Don't Double Our Rates

An Issue Brief

Congress should be helping to keep college affordable, not making it more expensive for student loan borrowers to pay for college

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YOUNGINVINCIBLES

Background

Unless Congress acts decisively, the interest rate on new federal subsidized Stafford student loans will *double* from 3.4 percent to 6.8 percent on July 1, 2013. A 2007 college affordability plan gradually reduced the interest rate from 6.8 percent to 3.4 percent through 2012, when the rate was scheduled to revert to 6.8 percent. Last year, in the midst of the election cycle, motivated primarily by sluggish economic conditions, President Obama and Congress led a successful effort to extend the low 3.4 percent rate for one more year.

Students have already suffered from a variety of aid restrictions and limitations that have resulted in students contributing $4.6 billion to deficit reduction.

Since the federal government makes 36 cents on every dollar loaned, increasing interest rates simply increases the government's profits from students.

We need to overhaul the student loan system so it is equitable to all borrowers. Such a comprehensive approach will take time and must provide ample opportunity for participation by borrowers and the general public.

Economic Impact

If the interest rate is allowed to double, borrowers will pay about $1,000 more over the life of the loan per year of school. Nationally, more than 7 million borrowers each year would be forced to pay more for their college education.[1] Student loan borrowers already graduate with an average of more than $27,000 in education debt.[2]

The program in question, the federal subsidized Stafford student loan, primarily serves low and moderate income families. The federal government pays the interest on the loan while the borrower is enrolled in college on at least a half-time basis. More than two-thirds of all subsidized student loan borrowers come from families with annual incomes of less than $50,000.[3] These families have been hard hit in the recent recession and continue to face high unemployment and tight family finances.

Meanwhile, the job market is experiencing a skills gap between the number of people without jobs and the qualifications employers are seeking in prospective employees. By 2018, the nation will need 22 million additional college graduates but will fall short by at least 3 million. In addition, there will be a demand for at least 4.7 million new workers with post-secondary certificates.[4] Keeping the interest rate low on student loans enables students, workers, and the unemployed to get the post-secondary training needed to adapt to new economic realities.

Now is not the time to dramatically increase college loan costs and make college less affordable.

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[1] Brief, Keeping Student Interest Rates Low, The White House.
[2] Analysis, Debt At Graduation, Mark Kantrowitz, 2012.
[3] Analysis, Targeting Student Aid, Mark Kantrowitz, 2009.
[4] Report, Help Wanted: Projects of Jobs and Education Requirements through 2018, Georgetown Center on Education and Workforce, June 2010.

Federal Policy Earns Money off Student Aid Recipients

Doubling the interest rate on federal subsidized Stafford student loans will continue an unfortunate and inappropriate trend of using student aid funding to pay down the federal deficit, or simply to generate enormous federal revenues.

Surveys shows that the majority of Americans would increase spending on education, even as they support deficit reduction overall.[5] Sadly, federal student loan policy is already missing the mark, and will only get worse if an unjustifiable rate hike is allowed to stand.

Raiding student aid to pay for deficit reduction: In 2011, as part of the Budget Control Act, Congress reached a bipartisan commitment to maintain a maximum Pell grant of $5,550 for low-income students and provided $17 billion in additional funding over two years for Pell grants.[6] Unfortunately, to find the funds, Congress eliminated the in-school interest subsidy for all graduate student loans and also eliminated most student loan repayment incentives. These cuts generated $4.6 billion more 'savings' than were needed to maintain the Pell maximum.[7] Rather than re-invest those billions in student aid to keep college affordable, congressional leaders applied those dollars to deficit reduction.

In addition, Congress also robbed Peter to pay Pell through a series of other restrictions and eligibility limitations on student aid that shifted those 'savings' to Pell grants. Among these student aid cuts were the elimination of Pell grants for summer learning; the elimination of the in-school interest subsidy during the first six months after completing one's postsecondary education program; limits on the length of time a student can receive a Pell grant or a subsidized Stafford loan; restrictions that make it more difficult for low-income students to automatically qualify for the maximum Pell award; and the elimination of Pell eligibility for students without a high school degree who demonstrate the 'ability to benefit' from post-secondary education.

But cutting student aid to the generations that have to pay off the $17 trillion federal debt is the wrong choice. If this generation and future generations of American students have to shoulder the burden of the accumulated federal budget deficits of the past 40 years, at the very least the federal government should enable them access to the post-secondary skills and knowledge necessary to cope with that debt.

College students have already given up student aid funding to pay down the debt, aid that could have been used to help make college more affordable. Some 140,000 low-income students were knocked out of the Pell grant program due to the restrictions and limitations imposed.[8] Given what students and families have already given up, low-cost financing for needy students seeking loans is all the more critical now.

Squeezing student loan borrowers to generate revenue: Under our federal student loan system, student borrowers have generated revenue either for private banks and lenders, or for the federal government itself.

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[5] Poll, As Sequester Deadline Looms Little Support For Cutting Most Programs, Pew Research Center for the People and the Press, 2/13/12.

[6] Blog, Understand Why Federal Budgets Matter to Students, US News and World Report, 1/18/12; brief, Debt Ceiling Law Provides $17 Billion for Pell, National Association of Student Financial Aid Administrators, 8/3/11.

[7] Interview, Five Questions for Joel Packer of the Committee for Education Funding, National Education Writers Association, 2/28/13.

[8] Release, 143,000 Students Lose Their Pell Grant Next Year, U.S. Public Interest Research Group, 12/19/11.

Before 2010, Sallie Mae and other financial institutions received billions of dollars of student loan interest revenue each year through the Federal Family Education Loan (FFEL) program, which originated about two-thirds of all student loans. Borrowers suffered under this system.[9] Banks and lenders lobbied Congress aggressively to keep interest rates and loan fees high and offered various incentives to schools to capture higher loan volumes, all at the borrowers' expense. Before the market meltdown in 2008, lenders used the already lucrative federal loan programs as marketing tools to mislead hundreds of thousands of borrowers into taking out outrageously high-priced private student loans, among other wasteful and abusive activities.[10] Student aid and consumer advocates lobbied for years against the banks to lower student loan interest rates and improve borrower terms and conditions. While we enjoyed some victories, the loan industry's huge profit margins and lobbying muscle more often prevailed.

By 2008, faltering credit markets threatened to undermine lenders' abilities to make new federal loans to students. To keep the student loan program solvent, Congress had to step in to further support the banks, on top of the profits that the banks were already reaping from borrowers. Meanwhile, the Direct Loan program, which by this point handled roughly 35% of all federal student lending, was running efficiently and reliably, and certainly less expensively. Toward that end, in 2009, President Obama proposed student loan reform to eliminate FFEL, with the support of student and consumer groups.[11] Sallie Mae and other student lenders mounted a massive opposition campaign to halt the reform, but ultimately they failed, and the FFEL program ceased for all federal student loan borrowers taking out a loan on or after July 1, 2010, although private lenders currently still hold hundreds of billions of dollars of federal education loans.

Student loan borrowers have no doubt benefited from student loan reform, which delivered reliability in student lending, and some assurance that they would no longer be targeted by banks through their federal loans. Nonetheless, the high interest rates that banks had pushed for and won for years have persisted. Right now, the federal government is reaping the benefits rather than the banks. For instance, the federal government is borrowing money at a record low – the 91-day Treasury bill is selling at a .08% discount.[12] Federal student loan borrowers are paying rates that are stunningly high in comparison: 6.8% for unsubsidized Stafford student loan borrowers, 3.4% for subsidized Stafford student loan borrowers, and 7.9% for Grad PLUS student loan borrowers and for Parent PLUS loan borrowers.

Recent projections from the Congressional Budget Office, the official scorekeeper for federal programs, indicate that federal educational lending now carries a "negative cost subsidy" of 36.48 percent for 2013.[13] On average, every dollar lent will yield more than 36 cents of profit to the federal government.

The amount of profit varies by the type of loan. In 2014, according to the Congressional Budget Office, the federal government will make 12.5 cents per each dollar loaned through the federal subsidized Stafford student loan program. It will make 33.3 cents per dollar loaned through the federal unsubsidized Stafford student loan program, 54.8 cents on each dollar loaned through

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[9] Report, Obama's Budget Supporting Students, Not Banks, U.S. Public Interest Research Group, 3/26/09.
[10] Story, Pre-emptive Strike on Student Loans, Inside Higher Ed, 4/25/07.
[11] Speech, Remarks by the President on Innovation and Sustainable Growth at Hudson Valley Community College, President Obama, 10/21/09.
[12] Post, 91 Day Treasury Bill, www.bankrate.com.
[13] Report, CBO February 2013 Baseline Projections for the Student Loan Program, Congressional Budget Office, 2013.

loans to graduate students, and 49 cents on the dollar for parent loans[14]. Applying these margins to the $108 billion in educational loans that the government will make next year, the following chart calculates that over $34 billion in profit is generated[15].

Loan Program	Borrowers*	Amount Loaned	Revenue to Government
Subsidized Stafford	9,436,000	$28,129,000,000	$3,516,125,000
Unsubsidized Stafford	10,885,000	$60,516,000,000	$20,051,595,000
Grad PLUS	563,000	$9,341,000,000	$5,122,604,000
Parent PLUS	875,000	$10,881,000,000	$5,331,690,000
TOTAL	**21,759,000**	**$108,867,000,000**	**$34,022,014,000**

* CBO data provides net number of loan data per loan type. We assume one student per loan, although one student may borrow more than one type of loan.

The federal student loan program as it currently operates is the opposite of a low cost program to student loan borrowers – it makes billions in revenue yearly. Meanwhile, student loan borrowers, continuing to face economic uncertainty, bear the brunt of continued high costs.

Fixing the Student Loan System Will Require Deliberation and Time

Considering the enormity of the student debt problem and the significant number of students and borrowers impacted, it is clear that we need a comprehensive overhaul of federal student loan policy. The focus of that reform should be to ensure that students can access affordable borrowing rates and have reasonable repayment options to keep debt burden in check. Achieving a comprehensive student loan solution should be a priority for policy makers, particularly given the looming deadline on subsidized Stafford interest rates. If comprehensive student loan reform proves politically impossible, we must at least come to a short-term agreement that is good for students and leads us on a path toward a long term solution. Not only is it the right thing to do for the low- and moderate-income families that overwhelmingly receive federal subsidized Stafford student loans, but it demonstrates a political commitment to moving student loan and student aid policy away from being a financial bonanza for the federal government, and toward being a tool that enables Americans to access a higher education equitably.

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[14] Ibid.
[15] Report, [Direct Loan Program, AY 2011-2012, Q4](), Federal Student Aid, 2012.