

ISSUE BRIEF

FEDERAL STUDENT LOAN INTEREST RATES: HISTORY, SUBSIDIES, AND COST

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Introduction

The 2011 Occupy Wall Street protests brought countless media reports about unemployed college graduates struggling to repay their student loans and headlines sounding alarms that outstanding student loan debt will soon reach \$1 trillion. Even though evidence is mixed on whether today's college graduates leave school with significantly more debt than students did a decade ago, public anxiety over student indebtedness has led some to scrutinize the repayment policies that Congress and the U.S. Department of Education set on federal student loans.[1]

Federal loans account for more than \$650 billion of the \$845 billion in outstanding student loans.[2] In particular, many observers have questioned the 6.8 percent fixed interest rate the government currently charges on the most widely-available type of federal student loan (Unsubsidized Stafford) given that interest rates on other loans, such as home mortgages, are now at record lows. In the same vein, many are puzzled as to why a temporary reduction on interest rates for a subset of loans (Subsidized Stafford loans) in effect since 2008 expires this year. Relatedly, some observers – including members of Congress – claim that the federal government is making a profit on student loans because it charges higher rates than it pays to borrow.[3] They point to official cost estimates that appear to show that borrowers receive “negative subsidies” on their student loans.

This issue brief examines the claims and arguments outlined above. It explains why Congress set the interest rate on federal student loans at a fixed 6.8 percent rate and why Congress temporarily reduced this rate to 3.4 percent for certain loans. It also argues that federal student loan interest rates are still favorable even in today's low rate environment, and that current rates provide borrowers with subsidies and better terms than are available in the private market. This issue brief disputes the argument that the government's low cost of borrowing suggests that student loan interest rates are unfavorably high for borrowers. It concludes with an explanation of why official cost estimates, which suggest that student loan interest rates earn revenue for the government, do not fully account for the costs of the program.

History of Federal Student Loan Interest Rates

Why the Federal Student Loan Interest Rate is 6.8 Percent

Since the 1960s, the federal government has supported a loan program that helps students pay for the cost of higher education at institutions across the country. While the program has undergone many changes and evolved to provide loans to students from all income backgrounds, its original purpose remains. The program ensures that students can borrow at favorable terms without regard to

their credit histories, incomes, assets, or fields of study.[4] In 2011, students borrowed over \$100 billion in federal loans and over \$650 billion in federal student loans were outstanding.[5]

From the program's inception until 1992, Congress set the interest rate on student loans at fixed rates ranging from 6.0 percent for loans issued in the 1960s to 10.0 percent for loans issued between 1988 and 1992.[6] Congress enacted variable rates in 1992 seeking to better align them with the interest rate the government paid private lenders holding the loans, thereby reducing the government's costs.[7] The new variable rates reset once a year based on the interest rates on short-term U.S. Treasury securities plus 3.1 percentage points (a "markup"), capped at 9.0 percent. Congress made minor adjustments to this formula over the subsequent six years, lowering the markup and the cap.

Shortly after the move to variable rates, in 1993 Congress passed the Student Loan Reform Act to establish the Direct Loan program.[8] Congress intended this program, under which the U.S. Department of Education makes loans directly to students, to gradually replace the existing program that subsidized private lenders to make loans (i.e. the bank-based program). At the time, policymakers also sought to more closely link the interest rates borrowers were charged to the rates the government paid to borrow since there would be no further need to link them to subsidies for private lenders.[9] In response, the 1993 law pegged borrower rates to longer-term U.S. Treasury securities that were similar in duration to the student loans, plus a smaller markup of 1.0 percentage point would be calculated for loans issued after July 1, 1998.[10] This formula would also be used to set the interest rate guaranteed to lenders for any loans still made in the bank-based program in 1998 and later.

By the mid-1990s, the Direct Loan program phase-in had not gone as Congress had originally planned; as 1998 approached, the bank-based program still accounted for the majority of newly-issued federal loans. However, the

pending interest rate change for both borrowers and lenders enacted in 1993 was still set to occur in 1998. As a result, lenders in the bank-based program – whom Congress assumed in 1993 wouldn't be playing the major role they still were in 1998 – expressed concerns that the interest rate change would increase their costs and reduce returns to such an extent that they would no longer be willing to make federally-backed student loans.[11]

Fearing that lenders would flee the program and disrupt loan availability, in 1998 Congress postponed the pending rate changes until 2003 (a permanent fix was too costly) and left the then-current interest rate formulas in place with some minor adjustments (it reduced the markup on the borrower's annual interest rate from 3.1 to 2.3 percentage points). Despite this action, lenders participating in the bank-based loan program continued to express worries over the interest rate structure change, now delayed until 2003. They encouraged Congress to address it before mid-2002 to avoid disrupting student loan availability.

As an alternative to the pending rate change, lenders and some lawmakers proposed making permanent the then-current formulas (short-term interest rates plus 2.3 percentage points). But student advocates and some lawmakers opposed this approach because the formula set to take effect in 2003 (variable rates based on longer-term U.S. Treasury rates plus 1.0 percentage point) produced more favorable rates for borrowers.[12] At the time, short-term and long-term Treasury rates were similar, meaning that the lower markup built into the pending formula produced lower overall rates.

In late 2001, after months of negotiations, lawmakers proposed a bipartisan compromise that would avert the pending rate change and make permanent the then-current interest rate formula for lenders. It also extended through 2006 the existing variable rate formula for borrowers but established fixed interest rates at 6.8 percent for Subsidized

and Unsubsidized Stafford loans made after July 1, 2006.[13]

Lawmakers, higher education associations, and student advocate organizations championed the bill because the fixed 6.8 percent interest rate that would start in 2006 was lower than estimates of what borrowers would pay if Congress had maintained the variable formula.[14] In selecting a fixed rate, Congress and advocacy groups decided on 6.8 percent because it was approximately the average of the projected interest rates set to take effect in 2003 based on longer-term U.S. Treasury bills.[15] Supporters also cited the certainty that fixed rates provided over variable rates as a benefit to borrowers. The Senate passed the bill unanimously in December 2001, the House passed it with overwhelming support in January 2002, and the president signed it into law.

Congress chose to delay the implementation of the fixed rates until 2006 – maintaining the existing variable rate formula in the meantime – to reduce the costs of the policy over a ten-year budget window. The Congressional Budget Office estimated that adopting fixed rates would reduce the rates for borrowers compared to then-current law, increasing costs for the government by \$5.2 billion from 2007-2011.[16] It would have cost more if Congress had chosen to implement the change immediately.

Meanwhile, in the latter half of 2001, the U.S. Federal Reserve was in the midst of reducing its short-term benchmark interest rate in response to a mild economic recession and the terrorist attacks of September 11th, 2001. By the time the ink was dry on the 2002 law that established the fixed 6.8 percent interest rate, the Federal Reserve had cut short-term interest rates below 2.0 percent. It had been as high as 6.5 percent in early 2001. Two more Federal Reserve rate cuts in 2002 and 2003 brought the rate to 1.25 percent and 1.0 percent, respectively. Given the low-interest rate environment that began in 2002, it appeared unlikely that fixed 6.8 percent rates would lower costs for borrowers as supporters had previously argued.

A 2005 Effort to Block Fixed Rates Sets Stage for Temporary Rate Cut

Despite the low interest rate environment of the mid-2000s, the fixed rates scheduled to take effect in 2006 received little attention until 2005 when Congress considered proposals to reduce annual budget deficits. That year, Republican majorities in the House and Senate began drafting legislation to cut spending and reduce budget deficits. Both chambers made changes to federal student loans a large component of their respective proposals, spurred by reforms outlined in the president's budget request.

The House plan would have cancelled the fixed interest rates set to take effect in 2006, maintaining the existing variable rate formula, which that year set rates between 3.4 and 5.3 percent.[17] Sponsors of the proposal argued that variable rates would be better for borrowers and taxpayers. The Senate, however, maintained the fixed rates set to take effect in 2006.[18]

To meet deficit reduction goals, both the House and Senate bills made a change to the interest rate guaranteed to lenders making federally-backed student loans, requiring that they rebate interest borrowers paid in excess of the rate the government guaranteed lenders.[19] The provision cut spending compared to then-current law because it reduced what lenders could earn on the loans. However, the Senate bill had the greatest deficit-reducing effect because it left the scheduled fixed rates in place, increasing the size of the lender rebates. The rebate provision produced \$34.4 billion in savings over ten years in the Senate bill compared to \$14.5 billion under the House's variable rate proposal.[20]

Why Interest Rates on Some Loans May Double This Year

The president signed a final version of the deficit reduction bill into law in January 2006, which included the Senate's proposal to maintain the fixed rate formula and impose a rebate on lenders.[21] Even though Congress enacted the

fixed rates in 2002, some observers interpreted Congress' decision to maintain the rates as a Republican-led Congress charging higher interest rates on student loans to reduce the deficit.

In their 2006 campaign platform, A New Direction for America, House Democrats claimed that "Congressional Republicans... have allowed student loan interest rates to increase, making student loans even harder to repay." The platform document promised to "slash interest rates on college loans in half to 3.4 percent for students and to 4.25 percent for parents," if Democrats were elected that fall.[22]

After Democrats won majority control of both the House and Senate in 2006, the Congressional Budget Office estimated that the rate cut proposal would cost \$52 billion and \$133 billion over five and ten years, respectively, compared to then-current policy – revealing that the proposal was extremely costly. The rate cut for PLUS loans for graduate students and parents accounted for about two-thirds of the cost.

The high cost of the proposal did not bode well for the Democrats' campaign pledge because the newly elected majority had also pledged to follow Pay-As-You-Go budgeting principles to fully offset new spending with tax increases or other spending cuts. The Pay-As-You-Go principles meant that lawmakers would have to enact \$132 billion in spending cuts over ten years (a substantial sum) within education or other programs, or raise taxes to offset the new spending in the rate cut proposal. In the end, lawmakers opted to scale back their original proposal to reduce the cost.

Just weeks into the new session of Congress in January 2007, the new House Democratic majority passed a bill to cut interest rates in half, but with significant caveats.[23] The bill cut rates in half only for a subset of loans – Subsidized Stafford loans – which are available only to borrowers from families with middle and lower incomes. While both graduate and undergraduate students had been

eligible for Subsidized Stafford loans, only undergraduate students were eligible for the rate cut. The bill left rates unchanged for the largest loan category – Unsubsidized Stafford loans – as well as for PLUS loans for parents and graduate students, despite their inclusion in the campaign pledge. All new costs in the bill were offset with spending reductions on subsidies for lenders making federally-backed student loans, ensuring that the bill complied with Pay-As-You-Go principles.

To further reduce the cost of the proposal, the bill phased in incremental rate cuts starting in the 2008-09 school year such that only loans issued for the 2011-12 school year would carry rates of 3.4 percent (half of 6.8 percent). Subsidized Stafford loans issued after that year would again carry a fixed rate of 6.8 percent. In short, the proposed legislation "cut interest rates in half" for loans issued only in one year.

The changes to the original proposal – limiting the cut to Subsidized Stafford loans for undergraduates, phasing it in, and ending it in 2012 – reduced the cost to \$7.1 billion in the ten-year budget window, much less than the earlier estimate for the permanent cut for all loan categories. Making the rate cut permanent for Subsidized Stafford loans for undergraduates after 2012 would have cost an additional \$12.8 billion over ten years.[24]

In September of 2007, both the House and Senate passed a budget bill that included the rate cut provision, and the president signed it into law.[25] The first rate cut went into effect for Subsidized Stafford loans issued in the 2008-09 school year. Loans issued this coming 2012-13 school year will carry a 6.8 percent interest rate because the 2007 rate cuts will have expired.

Assessing the Current 6.8 Percent Interest Rate

Are Federal Student Loan Interest Rates Too High?

The federal student loan program has charged borrowers fixed interest rates for nearly its entire history – the period between 1992 and 2006, when Congress linked the rate annually to short-term U.S. Treasury rates, being the only exception. Due to interest rate fluctuations in the market, any fixed rates that Congress sets in law are bound to be either too high or too low over time. As such, in the early decades of the program Congress raised the fixed rates on newly issued loans to keep up with rising market interest rates. In today’s low interest rate environment, Congress is under pressure to lower the fixed rates. This pressure is likely to increase as the temporary rate cut on Subsidized Stafford loans is set to expire later this year.

Many people believe that the low interest rates lenders currently offer on home mortgages and other types of loans suggest that interest rates on federal student loans are too high. Some observers also argue that the current fixed interest rates for borrowers are far more expensive than what it costs the government to borrow, suggesting that the federal government overcharges borrowers and earns revenue from the program. Additionally, some claim that official budget estimates indicate that the rates the government charges are high enough that it earns a “profit” on student loans.

A review of key information, however, suggests that interest rates on new student loans are low relative to what private lenders charge on fixed rate loans and are below what it costs the government to make the loans. To be sure, rates may indeed be too high relative to some borrowers’ abilities to repay or according to those who believe the federal government ought to increase subsidies for higher education. Those measures, however, concern the degree to which the federal government subsidizes student loans, not whether the current terms offer any subsidy at all. On the

latter measure, current interest rates are in fact set low enough to subsidize borrowers and impose costs on the federal government.

Interest Rates on Home Mortgages and Private Student Loans

In today’s low interest rate environment, many types of loans carry interest rates below the 6.8 percent fixed rate Congress set on federal student loans. At first glance, this could indicate that the federal program does not provide the level of assistance that many believe it should or that lawmakers originally intended, possibly allowing the federal government to earn revenue on these loans. When compared to interest rates on private loans, however, it is clear that the interest rates on federal student loans do provide a benefit and subsidy to borrowers.

While many people think of the fixed rate 30-year mortgage as a benchmark by which to compare other types of loans, it is a poor reference point for the interest rate charged on student loans. Lenders are willing to provide relatively low fixed rates on mortgages (the rate on a 30-year fixed rate mortgage is approximately 4.0 percent) because losses from default are limited by the value of the home – which can be seized and sold by the lender – and by any equity the homeowner has in the property from a down payment, price appreciation, or both, that would be forfeited in a default.

Federal student loans pose a higher risk of default loss than a home mortgage because lenders have no asset to recover in the event of a default and borrowers with student loans have no equity at risk in the transaction. Additionally, mortgage lenders can screen out borrowers with poor credit histories and low incomes, further limiting the likelihood of default. Federal student loans impose no such requirements on borrowers as students are eligible regardless of their credit histories or incomes.

Federal student loan interest rates are also commonly

compared with the low variable rates that lenders have offered in recent years on non-federal student loans. However, these comparisons are misleading due to the nature of variable rates. Lenders offer lower initial rates on variable rate loans than on fixed rate loans because the borrower bears all the interest rate risk on the loan. That is, the borrower will have to shoulder the cost of rising interest rates, not the lender. On a fixed rate loan, in contrast, the lender bears the risk that interest rates will rise and financing costs will exceed the interest it charges on a fixed rate loan.

Thus a lender can charge less on a variable rate loan than a fixed rate loan (at the time the loans are issued) because it does not need to guard against the risk of rising interest rates in the future. That means that the 3.3 percent interest rate that Citibank currently charges on its variable rate CitiAssist loans for undergraduates, while lower than the fixed 6.8 percent rate on a federal loan, is not guaranteed to stay below 6.8 percent over the life of the loan.[26]

A more appropriate comparison for the fixed rates on federal student loans are the fixed rate loans that private lenders have recently begun to offer on non-federal student loans. (Historically, private lenders only offered variable rate loans.) While the terms on these loans vary widely, few lenders offer fixed rates as low as 6.8 percent. Those that offer rates that approach 6.8 percent (one lender advertises a 6.75 percent rate) have strict eligibility rules, usually requiring that borrowers, or co-signers who are obligated to repay the loan if the student does not, have high credit scores and incomes.[27] The lender may also require borrowers to pay an origination fee and immediately begin making monthly payments on the loan while still in school. U.S. Bank advertises a relatively low fixed rate of 7.99 percent, but borrowers who qualify for that rate must pay an upfront origination fee as high as 9.0 percent on the amount borrowed.[28]

Lenders may also limit eligibility for the lowest rate loans to undergraduate students attending four-year institutions.

Wells Fargo, for example, advertises a 9.24 percent rate for career and community college students, but offers lower rates to students attending other institutions.[29] Some lenders advertise that borrowers with no credit histories, low credit scores, or low incomes could pay rates as high as 12.25 percent.[30]

In comparison, federal student loans provide the same terms to all borrowers regardless of their credit histories or other measures of their abilities to repay. The loans never require a co-signer or charge different interest rates based on the type of institution a borrower attends.[31] Federal student loans also offer additional, non-interest rate benefits that private loans do not. These include three-year deferment and forbearance for economic hardship, as well as a wide range of repayment options, such as interest-only and income-based plans. Any comparison of the relative value of a private loan should account for the additional benefits and less restrictive eligibility criteria that are a standard part of federal student loans.

Loan Program Costs Exceed Government's Borrowing Rate

Though federal student loans offer more favorable rates and terms than comparable private loans, the 6.8 percent interest rate is much higher than the federal government's cost of borrowing. This gap leads some observers to question whether the current fixed rate provides an appropriate level of benefit to borrowers, arguing that student loan interest rates should be closer to the government's cost of borrowing to finance the loans. And since that cost is currently very low – the interest rate on a ten-year Treasury note is less than 2.0 percent – they believe student loan interest rates are too high.[32]

However, the federal government, like private lenders, faces several types of costs in addition to what it pays to borrow when making loans. Therefore the difference between the rate the government charges on a student loan and what it pays to finance it cannot simply be characterized as “profit”

or an indication that the rate is inappropriately high. In fact, the current fixed rates do not fully offset all of these additional costs even though these rates are above the rate the federal government pays to borrow.

To earn a profit or at least break even, private lenders charge interest rates high enough to cover any expected losses from defaults; the interest a lender earns on good loans must make up for the losses on bad loans. While the federal government is not a profit-making entity, it does incur costs when borrowers default or become delinquent on their loans.[33] Like private banks, the interest rate the government charges in excess of what it pays to borrow helps offset the costs associated with defaults, though it need not offset 100 percent of these costs.

Lenders also charge interest rates that are higher than what they pay to borrow because they need to offset their “cost of equity.” Stock holders in a lending company want to earn compensation for the risks they bear as equity investors. Stock holders could suffer losses on their invested capital if a lender’s loans experience costly defaults. Like bond holders who earn interest for the risks that they bear, stock holders also seek a return on the capital that they have put at risk by investing in the loan company. When the federal government issues student loans, taxpayers are effectively stock holders in those transactions because they will have to bear default losses while Treasury bond holders who finance the government’s loans are theoretically never at risk of loss. As a result, the interest rate on federal student loans helps to offset the government’s cost of capital – which includes its cost of borrowing and its cost of equity.

In addition to the expected default losses, lenders bear another form of risk and uncertainty when making loans. That is, in times of economic stress, loans may default at a higher rate than expected and these defaults are likely to be severe and costly. Lenders consider this type of risk an additional cost that is over and above expected losses from default and include an additional premium in the interest rate they charge borrowers to compensate for it. Lenders

cannot protect against such “market risk” by diversifying their loan pools because the performance of all loans will be similarly affected by bad economic climates. The government cannot reduce the market risk inherent in any student loan; thus, taxpayers bear this risk just as they would if they were acting as lenders in the private market.

In summary, what the federal government pays to borrow is not equivalent to what it costs the government to make a student loan. It is only one part of the cost. The government – like any lender – incurs additional costs when making a loan and the interest rate it charges borrowers partially offsets these costs. To be sure, policymakers could set an interest rate high enough to more than offset the costs listed above, but such a rate is likely to provide little value over the rates that private lenders offer and would undermine the goals of the program.

Are Student Loan Interest Rates Profitable for the Government?

Some observers argue that the higher rates and less favorable terms on private fixed-rate student loans do not sufficiently indicate that the government has set its loan terms below its costs. They say that the government’s official cost estimates show that after accounting for the costs of making the loan – what the government pays to borrow and expected losses from delinquencies and defaults – the government earns a positive return on the loans.[34] For example, estimates published by the Congressional Budget Office show the subsidy rate on Unsubsidized Stafford loans made in 2011 is negative 25.3 percent.[35] This means that, on average, loans issued in fiscal year 2011 will, over their entire repayment duration, earn the government \$25 for every \$100 it lends.[36] Some believe this “negative subsidy rate” demonstrates that the fixed 6.8 percent rate is set high enough to more than offset the costs the government incurs.

Budget and finance experts believe, however, that official government estimates systematically understate the costs of loan programs by excluding some costs of lending.

Specifically, they argue that the rules understate the government’s cost of capital. In calculating the net present value of a loan, current rules require budget analysts to use a discount rate equal to the interest rate on U.S. Treasury securities with a comparable duration.[37] Because the U.S. Treasury rate measures the risk-free rate of borrowing, and excludes any measure of the government’s cost of equity, it understates the cost of making a loan that is not risk-free. This rule effectively excludes “market risk” from official cost estimates even though taxpayers bear market risk when the government makes student loans and would consider such risk a cost.[38]

In fact, when budget analysts use a risk-adjusted discount rate instead of a risk-free discount rate to estimate the costs of a federal student loan (a so-called “fair value” estimate), the subsidy cost of providing an Unsubsidized Stafford loan at a fixed interest rate of 6.8 percent is positive. That is, the estimate shows that loans are made at a cost to the federal government and do not earn revenue. In a 2010 paper, the Congressional Budget Office estimated that a typical federal student loan issued over the next ten years would be made at a 12 percent subsidy rate, or a cost of \$12 for every \$100 lent, when using a fair value measure.[39]

In short, while official budget estimates show that student loans earn the government a return, suggesting that the fixed rates the government charges borrowers are relatively high, these estimates exclude a full measure of the costs the government incurs to make the loans, particularly a cost for bearing market risk. Fair value estimates, on the other hand, correct for this provision, and show that the federal government makes student loans at a loss. This suggests that students currently collect a subsidy from taxpayers, even at the current interest rates that many consider to be relatively high.

Conclusion

The 6.8 percent fixed interest rate on federal student loans may seem high to some in this low interest rate environment. That is partly because Congress set that rate some ten years ago using estimates that envisioned a different economic reality. At the time, members of Congress, student advocacy groups, and other stakeholders heralded the fixed rates as a significant benefit for students.

Today, some argue that low interest rates on home mortgages and other loans suggest that federal student loan rates are unfavorable for borrowers or that they are set too high to provide a subsidy to borrowers. Similarly, the government’s low borrowing rate leads some to conclude that federal student loans are too high compared to the low interest rates the government pays to borrow and allow the government to earn revenue on the program.

However, after comparing interest rates and terms on federal student loans to private fixed-rate loans, it is clear that current federal rates remain favorable to borrowers. Furthermore, “fair value” cost estimates reveal that despite the low interest rates the government pays to borrow, federal student loans charge borrowers less than the full cost that taxpayers incur in making them. That is, the loans provide borrowers with a taxpayer-funded subsidy.

That finding, however, should not be viewed as a negative judgment on the program. On the contrary, the purpose of the federal student loan program is to provide subsidized credit to the vast majority of students who would be unable to borrow to pay for their education in the absence of such a federal program. Indeed, the program makes more than \$100 billion in loans available annually at more favorable terms than students could otherwise obtain in the private market.

Notes

[1] According to the College Board's 2011 *Trends in Student Aid*, about 56 percent of students who earned bachelor's degrees in 2009-10 from the public four-year colleges at which they began their studies graduated with debt and the average debt per borrower was \$22,000, up from \$19,800 (in 2010 dollars) a decade earlier. From 1999-2000 to 2009-10, average debt per borrower among public college bachelor's degree recipients increased at an average annual rate of 1.1 percent over inflation as measured by the Consumer Price Index.

[2] Federal Reserve Bank of New York. "Quarterly Report on Household Debt and Credit," November 2011, http://www.newyorkfed.org/research/national_economy/householdcredit/DistrictReport_Q32011.pdf; White House Office of Management and Budget. Analytical Perspectives: FY2012 Budget, Page 389. <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/topics.pdf>.

[3] Nelson, Libby. "Loan Changes, Sans Congress," *Inside Higher Ed*, October 26, 2011. <http://www.insidehighered.com/news/2011/10/26/obama-proposes-changes-student-loan-programs>.

[4] White House Office of Management and Budget. Analytical Perspectives: FY2012 Budget, Page 369. <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/topics.pdf>.

[5] White House Office of Management and Budget. Analytical Perspectives: FY2012 Budget. <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/topics.pdf>.

[6] Senate Budget Committee. "2002 Student Loan Law Takes Effect, Lowers Interest Rates." *Budget Bulletin*, August 4, 2006.

[7] Until the early 1990s when Congress created the Direct Loan program, private lenders made and held all federal student loans. The government guaranteed the loans against default losses and guaranteed lenders a minimum interest rate each financial quarter that was based on short-term U.S. Treasury securities (plus a markup) if the rate the borrower paid fell below this formula in any given financial quarter. Congress terminated the guaranteed loan program in 2010 and no new loans have been through the program since July of that year.

[8] *Omnibus Budget Reconciliation Act of 1993*, P.L. 103-66, Title IV.

[9] U.S. Department of Education. "The Financial Viability of the Government-Guaranteed Student Loan Program," Page 2, February 1998. <http://www2.ed.gov/PDFDocs/stuloan9.pdf>

[10] Policymakers may also have chosen the new formula because longer-term interest rates are less volatile than the short-term rates used to set student loan rates at the time.

[11] U.S. Department of Education. "The Financial Viability of the Government-Guaranteed Student Loan Program," Page 2, February 1998. <http://www2.ed.gov/PDFDocs/stuloan9.pdf>; Burd, Stephen. "Bill Provides Fix for Dispute Over Interest Rates on Student Loans," *Chronicle of Higher Education*, June 5, 1998.

[12] Stoll, Adam. "Memorandum: Student Loans: Replacing the Interest Rate Structure Scheduled to Take Effect in 2003," Congressional Research Service, June 14, 2001.

[13] The law also set a fixed rate of 7.9 percent for PLUS loans made to parents of undergraduates. P.L. 107-139. <http://www.gpo.gov/fdsys/pkg/PLAW-107publ139/pdf/PLAW-107publ139.pdf>

[14] Bannon, Ellynn. "Student Loan Interest Rate Legislation (S. 1762) Will Make College More Affordable for Millions." The State PIRGs' Higher Education Project, January 24, 2002. http://www.pirg.org/highered/media/1_24_02.html.

[15] Burd, Stephen. "Lenders and Student Advocates Seek a Deal on Interest Rates." *Chronicle of Higher Education*, October 12, 2001.

[16] Congressional Budget Office. "Pay-As-You-Go Estimate: S. 1762," January 30, 2002. <http://www.cbo.gov/ftpdocs/32xx/doc3282/s1762.pdf>.

[17] U.S. Congress. House. College Access and Opportunity Act of 2006, H.R. 609. February 8, 2005. <http://www.gpo>.

gov/fdsys/pkg/BILLS-109hr609eh/pdf/BILLS-109hr609eh.pdf.

[18] The law also increased the interest rate charged on Parent PLUS loans made under the bank-based program and created a new category of loans that allowed graduate students to borrow Parent PLUS loans for themselves up to the full cost of attendance.

[19] This would have ended an existing policy that allowed lenders to keep the excess interest – sometimes called “floor income” or “windfall profits.”

[20] Congressional Budget Office. “Cost Estimate: S. 1932,” January 27, 2006. <http://www.cbo.gov/ftpdocs/70xx/doc7028/s1932conf.pdf>; and <http://www.cbo.gov/ftpdocs/66xx/doc6648/hr609.pdf>; and Congressional Budget Office. “Cost Estimate: H.R. 609,” September 16, 2005. <http://www.cbo.gov/ftpdocs/66xx/doc6648/hr609.pdf>. The Senate proposal also increased the fixed rates on PLUS loans for parents and graduates students to 8.5 percent from 7.9 percent for loans issued under the bank-based loan program and was included in the final law. This change also increased the deficit reduction compared to the House proposal.

[21] *Deficit Reduction Act of 2005*. P.L. 109-171. <http://www.gpo.gov/fdsys/pkg/PLAW-109publ171/pdf/PLAW-109publ171.pdf>

[22] “A New Direction for America,” Office of House Democratic Leader Nancy Pelosi. <http://www.democraticleader.gov/pdf/thebook.pdf>.

[23] “Estimated Impact on Direct Spending of H.R. 2669 with Possible Extensions.” Congressional Budget Office, July 10, 2007. <http://www.cbo.gov/ftpdocs/83xx/doc8303/hr2669Ryanltr.pdf>.

[24] While lawmakers needed to offset all the new spending provisions in the bill with spending reductions to comply with Pay-As-You-Go principles, they also needed to meet a similar requirement to pass the bill under budget reconciliation procedures which require that new spending in a bill be budget-neutral in the latter-years of a budget window. Legislation passed using budget reconciliation procedures cannot be filibustered in the Senate and therefore needs only a simple majority to pass.

[25] *College Cost Reduction and Access Act*. P.L. 110-84. <http://www.gpo.gov/fdsys/pkg/PLAW-110publ84/pdf/PLAW-110publ84.pdf>.

[26] “APR Examples.” Citigroup. <https://www.studentloan.com/studentloans/genericAPRExamples/GenericAPRExamplesView.do>.

[27] “TruFit Student Loan® Fixed Rate Repayment Example.” Charter One. http://www.charterone.com/pdf/studentloans/CO_Fixed_TrufitStudentLoan.pdf.

[28] “Student Loan Comparison Chart.” US Bancorp. <http://www.usbank.com/student-lending/loans.html>.

[29] “Compare Student Loans,” Wells Fargo. <https://www.wellsfargo.com/student/loans/>.

[30] “TruFit Student Loan® Fixed Rate Repayment Example.” Charter One. http://www.charterone.com/pdf/studentloans/CO_Fixed_TrufitStudentLoan.pdf.

[31] Some federal student loans charge higher rates than the fixed 6.8 percent, but these rates do not vary by borrower or type of institution a borrower attends. Specifically, federal student loans for parents of undergraduates (Parent PLUS loans) and Grad PLUS loans for graduate students who exceed the annual limit on Stafford loans charge fixed rates of 7.9 percent.

[32] Nelson, Libby. “Loan Changes, Sans Congress,” *Inside Higher Ed*, October 26, 2011. <http://www.insidehighered.com/news/2011/10/26/obama-proposes-changes-student-loan-programs>.

[33] Field, Kelly. “Government Doesn’t Profit from Student-Loan Defaults, Budget Analysis Shows,” *Chronicle of Higher Education*, February 14, 2011. <http://chronicle.com/article/Budget-Footer-Government/126373/>.

[34] Nelson, Libby. “Loans and the Deficit,” *Inside Higher Ed*, July 18, 2011. http://www.insidehighered.com/news/2011/07/18/increased_student_loan_interest_rates_to_reduce_deficit_and_probably_not_expand_grants.

[35] Using this method, the CBO concludes that the subsidy rates for Subsidized Stafford loans are 1.7 percent. For Parent Plus

and Grad PLUS the rates are -41.3 percent and -40.0 percent, respectively. <http://www.cbo.gov/budget/factsheets/201b/studentloan.pdf>

[36] The cost of all federal loan programs are shown in the budget and official cost estimates on a net-present value basis according to rules spelled out in the Federal Credit Reform Act of 1990. The net present value of a loan reflects the lifetime costs of the loans all at once, in the year that the loans originated, so that the costs can be assessed when the government's obligations become binding. The net present value of the loan expressed as a percentage of the size of the loan is the "subsidy" cost of the loan.

[37] 2 U.S.C. § 661a(5)(E) (1990). http://www.law.cornell.edu/uscode/html/uscode02/usc_sec_02_00000661---2000-.html.

[38] Lucas, Deborah, ed. "Measuring and Managing Financial Risk Conference Report," National Bureau of Economic Research. University of Chicago Press, 2010; and "Accounting for FHA's Single-Family Mortgage Insurance Program on a Fair-Value Basis," Congressional Budget Office, May 18, 2011. http://www.cbo.gov/ftpdocs/120xx/doc12054/05-18-FHA_Letter.pdf.

[39] "Costs and Policy Options for Federal Student Loan Programs," Congressional Budget Office, March 2010. <http://www.cbo.gov/ftpdocs/110xx/doc11043/03-25-StudentLoans.pdf>.



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