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A New Proposal for Educational Loans

This proposal combines two independent, but complimentary, ideas regarding loans for post-secondary education in the U.S.:

*individuals repay the loans by committing a percentage of their future income for twenty-five years [but not beyond age 65], rather than by a fixed dollar obligation; and

*a portion of the Social Security [OASDI] Trust Funds be used as initial capital to finance those loans.

An intermediate Agency would borrow money from the Social Security Trust Funds, and then arrange for loans to and collections from individuals. It is conceivable that the Agency could obtain its capital from other sources [in addition to, or instead of, the Social Security Trust Funds], but use of the Trust Funds for such loans is advocated as a productive investment for the surplus which is scheduled to be accumulated over the next half-century.

Aside from numerous policy issues raised by the proposal, there are many actuarial aspects. The published papers [see note below] cover both areas; this discussion focuses on the latter.

With respect to transactions between the Agency and individual borrowers, the repayment factors [percent of income per $1000 of loan] are determined by cohorts [calendar year of loan and borrower's age in that year], and it is intended that each cohort will repay its aggregate borrowed amount plus an interest charge. The factor for a cohort could not be increased, but future cohorts might have different factors; thus setting the factors is an actuarial activity. Anti-selection and possibility of repayment manipulation also are actuarial concerns: an upper limit would apply to the income affected by repayment obligation [in order to encourage participation by those expecting high earnings]; collection of the repayment obligation would be by payroll deduction, which could be cross-checked with Social Security [FICA] records; etc. One aspect not adequately dealt with is possible deferral of income to a time after the repayment period; undoubtedly there are other such problems.

With respect to transactions between the Agency and OASDI, a traditional debt obligation would exist; i.e. the Agency would sell 15 year bonds to OASDI. Thus the Agency would bear the actuarial risk involved in the individual borrower repayment arrangement, but it is proposed that OASDI's claims be guaranteed by the U.S. Treasury. Initially, the Agency would have to take large loans from OASDI each year. However, the interest charge paid by individuals is intended to cover not only the Agency's administrative costs and its interest payments to OASDI, but also to replace the capital and thus to permit the Agency to fully repay OASDI before the Trust Funds are needed for Social Security

benefit payments. Thereafter, the Agency is intended to be self-financing. Actuarial projections of the Agency's aggregate operations show its year-by-year obligations to OASDI in comparison with the projected Trust Fund levels, as well as the Agency's overall status. Here again, further actuarial analysis would be useful.

Note: The proposal is formally described in an article ("Generational Alliance ..." in The American Prospect, Summer 1990) by Barry Bluestone, Alan Clayton-Matthews, John Havens and Howard Young. A more detailed paper is available from the Economic Policy Institute, which financed work on the proposal.

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