New Legislation Will Help Federal Student Loan Borrowers, But Will it Hurt Taxpayers?

By: Kate Rogers – May 20, 2013

College graduates battling federal student loan costs might be able to refinance for a lower rate under proposed legislation.

The bill, introduced by Sen. Kirsten Gillibrand, (D-NY), seeks to have federal student loan borrowers take advantage of the historically low interest rates with those with rates higher than 4% be able to lock in rates at a flat 4%.

The Federal Student Loan Refinancing Act will help students lower their rates, however, critics say the move may cost taxpayers. An analyst priced a similar proposal to this refinancing move at $50 billion.

The legislation would change interest rates for all new federal student loans made on or after July 1, 2013, according to the CBO.

As of right now, the interest rates on government-issued student loans are set to double to 6.8% from 3.4% on July 1 if Congress doesn't pass legislation to prevent the increase. Without legislation, GradPLUS and parent loans will have a fixed rate of 7.9%. The interest rate on all consolidation loans is capped at 8.25%. Congress extended these rates through 2013 last May.

Under Gillibrand's bill, interest rates for all new subsidized and unsubsidized student loans will be based on the interest rate on a 10-year Treasury note, plus 2.5 percentage points. This will be capped at 8.5%, the CBO reports.

The CBO estimates that enacting the legislation will reduce direct government spending by nearly $1 billion over the 2013 through 2018 period, and by $3.7 billion through 2023.

Beth Akers, fellow at the Brown Center on Education Policy at the Brookings Institute, says its likely Congress will take action before the July 1 deadline to avoid the rate increase.

"It's in everyone's best interest to get something passed through," Akers says. "The short-term fix would be to have rates dropped back to where they were a year or two ago, or there could be a long-term fix. But people believe the incentives are in place to have Congress make something happen."

But just how much the bill would cost taxpayers and the federal government is still under debate
“The difference is in the assumptions of how you calculate costs,” Akers says. “The CBO has written about this, and with their 2013 measures, the government came out just ahead.”

Neal McCluskey of the CATO Institute tells the FOX Business Network, “the important point is that this will cost taxpayers more—though how much, we don’t know—and do nothing to slow the hyper-escalating price of college. If anything it will make it worse.”

Akers says it’s less clear if taxpayers will be impacted outright, or if more of their cash will just be allocated to these programs.

“If it were a cash cow, we would see other agencies trying to undercut the government,” Akers says. “It seems it’s a costly program, but that it’s money well-spent. Also, how generous do we want these subsidies to be? These rates are high, but they are lower than they would be if there were no subsidies.”