Obama loan repayment scheme maintains crushing debt burden on students

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Earlier this month, the Obama administration's Department of Education put into place its new regulations regarding the "Pay As You Earn" modification to Income-Based Repayment (IBR) of student loans.

This Obama "reform," supposedly a centerpiece of his program for young people, promises little and provides even less. For a small subset of students it can mean "only" 20 years of monthly payments, instead of 25, with decreased minimum payments of 10 percent of discretionary income instead of 15 percent.

As the federal "fiscal cliff" and additional cuts approach, the record shows that student aid has already been declining. According to a report released last month by the College Board, federal grants totaled $49 billion during the last academic year, down 5 percent from a year prior, after adjusting for inflation—the first drop after rising for five consecutive years. Federal work study, which allows colleges to create campus-based jobs for students, fell 4 percent to $972 million, after adjusting for inflation, the first time its has dropped below the $1 billion mark in at least a decade.

What small benefits accrue from IBR are, according to the New America Foundation, directed to providing "huge financial windfalls to people who, far from being in need, are among the most financially well-off graduates in today's job market."

The primary beneficiaries will be students who have taken on very large loans for graduate school. Because of federal loan maximums, those merely getting a four-year degree will not benefit. In fact, the report states that middle-income earners who start with salaries under $33,000 and later earn $63,000 or more for the majority of their repayment period, "will actually pay more and for longer due to the pending changes."

In addition, this updated IBR scheme has a myriad of qualifications. No student with loans prior to 2008 qualifies. Only certain types of loans are accepted—for example, no PLUS loans, private loans or consolidated loans. Payments have to be made without a problem for the entire 20-year period. And, should a student actually meet all of these hurdles, the amount forgiven will be entirely taxable. The process of application is described as "overly complicated."

The IBR fig leaf cannot rehabilitate the Obama record on student loans. Nor can it obscure the fact that, under his administration, students have amassed debt at a record rate. Since the third quarter of 2008, student loans have ballooned by $303 billion!

As of October 2012, average indebtedness is now up to $26,600 among those who borrowed for college and earned bachelor's degrees in 2011, rising from $25,250 in 2010, according to a new report from the Project on Student Debt. Sixty-six percent of students now borrow to finance their education.

Moreover official three-year rates of default show that 13.1 percent of students who began repaying in 2009 had defaulted by the end of 2011, a 53.4 percent increase in default, while the two-year default rate is the highest in a decade. The number for three-year defaults among for-profit school ex-students is nearly double, at 22.7 percent.

Obama's policies over the first term

Far from rescuing increasingly desperate defaulting students, Obama's policies can best be summarized as: protection of the financial industry, protection of the for-profit sector and intensification of the burdens on the poorest students.

As it is uniformly throughout the administration's policies, Obama's main constituency is the financial industry. Student loans are, in general, very profitable. Banks are receiving capital from the Federal Reserve at rates just above 0 percent. Student loans run from interest rates starting at 3.4 percent up through the double digits. In addition to this interest spread, the federal government makes Special Allowance Payments to banks making student loans. These are additional subsides pegged to commercial loan rates with an extra margin rolled in.

Hedge funds are the secondary beneficiary of student loans. Bundles of loans are transferred to trusts that sell shares to investors as asset-backed securities, just like mortgages. The principal of these loans is backed by the federal government, and securitization of these portfolios has been extremely profitable and are publicly traded. As just an example of this week's news in the "education market," it was reported that newly minted publicly traded debt buyer Performant Financial received $1.3 billion of student loan placements this quarter, showing a 27.1 percent revenue jump.

Then there are the education loan servicers and collectors. The Pennsylvania Higher Education Assistance Agency, for example, has seen its revenues for servicing loans triple, while money from defaulted loan collections quadrupled. It has earned multi-million-dollar profits for years, netting a cool $174 million last year alone.

Lastly, under Obama, the federal government itself cashes in on Direct Student Loans, an influx of money estimated to be $30 billion for 2012, according to the Department of Education. As a concession to the Republicans, Obama agreed that at least one-third of the savings from banking subsidies would go to the deficit.

Protection of the for-profit sector

At the start of his administration, Obama pledged to rein in the gouging of students by for-profit colleges and career schools. These institutions are notorious for their high costs, a nearly 50 percent student loan default rate, and failure to provide training adequate for students to secure employment of their chosen field.

The popularity of these career-driven programs is a sign of the times. More than 12 percent of the entire US student population now attends for-profits such as the University of Phoenix, the second largest higher education system in the country, right behind the state university system of New York. For-profit colleges are now a $25 billion industry, dominated by 13 large, extremely profitable, publicly traded corporations.

A two-year Senate investigation, concluded last year, stated that the federal government has failed to protect students from misleading sales pitches, an army of recruiters and poor quality programs. They pointed out that "publicly traded companies operating for-profit colleges had an average profit margin of 19.7 percent, generated a total of $3.2 billion in pre-tax profit and paid an average of $7.3 million to their chief executive officers in 2009." Additionally, they cited National Center for Education Statistics data showing that 23 percent of students who attended for-profit schools in 2008-2009 were unemployed and seeking work!

Despite the president's earlier rhetoric, when it came to drafting the rules the Obama administration met with the representatives of the largest for-profits—well-known Democratic Party contributors—in a series of 17 meetings before the final regulations were released. Student groups, in contrast, merited only one meeting.

The result was a relatively toothless "gainful employment" rule, providing only for the elimination of student loan eligibility to institutions where more than *two-thirds* [!] of the students were unable to repay their loans *and* failed debt-to-income measures *three out of four years* (loans more than 12 percent of income). Even among the egregious for-profits, only 5 percent of programs were considered at risk of losing their eligibility. Lastly, the programs were to be allowed to continue operating "with no requirements to improve," until at least 2015.

The Association of Private Sector Colleges and Universities launched a lawsuit challenging even this paltry restriction to the student loan spigot. Last June, the "gainful" rule was vacated by a US District Court judge. To date, the Obama administration has neither appealed the decision nor adopted further penalties on the exploitation of students by the for-profit industry.

Cuts to student aid under Obama

On the other hand, the Obama administration had adopted a whole series of cuts to existing programs, affecting Pell Grants, interest rate subsidies and grace periods—overall increasing student indebtedness. This is just a foretaste of what will happen after the new year's budget negotiations. Already discussions have begun on ending all fixed loan interest rates and allowing them to float, ending the 3.4 percent subsidy of Stafford loans, ending all in-school loan subsidies and making the Obama cuts to Pell permanent.

* *Pell Grants*: Obama has pointed to the "expansion" of Pell Grants, the only substantial non-loan program provided by the government for students, under his administration. Actually the growth of the program has been primarily the result of more students qualifying, due to the general impoverishment of the population.

Moreover, Obama has cut between $1,100 and $1,700 for 14 percent of recipients by tightening eligibility. In another new attack on the most needy, Pell Grants are now denied to students without a high school diploma who could show that they have an ability to benefit from college. The administration has also retroactively cut the number of semesters a student could receive Pell from 18 to 12, which disproportionately affects lower-income students who typically take a longer time to graduate in order to accommodate jobs or families. Obama also abolished the year-round Pell that many community college students used to take summer courses.

While the maximum Pell aid did rise from $4,731 to $5,550, fewer people will receive that maximum. Even more importantly, with the cost of college steadily rising, the typical grant covers only about one-third of the cost of a public four-year college. To receive a full-cost grant, a student's household must live on less than $23,000.

Ominously, Obama has continued the systematic underfunding of Pell. It now faces an $8 billion shortfall in 2014, and will be the inevitable target of further cuts during the "fiscal cliff" negotiations.

* *Interest rates and grace periods*: Obama also elected to maintain the 3.4 percent interest rate for certain qualifying undergraduate loans, allowing others to rise to 6.8 percent. That limited measure was also only enacted for a one-year period, to the consternation of student loan advocates. Additionally, he ended the government-subsidized interest payments for graduate students while in school, as well as the six-month grace period for undergrads. These measures add thousands of dollars to the typical cost of a degree.

Predatory student loan collectors unleashed

With $67 billion of student loans in default, the Obama Education Department has enlisted an army of private debt-collection companies to put the squeeze on borrowers. Education Department contracts—featuring commissions of as much as 20 percent of recoveries—collected $11 billion in defaults last year, and netted $1 billion in commissions.

As a whole, Obama has continued the overall trend of pricing the working class out of higher education, while creating a section of educated but desperate students working (if they are lucky) for the rest of their lives to pay off their student loan debt.