US student loan debt: Where did it come from and who benefits?

By Nancy Hanover
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The impoverishment of American students and their families by student loan debt has become a well-known fact.

A generation of young people are facing financial desperation in order to make huge monthly payments on their loans. The scale of this collective debt affects all aspects of their lives:

* 39 percent of 18-to-29-year-olds have no health insurance.
* 23 percent say they cannot buy basic necessities.
* 20 percent have credit card debt of more than $10,000.
* 49 percent have taken a job they didn’t want in order to pay bills.
* 24 percent have moved back home with parents to save money.
* 20 percent have postponed marriage.
* 22 percent of 18-to-34-year-olds have postponed having children. [1]

Today, 15.4 percent of Americans have student loans, and 14.4 percent of these loan holders are delinquent, the highest delinquency rate of any form of debt. [2]

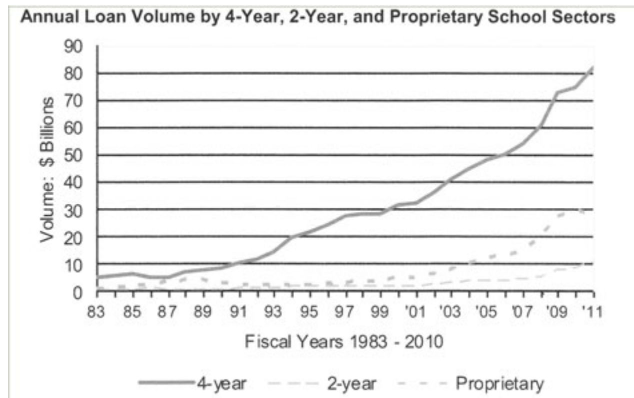
But *why* this is this tsunami of debt devastating a generation, and *who benefits*?

To avoid the mention of profit, the banking industry or the role of the government, the media typically blames either the students themselves, the purportedly overpaid faculty, or the mindset of an “entitled generation.”

A recent feature in the *New York Times,* entitled “A Generation Hobbled by the Soaring Cost of College,” is fairly typical. The lengthy series of articles attributes the crisis, more or less equally, to naïve “wide-eyed students and families,” lack of debt counseling, aggressive college marketing, the cost of campus amenities and state budget cuts.

The *Times* uses the piece to promote the Obama administration as “trying to make college pricing more understandable” and giving out “more grants and loans than ever to more and more college students, with the goal of making the United States first among developed nations in college completion.”

While the government is increasingly worried about the explosive implications of an entire generation facing a lifetime of debt and poverty, the media provides a smokescreen for the financial interests preying on students.



Loan volume at 4-year institutions continues to show substantial growth, increasing from $5 billion in FY 1983 to almost $82 billion in FY 2011, representing 67 percent of all gross commitment loan volume in FY 2011. The loan volume increase from 2010 to 2011 was about 9 percent.

The current debate on the doubling of Stafford loan rates from 3.4 percent to 6.8 percent, scheduled for July 1, is a case in point. Though Obama has made the proposal to avert this doubling of interest rates a campaign issue, the fact is that Democrats have agreed with Republicans that the cost of an interest freeze, about $6 billion, must be cut from somewhere else in the budget.

Yet the actual *cost* of the loans themselves is more than covered by the 3.4 percent rate, since the bankers’ interest rate, the Federal Reserve discount window, has fluctuated between 0 percent and 1 percent. The fact is that the Obama administration is not arguing with the Republicans over assisting students, but over how much to squeeze them.

As it stands now, student loans vary in rate from the highly profitable to the usurious, from the “discounted” cost of 3.4 percent up through 10 percent for PLUS loans. One doesn’t have to be a “naïve” student to see that the formulas are designed to be opaque to families and to protect the banks. Historically, Stafford loans have interest rates based on the 91-day rate from the last Treasury bill auction and the average one-year constant maturity Treasury yield for the last calendar week of the quarter. (If you are not yet confused, consult the myriad year-by-year variations of these loan rates at http://www.finaid.org/loans/historicalrates.phtml.)

Even without doing all the math, clearly it is the banks that profit most handsomely from student loan payments—while being uniquely protected by the federal government.

Loans originated in the Federal Family Education Loan Program (FFEL) have a 97 percent guarantee against default by the federal government (with accrued interest in addition). Additionally, since the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, student loans are the only type of consumer debt that may not be discharged in bankruptcy.

In case interest revenues do not meet expectations, the government also provides for a “special allowance” to the banks in the federal budget. In this way, student loan lenders can be ensured “a specified rate of return on their loans” based on the fluctuation of Treasury bills. Obama has not opposed any of these industry provisions.

Instead of exposing the financial services industry and the Obama administration, the *Times* cites student “naivete.” Yet, under conditions of growing unemployment, stagnating or declining wages, vast numbers of students have only two choices: dropping out of school or taking out more loans.

With more than two thirds of students (up from 45 percent in 1993) forced to borrow to earn a bachelor’s degree [3], the indebtedness of a generation is clearly social policy. On average, for every dollar borrowed, a student will pay $2.

Cost shifting from government to individuals

The second major factor in the creation of a mountain of student debt is the structural shift in costs from the government to individuals.

A recent study by the Demos organization describes “the radical reorganization of the financial aid environment.” They demonstrate how the elimination of grants, the expansion of loans and the shift toward merit-based aid favor wealthier students and tend to make college both less affordable and less accessible. [4]

Over the past two decades, states have cut the funding of public colleges and universities by a massive 26 percent, Demos reports. And this trend is accelerating, as the bipartisan policy of tax breaks for big business and the wealthy is paid for by the shredding of the nation’s social infrastructure. Between 2007 and 2011 alone, states cut 11.1 percent of higher education funding, $8.9 billion.

In addition to this shift in financial responsibility, placing the burden more heavily on the student, the US Department of Education reports that the average total per-year cost of a four-year public college has increased a staggering 90 percent, from $9,032 to $17,131.

The dirty secret in all of this, carefully hidden in the media, is the active role of the Democratic Party and specifically the Obama administration in the assault on higher education. At the most fundamental level, the Democrats have colluded with the Republicans in the systematic starvation of education while diverting society’s resources into endless wars, tax cuts for the rich, and bank and corporate bailouts.

Despite Obama’s claims that he is doing all he can to “make college more affordable,” he has implemented a whole battery of measures to attack student borrowers—a broadside attack on the young generation.

Obama cuts student loan programs

Effective July 1, 2012, the federal government has ended the in-school interest subsidy for graduate and professional students with Stafford Loans. This relatively little-reported event was enacted as part of the 2011 Budget Control Act. It will substantially increase the cost of graduate school, already notoriously expensive, and will add an estimated $18 billion to student debt burdens over 10 years. Seventy-six percent of US graduate school students borrow to cover tuition, and their yearly costs vary from $15,000 to $45,000 for tuition alone.

The Consolidated Appropriations Act of 2012 eliminated the grace period benefit (a six- or nine-month window after a student leaves school when no payments are due) for loans made in academic years 2012-2013 and 2013-2014, automatically increasing the net cost of the loan.

Also effective immediately and retroactively, students are only eligible for six full-time years of the Pell Grant, a decision primarily affecting low-income adults working their way through college. The measure will eliminate benefits for 63,000 recipients. Also, students may no longer receive two Pell Grants in a year or receive summer school funding. The government has also modified the amount families are expected to pay, the Expected Family Contribution, so that fewer students will be eligible for the grants.

Smaller Pell Grant awards of $277 to $550 have been cut completely. Also eliminated are the Pell Grants for students who pass the “ability to benefit” test but have not been awarded a high school diploma or GED.

The overall effectiveness of the Pell program has steadily been eroded by budget cuts and tuition increases. Between 1991-1992 and 2011-2012, the maximum Pell Grant has declined to the point where it presently covers an average of 32 percent of tuition costs, compared to 44 percent 20 years ago.

While these measures represent a major attack on the right of students to an education, there is an additional side to the assault. Under the Obama administration’s cuts, loans are now subsidizing the government. With all new loans mandated to be government-sourced, the government is the direct and prime beneficiary of student loan debt. Students who cannot afford health insurance, necessities or families are, instead, subsidizing the government.

Buried inside the Obama administration’s Department of Education (DOE) Fiscal Year 2013 Budget Request is some startling data on the sordid business of student loan financing. [5]

A comprehensive section entitled “Student Loans Overview” shows that the federal government, far from preventing education profiteering, is working to increase indebtedness among the young.

No longer just protecting the profits of the banks, the government is now well on its way to becoming the largest holder of student debt. This process was dramatically accelerated with Obama’s Health Care and Education Reconciliation Act, which made the government the sole funder of new student loans.

According to the Federal Reserve Bank of New York, non-revolving personal bank debt—the vast bulk of which is student loan debt—has jumped a massive 368 percent since 2007. The amount of student loans held by banks is now about $500 billion, or half of existing student debt, with the federal government just slightly behind. Federal-held student loans have quadrupled over the past four years.

This process has transformed the government’s role. The DOE report shows that there is not just a declining higher education subsidy, but that there is actually no overall subsidy from the federal government for student loans. On the contrary, student loans are an income source, to the tune of nearly $30 billion for 2012. Below is a chart from the president’s 2013 budget request showing the net inflow of cash from student debtors into federal coffers since 2009. The negative figures are inflows, the positive ones represent federal costs.

Total net FFEL and Direct Loan subsidy costs

(dollars in thousands)

Fiscal Year	FFEL	Direct Loans	Net Govt Cost
2008	-$1,977,384	$4,075,330	$2,097,946
2009	-$32,801,648	-$5,709,053	-$38,510,701
2010	-$9,104,047	-$11,215,767	-$20,319,814
2011	-$24,492,931	-$27,448,992	-$51,941,923

2012
-$14,914,412
-$23,953,022
-$38,867,434

Government "subsidies" for student loans go from a cost to the federal government in 2008 of $2 billion to an estimated cash inflow of $39 billion for 2012. (Source: US DOE)

In 2011, more than 11 million new Direct Loans have been issued to students, for a total of $109 billion. The administration is realizing a steady increase in student loan market share. The DOE budget proposal states, with dry but unmistakable language, "For FY 2013, based on proposed policies, the Direct Loan program weighted average subsidy rate is estimated to be -20.08 percent. The reflects the projection that on average, the Federal Government will earn 20.08 percent on each dollar of loans originated in FY 2013."

This is a far cry from the official line—"students who rely on loans to finance postsecondary education should not be burdened with additional college debt." It is the government that will collect the debt, interest, origination fees and late penalties from student debt, rather than the servicers, guarantors and banks that dominated the business in the past.

New attacks from Obama

The report then details Obama's proposed student loan "reforms" for the FY 2013 budget. These changes will actually *increase* the cost of college borrowing, place more loans under the DOE's aegis and allow debt collectors to apply more pressure on students.

*** Eliminate subsidized loans for students who take longer to complete their degrees.**

The administration calls for ending the in-school interest subsidy for borrowers who do not complete their program within 150 percent of the program's duration (for example, those who do not graduate from a four-year program within six years will lose their subsidy).

This measure will primarily affect working students. Eighty-four percent of students enrolled in two-year colleges now work, according to a Demos study. Of those, more than two thirds work 21 hours or more. The net result is that more than half of all two-year college students do not complete within three years and therefore would be subject to Obama's cutoff.

Financial pressures are pushing college completion rates downward; 27 states saw a decrease in two-year college completion over the last decade. Moreover, the statistics are not that much better for four-year institutions, where barely half graduate in six years.

*** "Modernize" the Perkins Loan program.**

Obama calls for an increase in Perkins loans, moving administration away from colleges to the DOE, and further increasing DOE revenues substantially. The February 2013 budget proposal calls for *raising* the interest rate from the current 5.0 percent to 6.8 percent *and eliminating the in-school interest subsidy.*

*** Legalize auto-dialing collection calls to students' cell phones.**

In the "President's Plan for Economic Growth and Deficit Reduction," he calls for an amendment of the 1934 Communications Act to allow prerecorded voice messages and robo-dialing to wireless phones for the purposes of debt collection.

*** Require guaranty agencies to forward their portfolio of rehabilitated loans (student loans which were temporarily in default, but are now in repayment) to the DOE.**

While the Obama administration insists on being the new collector, the rules stipulate that the former guaranty agencies may still collect a whopping 16 percent fee.

Obama has also pointed the way toward creating a national rating system on college affordability and value, and hinted that low-rated schools could be punished via withholding of loan or grant eligibility. There has been similar action threatened against the for-profit schools with skyrocketing default rates. Neither of these public relations maneuvers encroaches in the slightest on the banking industry's ability to profit from student loans or lessens the income accruing to the federal government from their loans.

Already, state and federal governments are withdrawing professional licenses from those who default on their student loans, and garnisheeing Social Security and other government checks. Under the Higher Education Act, the DOE can subject student loan defaulters to Administrative Wage Garnishment or Federal Salary Offset, and require employers to forward 15 percent of "disposable pay" toward repayment of loans. The Debt Collection Improvement Act of 1996 permits the DOE to garnish up to 15 percent of disposable pay until the entire balance of the outstanding loan is paid.

The government is also pressing schools to withhold transcripts for those students delinquent in payments, which prevents them from transferring, applying for certain types of work, or seeking further degrees.

The fact that government is itself holding a much larger percentage of the debt has ominous implications for further aggressive debt collection.

Student loan debt collection, a new parasitic industry

Student loans have become so lucrative that their debt collection has become its own spin-off industry—all overseen by the federal government. MyDebt.com explains ballooning fees that defaulters face: "The largest of these costs is usually the cost of contingent fees that may be incurred to collect the loan…. The contractors earn a commission, or contingent fee, for any payments then made on those loans. The Department [of Education] charges each borrower the cost of the commission earned by the contractor…the amount needed to satisfy a student loan debt collected by the Department's contractors will be up to 25 percent more than the principal and interest repaid by the borrower."

Student loan collection agencies are becoming big enough investment possibilities to successfully go public. One that is well rated by Fitch is Access Group's 2002 FFELP Student Loan ABS. A partial list of student loan collection agencies gives a glimpse of the growth of this parasitic financial industry: Account Control Technology, Inc., Allied Interstate, Inc., The CBE Group, Inc., Client Services, Inc., Coast Professional Inc., CollectCorp., Collection Technology, Inc., Client Services, Inc., Coast Professional, Collection Technology, Inc., Collection Company of America, ConServe, DEBTCOM Incorporated, Delta Management Associates, Diversified Collection Services, Financial Asset Management, FMS Investment Crop, GC Services, Immediate Credit Recovery inc., National Recoveries, NCO, Pioneer Credit Recovery, Premiere Credit of North American, Progressive Financial Services, LLC Transworld Systems, Van Ru Credit Corporation, West Asset Management, Windham Professionals, Inc.

Last week, the *San Francisco Chronicle*'s "Number of the Day" was $454,000, the one-year income of Joshua Mandelman, a student-loan debt collector. It reports on the nearly half-million dollars earned by Mandelman and six others at Educational Credit Management, a Minnesota nonprofit group, which subcontracts with the U.S. government to collect on defaulted student debt.

Education is a basic right

Only the Socialist Equality Party considers education a basic right. It should not be a means to prey on the young and create a new form of lifelong peonage.

We call for the immediate forgiveness of all student loan debt. Neither the banks nor the government have the right to profit from the determination of the population to become educated and productive.

We call for the right to free education for all, from pre-school through college and adult education.

There must be a series of socialist policies to dramatically expand education and provide access to mankind's collective culture to all on a free and equal basis. We urge students to join the International Students for Social Equality, support the election campaign of Jerry White and Phyllis Scherrer, and devote themselves to fighting for these policies throughout the working class.

Notes

1. Data: Pew Research Center, Bureau of Labor Statistics, Bloomberg Businessweek

2. http://www.insidearm.com/daily/credit-card-accounts-receivable/credit-card-receivables/mortgages-student-loans-mitigate-plunging-consumer-credit-deliquencies/?utm_source=WhatCountsEmail&utm_medium=2012%20Insider%20Daily%20and%20Weekender&utm_campaign=ARM%20insider%20-%205-23-12

3. http://www.nytimes.com/2012/05/13/business/student-loans-weighing-down-a-generation-with-heavy-debt.html?pagewanted=2&tntemail1=y&_r=1&emc=tnt

4. John Quinterno, Demos, The Great Cost Shift, How Higher Education Cuts Undermine the Future Middle Class, March 2012. http://www.demos.org/sites/default/files/publications/TheGreatCostShift_Demos.pdf

5. http://www2.ed.gov/about/overview/budget/budget13/justifications/r-loansoverview.pdf