

President Obama's recent State of the Union address offered a vision of "middle-class economics". At the centre of that vision, he repeated his proposal of providing free community college education to ensure that "two years of college becomes as free and universal in America as high school is today".

And Mr Obama added that he wanted to "make sure Americans already burdened with student loans can reduce their monthly payments, so that student debt doesn't derail anyone's dreams".

Commentators saw this as a reference to his previous proposal to expand a federal loan relief programme, which caps graduates' loan repayments at 10 per cent of their discretionary income.

Clearly, student debt is a major political issue in the US. Across the nation, 40 million current and former students owe \$1.12 trillion (£740 billion). US student loan debt is higher than both the nation's credit card debt (\$669 billion) and car loan debt (\$905 billion).

More than 40 per cent of students do not borrow at all. But for those who do, most owe between \$10,000 and \$50,000.

The toughest part for students is working out where to borrow and at what price and under what terms. As with the array of choices of where and what to study, there are plenty of loan options.

The cheapest are the fixed-rate loans from the federal government. Some are needs-based and subsidised, with the government paying interest during the programme of study. Depending on the loan programme, the current interest rates vary from 4.6 per cent to 6.2 per cent, and there is a 1 per cent loan fee for all types of loans. Most of the government loans being issued now have a six-month grace period before repayments start. Most borrowers take the standard 10-year repayment plan, although shorter and longer plans are available.

There are also many private lenders in the student loan market. Some are large, such as the retail banks, and some are niche providers. The private loans are more expensive, often with variable interest rates. They usually require a credit check and a co-signer to minimise the risk of default. Repayment plans are negotiable, but they usually do not have the grace periods or deferment clauses that are included in public loans.

The design and complexity of the loans are not user-friendly. Most student loans come due on, or soon after, graduation, when most people have relatively low incomes or are looking for a job. Income-contingent loans are less common and less aggressively promoted, even though they align repayment with capacity to pay.

Interest rates are high. The public loan rates are two to three times higher than the current interest rates for US Treasury 30-year bonds and 10-year notes. To grossly caricature its policy approach, the US government is borrowing long and low from the wealthy and lending short and high to the poor seeking an education.

Private loan rates are roughly in line with the low end of credit card rates of 10 to 12 per cent, but higher than car loan rates of 4 to 5 per cent. The market seems to undervalue an investment in skill and to see it as high risk – because you cannot repossess a diploma.

In short, the financing options available to students do not match up with the political rhetoric about the "dream" of higher education.