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The Student Debt Crisis: The Impact of the Obama Administration's "Pay as You Earn" Plan on Millions of Current & Former Students

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THE STUDENT DEBT CRISIS: THE IMPACT OF THE OBAMA ADMINISTRATION'S "PAY AS YOU EARN" PLAN ON MILLIONS OF CURRENT & FORMER STUDENTS

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INTRODUCTION

Traditionally, graduation day has always been a joyous event for students, parents, family, and friends of students. For years, this day has symbolized the transition into adulthood and, as many would hope, a road to prosperity. In recent years, this day has, however, come to symbolize something much more troubling. Unfortunately, this day has come to symbolize the day students must begin to find gainful employment in a stagnant economy and pay off tens, and in some cases hundreds, of thousands of dollars in debt.

Since the early 2000s, tuition rates have skyrocketed, the job market has stagnated, and financial aid has in many cases simply not kept up. This growing problem will cause student loan debt to soon exceed credit card debt for the first time in our nation's history.[1] In 2010, the average college senior graduated with $25,520 in debt.[2] This figure is even more daunting given that young graduates are pitted in a job market that is fiercely competitive and unforgiving to young job seekers who have yet to acquire the practical job experience that employers value. The situation for students graduating with advanced and professional degrees is equally daunting, where it is not uncommon for students to have debts of more than $125,000 on graduation day. Students also face similar

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[1] *See* David Nakamura & Scott Wilson, *Obama Unveils Student Loan Relief Plan in Denver Campus Appearance*, WASH. POST, Oct. 26, 2011, *available at* http://www.washingtonpost.com/politics/obama-unveils-student-loan-relief-plan-in-denver-campus-appearance/2011/10/26/gIQAOcDNJM_story.html.

[2] Richard Lee Colvin, *A Sensible Solution to Student Loan Debt*, L.A. TIMES, Nov. 10, 2011, *available at* http://articles.latimes.com/2011/nov/10/opinion/la-oe-colvin-school-loans-20111110.

hurdles in these job markets. While the unemployment rate for college grads aged 25 and older is still significantly lower than high school grads 25 and older, 4.2 percent compared to 9.7 percent, this debt is still troublesome and a burden for many.[3]

These steep debts also have a profound effect on the economy and consumer spending. Many people in their mid to late twenties are putting off marriage, home ownership and are even moving back with their parents because of the dismal job market and overwhelming amount of debt they are in. Many graduates also find student debt daunting because it is one of the few debts that cannot be discharged by bankruptcy.[4]

Recently, President Obama implemented the "Pay as You Earn" plan in an effort to help combat fiercely growing student debt.[5] This plan will allow students who have taken out recent loans to only be required to pay a capped percentage of their student loan every month and be able to discharge the loans after a specified period of time.[6] While "Pay as You Earn" was hailed by many as being a big step in the right direction to lowering high student loan debt, many others do not believe that this plan does enough to attack the student debt crisis. Critics believe that this plan does not go far enough to attack the real problem of quickly growing tuition rates, does not extend benefits to enough graduates and does not have a far reaching impact on consumer spending and the economy.

Accordingly, this Article will analyze the "Pay as You Earn" plan and the issues surrounding this plan. First, this Article will present statistics on student debt and college tuition to illustrate the severity of the debt problem. Next, the origins of "Income Based Repayment" ("IBR") will be discussed. Then, the Obama "Pay as You Earn" plan will be discussed. Finally, this Article will discuss the praises and criticisms of the plan and whether it attacks the real cause of exponentially growing student debt.

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[3] Carolyn Bigda, *Too Much Student Loan Debt Can Lead to Turbulence*, CHI. TRIB., Oct. 11, 2011, *available at* http://articles.chicagotribune.com/2011-10-14/business/sc-cons-1013-started-20111014_1_student-loan-debt-borrowing-credit-card.

[4] *Id.*

[5] Press Release, The White House, *Fact Sheet: "Help Americans Manage Student Loan Debt"* [hereinafter *White House Fact Sheet*], http://www.whitehouse.gov/the-press-office/2011/10/25/fact-sheet-help-americans-manage-student-loan-debt (last visited Feb. 18, 2011).

[6] *Id.*

I. COLLEGE TUITION AND STUDENT DEBT

For many Americans, college is the single largest expense that they will have in their early adulthood, and it is what many families often spend years saving for. This expense has turned into an even bigger burden due to the soaring cost of tuition.[7] This increase has been seen in both state-funded and private universities.[8] Many commentators and experts in the area believe that this drastic increase is the true issue that analysts and politicians must address. For example, in 2005, tuition alone at Loyola University Chicago for an undergraduate was $23,900 per year.[9] In 2011, this number rapidly jumped to $32,200 per year.[10] This is an increase of around 25% in just six years. Statistics such as this are common at universities across the United States, and hold true for both graduate and post-graduate studies. In the last ten years, tuition, fees, and room and board at four-year public colleges rose by almost 80% to $12,796 a year, and for private universities it rose around 65% to $30,367.[11]

While financial aid has increased as well, it is not keeping up with rising tuition, and students must now fill the gap with higher interest loans.[12] This problem is also present in graduate level programs, where tuition rates are oftentimes much higher and financial aid is even scarcer. Not surprisingly, it is not uncommon to find graduates of law or medical school with upwards of $150,000 in debt.[13]

Sadly, students often come into college and graduation not knowing the true details of how much they owe and the repayment terms of their loans.[14] Luckily, the Department of Education has set up the National Student Loan Data System ("NSLDS"), where a

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[7] Marcy Gordon, *Student Loans Sow Seeds of Economic Ills*, USA TODAY, Sept. 30, 2007, *available at* http://www.usatoday.com/money/economy/2007-09-30-studentloans_N.htm.

[8] *Id.*

[9] Author's own tuition bill from Fall of 2005 at Loyola University Chicago.

[10] *Loyola University Chicago- Tuition and Fees*, LOYOLA UNIVERSITY CHICAGO, http://www.luc.edu/undergrad/financialaidcosts/loyola-university-chicago-tuition.html (last visited Feb. 18, 2012) [hereinafter *Loyola Undergraduate Tuition*].

[11] Gordon, *supra* note 7.

[12] *Id.*

[13] *Id.*

[14] *See* Susan Tompor, *Student Loan Debt Exceeds Credit Card Debt in USA*, USA TODAY, Sept. 9, 2010, *available at* http://www.usatoday.com/money/perfi/college/2010-09-10-student-loan-debt_N.htm.

student may use their social security number and student aid PIN number to see the exact amount of money they owe, amount of interest they owe, types of loans and date of disbursement of each loan, and receive information on repayment options.[15] This site is very helpful to students who feel they cannot manage all of their different loans and various disbursements.

Not surprisingly, rising tuition rates and slowly growing financial aid are forcing students to take out much more in student loans. While the government does subsidize and offer attractive interest rates on many loans, these government-guaranteed and interest-subsidized loans top out at $23,000 over four years for undergraduates.[16] This means that many undergraduates will be forced to take out alternate loans that have a higher interest rate than the subsidized 6.8% on government-backed loans.[17] In part, this combination of rising tuition costs and additional loans has increased student debt nearly sevenfold from $80 billion in 1999 to a whopping $550 billion in June of 2011.[18] This number is expected to reach around $1 trillion in the near future.[19] The amount of student loan debt in America will soon exceed the amount of credit card debt.[20]

These increases have left many young graduates crying for help. Defaults on student loans have increased substantially in this time period as well, from 6.5% in 2003 to over 11% in 2011.[21] The 11.2% default rate for student loans is now just under the 12.2% default rate for credit cards.[22] This statistic is even more daunting since unlike virtually all other types of debt, student loans may not be

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[15] *Repayment Plans and Calculator*, FEDERAL STUDENT AID, http://studentaid.ed.gov/PORTALSWebApp/students/english/OtherFormsOfRepay.jsp (last visited Feb. 18, 2012); *Retrieve Your Loan Information*, NATIONAL STUDENT LOAN DATABASE; http://www.nslds.ed.gov/nslds_SA/ (last visited Feb. 18, 2012).

[16] Gordon, *supra* note 7; *Direct Stafford Loans*, FEDERAL STUDENT AID, http://studentaid.ed.gov/PORTALSWebApp/students/english/studentloans.jsp (last visited Feb. 18, 2012).

[17] *Id.*

[18] Matt Kennard & Shannon Bond, *U.S. Student Debt Impact Likened to Subprime Crisis*, FIN. TIMES, Oct. 16, 2011, *available at* http://www.ft.com/intl/cms/s/0/6ae7dfc4-ef78-11e0-941e-00144feab49a.html#axzz1mmWFSUeb.

[19] *Id.*

[20] Colvin, *supra* note 2; *Nope, Just Debt, The Next Big Credit Bubble?*, ECONOMIST, Oct. 29, 2011, *available at* http://www.economist.com/node/21534792.

[21] Kennard & Bond, *supra* note 18.

[22] *Id.*

modified or discharged with bankruptcy absent *extreme* circumstances.[23] In the event that students do not pay, the federal government has the power to garnish wages, up to 15%, and withhold income tax refunds.[24] In sum, borrowers who decide not to pay ultimately do have to pay and end up paying much more because of various collection fees and interest.[25]

Accordingly, when many students finally leave college, they are faced with tough economic choices. Many new graduates have to forgo things such as vacations, new cars, home purchases, and starting a family because they simply cannot afford it. This also makes it almost impossible for a young entrepreneur to start up his own business upon graduation or even a few years thereafter.[26] These choices are even more difficult given the current state of the economy. While statistics do indicate that college graduates have a much lower unemployment rate than those with only a high school diploma, young graduates face a plethora of competitors who possess an equally low amount of the job experience that employers seek.[27] Not surprisingly, the unemployment rate for college graduates aged twenty to twenty-four rose to about 12.1% in June of 2011.[28]

II. "PAY AS YOU EARN" & ITS ORIGINS

A. Overview

Given the rising costs of education and the payment difficulties that many students are having, in October of 2011, President Obama announced a new plan to help tackle these issues.[29] This plan is, however, a continuation of earlier efforts to relieve the burden of student loan debt. This section will briefly discuss the origins of the "Pay as You Earn" plan and then discuss the specifics of the plan itself.

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[23] Kayla Webley, *What To Do If You Can't Pay Your Student Loans*, TIME, Jan. 18, 2012, *available at* http://moneyland.time.com/2012/01/18/what-to-do-if-you-cant-pay-your-student-loans/.

[24] *Id.*

[25] *Id.*

[26] *See* Gordon, *supra* note 7.

[27] *See id.*

[28] Amanda Fairbanks & Andres Lenoir, *Jobless College Graduates Struggle Under Ongoing Recession*, HUFFINGTON POST (Sept. 7, 2011), http://www.huffingtonpost.com/2011/07/08/college-graduates-jobs-unemployment_n_893495.html.

[29] Nakamura & Wilson, *supra* note 1.

B. The Origins

The origins of the "Pay as You Earn" plan started in the College Cost Reduction and Access Act of 2007.[30] This Act created "Income Based Repayment" ("IBR"), which means that graduates who qualified for the plan had a capped student loan payment equal to 15% of their disposable income per month, and the plan forgave these student loans after twenty-five years.[31] Under this plan, graduates who pursued a career in public service would have their loans forgiven after ten years of employment.[32] This plan was meant to assist students who pursued careers which were low-paying and students who pursued careers in the public sector.[33]

The 15% figure was based on the amount of discretionary income a person had. Discretionary income is calculated by subtracting a borrower's adjusted gross income from 150% of the federal poverty line.[34] Adjusted gross income is based on the borrower's prior year tax return and is re-calculated yearly.[35] When calculating the federal poverty line, the federal government takes into account a person's household size.[36] For example, a borrower with a household of one would have a "150% poverty level" of $16,335.[37] If that borrower had an adjusted gross income of $40,000, his discretionary income would be $23,665. If all of that borrower's loans qualified for income based repayment, then that borrower would have to pay a maximum of $3,549.75 per year, or $295.81 per month. If, however, the borrow would have a loan payment under a standard ten year repayment schedule that was less than $295.81, then the borrower would not qualify for, nor would he need, income based repayment.[38] These maximum payment levels are re-determined every year to take into account salary increases and other circumstances.

In order to qualify for income-based repayment, the borrower

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[30] *Income Based Repayment*, FINAID, http://www.finaid.org/loans/ibr.phtml (last visited Feb. 18, 2011).

[31] *Id.* Typically, student loans have a repayment period of 10 years.

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] *The 2011 HHS Poverty Guidelines*, U.S. DEP'T OF HEALTH & HUMAN SERVS., http://www.aspe.hhs.gov/poverty/11poverty.shtml

[37] *Id.*

[38] *Income Based Repayment*, FEDERAL STUDENT AID, http://www.studentaid.ed.gov/PORTALSWebApp/students/english/IBRPlan.jsp (last visited Feb. 18, 2011).

must have a specific type of loan. The loans which are eligible for this program are all Stafford, PLUS, and Consolidation Loans made under the "Direct Loan" or "Federal Family Education and Loan" programs.[39] Loans that are currently in default or "Parent PLUS" loans are not eligible for income-based repayment.[40] While these federal loan plans are very attractive, borrowers should be aware that paying less and postponing payment will add interest to the loan. Borrowers will ultimately have to pay some of this interest if they get a higher paying job before the ten or twenty-five year period that the loan is canceled.[41] While these plans are in fact geared towards graduates who feel that they cannot make ends meet, statistics show that they are somewhat rarely used.[42]

The Income Based Repayment plan was modified to further assist graduates in the 2010 Health Care and Education Reconciliation Act ("HCERA").[43] Most notably, this Act modified the percentage of discretionary income a graduate would have to pay from 15% to 10% and changed the cancelation period to twenty years, as opposed to twenty-five years.[44] While this Act was hailed by many student advocates as a great relief to the student debt burden, reprieve was distant since the Act was not set to take effect until 2014.[45] This Act would also only apply to student loans that would be taken out after July 1, 2014.[46] Thus, many still believed that something more had to be done to combat this growing problem.

C. "Pay as You Earn"

In late 2011, protestors took to the streets of many cities in the "Occupy Wall Street" movement. One of the highly charged issues at

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[39] *Id.*

[40] *Id.*

[41] *Id.* The government will cover the first three years of interest of federally subsidized loans.

[42] *White House Fact Sheet, supra* note 5.

[43] Healthcare and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 2214 (2010); *AAU Summary of the Education Provisions of the Health Care and Education Reconciliation Act of 2010*, AMERICAN ASS'N OF UNIVERSITIES, http://www.aau.edu/WorkArea/showcontent.aspx?id=10628 (last visited Feb. 18, 2012).

[44] *AAU Summary of the Education Provisions of the Health Care and Education Reconciliation Act of 2010*, AMERICAN ASS'N OF UNIVERSITIES, http://www.aau.edu/WorkArea/showcontent.aspx?id=10628 (last visited Feb. 18, 2012).

[45] *Id.*

[46] *Id.*

these protests was the need for more immediate relief from rising education costs and student loan debt.[47] While some protestors supported the radical idea of outright loan forgiveness as a necessity and a good way to boost consumer spending, this proposition did not materialize. However, the protests did have an impact on the implementation of the 10%/twenty year provisions in the HCERA.[48] Accordingly, on October 26, 2011, President Obama announced that, by Executive Order, he would expedite the implementation of this provision to provide more immediate relief to borrowers.[49] This plan also had provisions which would help borrowers consolidate their loans and lower their interest rates.[50]

The "Pay as You Earn" executive order went into effect in January of 2012. In order to qualify for coverage under the plan, a borrower must have student loans which are federal loans or government-guaranteed private loans, as was also the case with 15% IBR.[51] The main difference in regards to qualification for the 10% plan is when the student loan was taken out.[52] The only people who will qualify are students who took out all of their loans in 2012 or later, or students who took out the loans in question after 2008 and took at least one loan out after 2012.[53] This means that students who graduated in 2011 and before will not qualify for the 10% plan.[54] As with the previous 15% plan, borrowers who are currently in default will also not qualify for this plan.[55]

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[47] Nakamura & Wilson, *supra* note 1.

[48] *Id.*

[49] *Id.*

[50] Lucy Madison, *Who Will Benefit From Obama's Student Loan Plan*, CBSNEWS.COM (Oct. 26, 2011), http://www.cbsnews.com/8301-503544_162-20126172-503544/who-will-benefit-from-obamas-student-loan-plan/; Liz Davidson, *What the New Student Loan Plan Means For You*, FORBES, Jan 18, 2012, *available at* http://www.forbes.com/sites/financialfinesse/2012/01/18/what-the-new-student-loan-plans-mean-for-you/.

[51] Daniel Indiviglio, *Who Qualifies for Obama's 10% Student Loan Payment Cap*, ATLANTIC (Oct. 27, 2011), http://www.theatlantic.com/business/archive/2011/10/%E2%80%A6/247470/; *White House Fact Sheet*, *supra* note 5.

[52] Daniel Indiviglio, *Who Qualifies for Obama's 10% Student Loan Payment Cap*, THE ATLANTIC (Oct. 27, 2011), http://www.theatlantic.com/business/archive/2011/10/%E2%80%A6/247470/; *White House Fact Sheet*, supra note 5.

[53] Daniel Indiviglio, *Who Qualifies for Obama's 10% Student Loan Payment Cap*, The ATLANTIC (Oct. 27, 2011), http://www.theatlantic.com/business/archive/2011/10/%E2%80%A6/247470/;

[54] *Id.* Students who took loans out before this period of time may still, however, qualify for the previous 15% cap.

[55] *Id.*

Given the same $40,000 income mentioned in section IIB, under the new plan, a borrower would have to pay a maximum of $2,366.50 per year, or $197.21 per month. This amounts to a savings of almost $100 per month, as compared with the previous IBR plan. While these savings do indeed seem substantial, many commentators believe this plan will take years to truly make an impact because of the restrictions on who qualifies.

III. PRAISES & CRITICISMS OF "PAY AS YOU EARN"

While there is general agreement that student costs and debts are spiraling out of control, there is substantial disagreement on what should be done about this problem. Many believe that "Pay as You Earn" is a step in the right direction and a genuine effort to help young graduates battle high loans and a difficult job market. However, there are many others who believe that this plan simply does not go far enough, excludes the vast majority of current student loan debtors, and will take too long to effectively implement.

A. Praises of "Pay as You Earn"

As has been discussed, "Pay as You Earn" has been praised by many as being much needed relief in difficult economic times and in times of high student loan debts. Young borrowers who enter fields such as nursing, teaching, and other public sectors will likely save hundreds of dollars each month if they qualify for "Pay as You Earn." By cutting monthly payments by a third or even at times half, the new plan gives young graduates more disposable income, gives graduates more money to start their post-graduate lives, and also helps stimulate the economy and increases consumption.[56]

This plan may also have the effect of encouraging higher education. Many people who would otherwise be discouraged from going to college or graduate school because of the prohibitive costs may be encouraged to pursue higher education by this plan. This plan has also been praised because it allows graduates to start their careers with smaller monthly loan payments and the prospect of having their debt eliminated in either ten or twenty years.[57] While the plan was well accepted by many, some commentators and politicians, such as Senator Al Franken, supported the plan but believe that the real

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[56] See *White House Fact Sheet*, *supra* note 5.

[57] Lucy Madison, *Who Will Benefit From Obama's Student Loan Plan*, CBSNEWS.COM (Oct. 26, 2011), http://www.cbsnews.com/8301-503544_162-20126172-503544/who-will-benefit-from-obamas-student-loan-plan/.

problem is rapidly rising educational costs.[58]

B. Criticisms of "Pay as You Earn"

While "Pay as You Earn" has been hailed as a plan that will help millions of graduates and current students, there are many who believe that this plan simply does not go far enough to help students and that it does not attack the problem of exponentially growing tuition costs.

The new IBR plan covers only a limited number of students. The plan covers only those loans that are taken out after 2008, and in order for a borrower to qualify, they must have taken out at least one student loan in 2012.[59] This plan has been criticized by some because it is mainly geared towards future generations and does very little to help students today. Many commentators believe that relief is needed now and this plan will not have the economic stimulus and burden-relieving effects that the Obama administration is promising.[60]

In addition to the plan not covering a wide enough range of loans, many commentators also argue that the plan will only assist those who make an extremely small amount of money as compared to very large amounts of debt. Many borrowers will eventually find that they make too much money and have too little debt to qualify for any real benefits under the plan. Likewise, those who may have qualified for the first few years after graduation may find that they no longer qualify when they start making more money. However, it must be recognized that there are benefits to allowing new graduates the chance to pay less on their loans and have their interest subsidized on certain loans in the years after graduation. This measure will give graduates an opportunity to gain valuable job experience and advance their careers while having less of a student loan burden.

In spite of these benefits, many commentators still believe that this plan does not attack the real issue of rapidly rising education costs.[61] As this Article has stated, the cost of a college education has skyrocketed in the last ten years. Families, borrowers, and financial aid simply cannot sustain tuition, room and board, and costs that have risen exponentially.[62] Even President Obama has recently "put universities on notice" that the era of unabated tuition increases is

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[58] *Id.*
[59] Indiviglio, *supra* note 53; *Income Based Repayment*, *supra* note 30.
[60] Indiviglio, *supra* note 53.
[61] Madison, *supra* note 57.
[62] Gordon, *supra* note 7.

over.[63] Some commentators believe that the cost of education is out of control because schools are attempting to maintain and increase quality by spending more, but are not spending efficiently by reducing costs or reallocating funds.[64] Schools oftentimes attempt to increase their prestige, number of applicants, and *U.S. News & World Report* ranking, but do so without spending efficiently or having efficiency checks.[65] Also, many believe that the shared system of governance between trustees, administrators, and faculty at private institutions creates a system that does not react well to cost pressures.[66] These rising costs will be a pivotal issue for students in the coming decades.

IV. CONCLUSION

This coming May, a new class of graduates will walk down the aisle, get their hard-earned college or graduate diploma, and begin a journey of loan repayment. This day is a joyous occasion for graduates and the friends, family members, and others that have been at the graduates' side for years. However, this day has been overshadowed in recent times by the mountain of student debt that many graduates take out in order to fund their education. The "Pay as You Earn" plan creates breathing room for students who may have difficulties making ends meets in this extremely competitive job market.

While "Pay as You Earn" was announced with much fanfare and excitement, this plan is not without its faults and shortcomings. As this Article has discussed, this plan is a continuation of a previous plan to help graduates with mounting debt. However, "Pay as You Earn" does little to help those who have already graduated and are faced with high monthly payments and low salaries. While graduates who took all of their loans out prior to 2008 may still qualify and benefit from the previous 15% IBR, they will unfortunately not be able to reap the added benefits of "Pay as You Earn."

Likewise, "Pay as You Earn" has been seen as problematic by

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[63] Jim Kuhnhenn & Kimberly Hefling, *Obama Decries Rising Cost of College Education*, ASSOCIATED PRESS, Jan. 27, 2012, *available at* http://news.yahoo.com/obama-decries-rising-cost-college-education-152613213.html.

[64] Ronald Ehrenberg, *Tuition Rising: Why College Costs So Much*, EDUCAUSE.EDU, http://net.educause.edu/ir/library/pdf/ffp0005s.pdf (last visited Feb. 18, 2012).

[65] *Id.*

[66] *Id.*

many because it does not attack the real problem of out of control student loan debt: out of control tuition. While lower monthly payments and a shorter loan cancellation period do help many graduates, the causes of high student loan debt must be addressed. The Obama plan is a step in the right direction, but lasting change and benefits will be difficult to achieve if tuition increases do not slow down. Accordingly, if more meaningful changes occur, they will give young borrowers and consumers the power to start their lives on the right foot and not hopelessly indebted.

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