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COST OF COLLEGE

A Quiet Revolution in Helping Lift the Burden of Student Debt

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Has the student loan crisis already been solved?

This might seem an absurd question. Student loan debt is at a record high of \$1.1 trillion, and the average undergraduate who borrows to attend school graduates nearly \$30,000 in debt. Almost 20 percent of student borrowers are in default.

Yet a couple of little-noticed legislative tweaks to a small, obscure loan repayment program — revisions made under two very different presidents — appear to have created the conditions for far-reaching changes in how a college education is bought and paid for. The result may make it much easier for students to get out from under their debts.

The first changes happened in September 2007, when Congress passed a major overhaul of the federal college financial aid system. Most of the news coverage at the time focused on the fact that government subsidies would shift from private banks that offered loans to Pell Grants for low-income students. But the bill that President George W. Bush later signed contained another modest change in the law that would later gather significance.

To understand how that change set in motion what is happening today, it first helps to understand how the original government loan program worked. Starting in the 1960s, the federal government offered generous subsidies to private banks, which would then make loans to students.

In the 1990s, President Clinton helped create a new loan option that allowed students to borrow directly from the United States Department of Education. If they did, they were eligible for an income-based repayment regime in which loan payments were limited to 20 percent of the borrower's income, after a deduction for basic living expenses. Any balance remaining after 25 years of payments was forgiven.

But the repayment option wasn't available to students who borrowed under the private sector loan program. Those lenders, flush with federal subsidies, dominated the market at the time. Few people enrolled in the income-based program.

The 2007 law modified that idea and called it IBR (for Income-Based Repayment). Under the new program, the repayment terms were made more generous. Monthly payments were capped at 15 percent of income, rather than 20 percent, and the living expense deduction was raised significantly. The loan forgiveness threshold stayed at 25 years, with an important exception: Loan balances would be wiped clean after only 10 years for people who worked in public service jobs, broadly defined as anywhere in the government or nonprofit sectors.

The logic behind income-based repayment is that because students can't control whether they graduate in a recession, the student loan system is particularly vulnerable to the business cycle.

"College degrees pay off in the long run, but many graduates struggle to manage their debt upon graduation," said Rory O'Sullivan, deputy director of Young Invincibles, a millennial research and advocacy group. "Income-based repayment plans protect students from early career struggles, layoffs and tough economic times."

Under an income-based repayment, if you make little money, you repay little money. If you make nothing, you owe nothing, and your loan doesn't go into default. The loan forgiveness provision protects borrowers from too much interest accumulating over time.

In 2010, Barack Obama was president, and he, too, pushed a financial aid overhaul through Congress. This time, the government-subsidized private sector loan program was entirely shut down.

Important changes to the income-based repayments were made, but because they were passed under the same legislation that created the Affordable Care Act, few people paid much attention to them. IBR had been made even more generous. Now borrowers had to pay only 10 percent of their income per month, even as the forgiveness threshold was lowered to 20 years. People who work in government or nonprofits are still eligible for forgiveness after a decade. Although it was originally slated to become effective in 2014, Obama administration lawyers found a way to effectively speed up the IBR start date by several years. Most important, all students would now borrow directly from the federal government and be eligible for the more favorable repayment terms.

At first, uptake was slow. Students have to apply for IBR, and it took time for the Education Department to spread the word.

But the latest numbers show a powerful shift. By the third quarter of the 2013 federal fiscal year, only 6 percent of federal borrowers, representing 14.4 percent of the Education Department's outstanding loan portfolio, were enrolled. Since then, awareness has grown and the numbers have surged. By the end of 2014, the number of borrowers in IBR had nearly doubled, to 11.8 percent. Those borrowers had larger loans on average and represented almost 25 percent of all federal direct student loan dollars owed — over \$100 billion. As loans made before IBR was put into effect continue to come off the books, the new system is sure to grow.

We appear to be in the middle of a rapid transition in how student loans are repaid, one that is moving the federal government into the same role that state governments played for much of the 20th century: the foundational provider of broad, unqualified subsidies for higher learning.

The historical social contract used to be straightforward. All citizens were eligible for generous government college subsidies in the form of low tuition at public colleges and universities. Graduates “paid back” that subsidy in the form of larger tax payments — and in most states, higher marginal tax rates — on the additional income that their diplomas helped them earn.

Some graduates earned more and paid more; some earned less and paid less. Nobody said that a college graduate who ultimately paid back less in taxes than the amount of his or her original tuition subsidy had “defaulted,” because it was

understood that luck, business cycles and career choices vary, and that the collective result for all students was good for society.

By moving more students into IBR, the federal government is essentially replicating this arrangement. Once again, those who earn more pay more, returning the full amount of their loan, plus interest, before the 20-year forgiveness threshold is met. Those who earn less, for whatever reason, pay less. Nobody will ever default simply because they can't afford to pay.

For many, the interest rate on their loan won't matter. Take, for example, someone who finishes a bachelor's degree with the national average of \$29,000 in debt, and borrows another \$13,000 for a master's degree in education. The new graduate goes to work as a schoolteacher at a starting salary of \$35,000, which grows to \$50,000 after 10 years. Under IBR, the monthly loan payment will start at \$117 and never rise above \$200. The teacher will pay only \$18,360 in total on the loans, and \$48,840 in principal and accumulated interest will be forgiven after 10 years.

If it seems as if the whole concept of a government-backed student "loan" is disappearing, that's true, and probably a good thing. Using a debt system to make college affordable has always been an awkward fit.

While home borrowers need a down payment, income and a credit rating, federal student loans are available to anyone who enrolls in an accredited college. While home and car loans are backed by assets that can be repossessed, banks can't seize a college degree. This is one reason lenders successfully lobbied Congress to make student loans very difficult to discharge in bankruptcy, and thus even more onerous for people who can't afford to repay them.

Robert Shireman, a former Obama administration official and architect of the 2010 loan changes, says we are better off now that "how students make payments on student loans, and how much they need to pay, is no longer complicated by how the banks will feel about it."

Not everyone is enthusiastic about the idea of more government spending on higher education. "The potential cost of this program is enormous," said Representative Virginia Foxx, a North Carolina Republican who leads the House Education and the Workforce Committee's higher education subcommittee. "It's unfair to burden hardworking taxpayers, many of whom have not had the opportunity to attend college, with that debt," she said.

The change in college financing has a potentially serious drawback when it comes to college pricing. Income-based repayment programs in Australia and

Britain work in part because national governments keep tuition low. Public universities are, to different degrees, legally obligated to hold down tuition prices in exchange for financial support from state governments. But that system has been eroded by state budget cuts, driving tuition and borrowing up, and there are no price restraints attached to the federal IBR system.

This is less a problem for undergraduate programs, for which traditional students are allowed to borrow only up to \$31,000 in total. Graduate students, by contrast, can borrow up to the full “cost of attendance” — tuition, fees, room and board. For medical and law schools, this can run into the hundreds of thousands of dollars, all potentially forgivable under IBR. This creates a strong incentive for graduate and professional schools to raise prices and pass federal taxpayers the bill.

To counter such practices, the Obama administration has proposed moving the forgiveness threshold for students with large graduate debts to 25 years from 20, and capping public service loan forgiveness at \$57,000.

The free community college tuition program President Obama proposed and discussed last week in his State of the Union address would help a different group of students (most community college students don't take out federal loans to attend school). The two programs would be complementary, expanding free universal public education for two years beyond high school while making more affordable any additional higher education that students would have to pay for.

In the long run, the signs point toward the federal government replacing states as the primary financier of American higher education. Given how much unnecessary financial hardship has been imposed on students, this is a welcome trend. The sense of pervasive student loan anxiety that characterizes much of the contemporary higher education conversation could become a relic of an older time.

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