NO INTEREST STUDENT LOANS WITH A COST OFFSET

PROBLEM

An increasingly large share of student loan borrowers are unable to pay down their principal. Their loan balances grow primarily because of negative amortization, which happens when interest is accumulating faster than payments are received. The accumulated interest is added onto the original loan principal, compounding interest and increasing future monthly repayment obligations.

This disproportionately impacts borrowers already facing economic hardship as well as borrowers of color. Black graduates are much more likely to experience negative amortization: nearly half (48 percent) of black graduates see their undergraduate loan balances grow after graduation, compared to just 17 percent of white graduates. This disproportionate impact - combined with the labor market discrimination and occupational segregation these students face - further exacerbates racial disparities.

SOLUTION

One step to ease the burden on student borrowers is to remove the interest obligation. This would be a critical step to provide relief to both current and future borrowers. To offset the cost of waiving these interest payments, the federal government could generate revenue by investing principal repayments.

The federal government lends no interest loans to students

Borrowers repay principal only over a set period of years

The principal repayments are invested in risk-free assets to generate a return over time

Once matured, the funds are used to cover administrative costs and issue new student loans

Key Areas to Discuss & Address:

- The place of a principal-only repayment plan among existing repayment plan options
- Inclusion or exclusion of Graduate Plus and Parent Plus Loans
- Whether borrowers should be automaticly enrolled or given the choice to opt-in
- Potential for moral hazard and/or increased borrowing
- Risk of increased tuition rates