicates that a second and fourth order moving average error correction renders a good model. The MA(2) and MA(4) variables may be mimicking the effects of legislative and executive cycles - the politics that the *REAUTH* variable was intended to capture. In any event, the regression explains almost 97% of the

[87] Thanks go to Professor Irwin Morris for this suggestion. In a regression sans the lagged dependent variable, all dependents remain significant ($p < .01$) and of the correct sign. Quite reasonably, the moving average corrections must be altered to MA(1) and MA(3). The resulting error terms are well-behaved, though the coefficient on the DLDUMMY inflates from $685 million to a little more than $1 billion.

variance in the cost of the programs, all variables are of a sign we would expect and all are significant at better than the 1% level. With 95% confidence we can say that the true cost to the federal government of a new student loan lies between $624.54 and $399.72. Similarly, a rise of one percentage point in the previous year's average T-bill rate will cost between $198,731,480 and $83,104,000. Most importantly, though, according to this model the institution of the Direct Student Loan program saved the government between $185,104,485 and $1,1,84,565,515 annually.

All is not perfect, though. While the residuals, plotted as figure 2.20 on the next page, show no evidence of heteroskedasticity, we see that the model has a difficult time dealing with the cost volatility in the 1980s we saw in figure 2.11. Large positive residual spikes (under predictions) of more than two standard errors are evident in 1985 and 1992. A serious negative residual (over prediction) is present in 1993 of about one and a half standard errors though the model comes back on track just as the Direct Loan program gets under way. These errors are a principal motivation behind the creation of the next model, model two.

Additionally, these errors are also at the root of the less than normal distributions of the residuals evident in figure 2.21 displayed on the next page. The mean value of the residuals is not significantly different from zero (compare the mean to the standard deviation) though their distribution is skewed to the right and the kurtosis - which measures the "fatness" of the tails - is larger than we should like. For a perfectly normal distribution, skewness will equal zero and the value of the kurtosis will be three. The Jarque-Bera statistic uses both skewness and kurtosis to test the null hypothesis that the distribution is normal. Its high value leads one to reject the

supposition of normality. Figure 2.22 demonstrates that there is no evidence of serial correlation between the residuals.

Figure 2.20 - Residuals for Model One

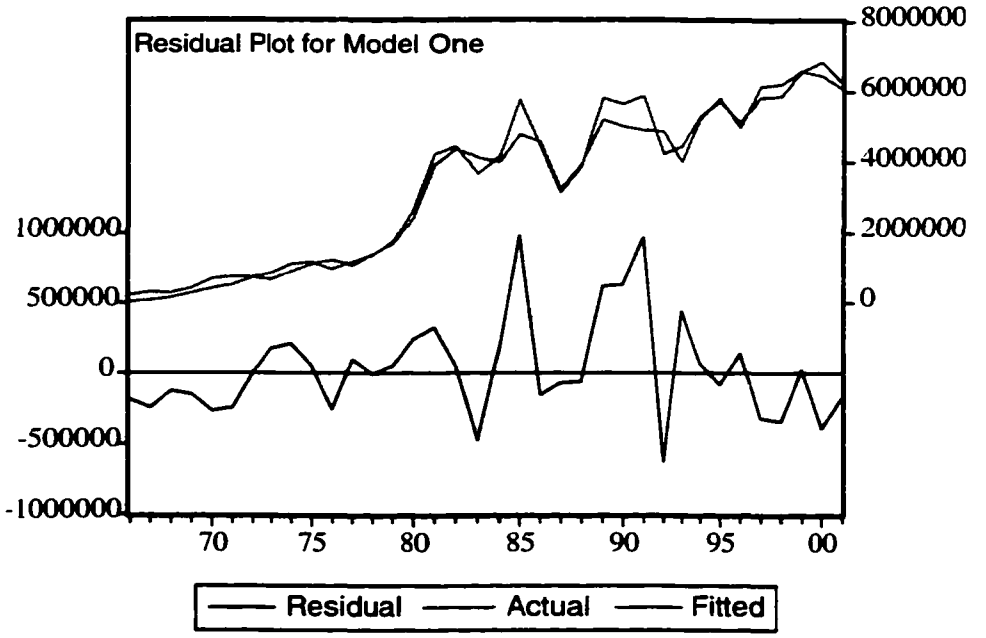


Figure 2.21 - Distribution of Residuals for Model One.

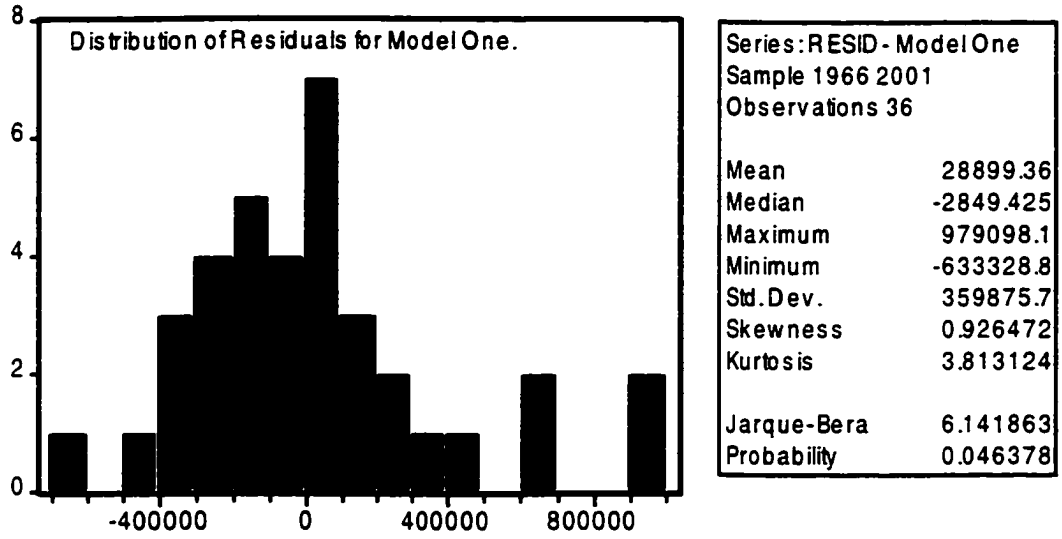
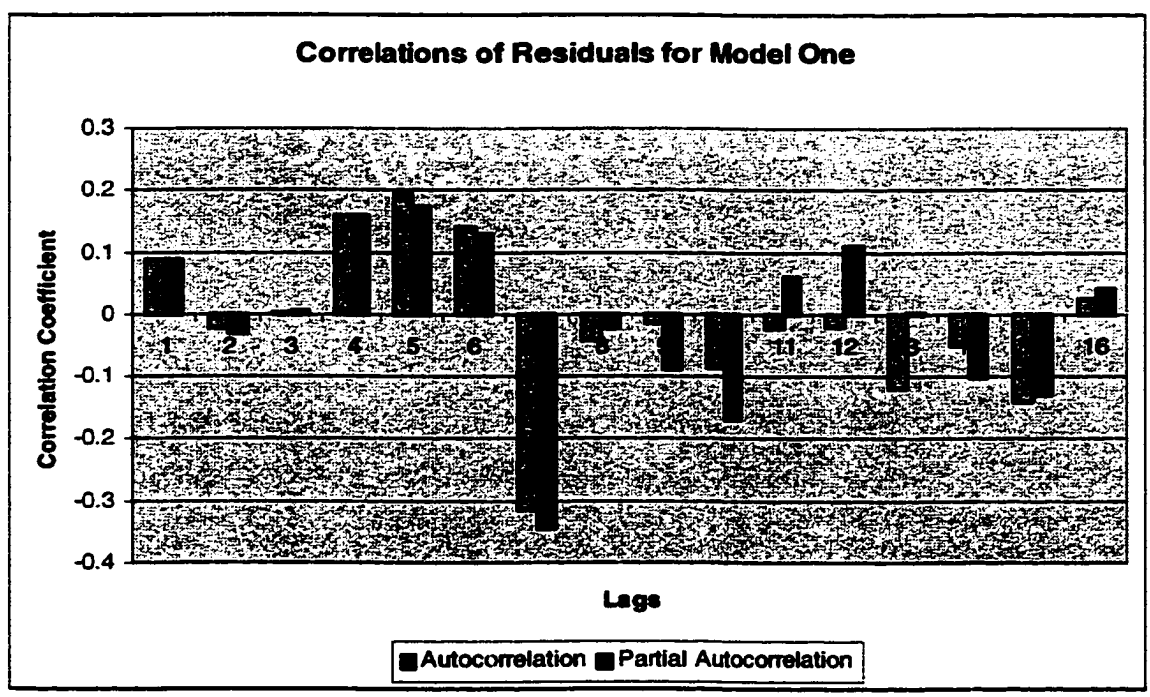


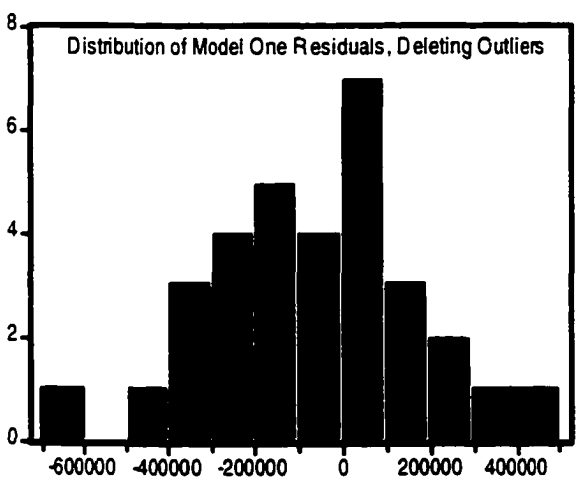
Figure 2.22 - Correlations of Model One Residuals with Their Past Values



Model Two - The Influence of the Direct Loan Program on Real, Net, Total Cost Since 1980.

Model One provides strong evidence for the argument that the institution of the Direct Student Loan program, in 1994, brought considerable cost savings to the Federal government in its efforts to make postsecondary education accessible to all. The model is not perfect, however, as the discussion in the previous paragraph suggested. As figure 2.21 indicates, there are four rather troublesome, though not totally unacceptable, blemishes which all coincide with a period of economic and, for the GSLP, political instability. Two under predictions of more than $900 million occurred in 1985 and 1991. Two more positive residuals of greater than $600 million are present in 1989 and 1990.

Figure 2.23 - Distribution of Residuals for Model One, Deleting Outliers



Series: RESID-Model 1 Deleting 1985, 1989-1991	
Sample 1966 2001	
Observations 32	
Mean	-67313.43
Median	-62998.45
Maximum	436880.0
Minimum	-633328.8
Std. Dev.	237166.6
Skewness	-0.157939
Kurtosis	2.735000
Jarque-Bera	0.226671
Probability	0.892851

As figure 2.23 demonstrates, if we could delete these four problem cases the distribution of the remaining residuals would be acceptably normal. The problem is that the variable TBILL90(-1) is insufficiently sensitive. Over the period from 1966

to 2001, the average rate for the Treasury bill is about 6.46%. However, in 1979 it exploded to better than 10%, remaining well above average until 1986. During this period, fluctuations of 2 1/2% to almost 3% from year to year are common. Interest rates remained stable from 1986 through 1988, but again ballooned briefly in 1989 and 1990. While TBILL90(-1) is a significant indicator for RTOTCT it may be asking too much to expect it to handle so much variation compressed to within only one-third of its range (review figure 2.15).

We also know that it was during the Reagan administration - and particularly during his second term - that abuses in the GSLP came under close scrutiny and attack. The glare of the public spotlight, and the hot breath of ED secretary Bennett, may have sporadically influenced program costs in a manner that we cannot quantify.

For these reasons, it is desirable to model the phenomenon of the Federal student loan programs again, this time restricting the lower limit of its range to 1980. I use the same specification and expect that because we are losing 14 data point the standard error of the regression will increase.

Table 2.10- Model Two

LS // Dependent Variable is RTOTCT
Sample: 1980 2001
Included observations: 22
Convergence achieved after 21 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	911672.6	857167	1.063588	0.3043
TOTALLNS	398.4984	98.9183	4.028563	0.0011
RTOTCT(-1)	0.343041	0.18173	1.887649	0.0786
TBILL90(-1)	69066.51	46386.7	1.488931	0.1572
DLDUMMY	-651945.2	326482	-1.996878	0.0643
MA(2)	-0.595577	0.20701	-2.877026	0.0115
MA(4)	0.848433	0.1251	6.781939	0

R-squared	0.862639	Mean dependent var	4978055
Adjusted R-squared	0.807695	S.D. dependent var	1099673
S.E. of regression	482235.1	Akaike info criterion	26.42575
Sum squared resid	3.49E+12	Schwarz criterion	26.7729
Log likelihood	-314.8998	F-statistic	15.70025
Durbin-Watson sta	2.304447	Prob(F-statistic)	0.000011

Inverted MA Roots	.78+.56i	.78 -.56i	-.78+.56i	-.78 -.56i

Comparing Model Two in table 2.10 with Model One (table 2.9) it is evident that the standard error of the regression has increased by 22%. This results in a decrease in the adjusted R^2 to 81% from 97%. It is comforting to observe that the signs on all of the coefficients remain unchanged, though. Moreover, with the exception of TBILL90(-1), the magnitudes of the coefficients have not been altered radically. For example, TOTALLNS decreases from $512.13 to $398.50 while the DLDUMMY is reduced by only 4%. On the other hand, the coefficient for

TBILL90(-1) is almost cut in half while its standard error increases by 64%. Not surprisingly, significance levels have also changed. While TOTALLNS, and the MA variables remain statistically significant, RTOTCT(-1) and the DLDUMMY fall just out of bounds of the traditional 5% cut off level. TBILL90(-1), however, must clearly be rejected as significant. In fact, an identical regression sans the TBILL90 variable (in any form) displayed as table 2.11 is almost as good a fit to the data.

Table 2.11- Model Two without the Treasury Bill Variable.

LS // Dependent Variable is RTOTCT
Sample: 1980 2001
Included observations: 22
Convergence achieved after 21 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1936518	559087.7	3.463712	0.0032
TOTALLNS	360.3118	105.131	3.427265	0.0035
RTOTCT(-1)	0.282188	0.185773	1.518997	0.1483
DLDUMMY	-690630	306371.6	-2.254223	0.0386
MA(2)	-0.705589	0.21908	-3.220692	0.0053
MA(4)	0.788512	0.114233	6.902664	0

R-squared	0.846152	Mean dependent var	4978055
Adjusted R-squared	0.798075	S.D. dependent var	1099673
S.E. of regression	494149.7	Akaike info criterion	26.44819
Sum squared resid	3.91E+12	Schwarz criterion	26.74575
Log likelihood	-316.1467	F-statistic	17.5998
Durbin-Watson stat	2.33806	Prob(F-statistic)	0.000005

Inverted MA Roots	.79+.52i	.79 -.52i	-.79+.52i	-.79 -.52i

Because interest benefits and special allowances are tightly entwined with the Treasury bill rate, it is not a variable we would like to remove from any regression. In model one it works very well. From 1966 to the present, RTOTCT displays a

relentless upward trend notwithstanding its period of greatest variation during the Reagan/Bush years. Yet, the Treasury bill seems constrained within the bounds of 4% to 8% until 1979. By 1991 it returns to these confines, but in the interim it reaches record levels. The Treasury bill rate, in effect, is conditioned by the moderate values it takes in the 1960s, 1970s, and 1990s and, therefore, is unable to contend with the extremes of the 1980s.

If we "de-condition" it, i.e. if we restrict the range to 1980 - 1992 while removing the DLDUMMY (the DSLP did not exist at this time) and the MA corrections (there are not enough points in time to allow for such estimates), then we see that TBILL90(-1) regains its significance. More than this, table 2.12 demonstrates that its coefficient is almost 2 and 1/3 times as large as that of model one. In other words, it is more sensitive.

Table 2.12- Model Two Restricted to 1980 - 1992

LS // Dependent Variable is RTOTCT
Sample: 1980 1992
Included observations: 13

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4052146	2337199	-1.733761	0.117
TOTALLNS	1330.084	422.5941	3.147426	0.0118
RTOTCT(-1)	0.137919	0.196413	0.702192	0.5003
TBILL90(-1)	326550.1	125218.5	2.607842	0.0284

R-squared	0.650452	Mean dependent var	4459679
Adjusted R-squared	0.533936	S.D. dependent var	1048235
S.E. of regression	715617.8	Akaike info criterion	27.20946
Sum squared resid	4.61E+12	Schwarz criterion	27.38329
Log likelihood	-191.3077	F-statistic	5.58252
Durbin-Watson stat	1.457151	Prob(F-statistic)	0.019281

Figures 2.24 through 2.26, below, reveal that the Residuals for Model Two in table 2.11 are well behaved. Respectively, they represent the residual plot, the residual distribution, and residual serial correlations for Model Two.

Figure 2.24 - Residuals for Model Two

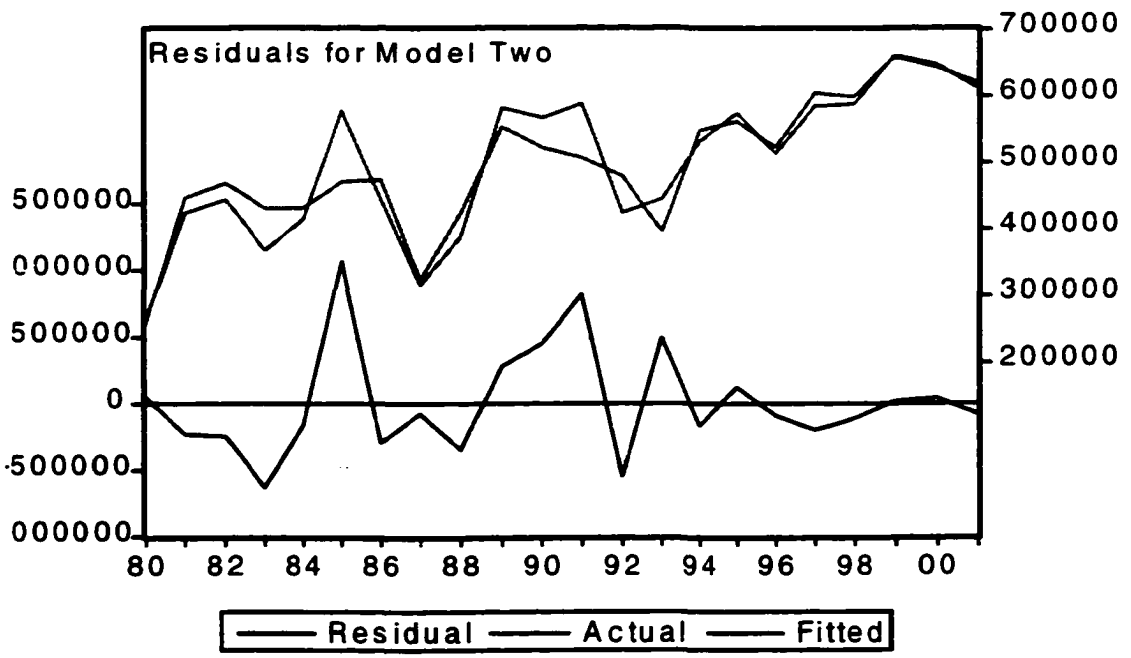


Figure 2.25 - Distribution of Residuals for Model Two

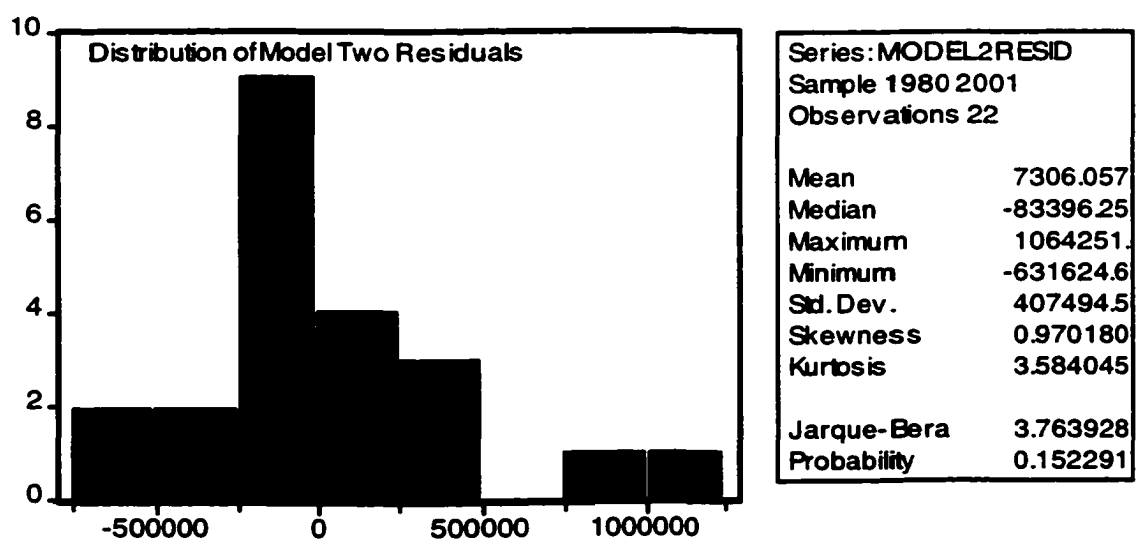
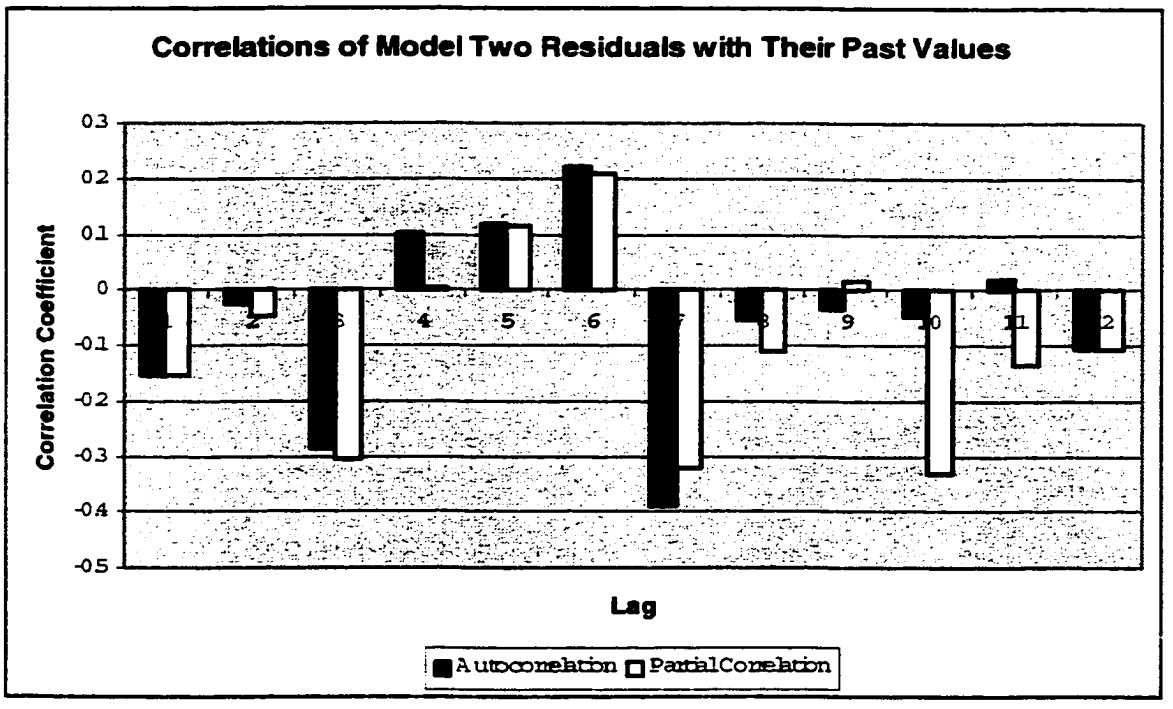


Figure 2.26 - Correlations of Model Two Residuals with Their Past Values



Model Three - The Influence of the Direct Loan Program on Real, Net Cost for the GSLP/FFELP Since 1966.

Models one and two present fairly strong evidence for the inference that the advent of the Direct Student Loan program contributed to a reduction in the cost of the Federal government's efforts to make postsecondary education attainable for all through the use of student loans. The significance of the DLDUMMY could be the result of cost efficiencies unique to the DSLP. However, part of my thesis is that cost reductions are achieved through the introduction of competition to the provision of government provided goods and services. It is not my intent to claim,

for example, that "in-house" production, as represented by the DSLP, is superior to "out-sourcing" arrangements (GSLP/FFELP).

To test the hypothesis that the presence of an alternative source for student loans influenced a reduction in cost associated with the GSLP/FFELP I run a regression substantially identical to that for model one. However, the dependent variable (RFFELCT) is reduced to reflect only those costs associated with the GSLP/FFELP. The scale of the program is captured by an independent variable (FFELLNS) that represents the number of GSLP/FFELP loans only in a given year. The DLDUMMY and TBILL90(-1) variables are unchanged[88]. In essence, the institution of the DSLP is used as a treatment on the cost of the "out-sourcing" effort. The results are presented in table 2.13.

[88] Note that the variables RTOTCT and RFFELCT, as well as TOTALLNS and FFELLNS, are identical until 1994, the year the DSLP began operation.

Table 2.13 - Model Three

LS // Dependent Variable is RFFELCT
Sample: 1966 2001
Included observations: 36
Convergence achieved after 18 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-655103.7	260801	-2.51189	0.0178
FFELLNS	469.8323	83.67101	5.615234	0
RFFELCT(-1)	0.516936	0.075949	6.806358	0
TBILL90(-1)	111414.2	29880.05	3.728716	0.0008
DLDUMMY	-620175.7	265013.6	-2.34017	0.0264
MA(2)	-0.394221	0.056675	-6.95577	0
MA(4)	0.895389	0.07798	11.48233	0

R-squared	0.955246	Mean dependent var	2936979
Adjusted R-squared	0.945987	S.D. dependent var	1936562
S.E. of regression	450069.9	Akaike info criterion	26.20698
Sum squared resid	5.87E+12	Schwarz criterion	26.51489
Log likelihood	-515.8075	F-statistic	103.1656
Durbin-Watson stat	1.79064	Prob(F-statistic)	0

Inverted MA Roots	.76+.61i	.76 -.61i	-.76+.61i	-.76 -.61i

A comparison of models one and three reveals that they are very similar. The coefficients on all comparable variables remain significant, retain their signs and, roughly, their magnitudes. Looking back at table 2.9 it is evident that the contemporaneous influence of a student loan on cost is reduced by $42.30 in Model three. Also, the effect of the lagged T-bill rate is reduced by almost 21%. However, most interestingly, the coefficient on the DLDUMMY is reduced from almost $685 million in model one, to $620 million in model three. The difference between these coefficients lends some credence to the notion that, to some extent, the DSLP is a more cost efficient method of administering student loans. More important to my purposes, though, the comparable coefficients on the DLDUMMY support the

hypothesis that it is the presence of a competitor in the student loan market that reduced cost in the Federal Family Education program.

Figure 2.27 - Residual Plot for Model Three

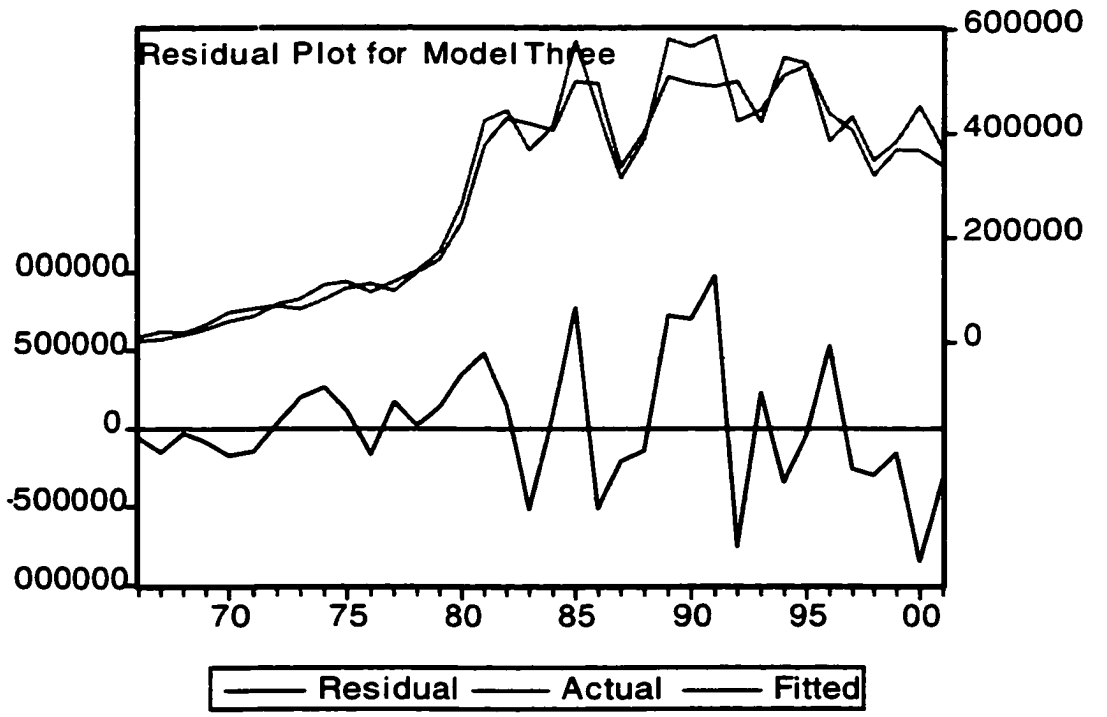
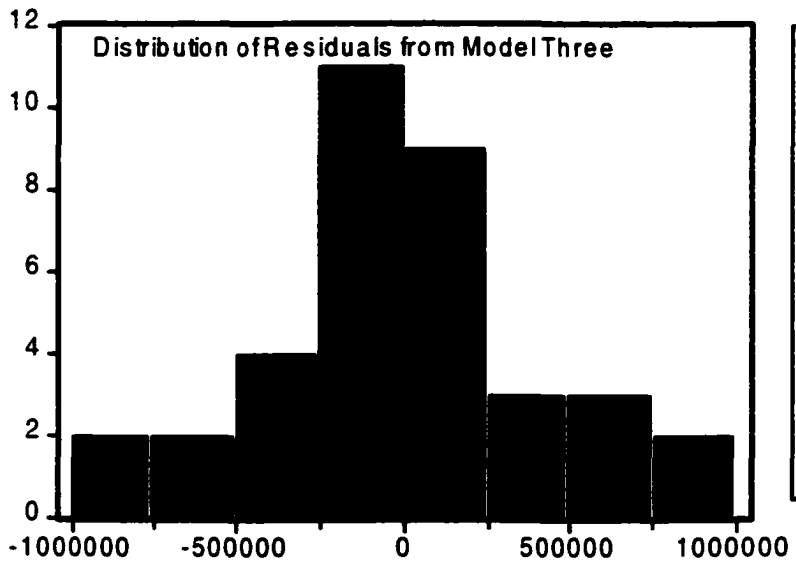


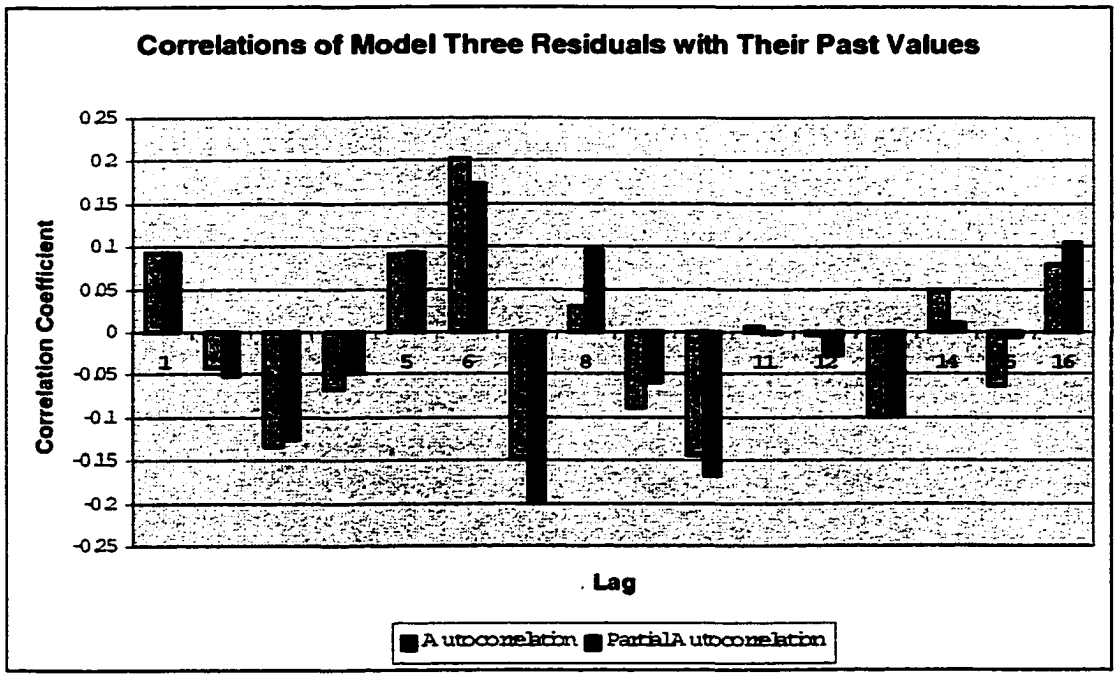
Figure 2.28 - Distribution of Model Three Residuals



Series: MODEL3RESID	
Sample 1966 2001	
Observations 36	
Mean	20254.88
Median	-33737.27
Maximum	979199.1
Minimum	-848007.5
Std. Dev.	409164.8
Skewness	0.272410
Kurtosis	2.977338
Jarque-Bera	0.446015
Probability	0.800109

The distribution of the residuals from Model Three, depicted in figure 2.28, reveals that they are unusually well behaved. The mean is not far from zero relative to the standard deviation, the skewness is very close to zero, and the kurtosis is almost a perfect three. Figure 2.27 shows that, as in model one, most of the largest residuals are spread between 1983 and 1993. As stated in the examination of model two, this period approximately corresponds to that in which 1) Interest rates take abnormally high values and, 2) Serious efforts, which culminated in the genesis of the DSLP, were undertaken to bring GSLP/FFELP cost within reason. Also note in figure 2.27 that fairly large over predictions (negative residuals) are present for the span of 1994 through 1999, indicating that the *DLDUMMY* may not be capturing all of the cost savings associated with program competition. Figure 2.19, below, demonstrates that there is no evidence of serial correlation between model three residuals.

Figure 2.29 - Correlations of Model Three Residuals with Their Past Values



Model Four - The Influence of the Direct Loan Program on Real, Net Cost for the GSLP/FFELP Since 1980.

Model four is analogous to Model two. Just as model two is the application of Model one to the more limited range of 1980 through 2001, model four is simply Model three restricted to the same span of years. The results of these range restrictions are similar. Again, all coefficients retain their signs and most fall within traditional intervals of statistical significance. Due to the loss of data point the standard error of the regression in model four increases by almost 30% over that in model three and, thus, the adjusted R^2 falls considerably.

In model two the lagged Treasury bill rate became statistically insignificant while the DLDUMMY fell just outside to the traditional 5% cutoff. Though they exchange roles, these variables exhibit similar behaviors in Model 4. The probability of TBILL90(-1) being significant when, in fact, it is not increases to 7% and that of DLDUMMY to almost 18%. Removing the DLDUMMY from the regression almost doubles the coefficient on TBILL90(-1) - with almost the same effect on its standard error - and, thus, barely restores the Treasury bill to the 5% level of significance[89]. Including the DLDUMMY while deleting the Treasury bill rate (see table 2.15) brings the coefficient on the former back to its former magnitude in Model Three. However, its standard error increases by almost a third over its Model three level. Together, these observations lead one to conclude, again, that the lagged Treasury bill rate is an important predictor. Yet it is a predictor that is somewhat confused by the high variation in the levels it obtains in adjacent time periods - 1966 through 1978, 1979 through 1992, and 1993 through the present. In conjunction with the political turmoil surrounding the student loan programs over the sample range, it is not surprising that Model four is not as efficient as we might like. In sum, the DLDUMMY variable is not significant in model four. Its insignificance, though, should be taken lightly. The properties of model four residuals are depicted in figures 2.30, 2.31, and 2.32.

[89] The t-statistic is 2.165 with a p-value of 0.0459

Table 2.14 - Model Four

LS // Dependent Variable is RFFELCT
Sample: 1980 2001
Included observations: 22
Convergence achieved after 19 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1809767	1661032	-1.089543	0.2931
FFELLNS	457.7346	207.9663	2.201003	0.0438
RFFELCT(-1)	0.733357	0.14929	4.912291	0.0002
TBILL90(-1)	150686.9	77442.91	1.94578	0.0707
DLDUMMY	-493746.9	349234.7	-1.413797	0.1778
MA(2)	-0.631191	0.194972	-3.237338	0.0055
MA(4)	0.880175	0.10223	8.609736	0

R-squared	0.717197	Mean dependent var	4328609
Adjusted R-squared	0.604075	S.D. dependent var	927812.6
S.E. of regression	583803.4	Akaike info criterion	26.80801
Sum squared resid	5.11E+12	Schwarz criterion	27.15516
Log likelihood	-319.1048	F-statistic	6.340062
Durbin-Watson stat	2.323616	Prob(F-statistic)	0.001752

Inverted MA Roots	.79+.56i	.79 -.56i	-.79+.56i	-.79 -.56i

Table 2.15 - Model Four without the Lagged Treasury Bill Rate

LS // Dependent Variable is RFFELCT
Sample: 1980 2001
Included observations: 22
Convergence achieved after 14 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1241605	800623.3	1.550798	0.1405
FFELLNS	153.5754	172.486	0.890364	0.3865
RFFELCT(-1)	0.615037	0.157409	3.907263	0.0013
DLDUMMY	-639206.3	350179	-1.82537	0.0867
MA(2)	-0.537812	0.121861	-4.41332	0.0004
MA(4)	0.801737	0.108714	7.374761	0

R-squared	0.664179	Mean dependent var	4328609
Adjusted R-squared	0.559235	S.D. dependent var	927812.6
S.E. of regression	615976	Akaike info criterion	26.88893
Sum squared resid	6.07E+12	Schwarz criterion	27.18648
Log likelihood	-320.9948	F-statistic	6.328888
Durbin-Watson stat	2.177295	Prob(F-statistic)	0.002011

Inverted MA Roots	.76 -.56i	.76+.56i	-.76 -.56i	-.76+.56i

Figure 2.30 - Residual Plot for Model Four

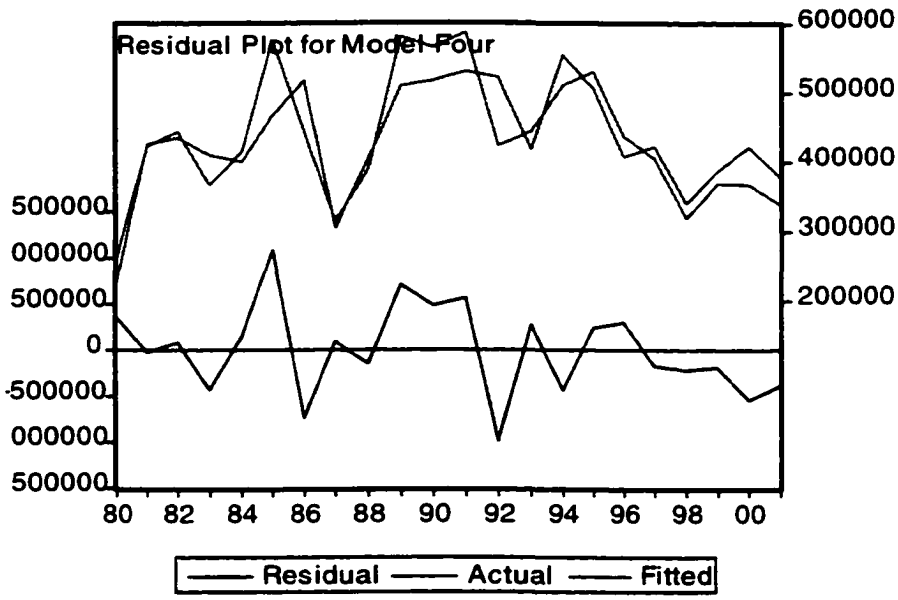


Figure 2.31 - Distribution of Residuals from Model Four

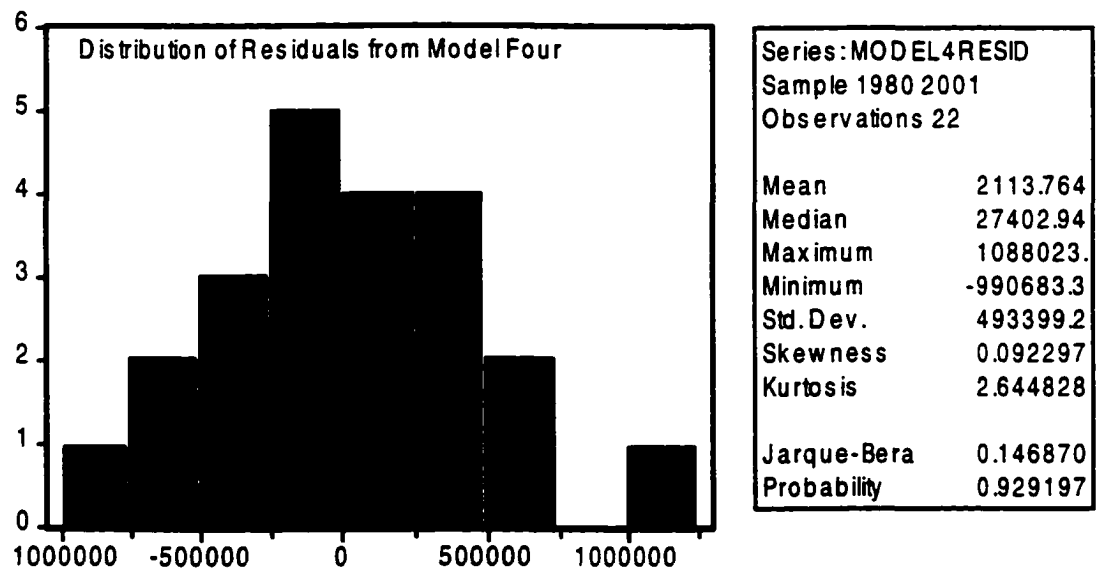
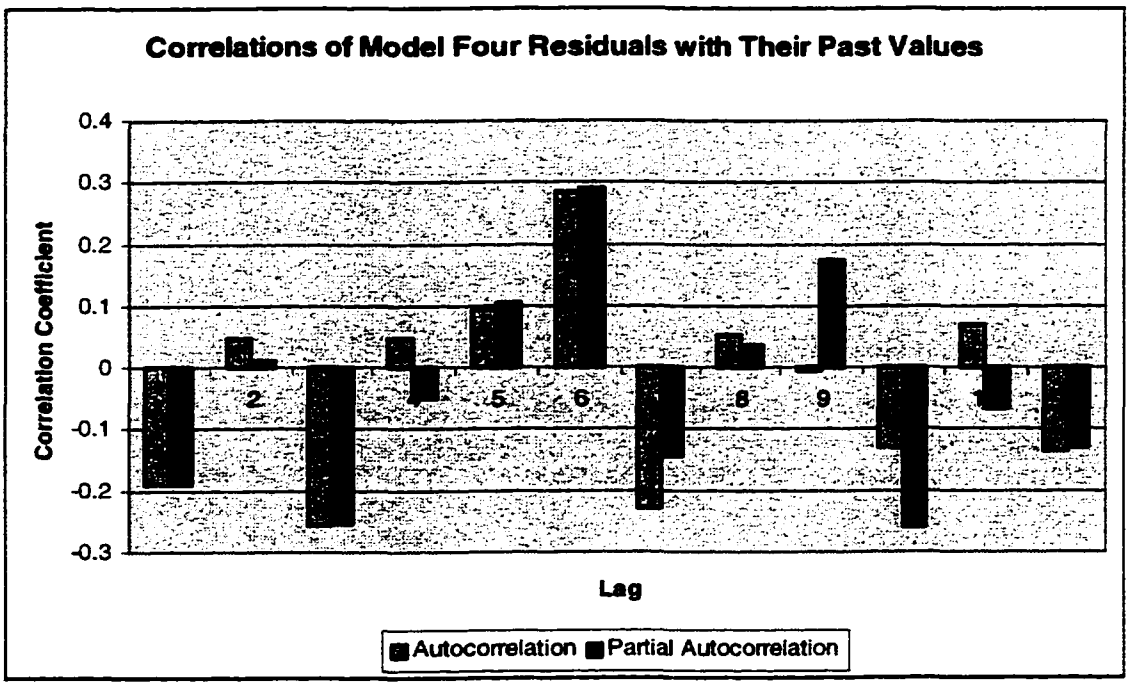


Figure 2.32 - Correlations of Model Four Residuals with Their Past Values



Cost Analysis Summary

The preceeding section presented four different models of the effects of the introduction of competition to the provision of student loans. Model One estimated the cost, in constant 1994 dollars, of the GSL/FFEL/DL programs since their inception and found that the introduction of competition saved the government, on average, $685 million per year. However, Model One's errors exhibit their greatest volatility in the period 1980 - 1993. As a check on the robustness of Model One, I created another model, Model Two, in which the range of analysis is restricted to 1980 through the present.

Model Two, therefore, is an attempt to see how Model One performs under the very worst of circumstances. By discarding a third of the data points, I ensure that all standard errors will increase. I also guarantee a less precise estimation by asking the model to deal with anomolous economic and political circumstances to a proportionally greater extent. Nonetheless, Model Two performs fairly well. The DLDUMMY remains fairly signficant at $p = .064$ with its coefficient dropping slightly to $651 million. The lagged T-Bill rate, though, has a difficult time coping with the high levels and variability of interest rates in the 1980s, and then switching to the more typical patterns exhibited in the 1990s. Model Two serves, however, to provide us with a greater measure of confidence in accepting the estimates of Model One.

Models Three and Four are analogous to One and Two. The difference between the two sets of models lies in that Models Three's and Four's dependent variable is the real, total cost associated with the GSL/FFEL program solely, as opposed to the cost for the combined programs. Additionally, the variable FFELLNS is the number of loans made under the GSL/FFEL program exclusively.

The purpose of Models Three and Four is to determine if the introduction of competition had any effect on the existing student loan program. If it did not, then one could conclude that savings realized with the introduction of the Direct Loan program were simply associated with the implementation of a more cost effective program, and not competition. Models Three and Four do demonstrate that the

presence of a program in direct competition with the GSL/FFEL inspired the program's previously intransigent lenders, guarantors and servicers to improve cost efficiencies and accept reforms.

Model Three, a model of GSL/FFEL costs over the history of the program, explains 95% of the variance, has an unusually well-behaved error structure, and boasts explanatory variables significant at no more than the p =.03 level. In particular, the coefficient on the DLDUMMY states that, on average, the presence of the DL program brought savings to the FFEL program of around $620 million per year.

Model Four is an exercise identical to that of Model Two. Again, the range is restricted to 1980 through 2001 and the results are similar to those of Model Two. Specifically, the coefficient on the DLDUMMY remains largely unchanged, though its significance declines to p = .178. Confounded by high levels and variations in interest rates in the 1980s, the coefficient of the lagged T-Bill rate also loses significance, but only to p = .07. Removing the lagged Treasury Bill rate restores the significance of the DLDUMMY to the p < .09 level.

In sum, Model One demonstrates that the provision of student loans, generally, became cheaper with the introduction of the Direct Loan program. Model Three confirms the hypothesis that much of these savings were associated not with the DL program, per se, but instead with the influence that the presence of a competitior had upon the FFEL program.

The introduction of a competitor to the FFEL program inspired the program's providors to accept reforms that, previously, they had adamantly and successfully opposed. For example, prior to the creation of the Direct Loan program special allowances - the interest the government pays lenders beyond the T-Bill rate in order to induce them to participate in the FFELP - averaged $371.34 per loan in constant 1994 dollars. However, since 1994 that average has fallen to just $67.70. In 1993, special allowances were calculated as the difference between the rate charged student borrowers (8 percent) and the sum of the 91-day Treasury bill rate plus 3.25 percent. Within a year the ceiling was lowered to the Treasury bill rate plus 3.1 percent and was ratcheted down three more times until, today, it is fixed at the level of the three-month commercial paper rate plus 2.34 percent. More than this, presently while a student is still in school, the maximum lender return stands reduced to the commercial paper rate plus 1.74 percent[90]. Additionally, lenders are now required to hold loans and pursue their collection for 270 days (up from 180) before declaring them in default and, as of 1995, must pay 0.6 percent of the principal of all new loans to the Federal government[91].

Since the institution of the DSLP, guarantee agencies have experienced a slash in their revenues as well. In 1995, the government's maximum default liability was reduced to 98 percent and again reduced to 95 percent in 2000. In addition to the

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[90] On average in 2000, the commercial paper rate was about a half a percentage point higher than that of the 91-day Treasury bill. To compensate, it has been proposed that both rates be further lowered by 31 basis points - to commercial paper plus 1.43 percent during in-school, grace and deferment periods, and commercial paper plus 2.03 percent at all other times.

[91] Deducted from special allowances and interest benefits.

direct savings, the transfer of some risk from the government to guarantors may have contributed to the fall in the FFELP default rate. The gross default rate for the FFELP, calculated as the percentage of loan volume in default relative to total loan volume, was 18.82 percent in 1995. By 1998, it had fallen to 15.62 percent, a level that it has roughly maintained ever since. In the year 2000, guarantee agency retentions, a payment based on the percentage of defaulted loan volume they are able to recover, was reduced to 23% from 27%.

Previous to the creation of the DSLP, the administrative cost allowance (1% of loan volume) paid to guarantee agencies was also a significant expense for the Federal government. In 1993, administrative cost allowances amounted to slightly more than $240 million. In that same year, however, the Student Loan Reform Act, the same act that created the DSLP, eliminated administrative cost allowances altogether.

Also, with the reauthorization of the HEA in 1998, guarantee agencies will finally return the reserves they felt were so necessary (and profitable) to their endeavors. $165 million was recalled in 1999 with an additional $1.6 billion to be returned over the period 2000 through 2004.

Speculators and secondary marketers, especially Sallie Mae, have also discovered that their trough is drying up. Sallie Mae must now pay an "offset fee" of 0.3% on the principal of every loan it acquired on, or after, 1993. Sallie Mae offset fees

amounted to $18 million in 1999 and are projected to total $36 million in 2001. It has further been proposed (2000) that a semi-annual fee of 0.035 percent be assessed on the outstanding principals in the portfolios of all holders of student loans, and that special allowances paid on student loans financed with tax-exempt bonds be reduced by 20 basis points.

What is important to remember is that none of these reforms would have been possible without the existence of the DSLP. Previously, the government struggled to keep expenses from continually ratcheting upwards. Mere whispers from lenders and guarantors about a lack of profitability and, thus, their inability to continue participating sent shock waves through the ivory towers of academia that rippled through the halls of Congress. Attempts at reducing costs were usually stymied and, more frequently, incentives/costs were increased. In fact, over the history of the GSL/FFEL program, only once did an administration succeed in reducing some aspect of provider expenses. In 1988, Reagan's last year in office, his administration finally - after years of vociferous confrontation with lenders and guarantors - was able to reduce lender return to the Treasury bill rate plus 3.25 percent from its high of the Treasury bill rate plus 3.50 percent.

Given that Reagan enjoyed no leverage with lenders, guarantors, marketers and servicers, his reduction of the lender special allowance is a considerable accomplishment. Before the Direct Loan program was created, GSL/FFEL providers held postsecondary institutions and the middle class hostage to their

whims. With the advent of the Direct Loan program, however, private providers who contemplate leaving the program can be allowed to do so without fanfare. Few have chosen this course, interestingly.

Quality Analysis

The preceding discussion provides ample evidence for the assertion that competition has lowered the cost of providing student loans. Yet, lower cost is not enough. What we really seek is greater value where value may be thought of as the quality of a good or service divided by its price. If a good's price goes down while its quality stays the same then we can think of its value increasing. With respect to the provision of student loans, we have seen that their price - the cost to government - has surely diminished as a result of the introduction of competition to the student loan market. Yet, has the value of the product increased?

Few of us would consider a 1974 Yugo to be a better value than a new Mercedes simply because it costs a few dollars less. Similarly with student loans, we should not assume that the genesis of the DSLP spurred an improvement in the value of the product unless we can determine that the quality of the service provided at least remained unchanged. To evaluate quality I examine two data sets compiled by ORC/Macro International, inc., under contract to the Department of Education. The first quantifies the satisfaction of financial aid directors (FADs) at postsecondary

institutions participating in the Federal student loan programs. The second evaluates the satisfaction of student borrowers with the student loan process.

Institutional Evaluation

Institutional Data

This panel data was constructed by Macro sampling statistician, Pedro Saavedra, Ph.D., in the following manner. In 1994, all of the 112 first-year Direct Loan schools were selected and 105 responded. These schools were then stratified by type and control[92], and by size (large or small). This stratification resulted in ten cells.[93] An additional 3,059 FFELP institutions (of which 2,303 responded) were then selected such that they matched the type and control/size characteristics of the DSLP institutions proportionally. In other words, 22% of the DSLP schools in 1994 were large, four-year, public institutions. Therefore, FFELP schools were selected so that 22% of them were also large, four-year, public institutions.

This sample was then surveyed[94] to gauge everything from their overall satisfaction with the programs to nuances such as whether expenditures on supplies had

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[92] "Type" refers to whether an institution is a four-year, two-year, or proprietary school. "Control" designates an institution as privately controlled, publicly controlled, or a proprietary school. If an institution's type is proprietary, so is its control designation. Thus there are five type and control categories.

[93] Examples include 4-year public/small, 4-year public/large, 4-year private/small, ..., 2-year private/large

[94] Evaluation was conducted primarily through the use of mail surveys, but also consisted of computer assisted telephone interviewing (CATI).

increased relative to the previous year. The same set of institutions was re-evaluated for the 1995, 1996, and 1997 academic years. Over the course of the study, the composition of the sample by program participation (FFELP or DSLP) changed as schools moved between programs. Specifically, the number of schools participating exclusively in the DSLP, or in tandem with the FFELP, increased, reflecting the growth of the DSLP in the population of all schools. As the table below indicates, only 3.8% of schools responding in 1995 - and thus being evaluated for 1994 - identified themselves as exclusive DSLP participants. By the following year, this percentage rose to 21.4%. A related decline in exclusive FFELP participants can also be observed.

Not every school paneled responded in every year, though the vast majority did. 2,763 schools are represented by the data at least once with 52% responding in all four years. 76% responded in at least three years. 263 responded in only one year and 383 responded at least twice.

Table 2.15 - Program Participation by Response Year

Program Participation * Response Year Crosstabulation

			Response Year				
			95	96	97	98	Total
Program Participation	DL	Count	91	472	468	442	1473
		% within Program Participation	6.2%	32.0%	31.8%	30.0%	100.0%
		% within Response Year	3.8%	21.4%	21.2%	19.6%	16.2%
		% of Total	1.0%	5.2%	5.2%	4.9%	16.2%
	FFEL	Count	2304	1694	1637	1650	7285
		% within Program Participation	31.6%	23.3%	22.5%	22.6%	100.0%
		% within Response Year	95.7%	76.7%	74.0%	73.1%	80.2%
		% of Total	25.4%	18.6%	18.0%	18.2%	80.2%
	BOTH	Count	12	43	107	164	326
		% within Program Participation	3.7%	13.2%	32.8%	50.3%	100.0%
		% within Response Year	.5%	1.9%	4.8%	7.3%	3.6%
		% of Total	.1%	.5%	1.2%	1.8%	3.6%
Total		Count	2407	2209	2212	2256	9084
		% within Program Participation	26.5%	24.3%	24.4%	24.8%	100.0%
		% within Response Year	100.0%	100.0%	100.0%	100.0%	100.0%
		% of Total	26.5%	24.3%	24.4%	24.8%	100.0%

Methodology

Because the data in the study of institutional satisfaction with the two, major student loan programs is ordinal, it does not lend itself well to parametric techniques. By parametric techniques I mean those that rely on estimates of means, variances, and other distributional descriptors. The concept of an average to ordinal data is meaningless. Ordinal data reflects an ordering of preferences/opinions only and, by definition can not be expressed as a ratio. To understand the problem, consider the following intuitive example. Suppose we have two professors who must evaluate their students work on a subjective scale of A to E. Professor 1 is reticent to assign a grade of C to work that displays a modicum of effort, regardless of the content of

that work. On the other hand, Professor 1 is reluctant to award an A unless a student's work is truly exemplary. Thus, it is obvious that most of Professor 1's students will receive Bs even though there is likely to be a wide range of quality to his B students' work. In contrast, Professor 2 is more uniform in his grading policies. She is just as likely to assign a student a grade of E as A. If we were to compare the students in the two classes by "averaging" their grades we would probably find that Professor 2's class averaged a lower grade (the As are offset by the equally likely Es, and the Bs are dragged down by the equal number of Ds) of C. Professor 1 assigns the majority of his students Bs and, thus, his class's average grade will be higher than that of Professor 2. Can we say that Professor 1 has better students than Professor 2? No, we cannot. While Professor 1 may have better students, it is impossible to say for certain because we are befuddled by the different, subjective orderings employed by the two instructors. The best we can do is to examine their rankings. Doing so, we will find that more of Professor 2's students rank at the top of the pooled population and, similarly, more will be ranked at the bottom. Most of Professor 1's charges will fill the middle ranks. Averaging these ranks, we will discover that there is no difference between the two classes in terms of intellectual capacity.

Comparing the orderings/ranks of possibly different populations is the approach used in most nonparametric tests. My objective in this part of the analysis is to compare the rankings by financial aid administrators of numerous aspects of the two

student loan programs across years. To do so, I use the Kruskal-Wallis H test for *k*-independent samples.

Very briefly, the H test compares ordinal data across two or more years[95]. The data is arranged so that the lowest numerical value for each question represents the most favorable response - very satisfied, very useful, etc. The H test combines the data from all years and ranks them from smallest value to largest. Favorable responses, then, are assigned are assigned a high rank, and thus a small numerical value.[96] In cases of ties, an average rank is assigned. For example, should two responses tie for first, then they are both assigned the rank of (1+2)/2 = 1.5. Similarly, if three responses have identically lowest values, then all three are assigned the rank of (1+2+3)/3=2.

The data, with their overall ranks, are then regrouped into their original categorical divisions, the ranks are then summed and averaged to take into account differences in responses for each year. The average ranks are then compared. If the distribution of assessments in each year are roughly equal, then their average ranks will be similar. Specifically, the H statistic is calculated as:

$$H = \frac{12}{n(n+1)} \sum_{i=1}^{k} \frac{R_i^2}{n_i} - 3(n+1)$$

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[95] Obviously, the grouping variable does not have to represent time. It could represent different professors' classes, etc.

[96] Numerically, a rank of 1st is smaller than that of 2nd, though the former is a higher rank than the latter.

where n is equal to the total number of pooled observations, n_i is equal to the number of observations in year/group *i*, and R^2_i equals the square of the rank sum for year *i*.[97] This statistic exhibits a chi-square distribution with degrees of freedom equal to one less than the number of groups being compared.

In this analysis the H statistic and average ranks are calculated[98] for all four years for each questionnaire item. If a significant difference is found, (I use 0.05... as the critical value) I attempt to identify the years in which the change occurred. This is accomplished by rerunning the test for the years 1994 through 1996. If no difference is found in the average ranks for these years, then it is clear that the significance of the four-year test is a product of change in the last year evaluated, 1997. If a significant difference in the three-year test (1994 - 1997) is found, then each pairing of consecutive years is analyzed. That is, the test is run comparing 1994 with 1995, 1995 with 1996, and 1997. If differences in rank are found, we can determine the direction of the change by comparing the value of the average ranks. A shift toward more favorable responses in a given year will be reflected by lower average ranks for that year. Due to the ordinal nature of the data, the magnitude of the change cannot be determined.

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[97] For the derivation, see Mendenhall, Scheaffer and Wackerly, Mathematical Statistics, 1986, pp. 629-635.

[98] SPSS version 8.0 is used to calculate the H statistic, average rank sums and accompanying significance levels.

Analysis of Institutional Satisfaction with the FFELP

Table 2.16 reports the results for all forty nine questionnaire items concerning the FFELP in which a significant difference was found across all four years. The data set was restricted to only those schools participating exclusively in the FFELP in a given year. This was done to ensure that, as much as possible, responses would not be clouded by comparisons with the DSLP. After all, I am interested in determining whether or not the quality of the FFELP product improved as a result of the introduction of the DSLP and not what financial aid administrators thought of the FFELP relative to the DSLP. I hypothesize that improvement in the FFELP product is the result of innovations by FFELP service providers (banks, guarantee agencies and servicers) in response to competition.

In table 2.16 the significance of the H test for each time period is given (the p-value, if you will) as well as an indication of the direction of change. An increasing approval rating (smaller average rank from one year to the next) is denoted by "Improved", whereas increasing disapproval is marked as "Decreased". In question one, for example, we find that financial aid directors (FADs) felt it became progressively more difficult to keep up with changes in FFELP rules and regulations over the years studied. This is not surprising as ED, given the leverage of the DSLP, was able to institute reforms at a faster pace than in previous years. Additionally, until 1998 ED and the Clinton Administration were convinced that the FFELP was a lame duck. It would be replaced by the DSLP and there may have

been a diminished incentive to devote resources to a program on the way out that otherwise might be spent on its successor.

Table 2.16 - Institutional Satisfaction with the FFELP

1) Satisfaction w/ Keeping up with Regulations (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	**Decreased**, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
2) Satisfaction w/ Answering General Questions about Loans and Financial Aid (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	**Decreased**, H: 0.000
	1996 - 1997	No Change, H: 0.154
3) Satisfaction w/ Counseling In-School Borrowers (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.182
	1996 - 1997	No Change, H: 0.800
4) Satisfaction w/ Processing Loan Applications (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.250
	1996 - 1997	No Change, H: 0.425
5) Satisfaction w/ Requesting and Receiving Loan Funds (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	**Decreased**, H: 0.003
	1996 - 1997	Improved, H: 0.040
6) Satisfaction w/ Disbursing Loan Funds (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.062
	1996 - 1997	No Change, H: 0.186
7) Satisfaction w/ Refunding Excess Loan Funds to Students (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.829
	1996 - 1997	No Change, H: 0.562
8) Satisfaction w/ Performing Reconciliation/Financial Monitoring and Reporting (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.062
	1996 - 1997	No Change, H: 0.087

9) Satisfaction w/ Recordkeeping and Reporting Student Information	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.357
	1996 - 1997	No Change, H: 0.892
10) Satisfaction w/ Assisting Out-of-School Borrowers (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.032
	1995 - 1996	**Decreased**, H: 0.000
	1996 - 1997	No Change, H: 0.368
11) Level of Work Need to Administer the FFEL Program	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	**Decreased**, H: 0.023
	1996 - 1997	**Decreased**, H: 0.020
12) Change in Staff (FAO) Necessary to Administer FFEL	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.428
	1996 - 1997	No Change, H: 0.911
13) Change in Number of Staff for Technical Support (FFEL)	1994 - 1997	H: 0.021
	1994 - 1996	**Decreased**, H: 0.018
	1994 - 1995	**Decreased**, H: 0.008
	1995 - 1996	No Change, H: 0.544
	1996 - 1997	No Change, H: 0.659
14) Change in Number of Hours Current Staff Work (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.018
	1994 - 1995	**Decreased**, H: 0.018
	1995 - 1996	No Change, H: 0.298
	1996 - 1997	No Change, H: 0.356
15) Change in Level of Necessary Computers/Equipment Needed for FFEL	1994 - 1997	H: 0.002
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.000
	1995 - 1996	**Decreased**, H: 0.055
	1996 - 1997	No Change, H: 0.140

16) Change in Supplies (Postage, Copying, etc.) Needed to Administer FFEL	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.280
	1996 - 1997	No Change, H: 0.144
17) Change in Funds for Training (FFEL)	1994 - 1997	H: 0.029
	1994 - 1996	Improved, H: 0.016
	1994 - 1995	**Decreased**, H: 0.014
	1995 - 1996	Improved, H: 0.010
	1996 - 1997	No Change, H: 0.128
18) Change in Funds for Staff Travel (FFEL)	1994 - 1997	H: 0.001
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	**Decreased**, H: 0.001
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.138
19) Changes in Development/Modification of Computer Programs/Procedures for FFEL	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.001
	1995 - 1996	No Change, H: 0.965
	1996 - 1997	**Decreased**, H: 0.001
20) Timeliness of Information on Rules/Regs Provided by ED (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.001
	1994 - 1995	**Decreased**, H: 0.001
	1995 - 1996	No Change, H: 0.171
	1996 - 1997	**Decreased**, H: 0.001
21) Timeliness of Telephone Support from ED (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.709
	1995 - 1996	Improved, H: 0.002
	1996 - 1997	**Decreased**, H: 0.000
22) Timeliness of Borrower Counseling Materials from ED (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.896
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.022
23) Timeliness of Training Sessions by ED (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.028
	1995 - 1996	Improved, H: 0.020
	1996 - 1997	**Decreased**, H: 0.009

24) Timeliness of Provision of Software by ED (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
25) Timeliness of Information on Rules/Regs Provided by Lender/Servicer (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.710
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.579
26) Timeliness of Borrower Counseling Materials from Lender/Servicer (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.518
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.334
27) Timeliness of Training Sessions from Lender/Servicer (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.960
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.425
28) Timeliness of Software Provided by Lender/Servicer (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.665
29) Timeliness of Information on FFEL Rules/Regs Provided by Primary Guarantor	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.075
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.322
30) Timeliness of Telephone Support from Primary Guarantor (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	**Decreased**, H: 0.012
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.299

31) Timeliness of Borrower Counseling Materials Provided by Primary Guarantor (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.532
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.618
32) Timeliness of Guarantor Provided Training Sessions (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.715
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.365
33) Timeliness of Guarantor Provided Software (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.116
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.570
34) Usefulness of ED Provided Information on FFEL Rules/Regs	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	Improved, H: 0.000
	1995 - 1996	**Decreased**, H: 0.000
	1996 - 1997	**Decreased**, H: 0.027
35) Usefulness of ED Provided Telephone Support (FFEL)	1994 - 1997	
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.430
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.001
36) Usefulness of ED Provided Borrower Counseling Materials (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.917
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.057
37) Usefulness of ED Provided Training Sessions (FFEL)	1994 - 1997	H: 0.001
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.010
	1995 - 1996	No Change, H: 0.306
	1996 - 1997	No Change, H: 0.087
38) Usefulness of ED Provided Software (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.144
	1995 - 1996	H: 0.000
	1996 - 1997	**Decreased**, H: 0.000

39) Usefulness of Lender/Servicer Provided Info on FFEL Rules/Regs (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.734
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.362
40) Usefulness of Lender/Servicer Provided Borrower Counseling Materials (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.351
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.673
41) Usefulness of Lender/Servicer Provided Training Sessions (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.369
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.228
42) Usefulness of Lender/Servicer Provided Software (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.022
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	Improved, H: 0.038
43) Usefulness of Guarantor Provided Info on Rules/Regs (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.389
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.786
44) Usefulness of Guarantor Provided Telephone Support (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	**Decreased**, H: 0.01
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.621
45) Usefulness of Guarantor Provided Borrower Counseling Materials (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.651
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.671

46) Usefuless of Guarantor Provided Training Sessions (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.935
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.309
47) Usefulness of Guarantor Provided Software (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.394
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.372
48) Overall Satisfaction with the FFEL Program This Year (FFEL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	No Change, H: 0.447
	1996 - 1997	No Change, H: 0.084
49) Overall Satisfaction with the FFEL Program Relative to the Previous Year	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	Improved, H: 0.019
	1996 - 1997	Improved, H: 0.000

Amalgamated and compared across years, though, an overall improvement in FADs' assessment of the FFELP can be discerned. In 1995 relative to 1994, FADs felt that the program had improved on only eight criteria. Just as importantly, they believed that the program had actually gotten worse on 22 points. By 1996 their assessments improved dramatically. 28 criteria were rated more favorably than in 1995 and only seven were rated less favorably. This represents almost a perfect inversion of the 95/96 results relative to those for 94/95. By 1997, there is evidence of a reversal to this pattern with improvement noted on only three criteria and twelve declining. One could also argue that 1997 exhibits stabilization as 34 criteria (69%) display no significant change. Tables 2.17 and 2.18 confirm casual observation. Respectively,

they represent an H test and a median test of data coded in the following way: if across two years a significant decrease in evaluation is demonstrated, a value of zero is given. If no significant change is discovered a value of one is assigned. Finally, if a significant improvement in assessment is noted, then the variable is given the value of two. Therefore, a higher average rank represents an improvement over amalgamated criteria for the H test. In the median comparison, values greater than the median represent criteria rated as improved. Pair-wise comparisons confirm that improvements were realized in 1996, but many of these gains were lost by the following year. In fact, possibly all gains were lost.

Table 2.17 - H-Test of Relative, Program Approval over Amalgamated Criteria

Ranks

	Comparision Years	N	Mean Rank
FFELP Assessement	95	49	59.41
	96	49	97.57
	97	49	65.02
	Total	147	

Test Statistics[a,b]

	FFELP Assessement
Chi-Square	26.533
df	2
Asymp. Sig.	.000

a. Kruskal Wallis Test

b. Grouping Variable: Comparision Years

Table 2.18 - Median Test of Relative Program Approval over Amalgamated Criteria

Frequencies

		Comparision Years		
		95	96	97
FFELP Assessement	> Median	8	28	3
	<= Median	41	21	46

Test Statistics [b]

	FFELP Assessement
N	147
Median	1.00
Chi-Square	36.645[a]
df	2
Asymp. Sig.	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 13.0.

b. Grouping Variable: Comparision Years

A Mann-Whitney test (closely related to the Kruskal-Wallis H-test) reports a larger mean rank for 1997/1996 than for 1995/1994 and thus an improvement, yet the difference is statistically insignificant (0.274).

Interestingly, though, when criteria explicitly illuminating ED as the service provider are removed from the analysis we see the same pattern with one important difference. Again in 1996 we witness a sharp improvement in evaluation that significantly falls off in 1997. However, a Mann-Whitney comparison of 1995/1994 with 1997/1996 reveals that not all gains recede. Instead, the average rank increases from 31.42 to 46.38 and this improvement is significant at the 0.001 level.

In sum, from the inaugural year of the DSLP, 1994, until 1996, the FFELP did exhibit gains in terms of the level of service it provided institutions participating in the program. By 1997, the final year of the analysis, many of these gains were lost. Curiously, whether or not one concludes that over the length of the study FFELP service provision to institutions improved is largely dependent on the inclusion of ED as a FFELP service provider. If ED is included then one must conclude that, while services did not markedly decline over the entire period, they did not improve either. If ED is omitted, then one should infer that service provision did improve. As for other service providers involved with the FFELP, of the 18 questionnaire items that deal explicitly with banks, guarantee agencies or servicers, 16 display unambiguous improvement over the course of the four years studied. Though improvement is usually not noted until 1996 - two years after the genesis of the DSLP - this implies that by this time the FFELP community had decided to shift some of its efforts out of the political arena and into the betterment of the product they offered FADs.

The results for questions 48 and 49 are interesting in and of themselves. Question 48 asks FADs to evaluate their overall satisfaction with the FFELP. We see that in 1995 respondents gave the FFELP a lower approval rating than they did in 1994 and it remains at the 1995 level through 1997. Apparently FADs grew less content (though not necessarily discontent) with the FFELP in 1995 and their satisfaction with the program did not rebound to its 1994 level through 1997. On the other hand, question 49 asks FADs to evaluate their satisfaction with the program relative

to the previous year. Again, we see that their ratings of the programs year-to-year improvement declined in 1995. However, their evaluation recovered in 1996 and made further gains in 1997. In other words, in 1996 they were more satisfied with the program than in 1995 and, by 1997, they were happier still. Taken together these questions underscore the fact that FADs were never satisfied with the program yet, after the fall off of 1995, they did believe that it was headed in the right direction in terms of service improvement. This confirms the conclusion that, after a year of adjustment, FFELP service providers, especially lenders, servicers and guarantee agencies, strove to improve their product.

Analysis of Institutional Satisfaction with the DSLP

Table 2.19, below, is the DSLP analog to table 2.16 and it summarizes the results of H-tests on 65 questionnaire items for which a significant difference in average ranks was discovered across all four years.

Table 2.19 - Institutional Satisfaction with the DSLP

1)DL Setup Process - Installation of EDExpress Software	1994 - 1997	H: 0.033
	1994 - 1996	Improved, H: 0.053
	1994 - 1995	Improved, H: 0.035
	1995 - 1996	No Change, H: 0.368
	1997 - 1998	Improved, H: 0.045
2) DL Setup Process - Developing Procedures for Processing Applications and Origination	1994 - 1997	H: 0.036
	1994 - 1996	Improved, H: 0.016
	1994 - 1995	No Change, H: 0.668
	1995 - 1996	Improved, H: 0.005
	1996 - 1997	No Change, H: 0.219
3) Satisfaction w/ ED's Response to Reported Problems During Implementation of DL	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.097
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.212

4) Answering General Questions about Loans and Financial Aid (DL)	1994 - 1997	H: 0.012
	1994 - 1996	Improved, H: 0.004
	1994 - 1995	No Change, H: 0.787
	1995 - 1996	Improved, H: 0.002
	1996 - 1997	Improved, H: 0.051
5) Processing Promissory Notes (DL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.243
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
6) Creating and Transmitting Records (DL)	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.311
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
7) Requesting and Receiving Loan Funds (DL)	1994 - 1997	H: 0.004
	1994 - 1996	Improved, H: 0.002
	1994 - 1995	Improved, H: 0.029
	1995 - 1996	Improved, H: 0.034
	1996 - 1997	**Decreased**, H: 0.037
8) Performing Reconciliation/Financial Monitoring and Reporting	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.509
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.535
9) Recordkeeping and Reporting of Student Information	1994 - 1997	H: 0.002
	1994 - 1996	Improved, H: 0.011
	1994 - 1995	Improved, H: 0.053
	1995 - 1996	No Change, H: 0.067
	1996 - 1997	**Decreased**, H: 0.001
10) Assisting Out-of-School Borrowers	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.337
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.105
11) Level of Work or Staff Effort Needed to Administer DL	1994 - 1997	H: 0.005
	1994 - 1996	Improved, H: 0.003
	1994 - 1995	No Change, H: 0.503
	1995 - 1996	**Decreased**, H: 0.002
	1996 - 1997	No Change, H: 0.433

12) Change in the Number of Technical Support Staff Needed to Administer DL	1994 - 1997	H: 0.010
	1994 - 1996	Improved, H: 0.046
	1994 - 1995	No Change, H: 0.975
	1995 - 1996	Improved, H: 0.018
	1996 - 1997	**Decreased**, H: 0.001
13) Change in the Number of Hours Current Staff Work (DL)	1994 - 1997	H: 0.031
	1994 - 1996	Improved, H: 0.023
	1994 - 1995	No Change, H: 0.213
	1995 - 1996	Improved, H: 0.034
	1996 - 1997	**Decreased**, H: 0.028
14) Change in Computers/Equipment Needed for the DL	1994 - 1997	H: 0.001
	1994 - 1996	No Change, H: 0.217
	1996 - 1997	**Decreased**, H: 0.000
15) Change in Funds for Staff Travel (DL)	1994 - 1997	H: 0.000
	1994 - 1996	**Decreased**, H: 0.000
	1994 - 1995	**Decreased**, H: 0.025
	1995 - 1996	**Decreased**, H: 0.013
	1996 - 1997	No Change, H: 0.635
16) Overall Change in Workload at Institution Due to DL	1994 - 1997	H: 0.008
	1994 - 1996	**Decreased**, H: 0.007
	1994 - 1995	No Change, H: 0.231
	1995 - 1996	**Decreased**, H: 0.020
	1996 - 1997	Improved, H: 0.006
17) Change in Workload (DL) - Training Staff [No Responses for 1994]	1995 - 1997	H: 0.003
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.047
18) Change in Workload (DL) - Processing Loan Applications [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.018
	1996 - 1997	**Decreased**, H: 0.000
19) Change in Workload (DL) - Creating and Transmitting Origination Records [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.018
	1996 - 1997	Improved, H: 0.022
20) Change in Workload (DL) - Requesting and Receiving Loans [No Responses for 1994]	1995 - 1997	**Decreased**, H: 0.000
	1995 - 1996	**Decreased**, H: 0.001
	1996 - 1997	No Change, H: 0.587

21) Change in Workload (DL) - Disbursing Loan Funds to Borrowers [No Responses for 1994]	1995 - 1997	**Decreased**, H: 0.001
	1995 - 1996	**Decreased**, H: 0.001
	1996 - 1997	No Change, H: 0.638
22) Change in Workload (DL) - Canceling and Changing Loans [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
23) Change in Workload (DL) - Cash Management [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change
24) Change in Workload (DL) - Reconciliation [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.455
25) Overall Usefulness of EDExpress Software [No Responses for 1994]	1995 - 1998	Improved, H: 0.008
	1995 - 1996	Improved, H: 0.004
	1996 - 1997	**Decreased**, H: 0.022
26) Timeliness of Info on DL Rules/Regs Provided by ED	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.438
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
27) Timeliness of Telephone Support from ED Concerning DL	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.176
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.020
28) Timeliness of ED Provided DL User's Guide	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.070
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.001
29) Timeliness of ED's In-Person Assistance	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.268
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.005

30) Timeliness of ED Provided DL Borrower Counseling Materials	1994 - 1997	H: 0.000
	1994 - 1997	Improved, H: 0.000
	1994 - 1995	**Decreased**, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
31) Timeliness of ED's DL Consolidation Booklet [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.116
32) Timeliness of ED Provided DL Training Materials for Counselors [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H:0.004
33) Timeliness of ED Provided Entrance/Exit Counseling Videos [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.589
34) Timeliness of ED Provided Preprinted DL Promissory Notes	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.542
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.994
35) Timeliness of ED DL Reconciliation Guide [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change
36) Timeliness of ED's DL Loan Origination Support	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.217
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.000
37) Timeliness of ED's DL Loan Reconciliation Support [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.018
38) Timeliness of ED DL Training and Technical Support [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.006
39) Timeliness of ED Videoconferences [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.246

40) Usefulness of ED Provided Information on DL Rules/Regs	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.170
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.012
41)Usefulness of ED's DL Telephone Support	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.031
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.081
42) Usefulness of ED DL User's Guide	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.181
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.844
43) Usefulness of ED's In-Person DL Assistance	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.731
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.253
44) Usefulness of ED DL Borrower Counseling Materials	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.780
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.646
45) Usefulness of ED's DL Consolidation Booklet [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.532
46) Usefulness of ED's DL Training Materials for Counselors [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.784
47) Usefulness of ED DL Entrance/Exit Counseling Videos [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.002
	1996 - 1997	No Change, H: 0.246
48) Usefulness of ED Preprinted DL Promissory Notes	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	No Change, H: 0.545
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.965

49) Usefulness of ED DL Reconciliation Guide [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.186
50) Usefulness of ED DL Loan Origination Support	1994 - 1997	H: 0.000
	1994 - 1996	Improved,H: 0.000
	1994 - 1995	No Change, H: 0.110
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.007
51) Usefulness of ED DL Loan Reconciliation Support [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.097
52) Usefulness of ED DL Training and Technical Support [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.500
53) Usefulness of ED DL Videoconferences [No Responses for 1994]	1995 - 1997	Improved, H: 0.003
	1995 - 1996	**Decreased**, H: 0.001
	1996 - 1997	No Change, H: 0.536
53) Communications w/ ED DL Servicer or Loan Origination Center Concerning Repayment [No Responses for 1994]	1995 - 1997	Improved, H: 0.001
	1995 - 1996	No Change, H: 0.141
	1996 - 1997	Improved, H: 0.052
54) Communications w/ ED DL Servicer of Loan Origination Center Concerning Out-of-School Consolidation [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.021
	1996 - 1997	Improved, H: 0.038
55) Timeliness of Training From Regional Office [No Responses for 1994]	1995 - 1997	Improved, H: 0.001
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.955
56) Timeliness of Guidance Delivered by DL Account Manager at Institution [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.762
57) Timeliness of Questions Handled by DL Regional Account Office [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.887

58) Timeliness of DL Regional Office's Handling of Entrance/Exit Counseling Issues [No Responses for 1994]	1995 - 1997	Improved, H: 0.001
	1995 - 1996	Improved, H: 0.001
	1996 - 1997	No Change, H: 0.537
59) Timeliness of DL Regional Office's Response to Requests for Materials [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.338
60) Timeliness of DL Regional Office's Response to Questions Concerning Computers [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.529
61) Timeliness of DL Regional Office's Response to Questions Concerning Origination [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.214
62) Timeliness of DL Regional Office's Response to Questions Regarding Disbursement [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	No Change, H: 0.687
63) Timeliness of DL Account Manager's Liason w/ Servicer, Origination or Software Contractor [No Responses for 1994]	1995 - 1997	Improved, H: 0.000
	1995 - 1996	Improved, H: 0.00
	1996 - 1997	No Change, H: 0.408
64) Overall Satisfaction with DL During the Year	1994 - 1997	H: 0.000
	1994 - 1996	Improved, H: 0.000
	1994 - 1995	Improved, H: 0.009
	1995 - 1996	Improved, H: 0.000
	1996 - 1997	**Decreased**, H: 0.015
65) Satisfaction w/ DL Relative to Previous Year [No Responses for 1994]	1995 - 1997	Improved, H: 0.005
	1995 - 1996	Improved, H: 0.003
	1996 - 1997	No Change, H: 0.379

Patterns very similar to that of table 2.16 are evident. Overall, FADs whose institutions participated exclusively in the DSLP generally found the program improving over most criteria. Of the 65 questionnaire items more than half (37) exhibit unambiguous improvement over the course of the study. Only five display unambiguous decline. Still, as question 64 demonstrates and relative to previous

years, FADs were not as satisfied with the DSLP overall in 1997 as they had been in previous years. Specifically, while they found the program improved in 1995 relative to 1994 and again in 1996 relative to 1995, by 1997 they ceased endorsing the program with the same enthusiasm. Tables 2.20 and 2.21 employ the same methodology used in tables 2.17 and 2.18. They confirm that the rate of improvement across years increased sharply through 1996, but then fell just as steeply in 1997. A Mann-Whitney comparison of 1994/1995 with 1996/1997 demonstrates that the relative evaluation rates did not improve over all years. The average rank score declines

Table 2.20 - H-Test of Relative, DSLP Approval over Amalgamated Criteria

Ranks

	Comparision Years	N	Mean Rank
DSLP Assesment	95	32	71.00
	96	64	112.50
	97	65	54.91
	Total	161	

Test Statistics[a,b]

	DSLP Assesment
Chi-Square	58.969
df	2
Asymp. Sig.	.000

a. Kruskal Wallis Test

b. Grouping Variable: Comparision Years

Table 2.21 - Median Test of Relative, DSLP Approval over Amalgamated Criteria

Frequencies

		Comparision Years		
		95	96	97
DSLP Assesment	> Median	6	52	7
	<= Median	26	12	58

Test Statistics[b]

	DSLP Assesment
N	161
Median	1.00
Chi-Square	74.301[a]
df	2
Asymp. Sig.	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 12.9.

b. Grouping Variable: Comparision Years

from 57.31 to 44.91 which is significant at a level of 0.02. A crosstabulation of year-to-year change reinforces the notion that not only did the DSLP not improve over the course of all four years, but it actually declined. Relative to 1996, assessment on 23 criteria declined in 1997 - far more than in any other pair of years.

Table 2.22 - Crosstabulation of DSLP relative assessment by Comparison Years.

DSLP Assesment * Comparision Years Crosstabulation

Count

		Comparision Years			
		95	96	97	Total
DSLP Assesment	Decreased	4	6	23	33
	No Change	22	6	35	63
	Improvement	6	52	7	65
Total		32	64	65	161

Though ED does provide "alternative" originators for institutions choosing not to carry out such functions themselves, it is ultimately responsible for service and product provision in the DSLP. Clearly, the performance of the Department of Education in fulfilling its roles in both the FFELP and the DSLP has not improved. Initial gains experienced, especially in the latter program, seem to have been offset by less than attentive service provided in 1997. With regard to the DSLP., a perusal of table 2.16 reveals that most complaints emanate from issues regarding the timeliness with which ED administers services. The rest revolve around electronic processes such as processing promissory note, creating and transmitting records, and requesting and receiving loan funds. In the FFELP, where such duties are performed by private entities, these functions exhibit improvement, or at least no change, in 1997 relative to 1996[99]. In general, it appears that lenders, servicers and guarantee agencies - a previously recalcitrant set of actors open to change only if it included increases in special or administrative allowances - successfully improved

[99] Interestingly, however, FADs felt that the overall workload associated with the FFELP increased over every pair of years. For the DSLP, though, they report an

their product and service beginning in 1996. ED, on the other hand, appears to have lost the momentum it carried through that same year.

Analysis of the FFELP by Institutions Participating in Both the FFELP and the DSLP

Finally, I examine the opinions of the 326 schools within the sample that participate in both programs. In particular, we are interested in whether, in their opinion, the FFELP has improved since the introduction of the DSLP. Table 2.23 presents the results of the H-test across all four years. Although the average rank does generally decline from one year to the next indicating improvement, the differences are not statistically significant. Table 2.24 presents crosstabulations for each relevant question. An upward trend can be observed but, again, these differences are insignificant.

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increase in workload only in 1996 relative to 1995 with an improvement realized in 1997.

Table 2.23 - H-Tests for Evaluations of the FFELP by Institutions Participating in Both Programs

Ranks

	Response Year	N	Mean Rank
Improvement in Student Access to FFEL Loans Since DL?	95	7	134.64
	96	17	148.74
	97	95	139.43
	98	143	124.03
	Total	262	
Improvement in Ease of FFEL Administration Since DL?	95	7	132.00
	96	18	122.75
	97	95	135.70
	98	141	128.84
	Total	261	
Improvement in Service from FFEL Banks/Guarantors Since DL?	95	7	143.36
	96	18	152.50
	97	93	129.32
	98	142	127.85
	Total	260	
Improvement in Service from FFEL Servicers/Collection Agencies Since DL?	95	6	143.83
	96	18	133.72
	97	90	119.86
	98	138	129.14
	Total	252	
Improvement in Service from FFEL Third-Party Servicer?	95	3	75.00
	96	8	71.94
	97	50	74.51
	98	89	76.39
	Total	150	

Table 2.24 - Crosstabulations for Evaluations of the FFELP by Institutions Participating in Both Programs by Response Year

nprovement in Student Access to FFEL Loans Since DL? * Response Year Crosstabulatio

Count

		Response Year				
		95	96	97	98	Total
Improvement in Student Access to FFEL Loans Since DL?	Improved	2	3	25	54	84
	Same	5	14	68	87	174
	Worsened			2	2	4
Total		7	17	95	143	262

Improvement in Ease of FFEL Administration Since DL? * Response Year Crosstabulation

Count

		Response Year				
		95	96	97	98	Total
Improvement in Ease of FFEL Administration Since DL?	Improved	3	9	38	65	115
	Same	4	9	57	74	144
	Worsened				2	2
Total		7	18	95	141	261

rovement in Service from FFEL Banks/Guarantors Since DL? * Response Year Crosstabulat

Count

		Response Year				
		95	96	97	98	Total
Improvement in Service from FFEL Banks/Guarantors Since DL?	Improved	4	9	64	99	176
	Same	3	9	27	41	80
	Worsened			2	2	4
Total		7	18	93	142	260

Improvement in Service from FFEL Servicers/Collection Agencies Since DL? * Response Year Crosstabulation

Count

		Response Year				
		95	96	97	98	Total
Improvement in Service from FFEL Servicers/Collection Agencies Since DL?	Improved	2	8	48	64	122
	Same	4	9	41	71	125
	Worsened		1	1	3	5
Total		6	18	90	138	252

Improvement in Service from FFEL Third-Party Servicer? * Response Year Crosstabulation

Count

		Response Year				
		95	96	97	98	Total
Improvement in Service from FFEL Third-Party Servicer?	Improved	1	3	17	30	51
	Same	2	5	33	56	96
	Worsened				3	3
Total		3	8	50	89	150

Analysis of Borrower Satisfaction with the Federally Sponsored Student Loan Programs

To this point, I have examined the effect of program competition on the cost of student loan provision as well as the quality of product and service from the perspective of the institutions that participate in the programs. I have found that cost has declined as a result of competition and that, with important qualifications, the quality of student loan provision has improved. As a result, the peripheral beneficiaries to the promotion of postsecondary education through the use of loans - taxpayers - have gained. Additionally, the institutions that constitute one of the principal beneficiary groups have also benefited. The other cohort to whom the loan

programs are primarily directed is, of course, students. This section attempts to assess their attitudes toward the student loan programs since the introduction of the DSLP. Unfortunately, the attempt fails badly.

Borrower Data

This data is based upon surveys of borrower attitudes conducted by ORC/Macro International on behalf of the Department of Education. Sampling was based upon the respondent pool for the institutional surveys. In other words, the sample was constructed to reflect not only program participation, but also size, type, and control of institutions in the greater population. Further elaboration on the construct of the sample is irrelevant, however, as it turns out that the data is fatally flawed.

Potential respondents were drawn from ED's National Student Loan Data System (NSLDS) such that the sample consisted of roughly equal numbers of recently graduated student borrowers who participated in the FFELP, the DSLP, or both. Unfortunately, ED could not justifiably place supreme faith in its data. When Macro informed its client that respondents very frequently offered that they did not participate in the program indicated by the NSLDS, ED chose to ignore its own information and proceed on the assumption that borrowers knew what program they were in. Bad assumption! By the admission of ED, the NSLDS has problems, but it is not as inaccurate as table 2.25 indicates.

Table 2.25 - Crosstabulation of Respondent Program Participation (NSLDS) by Respondent Reported Program Participation

Loan type-survey * Loan Type-NSLDS Crosstabulation

Count

		Loan Type-NSLDS			
		BOTH	DL	FFEL	Total
Loan type-survey	BOTH	18	6		24
	DL_ONLY	507	442	209	1158
	FL_ONLY	21	10	112	143
Total		546	458	321	1325

The table demonstrates, for example, that only 18 respondents out of 546 correctly identified themselves as having taken loans in both the DSLP and the FFELP. The vast majority (507) believed that they had signed for Direct Loans only. Similarly, only 35% of those identified by the NSLDS as having exclusively borrowed through the FFELP concurred. Most students apparently knew that the government was involved in some way and they did receive their loan funds "directly" from the postsecondary institutions they attended. It therefore may have seemed more reasonable that they were participants in the Federal Direct Student Loan Program rather than the Federal Family Education Loan Program. Family? What family? In almost all cases[100] students, not their families, were solely responsible for their loan obligations. As a result, almost 84% of all respondents identified themselves as participants in the DSLP, and the DSLP only!

[100] The exception is PLUS loans taken out on behalf of students by their parents..

Problems resulting from this confusion are twofold. First, across all years we can have reasonable confidence in the responses of only 130 (18 + 112) FFELP borrowers. This leaves the FFELP, the largest of the two student loan programs, grossly under-sampled. Worse than this, however, is the fact that responses for items related to the DSLP are polluted by respondents who never participated in the program. The data is virtually useless.

Analysis

Using the same methodology employed in the institutional analyses, though restricting the sample to only those responses in which the NSLDS and the respondent agreed on program participation, 26 criteria were evaluated. For both the FFELP and the DSLP no statistically significant differences were found. If we ignore the fact that students largely could not identify the program(s) they were in, but assume that they were familiar with the finer details, then we must conclude that the introduction of competition between programs had no effect on the product as students perceived it.

With any great confidence, all that we can really say is that students entering repayment in 1998 seemed very pleased with the student loan programs. However, the same can be said for students entering repayment in earlier years, and for students still in school. Table 2.26 presents a crosstabulation of borrower satisfaction with the student loan process overall by repayment year. Table 2.27 presents the results of the H-test.

Table 2.26 - Crosstab of Overall Borrower Satisfaction by Repayment Year

Overall Satisfaction - All Programs, pre and post consolidation * Year Repayment Began - both programs, preconsolidation Crosstabulation

			Year Repayment Began - both programs, preconsolidation						
			Not in repayment	94	95	96	97	98	Total
Overall Satisfaction - All Programs, pre and post consolidation	Very Satisfied	Count	145	2	41	114	210	48	560
		% within Overall Satisfaction - All Programs, pre and post consolidation	25.9%	.4%	7.3%	20.4%	37.5%	8.6%	100.0%
		% within Year Repayment Began - both programs, preconsolidation	43.7%	100.0%	49.4%	43.5%	42.7%	45.3%	43.9%
	Somewhat Satisfied	Count	135		33	121	226	40	555
		% within Overall Satisfaction - All Programs, pre and post consolidation	24.3%		5.9%	21.8%	40.7%	7.2%	100.0%
		% within Year Repayment Began - both programs, preconsolidation	40.7%		39.8%	46.2%	45.9%	37.7%	43.5%
	Somewhat Dissatisfied	Count	32		8	17	42	11	110
		% within Overall Satisfaction - All Programs, pre and post consolidation	29.1%		7.3%	15.5%	38.2%	10.0%	100.0%
		% within Year Repayment Began - both programs, preconsolidation	9.6%		9.6%	6.5%	8.5%	10.4%	8.6%
	Very Dissatisfied	Count	20		1	10	14	7	52
		% within Overall Satisfaction - All Programs, pre and post consolidation	38.5%		1.9%	19.2%	26.9%	13.5%	100.0%
		% within Year Repayment Began - both programs, preconsolidation	6.0%		1.2%	3.8%	2.8%	6.6%	4.1%
Total		Count	332	2	83	262	492	106	1277
		% within Overall Satisfaction - All Programs, pre and post consolidation	26.0%	.2%	6.5%	20.5%	38.5%	8.3%	100.0%
		% within Year Repayment Began - both programs, preconsolidation	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Table 2.27 - H-test of Overall Borrower Satisfaction by Repayment Year

Ranks

	Year Repayment Began - both programs,	N	Mean Rank
Overall Satisfaction - All Programs, pre and post consolidation	Not in repayment	332	651.47
	94	2	280.50
	95	83	599.64
	96	262	632.78
	97	492	640.19
	98	106	647.36
	Total	1277	

Test Statistics[a,b]

	Overall Satisfaction - All Programs, pre and post consolidation
Chi-Square	4.021
df	5
Asymp. Sig.	.546

a. Kruskal Wallis Test

b. Grouping Variable: Year Repayment Began - both programs, preconsolidation

Regardless of repayment year, no less than 83% (1998) of all borrowers surveyed expressed satisfaction with their student loan experience. Roughly 45% in each cohort, excluding 1994, reported that they were very happy with the process overall.

Chapter Summary

This chapter has tracked the evolution of the federal government's attempts to make postsecondary education accessible to the middle-class and below through the use of student loans. Confronted with the choice of providing loans "in-house", or "out-sourcing" to private financiers and service providers, as well as predominantly state sponsored insurers, the Johnson administration chose the latter. Whether this was a sound decision is irrelevant. What is germane is that the selected method soon degenerated into fiscal madness. The system spiraled to ever greater levels of inefficiency and blatant fraud. By the 1980s, abuses associated with the Guaranteed Student Loan Program caught the eyes of Congress, the Reagan administration, and the public. After grappling with attempts at reform for several years, by the end of the decade many began to believe that Johnson had made a mistake. The GSLP should be replaced with an in-house analog, they felt - the Federal Direct Student Loan Program.

Facing their demise, lenders and guarantors put aside the squabbles and competitions that helped to place the student loan program under public scrutiny. Mustering political support, predominantly from the Republican side of the aisle, they managed to stave off President Clinton's attempts at phasing out what was now referred to as the Federal Family Education Loan Program. They even mounted an unsuccessful counter attack in 1994, inferring that the continuation of the DSLP might inspire them to place a "contract" on the Department of Education.

By 1998 a political equilibrium was reached. Neither faction was able to eradicate the other so, strictly as an accident of politics, today we have two programs existing to provide the same beneficiaries with identical services. Folk wisdom would have it that such an arrangement is wasteful. When the provision by government of a collectively consumed good or service is contemplated, energies are spent to find the single, best method of provision. Usually this process reduces to a choice between whether the government should produce the good or service itself, or whether it should pay private entities to generate the good and restrict itself to the role of overseer. Whatever the choice, it is never decided to duplicate the effort. Do it once, and do it well, seems to be the credo.

Yet, relative to the past at least, duplicative waste is not what we find in the student loan programs. Instead, we discover that, as a result of inter-program competition, taxpayers saved around $680 million dollars per year In conjunction with reduced cost, there has been no evidence that the quality of service has declined in any way. In a four-year panel study of financial aid directors at American postsecondary institution, large and small, there is strong evidence indicating that lenders, guarantors and servicers have reacted favorably, from the perspective of FADs, to the competition. As well, the Department of Education seems to display a level of enthusiasm unusual for a government agency. This enthusiasm appears to have propelled the Department, over the first three years of the study, to providing an ever appreciating level of service to schools participating in the DSLP. It is true,

however, that the final year of the study brought with it a decline in FAD satisfaction great enough to offset the gains of previous years. Whether this decline is merely a temporary phenomenon - perhaps representing growing pains accompanying the rapid growth of the DSLP - or whether it is indicative of the department's inability to maintain its momentum is a question whose answer lies beyond the scope of the data.[101] In any event, the quality of the student loan product as evaluated by FADs has not declined.

Neither has its quality deteriorated in the eyes of the student borrower. Competition between the two programs has not disturbed their bliss. Students and former students now in repayment evaluated their loan experiences favorably across all years. So content do they seem that they show little awareness of the fact that there are two programs.

Inter-program competition between the FFELP and the DSLP has been a smashing success. Because of competition, the price has gone down while the overall quality of the product has not changed. In fact, if we remove the influence of the Department of Education, it has actually improved. If one wants to argue that competition is an "X-factor" that adds value, then one can find few better examples than the case of the Federal government's multi-program effort to provide student loans.

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[101] However, a follow up study of ALL student assistance programs is about to get underway.

Chapter Three

The thesis of this study has been that competition in the provision of a product brings to the purchasers of that product the greatest possible value. This is hardly a new and startling revelation. What is new is the assertion that by injecting competition into the provision of products usually deemed to be within the domain of government, improvements in product value can also be realized.

Competitive markets are rare indeed. Given the plethora of requirements for pure competition, this is not surprising. The good or service must be homogeneous[102] and we must have innumerable prospective customers and suppliers. Just as importantly suppliers must be able to enter and leave the market at will, devoting their resources to the pursuit of the highest possible profits. In turn, this implies that the labor and capital at their disposal can be as easily dedicated to the production of one good or service as another. Economists suggest that the requirements for a truly competitive market are rarely met and even then only in low-skill, labor intensive agricultural settings. Moreover, the requirements of a competitive market would almost preclude participation by government.

To fulfill the requirement of a large number of purchasers we imply that the good/service must be a "private" one. That is to say, it must not be a public good or one with appreciable positive externalities. The purchaser of a private good

exclusively enjoys all of the benefits of that good though this is not the case for public goods. If the potential customer could benefit from the purchases of others then it would be rational for him or her to forego entry into the market and allow others, in essence, to make his or her purchases. It would not be long before few purchasers, if any, were willing to participate. Further, because the market, in terms of price, would understate the full value of the product, it is unlikely that the market would be able to attract a large number of suppliers. In short, the existence of a competitive market implies the existence of a private good. Does this also imply that the producers of such goods necessarily need to be privately and not publicly owned?

No, not really. If the public supplier was motivated by the same incentives as private firms and, thus, equally efficient, there would be no need to discriminate between producers on the basis of ownership. Participation by a publicly owned supplier would seem to be superfluous, though. With producers already participating in the market to the extent that we can deem it "competitive," why should we require one more? What possible motive could we have for endorsing government participation in the market for a good already efficiently supplied? More importantly, because government is not propelled by the same incentives as private firms it cannot be as efficient a provider of private goods and its inclusion in a competitive market would be more than superfluous. It would be wasteful.

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[102] In other words, the product purchased from one supplier must be virtually identical to that derived from another.

The reforms of the Progressive era shielded civil servants from political winds. By assuring them that their careers would not be offered to others as payment for political favors, progressive reformers gave government employees the security they needed to pursue the long-term best interests of the nation. Insulating them from the cycles of political patronage, however, left civil servants accountable to virtually no one. In my experience I have found the vast majority of civil servants to be intelligent, knowledgeable and dedicated individuals. Still others are not, and the high degree of job security they enjoy allows them to pursue objectives divergent from what the rest of us might like. William Niskanen and others have argued that bureaucracies, and the bureaucrats who run them, eschew any form of social utility maximization in favor of policies targeted at augmenting their agencies' - and thus their own - power, influence and budget. Other critics of government, including E. S. Savas, James Bennett and Thomas DiLorenzo, contend that government employees, through their labor unions, are rent-seekers who use their insularity to pursue personal enrichment. Still others propose that because government does not digest the amalgamate of objective information that is price, but instead must rely on frequently ill-informed and misleading preferences expressed by the electorate, it is incapable of operating as effectively as a private firm.

If its critics are right - if government is a haven for blind and self-serving buffoons - why would we ever turn to government for the provision of anything? The answer, of course, is that we frequently have no choice. I have already stated that finding a truly competitive market is a little like a search for the Holy Grail - not quite impossible, but very difficult. Generally, though, markets are proximate enough to

competitive that we can argue against the inclusion of government, even when government participates merely to fulfill its own need. Under such circumstances, privatization advocates are surely correct in calling for "load shedding." In other cases, however, markets bear no resemblance to anything remotely competitive and it is in such instances that we turn to government, if not to produce the good, then at least to regulate its production.

Monopoly, of course, is the antithesis of competition and Chapter One reviewed a number of comparisons between public and private monopolists. While the conclusions to these studies were by no means uniform, most of the authors reviewed proposed that public and private utility monopolists were equally inefficient. As Atkinson and Halverson observed, the degree to which a monopoly operates inefficiently has less to do with the nature of its ownership and more to do with the lack of competition. Caves and Christensen, in their examination of Canadian railroads, confirmed this observation when they demonstrated that competition between a privately financed supplier and a publicly owned one improved the efficiency of both. This is not to say that duopoly closely mimics a competitive market, nor that we might not prefer our duopolists (if that is the best we can do) to both be privately owned. It is only to assert that any degree of competition, regardless of the source of that competition, is vastly preferable to none.

The outputs of utilities, railroads, airlines and the like can be considered private goods, though we might be tempted to argue that they exhibit many positive externalities. If it is advisable to introduce a publicly controlled competitor to the market for a private good supplied in a less than competitive market, would it also be prudent to induce competition to the provision of a public good? By their nature, public goods[103] cannot be produced in private markets at an optimal level so it is, again, in such cases that we turn to government for provision. Yet, if private firms will not supply public goods optimally, how do we inject competition into their provision? One answer is the so-called "Lakewood Plan," but this is only feasible at a level no higher than individual States. Recall that the Lakewood Plan pits larger municipalities against one another in a competition to provide services to smaller ones. An analog to the Lakewood plan at the Federal level, proposed by NPRG guru David Osborne and others, is the instigation of competition between Federal agencies. By allowing separate agencies to confront one another in contest over the provision of services, it is hoped that Niskanen's bureaucrats will move away from budget maximization and closer to the efficient provision of public goods.

The competition between the FFELP and the DSLP is not inter-agency. In fact, it could be more accurately described as intra-office. Both programs are administered out of the Department of Education's Office of Postsecondary Education. This may not be an ideal arrangement, but I will reserve comments concerning administration for a later time. Suffice it to say that this rare example of inter-program competition

[103] Public goods and those with positive externalities are not the same. Nonetheless, I treat them as though they were. This is not such an egregious error as in terms of

was not consciously designed, but instead was the product of serendipitous circumstance. Consequently, we should not be disappointed if it fails to live up to its full potential. Rather, we should be astonished that it has been successful at all.

Before the ratification of the HEA a private market for student loans did exist. How, then, could the Federal government justify its involvement? The answer is that, from a social perspective, postsecondary education was a public good that was characteristically under supplied. The value of a better educated and a more productive citizenry was simply too great to allow intellectually qualified individuals to be excluded from the market for student loans because of their lack of financial resources, their gender, or their skin color. To create a student loan market accessible to all, the government had to modify radically the existing one through its participation. The question confronting President Johnson, and the extent to which the student loan programs might be thought of as a planned operation, was how best to do so. Perhaps wisely, Johnson rejected his advisors' suggestion that the government produce loans in-house, funding them from Treasury coffers. Instead, he preferred a program that in its full fruition out-sourced production, altering the existing market through subsidies, guarantees and secondary markets such that the existing market, from a social perspective, might allocate loans optimally. What the progenitors of the FFELP/GSLP did not recognize was that the Federal government's partners in the program were, in essence, regional monopolists[104]. Not only did government planners not recognize this; they actually encouraged these

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the under supply inherent to both, they are identical
[104] Regional cartels might be more accurate.

monopolies through the expansion of the guarantee agency system and the creation of Sallie Mae.

The debate in the scholarly literature concerning the relative merits - or lack thereof - of publicly and privately owned monopolies did not begin until the mid-1970s, so even if the GSLP's engineers had foreseen the hazards presented by monopoly, we can excuse their lack of consideration of inter-program competition. President Johnson, at least, felt that the experience that could be brought to the program by professional financiers would be beneficial. In any case, out-sourcing might be less wasteful than the existing National Defense Student Loan program[105]. Was Johnson right? Within the setting of student loans, was a system of regional monopolist preferable to a Federal monopoly? Are a number of little devils less evil than one big one?

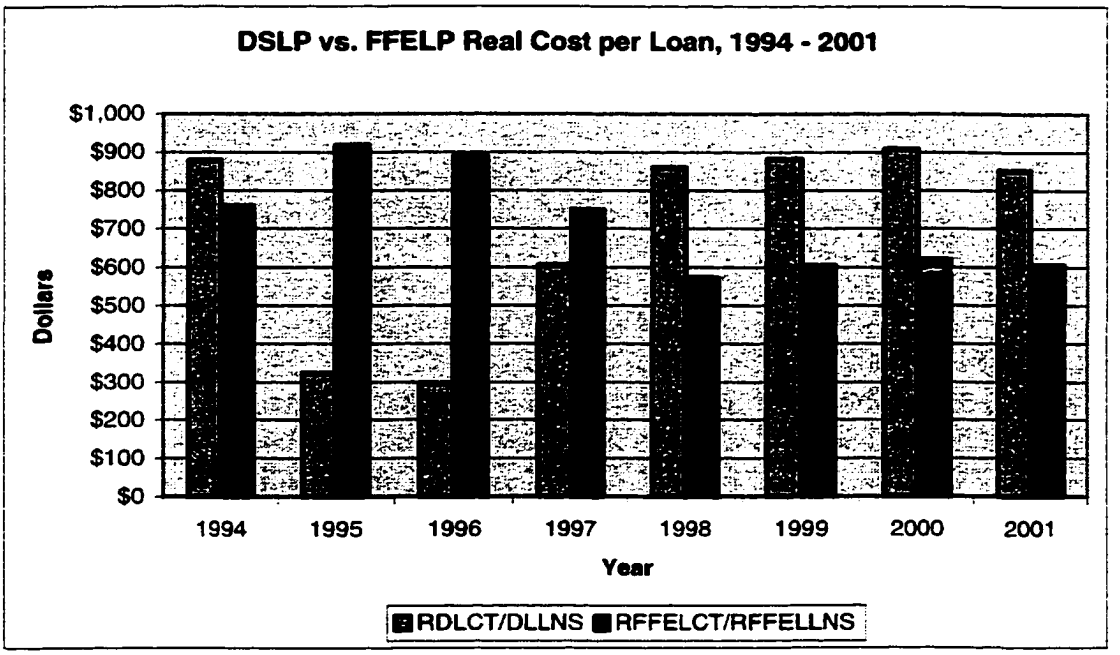
Possibly, though the data that I have presented is far from conclusive. For example, in cost model 1 in which the dependent variable is the real, total net cost for both programs combined, the coefficient on the DLDUMMY is negative $685 million. For cost model 3, where only FFELP expenses and loan levels are taken into account, the coefficient on the same variable is only about negative $620 million. The larger value (in absolute terms) for model one could be at least partially attributable to cost efficiencies associated with the DSLP alone. By this criterion, it would appear that Johnson made a mistake. It would seem that the Federal monopoly is better than the private cartel. However, such a comparison is not

kosher. It would be far better if we could run identical regressions on FFELP and DSLP variables alone. Unfortunately, the DSLP has not been in existence long enough to allow this. We simply do not have enough data points.

However, using a crude, per loan comparison of cost from 1994 to 2001 we see that the programs are fairly equivalent. Averaged over this period, the cost to the government of a Direct Loan was about $700 per loan while that for a Federal Family Education Loan was only $15 more. But examine figure 3.1. Ignoring 1994 and the large startup costs associated with it, we see that the cost of a Direct loan was considerably less than that of a FFEL through 1997. By 1997 - the same year in which we noted a sharp fall off in the quality of DSLP service as evaluated by postsecondary financial aid directors - the gap had been narrowed. By 1998, the cost of a Direct loan approached $900, surpassing that for a FFEL, and remained at this level throughout the remainder of the study. Note that from 1998 on, the cost of a FFEL remains fairly constant at about $600 dollars.

[105] Now known as Perkins loans.

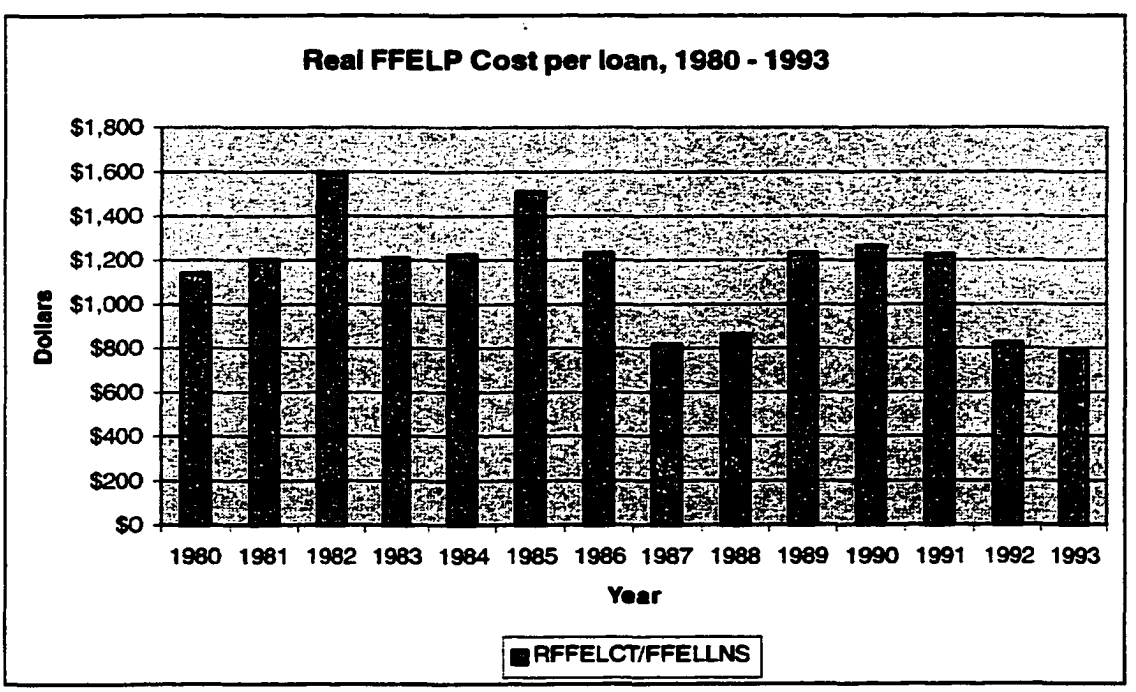
Figure 3.1 - DSLP vs. FFELP Real Cost per Loan, 1994 - 2001



Does this mean that as the excitement of high stakes political contest waned, so too did ED's enthusiasm for holding down costs? Is 1998 the first year of an equilibrium in which inefficiencies inherent to government manifest themselves as costs one third greater than those associated with private suppliers? Perhaps, though this does not mean that, in conjunction, the two loan programs are not greater than their parts. While the DSLP may settle down to be a more expensive program than the FFELP, the beneficial effects of competition are apparent in figure 3.1. The figure implies that over the course of three years, from 1996 through 1998, the per loan cost of a FFEL dipped steadily until it obtained its present $600 per loan level. Especially when one considers that from 1980 until 1993 (the year before the initiation of the DSLP) the average cost of a FFEL was $1,150, it is difficult to maintain that the low cost the government now pays for the FFELP is the result of

anything else but competition. The average for 1980 to 1993 includes the sharp downturns in cost that were a response to the intense political pressure put upon FFELP participants during Reagan's second term. At no time during this period did the per loan cost fall to much less than $800. These figures superficially imply that, indeed, the inefficiencies associated with provision by government alone are greater than those for the private sector. Out-sourcing may be superior to in-house production in this case. Still, neither method alone is superior in its benefits to those accrued through the introduction of competition. Figure 3.2 depicts real FFELP cost per loan over the period immediately prior to the introduction of competition.

Figure 3.2 - Real FFELP Cost per Loan, 1980 - 1993



In terms of service provision, we find exactly the same pattern that we did for cost. With respect to the FFELP, whether or not one concludes that the program improved in the eyes of FADs over the four years studied is entirely dependent on

the inclusion of criteria for which ED was responsible. Of the 18 items specifically relating to services provided by banks and guarantee agencies, 16 demonstrate unambiguous improvement. In other words, evaluations significantly improved in at least two consecutive years with no statistically significant drop-offs over the course of the entire study. Just as importantly, none of the 18 items exhibited unambiguous decline. The two questionnaire items for which a clear pattern is not evident relate to the timeliness and usefulness of telephone support from guarantors (questions 30 and 44). In both cases FADs expressed dissatisfaction early on (1995 relative to 1994), but reported a significant improvement only a year later with this level of satisfaction holding constant through 1997. Overall, and as noted in Chapter 2, removing ED from the analysis allows for a significant improvement in the satisfaction of FADs with the program in 1997 relative to 1994. Adding ED related criteria, however, removes the significance of this improvement.

Examining the eleven items referring to ED provided services two (questions 1 and 20) show unambiguous decline. They deal specifically with the level of satisfaction FADs reported in keeping abreast of FFELP rules and regulations. Another question (34) also deals with this topic and, although improvement is noted in 1995 relative to 1994, approval ratings fell significantly in each successive year, 1996 and 1997. Of the eleven ED items only one (question 37) shows unambiguous improvement. The other seven ED related items (questions 21, 22, 23, 24, 35, 36, and 38) show significant improvement, usually in 1995 relative to 1994, but all dip precipitously in their approval ratings in 1997.

ED could be forgiven for its failings in the FFELP. It was administering a program undergoing rapid change that was in direct competition with its pet program, the DSLP. Moreover, for the period studied, it was believed that the DSLP was going to entirely replace the FFELP and so the devotion of resources to the latter, for some within the Office of Postsecondary Education, might represent a misallocation. Yet the same pattern we witnessed for cost and FFELP administration is apparent in the administration of the DSLP. Again, it is as though once the adrenaline rush of creating a new program and using it to aggressively attack the incumbent FFELP wore off, a return to the level of service traditionally associated with government was in order.

As already stated in Chapter 2, of the 65 DSLP criteria for which significant differences were found across years, 37 of these showed unambiguous improvement. Only five displayed an unambiguous decline over all years. By this measure, it might seem that ED did a reasonably good job of seeing to it that its DSLP product improved. However, where statistically significant decline between concurrent years is observed, it almost always appears in 1997. For example, for 1995 relative to 1994, significant decline is observed for only two items. For 1996 relative to 1995, this figure rises slightly to six. Yet by 1997, fully 24 criteria are rated less satisfactorily than they were in the previous year. Additionally, no significant difference between amalgamated rank orderings can be discerned for 1994 relative to 1997.

What this means is that while ED appears to have carried itself a long way on its early enthusiasm for the DSLP, this energy may not be sustainable. It may be the case, of course, that the sharp rise in cost and the fall in the level of service for the DSLP may be temporary phenomena unique to 1997. DSLP service may have recovered in 1998 and per loan costs might decline in the future. Then again, possibly not.

In any event, even if ED in particular, and government in general, is less able to administer a large scale loan program than private entities, it is clear that the benefits of competition between the FFELP and the DSLP easily overwhelm the inefficiencies associated with government involvement. But is this universally true? Is it always the case that simply through the introduction of competition we can increase the value of goods and services? Almost certainly, no, though this must be a course of further study. While the NPRG may someday be successful in leading government to the "best practices" employed by private industry it is unlikely that, ceteris paribus, government will ever be as efficient in cost and service delivery of public goods as the private sector is in its provision of private ones. If so, then we must inquire into the circumstances under which the benefits of competition ameliorate losses associated with government participation.

One of the attributes that may have contributed to the success of the competition between the FFELP and the DSLP is that the provision of student loans requires the

application of existing technologies only. The administration of these programs is by no means a low-skill, labor intensive activity. It requires the use of expensive, cutting edge communications technologies and large, sophisticated databases. However, they do not mandate the use of technologies yet to be created. As Thomas McNaugher pointed out, when the product to be collectively consumed is, in effect, innovation itself, direct, continual competition will not be effective in improving the efficiency of provision.

Though it is true that the proliferation of repayment plans and other service improvements related to the FFELP were largely a response to nearly identical changes instituted under the DSLP, government is not in the habit of innovating. In fact, most of these improvements had been suggested as means to reducing default rates in the FFELP long before the DSLP had been created. The government's private and state partners in the GSLP/FFELP were reluctant, of course, to undertake any change that might threaten their profits, but with the onset of competition their attitudes changed. While government might be perceived as the leader over the first four years, it is probable that, in years to come and as the result of competition, it will be private entities within the FFELP that take the vanguard in service provision with the DSLP bringing up the rear. Without program competition, it would be unlikely that the programs could anticipate any future improvements at all, however. Not even the private sector will invest in change unless it is sure that it will recoup its losses, even in the presence of competition. If the proposed innovation entails a major investment in the development of

technologies with only limited direct applications to other markets - such as those surrounding the development of a new weapons system - it is not prudent to undertake the project. Fortunately for the students who rely on federally sponsored student loans, the FFELP and the DSLP do not require such innovations to function. If they did - if the success of these programs was dependent upon the introduction of hitherto unknown services and practices - it is unlikely that the introduction of competition to provision would do anything to improve the value of the product.

Conjecture might also lead one to believe that the opposition of in-house and out-source delivery techniques may also have contributed to the success of student loan program competition. I have already stated that the administration of both programs from the Office of Postsecondary Education may have represented a conflict of interest that contributed to poor service performance in the FFELP[106]. However, the presence of non-federal and non-governmental entities as a result of out-sourcing in the FFELP possibly diminished the damage that would otherwise have been the outcome of such an administrative structure.

Obviously, to sustain a competitive environment we need at least two independent actors with a personal stake in the demise of the other. Though ED on one side, and NCHELP and the CBA on the other, most certainly did have a vested interest in the extermination of their respective adversaries, from a governmental standpoint the administration of the programs was hardly independent. FFELP supporters were quite right in claiming that ED did /could use its bureaucratic powers to grade the

playing field in favor of the DSLP. Had the DSLP been administrated from an agency distinct from ED - or, at least, from a different office within ED - improvements within the FFELP might have been sharper.

To the extent that out-sourcing introduces more independent players to the competition, it is reasonable to speculate that it is always preferable to in-house arrangements. However, we know that out-sourcing is not always feasible. Does this mean that in such cases inter-program competition is not possible? Probably not, but it is likely that the gains from competition would be diminished. So long as service delivery requires no more than the application of existing technologies and knowledge bases, there is no reason to believe that competing, mutually independent agencies cannot use in-house techniques to provide identical goods/services to the same consumers. With agency revenues dependent upon the volume of service delivered, and with volume, in turn, dependent upon the quality of service, it is conceivable that Niskanen's bureaucracies could be driven from revenue maximization to quality maximization and cost minimization. By using two government providers, however, we double the potential for government associated inefficiencies. Under such an arrangement, the gains from inter-program competition could be more than lost.

A final factor necessary to the success of service provision based on inter-program competition is the existence of the political ecology to sustain it. Before the creation of the DSLP the environment surrounding the GSLP might be described as

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[106] Especially over the first two years of program competition

any of what James Q. Wilson has defined as majoritarian, interest-group, or client politics [Wilson, 1980, pp. 364 - 372]. At the highest level, it was majoritarian in that the benefits of the promotion of higher education were spread broadly throughout the polity while associated costs, as borne by taxpayers, were also dispersed. Yet, as the previous chapter pointed out, there were readily indentifiable interest-groups - students, public universities, private universities, trade schools, lenders, servicers and guarantors - who viewed the costs and benefits of the program as narrowly focused. With the exception of the guarantors' association, NCHELP, and the Consumer Bankers' Association, these groups were poorly organized and tactically unsophisticated, though. That being the case, one might have expected that ED and its predecessor, HEW's Office of Education, would have been "captured" by NCHELP and the CBA as is predicted by Wilson's model of client politics. Under this model, policy benefits are narrowly concentrated and costs are broadly distributed. If we consider special allowances, administrative cost allowances, astronomical levels of re-insurance, and hefty guarantee agency reserves as some of the benefits of the GSLP, then the client model might seem to be a good fit.

However, neither ED nor the Office of Education ever became subservient to the interest of lenders and guarantors. In fact, their relationship was most often openly adversarial. This antagonism spawned the Direct Loan program, allowed it to resist efforts backed by the CBA and NCHELP to dismantle it, and fosters the competition between the DSLP and the FFELP/GSLP. Such conflict is characteristic of classic

interest-group politics yet, as I have noted, only one set of interests - those of bankers and guarantors - seem cohesive enough to create a viable interest-group.

Latently, another interest-group did exist whose political potential was sufficient to offset, at least in part, the power of bankers and guarantors. Specifically, I refer to the middle-class. While the middle-class is large and, therefore, difficult to organize, with heterogenous interests, if galvanized its ability to exact retribution at the polls is considerable.

And galvanized it would be if the middle-class was excluded from the student loan programs. If left unchecked, the desires for progressively higher levels of compensation on the part of lenders and guarantors would have left policy makers with two choices. Allow the cost of the FFELP/GSLP to rise without limit, or lower income ceilings and otherwise restrict middle-class accessibility to student loans. Fiscally, the former is undesirable while the latter would represent political suicide. Any administration, Republican or Democratic, that chose a course of action that excluded the children of middle-class parents from postsecondary education would find it difficult to satisfactorily explain its decisions before the next election.

Therefore, it would appear that inter-program competition would be most successful when distinct political cohorts capable, at least potentially, of perceiving the effects of policy upon their self-interests exist. Scenarios under which the costs and/or the

benefits of policy are diffuse are not amenable to sustained competition. Politically, every program needs a powerful sponsor.

As evidence, compare the Food and Nutrition Service's (FNS) Office of Analysis, Nutrition, and Evaluation (OANE), and the Economic Research Service (ERS). Just as the FFELP and the DSLP are administered within the same department, so too are the OANE and ERS. Additionally, both the OANE and the ERS provide nearly identical services. As part of the U.S. Department of Agriculture (USDA), the ERS is directed, in part, to oversee the administration of the nation's Food Stamp program (FSP) through research and evaluation. The OANE is identically charged with conducting studies designed to inform and direct policymaking concerning the FSP. As an example of the extreme overlap in functions between the two offices, note that within the last year both offices have published nearly identical white papers. The OANE's "Trends in FSP Participation Rates: Focus on 1994 - 1998", and ERS's "The Decline in Food Stamp Participation in the 1990s" are almost indistinguishable in scope and content.

Competition between ERS and OANE could be beneficial. Replication of analysis and real scholarly debate would only benefit the FSP. However, true competition has not begun, nor is it likely. While part of ERS's function is to help direct the FSP, it has other areas of interest including the maintenance of a competitive agricultural system. Such a duty falls classically within the realm of Wilson's client politics and supports assertions by FNS/OANE officers that ERS is heavily

influenced by the interests of agri-business.[107] On the other hand, FNS/OANE serves low-income families who, as a group, are not know for their high levels of political participation. Individuals at FNS/OANE believe the office's future is secure given that it retains support within the House Appropriations Committee yet one gets the feeling that, with respect to ERS, they are walking on egg shells. One wrong move; one public and controversial confrontation with the ERS and FNS/OANE could find itself legislated out of existence. This is not an atmosphere conducive to competition and, fortunately, it is not at all similar to that which surrounds the student loan competition. In the case of the ERS and the FNS/OANE the existence of an ecology reminicent of client politics insures that competition will not be realized. Clearly dilineated and potentially powerful, offsetting interest-groups make the sustenance of prolonged competition between the DSLP and the FFELP a real possibility.

In sum, the biggest factor associated with the inefficient provision of any good or service - public or private - is monopoly. The NPRG, over the last eight years, has dedicated itself to the conversion of government providers to Performance Based Organizations (PBOs), attempting to restructure the incentives that motivate bureaucracies in such a fashion that their behavior more closely resembles that of their private sector analogs. However, even if the NPRG is wildly successful, so

[107] It is revealing that, without exception, everyone at FNS/OANE whom I interviewed refused to discuss competition with the ERS unless I promised not to

long as a good or service emanates from only one source, it is inconceivable that any government provider will improve over the cost and service delivery of private monopolists. As a final goal for the NPRG this is - or should be! - unacceptable.

The simultaneous existence of the DSLP and the FFELP proves that the introduction of competition, even in an extremely impure form, can lower the cost of a good or service provided by government as well as augment its quality. Even in the realm of public goods and those with appreciable externalities, competition leads to value.

At least it does in this instance. Before we summarily dictate the creation of dual, government service providers, a few more questions need to be answered.

- Foremost, we need to know the circumstances under which the benefits of dual service provision outweigh the costs of duplicating the inefficiencies of government. If the benefits that accrue to intra-governmental competition are marginal, at best, then introducing another government actor could be a serious mistake.
- To avoid such a misstep, it is incumbent upon us to determine the extent to which the involvement of private entities (out-sourcing) is beneficial. Causally, it would seem that their inclusion could only be superior to in-house provision techniques, competitive or otherwise. If for no other reason, it is logical to speculate that once an inter-program competition settled down to something like an equilibrium further improvements would only be the result of innovations brought about by private actors. For good or ill, the private sector acts.

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quote them or otherwise reveal my sources.

Governments only react. Again, we can hope that the NPRG will eliminate the lethargy associated with government provision. Until it is successful, though, we might assume that, if possible, any inter-program competition should include at least one out-sourcing entity. This assumption, of course, must be tested. Because instances of inter-program competition are so rare, this is likely best accomplished through continued observation of the student loan programs.

- However, out-sourcing is not always possible. Other authors have speculated that competition between two or more government entities using in-house provisional techniques could add to the value of the product they provide. Competition for agency revenues based on unit price could lower the joint cost of provision. As well, factoring gross unit volume of product provided into the calculation of agency revenues might also improve the quality of product as customers flock to the provider most sensitive to their needs. This could mean that even in the absence of private entities product innovation is possible. Because such a competition between government actors exclusively using in-house provision does not presently exist, we can only speculate. But speculate we must. Moreover, we must theorize as to what managerial/Public Policy arrangements are necessary to assure not only that competition is legitimate, but also sustained.
- The competition between the FFELP and the DSLP is administered out of a single office - the Department of Education's Office of Postsecondary Education - and I have asserted that this is less than ideal. I have implied that it was only the existence of an out-sourcing program, with its incorporation of private

entities, that made real competition possible. If it were only possible that student loans could be provided in-house, the dual existence of the FFELP and the DSLP might have been a colossal failure. Even with the programs as they are, competition might have been keener and its benefits greater if each program had been administered from independent agencies, or at least independent offices within the same agency. Again, due to the paucity of examples of inter-program competition, we can only speculate. Yet if we are to foster competition between programs that can only function in-house, we must do so creatively and constructively.

Inter-program competition has been successful in improving the value of the provision of student loan services. However, we can only guess as to whether the competition has been as fruitful as it could be under other arrangements. More than this, we can not be sure as to how broadly applicable the injection of competition into the supply of goods and services normally provided by government is. In search of answers to these questions, there is much work before us. We must be able to delineate the "wheres, whos and hows" of inter-program competition.

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