Obama, Congress prepare to hike interest on student loans

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On Friday, US President Barack Obama unveiled his administration's proposal for student loan borrowers. While Obama sought to rhetorically distance himself from a Republican measure that recently passed the House of Representatives, both plans would tie interest rates on student loans to Treasury bills, setting the stage for a significant increase in the amount paid by college students, graduates and their families.

During the presidential election campaign last year, Democrats and Republicans agreed to a one-year extension of the 3.4 percent loan rate for federally subsidized Stafford Loans. Beginning on July 1 of this year, interest rates for subsidized Stafford Loans and PLUS Loans are set to double if no action is taken by Congress.

Last week, House Republicans passed HR 1911, a bill that would introduce a variable interest rate for federally issued student loans, ending the current practice of setting a fixed rate. Student loans would fluctuate on a year-by-year basis, causing borrowers to face frequent changes in both the growth of their overall debt as well as the amount they are expected to pay each year.

According to the House bill, all government student debt would be tied to 10-year US Treasury notes, with an additional amount of 2.5 and 4.5 percentage points added for Stafford Loans and PLUS Loans, respectively. The rates in turn would be capped at 8.5 and 10.5 percent.

The overall goal of the bill is to generate $3.7 billion in deficit reduction over the next 10 years.

In his remarks Friday, Obama criticized the House's bill because it "fails to lock in low rates for students next year" and "eliminates safeguards for low-income families."

Obama's plan, however, is remarkably similar to that proposed by the Republicans, with the slight difference that his proposal would have interest rates fixed for each individual at the amount prevailing when the loan was initially taken out. Thus, under both plans future borrowers would have their interest rates tied to those prevailing in the market for US Treasuries. For example, if a student took out a loan under the Republican plan at a rate of 5 percent, this rate could go up or down in the future depending on the rate for Treasury notes, subject to a cap of 8.5 percent for Stafford Loans. Under Obama's plan, the rate would remain at 5 percent for the duration of the loan.

Obama's plan, however, does not include an overall cap. The rate for the duration of the loan would be set at whatever rate prevailed in the market when the loan was issued. The end result would be that, while some students might benefit from temporarily low interest rates in the initial period after Obama's plan was passed, eventually levels could actually be higher than what is proposed by the Republicans.

An ABC News report noted, "The dueling proposals in Congress and from the White House—even the ones that preserve the status quo in the short term—all acknowledge that the 3.4 percent interest rates on federally subsidized student loans will probably have to go up. The question now becomes when and how."

The similarity between the plans from the administration and from Congress was acknowledged by Republicans. Rep. John Kline (Republican of Minnesota), one of the sponsors of HR 1911, said that "coming up with a market-based student loan interest rate for the long term, I like it. I am very happy for the president on this one." This proposal was also included in Obama's budget.

Further demonstrating the closeness between Wall Street and the Obama administration, another recent

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report showed that the Department of Education was employing “debt specialists” from the private sector to recover loans that had fallen into default. In 2011 the Federal Trade Commission received 181,000 complaints of abusive debt collection practices from such firms.

The situation facing college graduates in the US is disastrous. Student loan debt has surpassed $1 trillion, more than the total owed by Americans on their credit cards and auto loans. Graduates today routinely have tens of thousands of dollars in debt, with little or no prospect for a decent job.

Some 43 percent of young people today have student debt, up from 25 percent in 2003. Among 25-year-olds who have student debt, the average amount is now more than $20,000, double what it was a decade ago.

No faction of the political establishment, Democrat or Republican, is offering anything to address this crushing burden of debt that college students already face, or to slow the continual rise of college tuition, which is placing higher education out of reach for an increasing number of working young people.

The authors also recommend:

Capitalism and the crisis facing young people
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US student loan interest rates expected to double
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