Economic Opportunity Institute

March 12, 2015

Rep. Tobias Read
Oregon State Capitol, H-286
Salem, Oregon 97301

Re: HB 2662 Pay It Forward pilot proposal – Notes on testimony of Kate Peterson

Chair Read:

On Friday, March 6, you heard a great deal of testimony on House Bill 2662, the Pay It Forward pilot proposal. First, we want to thank you for holding that hearing, and for keeping the hearing open until all testimony was finished. As you'll recall, most of the testimony was in support of the pilot proposal, but some was cautionary.

As the organization responsible for developing this policy, and having been an integral part of the workgroup that designed the pilot proposal, we would like to address some of the concerns you heard about Pay It Forward, especially in the testimony of Kate Peterson from Oregon State University.

Peterson's illustrations of costs under Pay It Forward and federal loans are deeply misleading.

1. First, they compare the cost of a $24,591 loan to the cost of Pay It Forward contributions (4%, 20 years) that are designed to finance an average of $33,800 in tuition over four years, a difference of 37%. Simply put, this biases the comparison by 37% against Pay It Forward.

2. Second, they total up the sums of future streams of payments without discounting them to reflect the time value of money, a fundamental feature of the financial sector of higher education and the entire economy. That overstates economic costs, much more so for a 20-year Pay It Forward contribution stream than for a 10-year loan repayment stream.

3. Third, her examples choose assumptions that exaggerate Pay It Forward contributions (*e.g.*, $80,000 incomes) and understate typical loan repayment obligations (*e.g.*, an average 4.66% interest rate on student loans). For example, an average income of $80,000 over 20 years is not "extremely conservative," as Peterson asserts.
    - Oregon's per capita annual money income between 2009 and 2013 was just **$26,809**.[1]
    - Median annual household income over the same period was just **$50,229**.[2]

[1] United States Census Bureau, State and Country QuickFacts, http://quickfacts.census.gov/qfd/states/41000.html.
[2] United States Census Bureau, State and Country QuickFacts, http://quickfacts.census.gov/qfd/states/41000.html.

- Median weekly earnings for a Bachelor's degree holder (over age 25) in the U.S. in 2013 was $1,108, or **$57,616** per year.[3]
- The income data on which the workgroup's Pay It Forward contributions for four-year colleges are based reflect a 20-year average income of **$48,747** (in 2014 dollars).

The HECC workgroup researched actual income data and based its report on that information. We were thus able to account for graduates' income growth over time, which has exceeded the rate of inflation. The following tables adjust for Nos. 1 and 2, above, and also include a case with actual average incomes based on the workgroup's research.[4]

Starting salary of $48,747, increasing at the rate of inflation over 20 years

	Federal Loan (4.66% Interest)	**Pay It Forward**
First Monthly Payment	$260	$110
NPV of Lifetime Payments	$24,591	$20,746

Starting salary of $38,000, increasing at the rate of inflation over 20 years

	Federal Loan (4.66% Interest)	**Pay It Forward**
First Monthly Payment	$260	$85
NPV of Lifetime Payments	$24,591	$16,172

Starting salary of $80,000, increasing at the rate of inflation over 20 years

	Federal Loan (4.66% Interest)	**Pay It Forward**
First Monthly Payment	$260	$180
NPV of Lifetime Payments	$24,591	$34,047

Peterson: "Although proponents claim it is not a student loan program, in fact it is a student loan."

Pay It Forward is not a loan. As Peterson herself defines it, a loan is "a thing that is borrowed, especially a sum of money that is expected to be paid back with interest."

1. Pay It Forward does not allow students to borrow any sum of money. It is a program that directly pays tuition and fees on their behalf.

[3] United State Department of Labor, Bureau of Labor Statistics, Employment Projections, http://www.bls.gov/emp/ep_chart_001.htm.
[4] Tuition is assumed to be $9,123 per year (equal to OSU's 2014-15 tuition); Pay It Forward rate is adjusted to reflect the portion of tuition covered by $24,591; student's discount rate is assumed to be 4.66% (equal to federal loan interest rate).

2. The Pay It Forward contract does not require any student to pay any specific principal back. The sum that participants ultimately contribute will not be known until after their last contribution.
3. Pay It Forward contributions are tied strictly to income. Contrary to loans, there is no principal amount to pay under Pay It Forward. This structure will be appealing to some students and less appealing to others. A traditional loan may offer certainty as to the ultimate amount participants will have to pay. Pay It Forward offers certainty as to the ability to afford contributions every month.
4. Because there is no principal to be repaid, there can be no interest charged on Pay It Forward contributions.

Peterson: "Most concerning, 'Pay It Forward' does not offer an opportunity to accelerate payments, buy out of the program, or consolidate with other student debt . . . ."

> Peterson presents the fact that Pay It Forward does not offer accelerated payments, buyouts or consolidation with other student debt as flaws. However, that set of tools is tailored to a fixed loan obligation system. They do not apply to Pay It Forward, which combines low-cost financing with the added "insurance benefit" of risk pooling.
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> To illustrate the difference, Pay It Forward opponents express concern about adverse selection among entering students, despite their highly uncertain future incomes. Buyout options would effectively guarantee adverse selection, since they could be exercised based on actual future incomes.

We want to reiterate how much we appreciate your consideration of this innovative pilot proposal. We are available for any additional questions or concerns you may have.

Thank you,

John Burbank	**John Gibson**	**Kelli Smith**
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cc: House Committee on Higher Education, Innovation, and Workforce Development