Recalculating Student Loans

The following editorial appeared in Monday's Washington Post:

Student loan interest rates are going to double in July. And, no, that's not nearly as terrible as it sounds.

Last year, President Obama promised to prevent such a scary-sounding outcome to whip up enthusiasm for his reelection campaign. In fact, only some rates were set to increase from 3.4 percent to 6.8 percent, and that would have been only on new loans, not existing ones. And even if certain rates had ratcheted up, the government still would have been giving students – risky borrowers, that is – a tremendous deal, and with very generous repayment terms to boot. Nevertheless, cowed lawmakers agreed to keep the lower rates in place for another year, cobbling together $6 billion to pay for it.

This year, the president is taking a more responsible approach, and it seems as though Congress might, too. If, that is, lawmakers can overcome the demagoguery that is almost certainly about to crop up as last year's rate extension approaches its expiration date.

Right now, Congress simply sets student loan interest rates in law, and they stay at that level for as long as lawmakers designate, regardless of how much it costs the government to borrow. That makes student loan rates excellent playthings for politicians in search of campaign gimmicks; the Democrats began campaigning on the 3.4 percent rates back in 2006.

But in his latest budget, Mr. Obama proposed to take that campaign cudgel off the table. He would peg student loan rates to the rate at which the government borrows, with a relatively modest markup to account for the risks taxpayers are taking. Since the government's borrowing rate is rock-bottom right now, the early years of the program would see rates lower than the 6.8 percent expected in July. But with normal interest-rate fluctuations over a 10-year window, however, the administration reckons the program would have no effect on the budget. It could even make money for the government.

The reform's primary attraction is that it would tie the amount students must pay to the real cost of borrowing and, therefore, to the real state of the economy. The program wouldn't cost more when the government's borrowing costs are higher. At the same time, the size of the subsidy the government offers to students wouldn't change with interest rates, as it does now. Combined with Mr. Obama's more generous, income-based repayment and forgiveness policies, students wouldn't have to face crushing loan payments after they graduate, even when interest rates rise.

Jason Delisle, the New America Foundation's higher-education maven, points out that there's still a lot more Congress and the White House have to fix. They could save billions, for example, by unifying the various loan terms the government offers to students who come from families of differing incomes. That would make sense if a generous income-based repayment program protects all after graduation. And, Mr. Delisle notes, Congress should remove certain incentives to borrow mountains of money for graduate studies that the government would probably never get back.

Still, the president has given lawmakers a proposal worth working on. They should take it up.

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