As Congress stares at a student loan rate deadline, undergrads foresee a life of debt

By Rick Montgomery – June 29th, 2013

The latest stalemate in Washington, D.C., is more than just a disagreement over how much college students should pay in interest on federally backed loans.

For Tyler Childress, entering his senior year at the University of Kansas, the question before Congress is how we stave off America's next economic crisis — the unsustainable cost of higher education.

The stakes for Childress and his peers get rather personal. With a college debt that could reach into six figures by the time he graduates from law school, will Childress be able to buy a house or a new car or start saving for retirement — or his own children's schooling — before he turns gray at the temples?

"Buying a house? Those things aren't on my radar at all," said Childress, 21, of Coffeyville, Kan. "They may not be even at age 40."

Congress is staring at a Monday deadline to set interest rates on federally subsidized loans for college undergraduates. If no action is taken, the present interest rate of 3.4 percent on popular Stafford loans will double to 6.8 percent for loans taken out after July 1.

A similar showdown loomed last June. Lawmakers at that time agreed to a one-year extension of the low interest rate rather than work out a long-term fix that would tie rates on future loans to Treasury bonds. Allowing student loan rates to float with the market is an idea supported in varying degrees by both sides of the nation's political divide.

But philosophies collide over how much the federal government should prime the lending pump — or if it should prime it at all.

Just as too-easy access to home mortgages helped create the housing bubble, subsidized loans for students may be enabling colleges to throttle up tuition rates even in hard economic times, some analysts argue.

"The price of college keeps going up because all this student aid enables it to go up," said Neal McCluskey of the Center for Educational Freedom at the Cato Institute, a libertarian-leaning think tank.

“If people have to pay with their own money, would they still choose college, or go to the same college, or would they take a less expensive approach?” he asked. “Would more students be saying, ‘I want to gain specific skills and then I want to move on?’”

Studies both support and knock down the “Bennett hypothesis,” which holds that colleges and universities face little incentive to keep costs down when scholarships, federal grants and low-cost loans help students foot the bills. The theory was advanced in the 1980s by William Bennett, then the U.S. secretary of education under President Ronald Reagan.

Critics of the Bennett hypothesis argue that a college degree has become so vital for success that students will seek loans whether or not rates are subsidized. They will just be paying more.

If the deadline passes and the interest rate doubles to 6.8 percent, the White House estimates that would add $1,000 to the average load of college debt, now about $28,000 by the time a borrower graduates.

“That’s like a $1,000 tax hike,” said President Barack Obama, flanked last month by college students in the Rose Garden to call on Congress to pass a long-term plan for loan subsidies. “I assume most of you cannot afford that.”

Like so many electives to choose from a course catalog, dozens of proposals for reforming student aid swirl around Capitol Hill.

The Smarter Solutions for Students Act, passed in May by the Republican-controlled House, would link interest rates on federally backed student loans to a market-based rate plus 2.5 percent. The plan allows the rate to fluctuate through the life of the loan, but never above 8.5 percent.

Obama, likewise, has proposed tying student loan interest to market-based rates. But he supports adding only 0.9 percent to prevailing Treasury rates and letting students lock in a fixed rate for the loan’s duration.

Obama’s plan would set interest on subsidized loans today at about 3.5 percent. The House bill would set the rate at about 5 percent.

Another key difference between conservative and liberal proposals is in how the government’s revenues from student loans should be spent. Many Republicans argue for directing funds made off interest toward reducing federal deficits. Democrats want the revenues to support education programs.

Others want Uncle Sam out of the student loan business.

“You can’t have the government acting as a big bank for student loans, because the government isn’t good at it,” said Evan Feinberg, president of the conservative advocacy group Generation Opportunity. “The best thing we can do is put (lending) back into the private market. Our parents went to college without these massive federal subsidies and they left without piling up mountains of debt.

“There’s a giant education bubble out there and it’s about to pop. And that ultimately would be good for students,” because colleges would be compelled to overhaul degree requirements and make schooling more affordable.

The big losers in that pop would be low-income and middle-income Americans, said Matthew Segal of OurTime.org, a progressive nonprofit group that seeks to galvanize young voters.

“It’s such a source of potential inequality if higher education is accessible only to a well-to-do handful,” Segal said. “Should the continuation of education past K-12 be seen as an accessible right for all who wish to seek it … or more a luxury item? That’s the philosophical question at the crux of the debate.”

As the deadline in Washington nears, one likely outcome is for lawmakers to defer from the debate and pass another extension on the 3.4 percent interest rate for subsidized loans.

Said Segal: “If they kick the can down the road, it’s not bad for college students. But it points again to the dysfunction of Congress.”

For his part, Eric Hurtt of Kansas City began his college journey on a prudent path.

He enrolled in some core courses at Johnson County Community College, then attended Fort Scott Community College, where he received a basketball scholarship.

Now a senior majoring in political science at the University of Kansas, he serves with classmate Childress on the student senate.

“I’m still driving the same used car I had at 16,” Hurtt said.

And he has kept his overall college debt, mostly built on federal Stafford loans, to a manageable $20,000.

But an increasingly competitive job market for his generation means Hurtt is planning to go to graduate school.

“Honestly, in the end I’m hoping to keep my debts under $100,000,” he said. “It hurts me to even say that. … I’ll be paying off those loans, truly, for decades.”

A recent report from the Federal Reserve Bank of New York found the national weight of college debt, totaling nearly $1 trillion, is crimping consumer spending on new cars, homes, travel and luxury purchases. Student loans have surpassed credit cards and become the second-largest source of debt for U.S. households, following mortgages.

The share of Americans age 25 with student debt rose from 25 percent in 2003 to 43 percent in 2012, the report found. And the average balance due on student loans soared 91 percent in that time for the same age group.

“This generation is beginning to understand that the world is sink or swim,” said KU graduate student Pantaleon Florez.

He and the university’s student body president, Marcus Tetwiler, recently signed a national petition for “comprehensive student loan reform.” Beyond calling on states to enhance funding for public universities, the petition implores Congress to enact legislation that would thwart the doubling of Stafford loan interest rates and cap them over the long term.

“If a college education falls out of reach for millions of Americans, our entire economy will suffer the consequences,” the letter reads.

The petitioners, all students, seek better refinancing options. They support a variety of loan repayment measures that allow graduates to draw down their debts based on income.

Presently, borrowers can have much of their loan balances forgiven so long as they can fork over a portion of their salaries — typically 10 or 15 percent of discretionary income — over a stretch of 20 or 25 years.

Whatever it takes to spare Darleen Denno from a lifetime of debt.

She was an exceptional student in high school. So Denno, at age 16, was admitted to the Missouri Academy at Northwest Missouri State University. Then she fulfilled a dream of living and learning in New York City by enrolling at Hofstra University on Long Island.

And the federally backed loans began to pile up.

Now 21 and back at Northwest Missouri State, Denno is desperate to close the valve on college debts exceeding $75,000.

“I’ll probably be eating ramen noodles for much of my adult life,” Denno said.

“The advice given to kids is awful: ‘You’ll get a good job after college. Pay off your student loans. No worries,’” she said. “Even if I disappeared off the face of the earth, (the repayment of) my loans would transfer to my parents, and that wouldn’t be fair to them.”

She even researched Holland’s low-cost colleges while there in a student exchange program, only to learn she would have to spend years establishing citizenship to qualify.

Originally drawn to newspaper journalism, Denno today turns to art — severe charcoal sketches — to express her anguish over debts that no bankruptcy court will erase.

She has settled on “interactive digital media” as a major — a career with promise, maybe. But not exactly her passion.

“I’m just looking to finish my studies,” Denno said, “and to get out.”