THE PROJECT ON STUDENT DEBT

Memorandum

TO: Reporters, Editors, Producers
FR: Robert Shireman
DT: February 10, 2006
RE: Rising Student Debt and the Limitations of the U.S. Repayment System

More students are borrowing larger amounts to pay for college than ever before. About two-thirds of recent graduates carry student loans, and their average debt has increased by more than 50 percent over the past decade, after accounting for inflation. In addition, interest rates are now rising, adding significantly to the size and duration of borrower payments. Students, families and others are understandably concerned.

The Project on Student Debt has just completed a review of U.S. student loan repayment policies, analyzing the extent to which borrowers are protected from excessive repayment burdens. Our new White Paper, available at http://projectonstudentdebt.org/files/pub/WHITE_PAPER_FINAL_PDF.pdf, describes the current system, assessing its strengths and weaknesses and identifying practical ways to achieve a more rational and effective balance of borrower obligations and protections. We found that:

- Many borrowers who clearly should qualify for assistance do not.
- Some provisions counter-productively reward borrowers for working less or earning less, or for borrowing more.
- Some programs fail to consider family size in assessing the amount the borrower can afford to repay.
- There is insufficient assistance for borrowers who have low incomes relative to their debt over a long period of time.
- Even when formulas for repayment assistance are designed appropriately, borrowers often are not informed that the assistance is available.

Most Americans agree that student loan repayment policies should aim to ensure that borrowers with low post-college earnings do not face unmanageable payment expectations, and that those who are responsible and make manageable payments are not burdened with indefinite repayment obligations. But, in those regards, our policies are falling short. Even though our student loan system includes provisions that aim to ease repayment burdens, the protections are inconsistent and sometimes irrational, complex, and too narrow in scope.

For instance, a graduate who works 40 hours a week and earns $12,000 a year does not qualify for federal “economic hardship” relief, which would cover the interest on student loans and allow delays on payments. But if he worked 25 hours and had same total income, he would qualify for “economic hardship” relief.

Similarly, a doctor serving indigent patients and earning $37,500 a year would pay more than $5,000 per year to keep her $79,000 loan balance from growing. But her colleague, with the same salary, would get interest relief from the federal government if she borrowed $80,000, rather than $79,000.

It's time to improve our loan repayment policies, and we are convinced that can be done without a radical overhaul of our system. The building blocks that are there simply need to be assembled in ways that make sense and that reach out to those who are eligible. Our new White Paper identifies three possible directions for addressing the system's shortcomings:

> **Expanded "economic hardship" provisions.** Some federal loans offer interest subsidies for periods of "economic hardship." However, the current formulas lead to situations in which borrowers in similar situations receive vastly different treatment. These provisions could be improved by phasing out the benefits as borrower incomes rise. Other potential improvements include adjusting the benefits for family size, eliminating the three-year limit, and making other loans eligible for interest assistance. In addition, information about the assistance needs to be more readily available and the process for applying less burdensome.
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> **Tax credit for student loan interest.** This proposal would provide taxpayers with incomes below a certain threshold with a refundable credit for their actual interest payments on student loans. The income threshold would take family size into account. Borrowers with incomes above the threshold would receive a partial credit. A tax credit gives borrowers a financial incentive to make payments on their loans. By using a sliding scale linked to repayment burdens, borrowers would also have a financial incentive to earn more.
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> **Simplify income-based repayment**. Some borrowers with federal loans have a repayment option called "income-contingent repayment," or ICR. It is the only current plan that allows for eventual forgiveness of remaining loan balances, after 25 years of income-based payments. This program could be improved by making it available to all borrowers, reducing the maximum repayment period, and ensuring that amounts forgiven are not treated as taxable income.

Last November, the Project on Student Debt held a symposium with the American Enterprise Institute, bringing together leading researchers and policy experts to explore the implications of rising student debt and consider innovative proposals. With the release of this White Paper, the Project is seeking feedback on potential solutions from student groups, loan providers, higher education leaders, policy makers and others, with the goal of developing specific proposals that will be announced by the spring. In the meantime, I encourage you to visit our web site, www.projectonstudentdebt.org, for regular updates and information. And if you need to talk to an expert, don't hesitate to call Gretchen Wright at 202/371-1999 or Lauren Asher at 510/647-4304. Thank you.

The Project on Student Debt is managed by the Institute for College Access and Success, a nonprofit, nonpartisan organization dedicated to expanding educational opportunity. The Project is supported by the Partnership to Reduce the Burden of Student Debt, an initiative of the Pew Charitable Trusts with support from the Surdna Foundation. The Project's other funders include The Rosalinde and Arthur Gilbert Foundation, The William and Flora Hewlett Foundation, the Open Society Institute, and the Level Playing Field Institute.