Advantages and Disadvantages of State Loan Forgiveness and Loan Repayment Programs

Is your state making the most of the financial aid resources it targets toward resolving labor shortages?

Over the years, states have increasingly used financial aid programs as a means to solve their labor needs. The most common new financial aid/labor incentive program is the loan forgiveness program. These programs are used to entice students into service as teachers and health care workers, and into other fields in which states are facing shortages of qualified workers. Some states mislead students by calling the funds provided through these programs "grants" or "scholarships" when they are actually loans with state service or employment obligations that students must fulfill.

Many states offer education loans to students who major in a particular field and agree to work in that field within the state after graduation. These are often referred to as "loan forgiveness programs." The state "forgives" (i.e., repays) a certain dollar amount of the loan for each year of service that the student performs in the qualifying field of study. If the student does not complete the total amount of service required, the student must either repay the remaining "unforgiven" portion of the loan or the entire loan amount (the exact provisions vary from state to state). The interest rate for the unforgiven amounts of these loans is often set at a punitive rate and charged from the date of the first disbursement of the funds to the student instead of from the time the student first failed to meet the service obligations.

An alternate but less often used incentive program that repays the educational loans (both principal and interest) that a former student has accumulated when he or she works in the designated field of service. These programs are usually referred to as "loan repayment programs." Loan repayment programs may cover all of the borrower's educational loans or they may be restricted to certain qualifying loans (e.g., specific federal loans). The repayment per year of service is generally a set amount or a percentage of the total loans. Payments are made directly to the lender or loan holder and are discontinued when the loans are paid off, when the designated service is completed or discontinued, or when the maximum amount of benefits have been reached. Penalties may be applied to recipients who receive some benefits but do not complete the required years of service.

Both loan forgiveness and loan repayment programs have the same goal—increasing the number of people providing certain services to the citizens within the state—but the programs have quite different advantages and disadvantages to the students and to the states that implement these programs.

By Cheryl K. Maplethorpe

Advantages and Disadvantages of Loan Forgiveness Programs

According to the National Association of State Student Grant and Aid Programs, the number of states that have implemented loan forgiveness programs has grown from 13 in 1996-97 to 18 in 1999-2000. Unfortunately, despite their growing popularity, loan forgiveness programs have many more weaknesses than strengths for students and states.

An Advantage of Loan Forgiveness

◆ The state may entice some in-state students to study a field or major they had not previously considered.

Disadvantages of Loan Forgiveness

◆ It usually takes two to four years from the inception of the program to produce the qualified workers.

◆ Graduates who may want to fulfill the commitment may not be able to find jobs that comply with the state's requirements. This happens when the labor market changes during the two- to four-year period from the beginning of the loan forgiveness program.

◆ States must appropriate and expend money for the initial loan program years before they see any results.

◆ State staff must maintain regular contact with the borrowers for several years of education and employment until the loan is repaid or the work commitments are fulfilled. Regular contact can extend well after the program has been discontinued. This requirement leads to additional administrative costs for the states.

◆ The administrative cost and burden of the program continue even after the program has been discontinued because the state must continue to contact and bill the former students.

◆ Even if the states' employment situation changes within the preferred field so that additional workers are no longer needed, the states must continue to repay loans for students who have borrowed through the loan forgiveness program.

◆ Loan forgiveness amounts sometimes are not significant enough relative to college costs to entice students into a particular career.

◆ The number of workers generated by the program is limited to the number of loans awarded to students in the past.

◆ Students may borrow additional loans (i.e., private or alternative loans) that cannot be consolidated with other federal loans and do not have any of the guarantees or extended payment options offered by the federal programs.

◆ States must pay for the cost of collection and litigating defaulted loans. Additional costs arise if a judge finds that the loan was not properly explained to the student or that the state's requirements were unfair or impossible for the students to meet.

◆ Defaulted loans eventually may be sent to collection agencies where a collection fee of 30% or more may be added to the original debt, further burdening the former students.

Advantages and Disadvantages of Loan Repayment Programs

Loan repayment programs also have both strengths and weaknesses. However, for most states and students, loan repayment offers many more pluses than minuses.

Advantages of Loan Repayment Programs

◆ Students are not enticed to major in a field they might not enjoy just because they need help paying for college.

◆ Students are not forced to commit to a particular career early in their education before they are exposed to a variety of career options.
◆ States eliminate all of the up-front cost of designing the loan program and lending the funds because students receive the loan proceeds from federal and other non-state sources.
◆ The number of students who choose to serve the state through the program is not restricted to the number of students who participated in the loan program years ago. If available to non-state residents, the number of potential program participants is dictated by the number of students nationwide who chose the major in the designated field of service.
◆ The state's incentives are delivered at the point of service so the education leading to that service can take many paths. Because non-state sources provide the loans, workers could be educated within the state, in another state or country, or through on-the-job training.

Citizens see immediate results from state expenditures and no longer have to wait as the students obtain their education.

◆ States purchase service from workers who selected their careers based on their interest and aptitude, rather than because they needed funds to pay for college. Thus, these recipients may remain in the needed career field for a longer time.
◆ Because the agreement to deliver the incentive is made at the point of delivery, states are not bound to continue to repay loans after the labor market produces enough skilled workers to fulfill the states' needs. The program can be eliminated easily once the need for it has been filled.
◆ States can be more responsive to market needs by quickly adjusting or changing the program's focus as the state's needs change.
◆ Due to the increased flexibility of loan repayment programs, incentives can be targeted specifically. States can provide an incentive to work in a particular city or for a particular employer whose needs would not have been known when workers were still enrolled in college.
◆ Because the program administration is less complicated, the state can house the administration of loan repayment programs in any agency.
◆ Although states may wish to follow the career paths of students for data or research purposes, they do not have the administrative burden of maintaining contact with borrowers for up to 20 years as they progress through college and into their careers. Workers contact the states for the incentive instead of the states chasing debtors for repayment.
◆ Citizens see immediate results from state expenditures and no longer have to wait as the students obtain their education.

A Disadvantage of Loan Repayment Programs

◆ States do not entice more of their own citizens into a particular field of study through the program.

Loan Repayment Programs Cost Less, Offer More

In many cases, loan repayment programs are more effective and less expensive than loan forgiveness programs. They allow students to select academic programs based on their aptitude and skills rather than the additional financial aid they may receive. Further, loan repayment programs cost less, more precisely target funds, and carry less administrative burden. Financial aid administrators consulting with state agencies about future student aid initiatives may want to suggest loan repayment programs as a more efficient use of state funds than loan forgiveness programs. ❧

Loan repayment programs allow students to select academic programs that are a good fit with their aptitude and skills.

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