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Affordable at Last: A New Student Loan System

By Erin Dillon

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Education Sector is an independent think tank that challenges conventional thinking in education policy. We are a nonprofit, nonpartisan organization committed to achieving measurable impact in education, both by improving existing reform initiatives and by developing new, innovative solutions to our nation's most pressing education problems.

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Last year, the United States reached a troubling new milestone in higher education: for the first time, total student loan debt in the United States exceeded total credit card debt. It's a development that should have come as no surprise. Over the past 15 years, the amount that students borrow to finance their postsecondary education has grown by every available measure: between 1993 and 2008, the percentage of bachelor's degree recipients who borrowed for their educations jumped from 49 percent to 66 percent, with average total debt at graduation increasing over 50 percent, from $15,149 to $24,700.[1] Borrowing money to go to college, like borrowing money to buy houses and cars, is fast becoming a fact of American life—and so, it is turning out, is the struggle to pay it back.

As with home mortgages, student loans are often billed as "good debt"—the sort of borrowing that, in the case of education, will ultimately pay off in the form of higher future earnings, better career options, and more stable employment. Happily for many students, debt does bring all of these dividends. But for others, school debt can be as toxic, or even more toxic, than the loan burdens from an overused MasterCard or Visa. Recent research shows that 56 percent of student borrowers had trouble making loan payments within five years of leaving school. Among those who left school without a degree, just 26 percent were making on-time payments. That means that more than half of student borrowers were in deferment, forbearance, delinquency, or default.[2] The consequences of such circumstances are severe: students who default face everything from ballooning repayments and wage garnishment to ruined credit ratings and revocation of professional licenses. Meanwhile, because most student loans are guaranteed by the federal government, taxpayers must pick up the tab.

It doesn't have to be this way. Recent federal reforms, which cut private loan companies out of the federal student loan program, have brought a rare opportunity for the government to abandon this rigid and punitive system in favor of one that is more flexible and forgiving—one that allows students to pay back loans on terms they can actually afford. Such a system would adopt the financing instrument known as the income-contingent loan, which allows borrowers to repay their debts based on their incomes. Economist Milton Friedman proposed this system as far back as 1955, and other countries have successfully used it as their primary repayment method for at least a decade.[3] If the United States ever hopes to clean up the wasteful, complex, burdensome mess that is the student loan system today, it should adopt the income-contingent loan as its sole method for repaying debt.

How Income-Contingent Loans Work

As any student who has ever used it knows, the existing federal loan system is positively dizzying in its complexity. It forces students to negotiate a maze of financing options—subsidized and unsubsidized Stafford loans, Perkins loans, special grant/loan combinations for specific professions or majors, and more. Each loan carries different borrowing limits and varying interest rates, from 3.4 percent for subsidized

Stafford loans to 8.5 percent for the loan targeted at graduate students known as Grad PLUS.

Once students get their loans, they face an equally baffling number of options for repaying them.[4] They can consolidate their loans and repay them as one, larger loan with a single interest rate, or they can repay them separately under different interest rates.

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They can pay over 10 years or, if their debt is high enough, over 25. To avoid default, they can apply for deferment, which postpones payments without accruing interest, or forbearance, which temporarily stops or reduces payments. Or, if their incomes are low enough, they can enroll in an income-based repayment program the government began offering in 2009. Significantly, all of these options require the student to take steps to actively avoid default—to file paperwork, re-apply every year, and sometimes even negotiate with the lender. In short, they treat students struggling to make payments as the exception, when in fact they are the rule.

As is often the case with products and services, multiple choices are not always a good thing. Students can have trouble distinguishing between the many public loans that are offered and costlier private loans, and the confusion, some research indicates, often causes them to take out more expensive loans than they should.[5] Students can also find themselves in delinquency or default as they lose track of multiple loans and the amount on each that they owe. And they may not know about alternative repayment plans, or which ones might be best for them.

A simple income-contingent loan would do away with all of this confusion, replacing the myriad financing instruments with just one loan, with one interest rate and one payment system. All borrowers would repay their loans as a percentage of their income, thereby virtually eliminating default: when their incomes went up, payments would go up; when their incomes went down, payments would go down. There would be no forms to fill out, no arbitrary timelines to meet. The payments would be automatically adjusted because they would be collected through the federal tax system. A borrower's obligation would end when he repaid the balance of his loan plus accrued interest, or when he had made regular payments for a specified time, generally 20 to 30 years. After that, any remaining debt would be forgiven. As Wisconsin

Income-Contingent Loan System vs. The Existing Option

The income-contingent loan system that we are proposing may sound like the income-based repayment (IBR) system the government started offering in 2009. Both let borrowers make payments based on their incomes. But the two have an important difference: income-contingent loans are an entire system, while income-based repayment is just one option in the existing, complicated loan system.

The current IBR program, which fewer than 450,000 borrowers are taking advantage of, caps monthly payments at an affordable amount based on income and family size.[1] The government limits what borrowers have to pay to 15 percent of the difference between their gross income and 150 percent of federal poverty guidelines.[2] After borrowers make payments on loans for 25 years, the balance is forgiven. Borrowers who are eligible for the current income-based repayment option must file paperwork and resubmit it annually to qualify.

Under a universal income-contingent lending system, however, *everyone* would automatically repay their loans based on their income. There would be no need to submit paperwork every year. Instead, payments would be calculated through the tax system and would be automatically adjusted if salaries or employment change.

Income-based repayment is a great option for struggling borrowers under the existing loan system. But the existing *system* needs to change—borrowers need more than another repayment option.

Notes

1. "Fact Sheet: Help Americans Manage Student Loan Debt," The White House, Office of the Press Secretary, Press Release, October 25, 2011.
2. For loans taken out on or after July 1, 2014, income-based repayment amounts will be capped at 10 percent of discretionary income and loans will be forgiven after 20 years of payments. President Obama has proposed a similar program to begin in 2012.

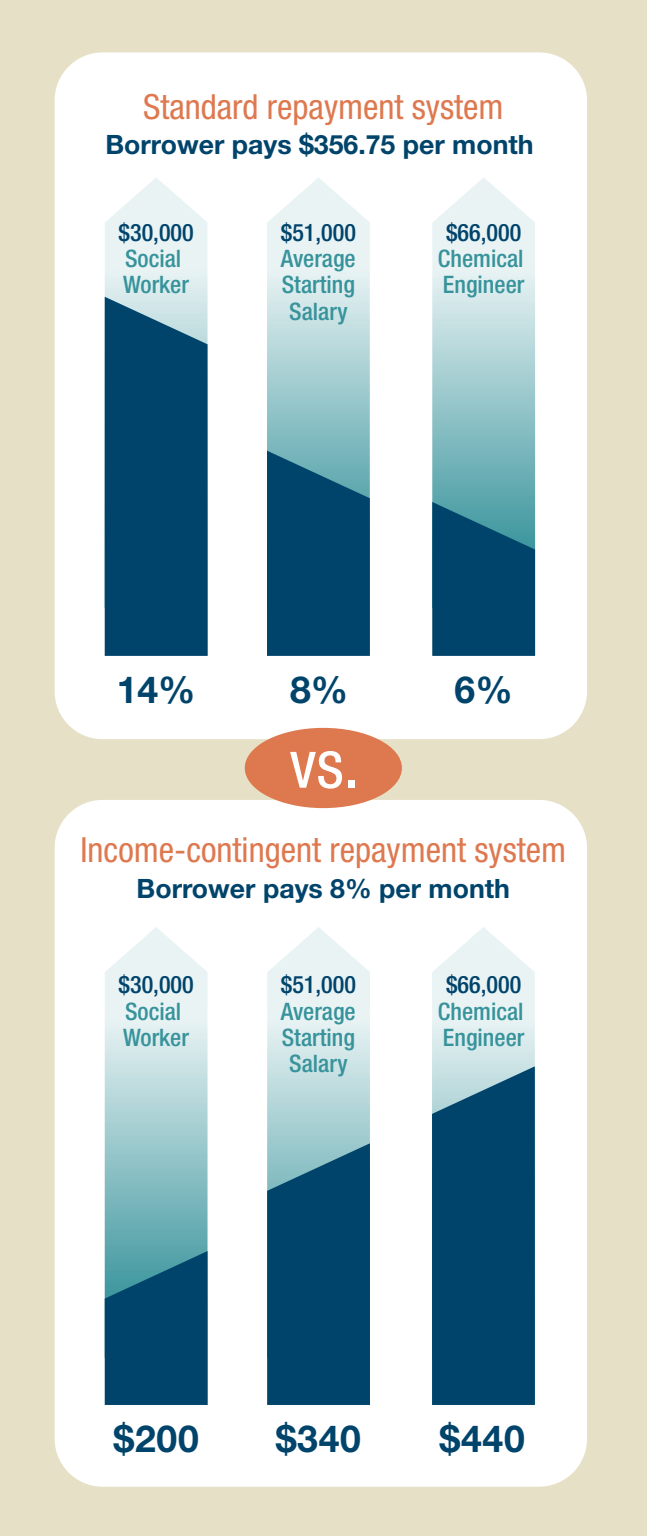
Congressman Tom Petri concluded 20 years ago when he proposed that the United States shift to an income-contingent student loan system: "With income dependence we can have a program open to everyone, far simpler for schools and the government to administer, far simpler for students at application, and more manageable and supremely flexible during repayment. At the same time virtually eliminating the default problem and saving immense amounts of money."[6]

Consider the undergraduate student who borrows the maximum amount—$31,000—from the federal government. Under the standard repayment schedule, this student would owe $356.75 a month for 10 years following a six-month grace period. If he got a job paying the average starting salary for college graduates—$51,000—he would find the monthly payment relatively affordable at about 8 percent of his pre-tax salary.[7] If he graduated with a degree in chemical engineering and received the average starting salary of about $66,000—among the highest for any major—he would be comfortably repaying his loans at 6 percent of his pre-tax income. At the other end, if this graduate received the average starting salary for graduates in social work—approximately $30,000—he would struggle to make monthly payments that would amount to 14 percent of his pre-tax income.[8] Under the current standard system, the social worker would be at a much higher risk of delinquency or default than the chemical engineer. Consequently, he would have to think carefully about the financial implications of his chosen career.[9]

Under an income-contingent payment system, our borrower could pursue a career in social work without worrying about too-large monthly payments. Instead of owing a fixed $356 a month, his monthly payments would vary while the percentage of his income used to calculate payments would remain constant. Let's say this new system set payments at 8 percent of pre-tax income. With a starting salary of $51,000, our borrower's payments wouldn't change much; they would drop by $17 to $340 a month. If our borrower made $66,000, his payments would be $440, and he would be able to repay his loan faster. If, on the other hand, he made $30,000, he would take longer to repay, but his payments would be a more affordable $200 a month—$157 less than under the standard repayment schedule. (See Figure 1.)

Figure 1. Comparison of monthly payments under existing and proposed loan systems

Under the existing system, student loan borrowers pay a fixed amount every month regardless of their incomes. Under an income-based system, payments vary because they are based on a percentage of income. These figures are based on a $31,000 loan.



Along with adjustable payments, income contingent systems typically have a minimum income below which borrowers needn't make any payments at all. In Australia, borrowers don't have to make payments if their income falls below the U.S. equivalent of $48,768.[10] In the United Kingdom, the minimum income level is the equivalent of $23,743 in U.S. dollars, and in New Zealand, it is the equivalent of $15,339. (See Appendix: International Income-Contingent Loan Systems.) In the United States, under the existing income-based repayment option, borrowers are exempt from payments if their income falls below 150 percent of the poverty line for their family size—currently $16,335 for a single person.

The percentage of the borrower's income that is used to calculate the payments is another important variable. With the existing U.S. income-based option, borrowers pay 15 percent of any income above 150 percent of the poverty line. Australia uses a sliding scale that charges anywhere from 4 percent of income for those just above the minimum income threshold to 8 percent for the highest earners. Both New Zealand and the United Kingdom set a flat percentage that is charged on income above the minimum income threshold—10 percent in New Zealand and 9 percent in the U.K. While 8 percent is often cited as the "right" amount of income to dedicate to student loan payments, research suggests that a sliding scale is better. It recognizes that those who earn less should dedicate a smaller percentage of their incomes to loan payments because necessities like housing and food take up proportionately more.[11] Ultimately, payment rates need to be set at a level that keeps monthly payments affordable, while also encouraging borrowers to pay their debts as quickly as possible.

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A third crucial variable is the interest rate charged on loans. Unlike mortgage-style loans, under which a higher interest rate means higher monthly loan payments, the interest rate on income-contingent loans doesn't change the monthly payment amount. But, a higher interest rate does mean that borrowers will take longer to repay the debt and will pay more over time.[12] Other countries charge minimal, or no, interest on income-contingent loans. New Zealand, for example, charges no interest for students who remain in the country after graduation, and Australia charges only enough interest to keep up with inflation.

To ensure that costs are covered, the U.S. government should base the interest rate on the cost of government borrowing plus any additional amount required to cover administrative expenses and loans that are not repaid.

One Loan

By offering students one loan at one interest rate, with a single repayment system, income-contingent loans would not only simplify the current loan system, they would also better target loan subsidies to those borrowers who truly need them. Currently, students whose family incomes are low enough are eligible for "subsidized" loans, which charge no interest while students are enrolled and low interest (now 3.4 percent) during repayment. Even "unsubsidized" student loans, loans on which interest is charged while students are in school, are actually subsidized. That is because they are offered to students at a below-market interest rate (now 6.8 percent), considering that most students have no credit history and, unlike mortgage borrowers, typically have no property for the bank to repossess if the borrower defaults.

A flaw of this system is that it charges interest based on a student's, or his family's income upon entering college but gives students no income-based help during repayment, when they may need that help the most.[13] Consider again the chemical engineer. He may have received a subsidized loan while in college, then gone on to earn a large salary, all the while receiving a government subsidy in the form of artificially low interest rates. Meanwhile, another student with a higher income upon entering college could take a low-paying job in social work after graduation, but

end up paying interest at double the rate of the chemical engineer.

An income-contingent loan system is blind to income at the time the loan is granted. Any subsidies would come well after graduation in the form of loan forgiveness for those students who reliably make payments for decades but who don't earn enough to repay their total debt.

Repayment Through the Tax System

Collecting payments through the federal tax system is essential to making an income-contingent loan system reliable and cost-effective. Deductions would be automatically adjusted and processed much like payroll taxes such as Social Security or Medicaid. Little additional bookkeeping would be required. In Australia, when a student takes out a college loan, the debt is recorded under his unique "tax file number," equivalent to the U.S. Social Security number. Once students leave college and their income reaches the minimum level for repayment, the government collects payments through the borrower's employer, with adjustments made automatically depending on the borrower's income. If the borrower is self-employed, he calculates his own payments, just as he would his taxes, and pays in installments throughout the year.[14] Because of these built-in efficiencies, administrative costs for an income-contingent system are likely to be no more, and potentially less, than the costs to administer the current student loan system.[15]

The Internal Revenue Service in the United States—like its counterparts in Australia, the United Kingdom, and New Zealand—clearly has the capacity to collect student loans. It has a strong legal framework, a universal and transparent system of personal taxation, and an efficient payment mechanism, including computerized record-keeping.[16] Indeed, the IRS essentially agreed that it had this capacity two decades ago. In 1992, a House subcommittee held a hearing on two pieces of legislation, including Petri's income-contingent loan proposal, which called for income-based repayment through the IRS. Michael Bigelow, the agency's deputy assistant commissioner of returns processing at the time, expressed misgivings about the proposals, but said: "I do not want to convey the impression that the IRS would not be able to collect student loan repayments if that is the will of the Congress and the President."[17] As Bigelow noted, the IRS already collects defaulted student loans as well as other non-tax debts such as child support payments and delinquent small business loans. And it has collected these debts successfully, suggesting it can handle the additional responsibility.[18]

But Bigelow wasn't entirely receptive to the idea, either. And it wasn't simply because of the many administrative adjustments he said would be necessary. Rather, his resistance was primarily based on what he saw as a significant shift in the IRS's function—from one of tax collector to one of primary debt collector. The proposed legislation, he said, would represent "a fundamental change in the mission of the Internal Revenue Service and our role in the lives of taxpayers."[19]

Similar concerns had been raised a few years earlier in Australia by the committee charged with developing a system to finance higher education there. The committee recommended income-contingent loans but, at the time, policymakers weren't sure that the Australian Tax Office was up to the job, or whether debt collection was even an appropriate role for the agency.[20] The Australian Tax Office agreed, arguing that its mission was to collect "taxes, not debt."[21] But the committee was ultimately persuaded by the tax office's success in collecting delinquent child support payments, another type of non-tax debt. Its decision has proven a sound one: the tax office has since succeeded in collecting student loan payments, and its role has not been dramatically expanded otherwise.

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In the United States, further pushback is likely to come from the private companies that once made student loans but who now only service them and depend on that function as an important source of their revenue.

The Real Moral Hazard

With progress often come pitfalls. And so a switch to income-contingent loans could bring some unwelcome side effects. Some students, for instance, may attempt to game the income-contingent loan system by hiding income or, less likely, avoiding high-earning jobs. But just as most people don't choose a life of criminality or impoverishment to avoid paying federal taxes, they are unlikely to do so in order to avoid paying federal loans.

But if there is a real moral hazard to instituting an income-contingent loan system, it largely lies with colleges and universities. Because these loans would reduce some of the pressure of loan repayment on students, it also stands to reason that they would reduce the pressure on universities to keep debt levels low. In other words, it is entirely possible that colleges and universities would see income-contingent loans as a free pass to raise tuition prices and reduce institutional grant aid to students. Those actions would cause even more students and families to rely on loans.

This potential danger could be headed off by re-allocating risk in the current loan system. Now, if a student fails to repay his loans, taxpayers must cover the cost of the unpaid debt, and the student faces ruined credit and the other consequences of default. The university, on the other hand, receives the loan money up front but faces no consequences if the loan is not repaid. Unless default rates are extremely high, colleges have little incentive to pay attention to whether their graduates are able to repay their loans. In short, colleges receive the money from student loans but take on little of the risk.

If an income-contingent loan system is implemented, the United States will also need to adopt a better system for distributing the risk of unpaid loans across all three beneficiaries: students, taxpayers, and colleges. Taxpayers and students will continue to take on the risk associated with student loan debt—taxpayers by offering loan forgiveness and students by committing a portion of their salary for decades, potentially. Colleges and universities could share in this risk by paying into an insurance pool based on their volume of loan dollars. This pool could then be used to cover the cost of unpaid loans. Another option, which was proposed for the U.K. higher education system, is to have colleges pay a "tax" on tuition charged above a specified amount, or on loan dollars received above a certain threshold.[1]

Institutions could also pay into this risk pool based on the repayment rates of their alumni, with schools with higher repayment rates paying less. Obviously, it would be important to ensure that schools serving a high proportion of low-income students are not unfairly punished in this system. Income-contingent repayment through the tax system may help. By providing much richer, more detailed information on student repayment than we have currently, income-contingent lending will make it easier to identify schools that are doing a good job of ensuring their students are not overloaded with debt.

Notes

1. *Securing a Sustainable Future for Higher Education* (Independent Review of Higher Education Funding and Student Finance, October 2010).

student loans but who now only service them and depend on that function as an important source of their revenue. Currently, only five companies—Great Lakes Educational Loan Services, Nelnet Servicing, Pennsylvania Higher Education Assistance Agency (PHEAA), SLM Corporation, and MOHELA—have contracts to service the federal government's direct loans. The government pays them a set amount per loan to notify borrowers when payments are due, to collect payments, and, when they are delinquent, work with borrowers to bring them current. This is a lucrative business—Sallie Mae's 2010 servicing revenue increased by $32 million over the prior year, primarily due to its direct loan servicing contract—but a switch to income-contingent loans would likely eliminate it.[22]

Why the U.S. Needs Income-Contingent Loans

Australia's case is instructive, if only because the United States finds itself in much the same boat Australia was in 20 years ago. Australia introduced income-contingent loans at the same time that it re-introduced fees and tuition for higher education. (The country had abolished tuition in 1973.) By announcing that it would make students repay tuition only when they were financially able to, the government both eased the burden on students and tempered the resistance to fees. And although the government was no longer fully subsidizing education, it made it known that it was still sharing the financial risks.[23]

By contrast, tuition is nothing new to U.S. students; in this country we have long recognized that both society and individuals benefit from higher learning and, thus, that both should contribute to its substantial cost. But while tuition has long been charged, it has not always been as high as it is today. And, in that sense, the United States is not so different from the Australia of two decades ago. Then, Australian students were paying for the first time; now, our students are paying dramatically more than ever, and they are paying a higher proportion of the total bill as government and private subsidies decline.[24] And yet, we are still relying on a financial aid system that was designed when the government covered much of the cost, and when far fewer families relied on loans to fill the gaps. Australia realized long ago that the shift in the cost burden of college must be accompanied by a financing system that both facilitates access to higher education and alleviates some of the financial risk.

Lately that risk has been more apparent than ever. For many years, the popular argument for getting a college degree was that it earned the average graduate a million dollars more over the course of their careers than a high school diploma alone; the return on the investment was high, so college was worth the huge cost and the heavy debt.[25] Although that earning figure has since been questioned, it's still safe to say that college is a profitable investment. On average, according to a recent study from Georgetown University, a college degree increased lifetime earnings by 84 percent. Yet it's also true that the return on the college investment varies considerably depending on students' majors and careers, on where they attend school, and on how much they borrow.[26]

The choice of academic major can play a particularly important role in determining earnings—and by extension, the ability to pay back loans. According to the Georgetown study, graduates with degrees in the highest-earning major, petroleum engineering, earned 314 percent more than students who graduated with the lowest-earning major, counseling psychology. Timing also matters: students who graduated from college in 2009 and 2010, following the 2008 recession, had a harder time finding jobs and earned lower salaries than those who had graduated just a couple of years before.[27]

The current standard repayment system doesn't recognize such variation, nor does it accommodate the basic fact that salaries are lowest immediately after graduation, but they increase over time. Instead of adjusting payments according to this natural progression, the standard program requires borrowers to pay the same amount six months after graduation as they do 10 years into their career.[28] Not surprisingly, the National Student Loan Survey found that students' debt burdens—the percentage of their income going to repay loans—was higher in the first years of their career than three years into repayment.[29]

Income-contingent loans can help students absorb salary differences, upon graduation and throughout their career.

Income-contingent loans can help students absorb these salary differences, upon graduation and throughout their career. The flexibility promised by such loans is even more important for the 29 percent of borrowers who never make it to graduation—a group whose numbers are growing.[30] Partly because these students don't benefit from the earning boost a degree provides, they are much more likely to become delinquent or to default.[31] An income-contingent system would not absolve these college drop-outs of their responsibility to repay their debts, but it would at least offer them a way to repay their loans without risking financial ruin.

No More Loan Defaults

The recent mortgage crisis served as a harsh reminder of how devastating debt can be, both for the debtor and the U.S. economy. So it is no small consideration that student debt is in some ways even more burdensome than housing debt. When a homeowner falls behind on mortgage payments, he can refinance at a lower interest rate or, in the worst cases (and at great risk to his credit rating), he can walk away from the debt through bankruptcy or foreclosure. But college debt virtually never disappears; with rare exceptions, it can't be wiped out even in bankruptcy. It haunts the debtor throughout his earning years

(even in times of unemployment) and right into retirement, sometimes leading to the absurd situation of the government garnisheeing Social Security checks.

It's difficult to get an accurate accounting of how many student borrowers end up in these unfortunate straits, but we do know that there are too many of them, and that their numbers are on the rise. The "official" cohort default rate, which calculates the percentage of students who default on their student loans within two years of leaving school, is 8.8 percent—the highest it's been in 12 years.[32] Longer-term default rates are even worse. Research that tracked borrowers for five years after school found a 15 percent default rate, which aligns with federal budget estimates that predict a lifetime default rate of between 15 and 21 percent.[33] (In the United Kingdom, by contrast, 98 percent of borrowers were meeting their repayment obligations in 2010–11, with just 2 percent unaccounted for and potentially in default.[34])

These numbers are not just harmful to students; they can hurt the whole U.S. economy. Generally young, educated, and just starting careers, student borrowers are precisely the population the country depends on to start businesses, buy homes and durable goods, and otherwise invest in the economy. Default keeps them from doing any of that.

An income-contingent loan system would not only eliminate default; it might also improve access to, and encourage completion of, college. Fear of debt, research shows, may not only deter low-income and some minority students from enrolling in college, it may also lead others to delay their studies, enroll part time, or work full time while attending college—all scenarios that put students at higher risk of dropping out.[35] It's entirely possible that income-contingent loans, by reducing the risk of delinquency or default, would relieve such students of their debt fears and encourage them to enroll and persist in college.

An income-contingent loan system would not only eliminate default; it might also improve access to, and encourage completion of, college.

Taxpayers would profit from this new loan system, as well. Instead of covering defaulted debt, limited tax dollars would be spent on forgiving loans for those who cannot fully repay after 20 or 30 years. The cost to the government of forgiving these loans might well be lower than the combined cost of loan dollars lost due to default plus the cost over the years of trying to collect them. And because debtors have so many years to pay before loans are forgiven, taxpayers are more likely to recoup the original principal and may earn more in interest payments than they would if the debt had been required to be repaid much earlier.

To be sure, some borrowers will always skip out on loan payments. But, as suggested by that 98 percent of U.K. borrowers who are meeting their obligations, they would have a harder time doing so under a system that requires payment of everyone earning a paycheck and tracks them through the tax system. And by taking so long to offer loan forgiveness, the new system would discourage devious borrowers from artificially lowering their salaries to avoid making payments: they would have to fool the system for two or three decades. In New Zealand, 84 percent of borrowers had fully repaid their loans within 16 years. And just 12 percent made no progress toward repayment during that time—a lower percentage than the current lifetime default rates in the United States.[36]

Simple, Streamlined, and Sensible

Although it may sometimes seem that way, the federal student loan system was not intentionally designed to frustrate students and encourage default. It has taken decades of piecemeal legislation for a system originally designed as supplemental aid to low-income students to morph into the maddeningly complicated source of financial aid for many more college students that it is today.[37] There have been numerous well-intentioned efforts over the years to improve the system—increasing loan limits, adding new loan options, and providing more repayment plans—but they have only served to increase its complexity. And until recently, influential private loan companies, which benefited from the status quo, have effectively stymied legislative efforts at comprehensive reform.[38]

Today, many factors have converged to make a solution possible at the very time it is more urgent than ever. The government can no longer blame private companies for blocking change: with the passage of the Healthcare and Budget Reconciliation Act of 2010, it no longer pays dozens of private companies to administer federal loans; all loans come directly from the government. At the same time, interest rates on some student loans are soon likely to double. When Democrats took control of Congress in 2007, they pushed through legislation that over the course of five years slashed the interest rate on subsidized student loans by half, from 6.8 percent to 3.4 percent—a subsidy that will ultimately cost taxpayers $6 billion.[39] In 2012, without action from Congress, the interest rate will jump back up to 6.8 percent. Given the state of the economy, Congress is likely to let the rate increase. But what may be better for taxpayers will be more costly for college students.

In this dilemma lies opportunity—a chance to implement a simple, streamlined, and sensible loan program that can help student-borrowers who need it without spending scarce tax dollars to prop up those who don't. And the system can be operated at no additional cost. Just as the government was able to save $67 billion by eliminating third parties from the process of making student loans, it can now collect payments more effectively through the existing tax system.[40]

The exploding growth in student loan debt, along with the relentless shifting of college expenses from the public to students and parents, demands a rethinking of how we finance higher education. As the government offers ever more loan money to students and their families, placing few limitations on who can borrow, it has a moral responsibility to share the risk—to accept the chance that the investment might not pay off, or, more likely, that it might not pay off soon enough or consistently enough for the student to afford his monthly obligations. An income-contingent system does just that. It provides a humane, efficient, and cost-effective way to support students who choose to invest in their educations and their futures. With the stroke of a pen, the government can make this happen.

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Notes

1. Alexander C. McCormick and Laura J. Horn, *A Descriptive Summary of 1992–93 Bachelor's Degree Recipients: 1 Year Later* (Washington, D.C.: National Center for Education Statistics, August 1996); Emily Forrest Cataldi, et. al., *2008–09 Baccalaureate and Beyond Longitudinal Study: First Look* (Washington, D.C.: National Center for Education Statistics, July 2011).
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3. Milton Friedman, "The Role of Government in Education," in *Economics and the Public Interest*, ed. Robert A. Solo (New Brunswick, N.J.: Rutgers University Press, 1955) and Bruce Chapman, "Income Contingent Loans for Higher Education: International Reform," in *Handbook on the Economics of Education*, eds. Eric Hanushek and Finis Welch (Oxford: North-Holland, 2006), 1435-1503.
4. For more on repayment options, see *Addressing Student Loan Repayment Burdens: Strengths and Weaknesses of the Current System* (Washington, D.C.: The Project on Student Debt, February 2006).
5. *Helping Families Finance College: Improved Student Loan Disclosures and Counseling*, (Yonkers, NY: Consumers Union, July 2007).
6. Hearing on H.R. 2336, The Income-Dependent Education Assistance Act and H.R. 3050, the Self-Reliance Scholarship Act: Hearing Before the Subcommittee on Postsecondary Education of the Committee on Education and Labor, House of Representatives 102nd Cong. (1992), p. 2.
7. Loan repayment amounts calculated using calculators at FinAid.org, available at: http://www.finaid.org/calculators/. Salary information from the National Association of Colleges and Employers, "Average Salary Offer to Class of 2011 Rises 4.8 Percent," National Association of Colleges and Employers Press Release, July 6, 2011.
8. There is some debate about what is a manageable debt burden for student loan borrowers. Eight percent of pre-tax income is often cited as a manageable amount, but as a 2006 College Board report describes, this figure has limitations. The authors of that report recommend a graduated threshold, with the percent dedicated to loan payments increasing with income—14 percent for single individuals earning $50,000,

for example, but only 10 percent for those making $30,000. See Sandy Baum and Saul Schwartz, *How Much Debt Is Too Much? Defining Benchmarks for Manageable Student Debt* (New York: The College Board, 2006). Salary data based on "2011–2012 PayScale College Salary Report," PayScale.com available at: http://www.payscale.com/best-colleges/degrees.asp and "Top-Paid Majors for the Class of 2011," National Association of Colleges and Employers Press Release, April 8, 2011, and "Careers in Social Work," National Association of Social Workers, available at: http://www.socialworkers.org/pubs/choices/default.asp.

9. High student debt levels can deter college graduates from entering public service—41 percent of students who borrowed for college between 2003 and 2009 reported that debt influenced their career choices. And among those who borrowed the highest amounts, 58 percent reported that it influenced their choice of career. (Author calculations using data from the U.S. Department of Education's Beginning Postsecondary Student Survey). Also see Luke Swarthout, *Paying Back, Not Giving Back: Student Debt's Negative Impact on Public Service Career Opportunities* (Washington, D.C.: The State PIRGs' Higher Education Project, April 2006).

10. All currency conversions are based on exchange rates as of October 16, 2011.

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12. Charging interest on loans, even at below market rates, makes it more likely that payments among borrowers with low incomes will not cover both the original loan balance and interest. This raises the potential problem of compound interest, in which borrowers' loan balances balloon as interest is charged on both the remaining loan balance and accrued interest. The current U.S. income-based repayment program addresses the issue of compounding interest by only charging interest based on the original principal of the loan, and not based on the principal plus accrued interest. Borrowers are still responsible for paying interest on their loans under this system, but won't have loan balances grow exponentially.

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APPENDIX: International Income-Contingent Loan Systems

	Maximum Loan Limit	Percentage of Income During Repayment	Length of Repayment
Australia	Full student contribution amount. Tuition rates are capped by the government at a maximum of A$9,080/year. Students who do not receive government tuition subsidies or continue to graduate study can take out FEE-HELP loans, which have a lifetime limit of $86,422 or $108,029 for students studying medicine, dentistry, or veterinary medicine.	No payments are required for borrowers earning less than $47,196. Repayment rates increase as income increases, from 4% of total income for those earning $47,196–$52,572 to 8% of total income for those earning above $87,650.	Until loan is fully repaid
United Kingdom (England recently instituted changes to its student finance system. All information for England references the new system that will begin in the 2012-2013 school year.)	**U.K.:** Tuition fee loans are available up to the amount charged by the university or the maximum set by the government that year (up to £3,375 in 2011–12). Maintenance loans are available for living costs and limits depend on where students live and their income. **England:** Entirety of tuition costs (up to £9,000/year for full-time students), plus up to £7,675/year for living costs.	**U.K.:** 9% of income above £15,000. No payments are required below £15,000. **England:** 9% of income above £21,000. No payments are required below £21,000.	**U.K.:** Until age 65 or after 25 years of repayment (35 years in Scotland). **England:** Any remaining loan balance after 30 years of repayment is written off.
New Zealand	Entirety of course fees, plus up to NZ$1,000/year for course-related costs like textbooks and up to $169.51/week for living costs.	10% of all taxable income above NZ$19,084 for the 2011–12 tax year. No payments are required below $19,084. Repayment for borrowers working overseas is based on the total loan volume instead of income.	Until loan is fully repaid
U.S. Income-based Repayment	Federal Stafford student loans are limited to a maximum of $31,000 for dependent undergraduates, $57,500 for independent undergraduates, and $138,500 for graduate students. PLUS loans to parents are not eligible for income-based repayment.	Loan payments are set at 15% of household income above 150% of the poverty threshold, which is based on family size. No payments are required for households with income below 150% of the poverty threshold. For loans made after July 1, 2014, repayment is set at 10% of income above 150% of poverty.	Loans are forgiven after 25 years of qualifying payments. Loans made after July 1, 2014 may qualify for forgiveness after 20 years of payments. President Obama has proposed a similar program to begin in 2012.

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APPENDIX: International Income-Contingent Loan Systems, cont.

	Interest Rate	Administration	Other Characteristics
Australia	No interest is charged, but debt is adjusted to reflect changes in the Consumer Price Index. In 2011, this resulted in a 3% increase in loan balances.	Student financial aid is administered through the Department of Education, Employment and Workplace Relations and repayment is administered through the Australia Taxation Office.	Students who pay more than $500 of their tuition up front receive a 20% discount on the amount paid. During repayment, students who enter certain fields can receive contributions from the government that match their payments. Borrowers receive a 10% bonus for making additional repayments above $500/year.
United Kingdom (England recently instituted changes to its student finance system. All information for England references the new system that will begin in the 2012-2013 school year.)	**U.K.:** 1.5% **England:** While a student is enrolled, interest is inflation plus 3%. During repayment, interest is set at inflation for those earning below £21,000; for those earning between £21,000 and £41,000 interest increases with income and is set between inflation and inflation plus 3%; and for those earning above £41,000, interest is inflation plus 3%.	Loans are collected through Her Majesty's Revenue and Customs, the United Kingdom tax office. The Student Loans Company, a public entity, helps to administer student loans and other federal financial aid.	
New Zealand	None if living in New Zealand, 6.6% if living overseas	StudyLink, a branch of the Ministry of Social Development issues loans and manages them while students are in school. The debt is then transferred to Inland Revenue, New Zealand's tax office, for collection.	10% bonus on additional payments above $500/year.
U.S. Income-based Repayment	The interest is charged based on the interest rate of the borrower's loan (currently 6.8% for unsubsidized Stafford loans). For subsidized Stafford loans, the government pays any interest charges when a borrower's payment does not cover interest for a maximum of 3 years. After the 3 year limit and for all other loans, interest accrues but does not compound.	Borrowers must contact their lender directly to apply for income-based repayment. For borrowers with private lenders, they need to complete that lender's paperwork. Borrowers with loans in the Federal Direct Loan Program apply through the U.S. Department of Education. Payments are collected through the lender or third-party loan servicing companies.	To be eligible, borrowers must demonstrate financial hardship, defined as having monthly payments under a 10-year repayment plan that exceed 15% of discretionary income. Borrowers who make payments while employed in a qualifying public service position (government or non-profit work) may be eligible for forgiveness after 10 years of repayment.