Insight

Public Sector Student Loan Forgiveness and the Taxpayer

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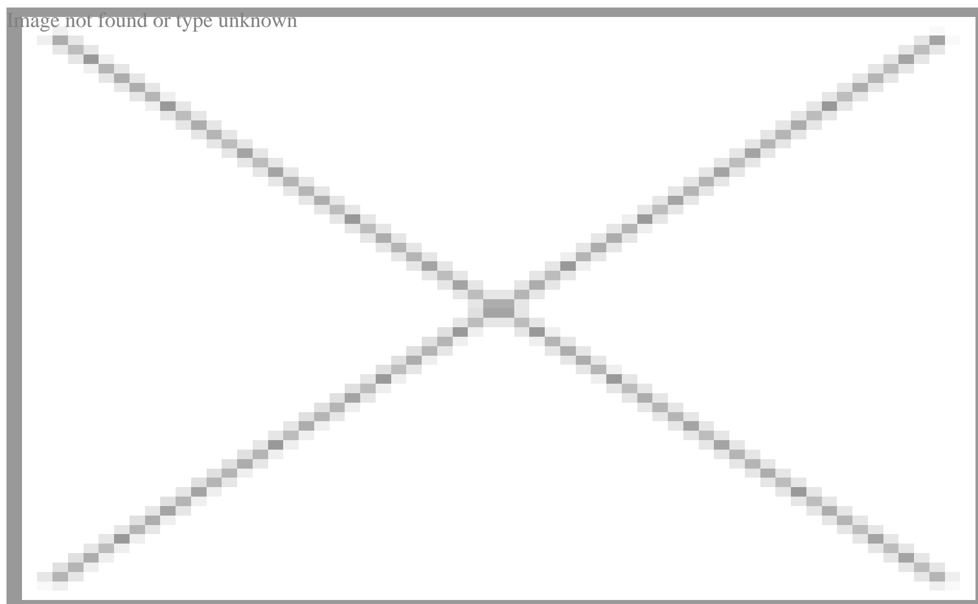
In the wake of the administration's effort to ensure college remains affordable for millions of low-income students by expanding loan repayment options, a recent report by the New American Foundation describes one of many reasons the income-based repayment program is bad policy. For many borrowers, it offers free money by permitting them to write off massive chunks of their debt while still earning relatively high incomes. That's bad enough, but it gets worse. The increasingly popular income-based repayment program is also adding billions of unadvertised costs to the direct loan program – costs borne by the taxpayer.

Income-based repayment is a form of student loan repayment that allows borrowers to cap repayment at approximately 15 percent of their annual adjusted gross income, less an allowance equal to 150 percent of the federally-defined poverty level (ranging from roughly $16,000 for a single person to more than $60,000 for a head of a household with eight people). This somewhat complicated formula ensures that students with higher debt loads and lower income levels can sign up for a program that lets them pay less each month than their peers with similar sized loans but higher incomes.

A second, and costlier, component of the program is a provision that permits students to discharge the balance of their federal direct student loan after making 25 years of on-time payments (reduced to 20 years in 2012) if they work for a non-profit organization or government entity. This means that someone working for any of a number of 501(c)(3) organizations – Teach for America with annual revenues of $306 million or the United Way with annual revenues topping $3.9 billion the Federal Government, the state of Maryland, or DC's Parking Administration, could have a considerable portion of their loan forgiven. This part gets a little bit trickier, as many high-paying professions are with non-profit organizations and even government agencies. In fact, as demonstrated in the table below, wage and income data for workers in the non-profit, private, or government sector see very little disparity.



Source: Created by AAF using Bureau of Labor Statistics, National Compensation Survey Data[1]

One of many challenges with this particular provision is that it was expanded through executive order, and Congress never considered the costs associated with the changes. When the federal government took over all student loan responsibilities in 2009, the stated rationale leaned heavily on the notion that a federally-run program would be cheaper than the private-sector program operating at the time. According to the Congressional Budget Office, after excluding administrative costs, the switch from private-sector to federal direct lending would save around $80 billion over 10 years.

That now-dubious supposition was based on an arcane set of budget calculations called subsidy rates, imposed by an even more arcane bit of legislation passed in 1990 called the Federal Credit Reform Act. In layman's terms, subsidy rates are basically the cost to the government per dollar lent. If a subsidy cost is positive, the loan will cost the government money. If the cost is negative, it will save the government money (or more accurately, generate revenue through interest and principal repayments). The key is that negative subsidy costs were good, positive subsidy costs were bad.

With that in mind, take a look at the President's own budget for fiscal year 2015, showing that what once was a good thing for the government becomes a very bad thing for the taxpayer as soon as a borrower enters income-based repayment. According to the table below, a $100,000 graduate loan (unsubsidized Stafford loan) would net the government $22,530 in interest revenue if the borrower stayed in standard repayment. A borrower entering extended or graduate repayment would pay back in the government's favor over $31,500.

Program	Fiscal Year 2013	Fiscal Year 2014	Fiscal Year 2105
Stafford:			
Standard	6.80	–2.03	3.28

Extended	11.40	–6.06	0.49
Graduated	12.54	–5.29	1.64
ICR/IBR2	21.22	13.02	19.23
Unsubsidized Stafford:			
Standard	–19.58	–25.11	–22.53
Extended	–25.31	–35.84	–31.59
Graduated	–24.78	–36.15	–31.52
ICR/IBR	20.96	12.66	18.59
PLUS:			
Standard	–28.74	–37.08	–33.78
Extended	–42.75	–62.90	–55.55
Graduated	–43.74	–65.21	–57.21
ICR/IBR	12.73	5.51	15.36

Source: White House, Budget of the United States, Fiscal Year 2015

In stark contrast, a $100,000 loan that switches into IBR would become a liability for the government, costing up to $18,590. That's over a $40,000 switch into the red. When one considers that the federal government expects to make over $55 billion in unsubsidized Stafford loans in fiscal year 2015 (a single fiscal year!), that potential swing gets to be pretty enormous. The President's budget suggests that if all of those borrowers opted for IBR, the cost to the taxpayer could end up being $10.9 billion, a far cry from the potential savings/earnings of $12.5 billion. And that's only the cost for unsubsidized Stafford loans. Stafford loan borrowers could add another $4 billion of costs by switching to IBR. And despite notions to the contrary, even Parent PLUS loan borrows can add to the taxpayers' pain by consolidating Parent PLUS loans and then entering IBR/ICR, winning the outright title of the most expensive bait and switch ever implemented by the U.S. Department of Education, or perhaps any agency, ever.

If these hidden costs aren't enough to make you question the value of the IBR program, consider some of the professions eligible for IBR's public sector loan forgiveness. Two attorneys, both enjoying life at the 75th

percentile income level for their profession who borrowed a typical amount, might each expect to repay around $200,000 total for their legal education. Yet if one opens her own practice and goes on to hire a handful of associates, she pays the full amount of her loans – principal and interest. Her peer, who makes the same amount but happens to work for a government agency, could have up to $99,000 of his loans forgiven. Contributions to the economy are not a factor, it's simply a measure of who they work for.

In another example, a pharmacist who works for one of the major retail store chains and enjoys an income at the 75th percentile for that profession will expect to pay back around $190,000 on a typical debt for pharmacy training. His peer, who works for a non-profit health insurer, could have close to $100,000 in loans forgiven. Should the pharmacist working for the non-profit health insurer decide to borrow more, he could enjoy almost $200,000 in debt forgiveness, as the public sector loan forgiveness program effectively eliminates any disincentive from borrowing more money if it can be forgiven later.

Taxpayers have a right to be upset. As New America accurately point out, the IBR program is an open invitation to borrow unnecessarily. And the way the program divvies out benefits makes it easy for anyone smart enough to attend graduate school to figure out how to potentially game the system. Combined with the program's massive hidden costs, taxpayers should be incensed that the IBR program, intended to provide better access to higher education and make student loans more manageable, is adding tens of billions of dollars to our nation's already unmanageable debt and doing nothing to improve access to postsecondary education.

[1] http://www.bls.gov/ncs/ncswage2010.htm