

Iowa College Student Aid Commission

**Student Loan Debt
Trends Affecting the American Dream**

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In recent years, there has been a growing interest in college access and with it, a growing concern about the debt incurred by students. Analysts on all sides suggest a variety of causes and solutions to this very complex problem. Some suggest that the problem is associated with increased tuition and fees. Others suggest it is associated with aggressive pricing and promotion by lenders. For some, the problem lies in the competition between the Federal Direct Program the Federal Family Education Loan Program (FFELP). Still others suggest the problem lies with the saving and spending habits of students and families. Commission analyses suggest that at least a part of the problem is the result of a disconnect between the growth of scholarship and grant assistance and the growth in college tuition and fees.

Whenever there are conversations about college funding, observers find that a portion of the discussion is about the growing level of debt upon graduation. Scholarships and grants are considered to a lesser extent and employment is even less frequently mentioned. The following text examines a selection of trends that may be related to the growth of debt among college students.

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This paper presents a collection of informational items that can be seen as both disparate and connected. We can see that the attainment of a college degree is

a fundamental part of our culture, as is debt. Federal student loan policies seem to favor the use of student loan debt to finance college, during a time when family savings rates are at the lowest level since 1933 and bankruptcies increased. At the same time, student loan defaults seemingly declined, although much of the decline can be attributed to policies not directly related to changes in consumer behavior. Other analysts may connect other data that leads to other conclusions. We hope that the ideas presented in this paper will be considered in the policy-making process.

1. College as Part of the American Dream

This section discusses college as a part of the American Dream and associates it with the need to finance the dream. Key ideas include the relationship between college attendance and income, health and economic development. The notion of the American Dream is associated with federal and state policies, which are reflected in the allocation of financial resources through appropriations. The section concludes with a description of the way that financial aid policy has changed from an emphasis on loans, to non-repayable aid, and back to loans.

Americans have a deeply held belief that individuals should attend college, graduate and get a good job. It is a fundamental element of the American Dream, and is reflected in the incomes that employers are willing to pay those who have attained college degrees. Even greater incomes go to those who have advanced degrees. The Bureau of Labor Statistics (2006) reported that individuals with less than a high school diploma had a national median weekly income of \$409, while a person with a bachelor's degree had a median weekly income of \$937, and a person with a doctorate had a national median weekly income of \$1,421. That is a difference of over \$1,000 per week or \$52,000 per year in the median wages for a person with less than a high school diploma and the doctoral graduate.

Table 1. Median Weekly Earnings of Full-time Wage-and-Salary Workers Aged 25 or Older, 2005.

Doctoral degree	\$1,421
Professional degree	\$1,370
Master's degree	\$1,129
Bachelor's degree	\$937
Associate's degree	\$699
Some college, no degree	\$653
High school diploma with no college	\$583
Less than a high school diploma	\$409

(BLS, 2006)

Broader perspectives on the benefits of college have been advanced by educators and politicians since the founding of our nation. One succinct explanation was published by Jamie Merisotis in 1998. Merisotis suggested that public benefits include increased tax revenues and reduced crime rates. Private benefits include higher income and improved health.

Table 2. Public and Private Benefits of Education.

	Public	Private
Economic	<ul style="list-style-type: none"> • Increased tax revenues • Greater productivity • Increased consumption • Increased workforce flexibility • Decreased reliance on government financial support 	<ul style="list-style-type: none"> • Higher salaries and benefits • Employment • Higher savings levels • Improved working conditions • Personal/professional mobility
Social	<ul style="list-style-type: none"> • Reduced crime rates • Increased charitable giving/community service • Increased quality of civic life • Social cohesion/appreciation of diversity • Improved ability to adapt to and use technology 	<ul style="list-style-type: none"> • Improved health/life expectancy • Improved quality of life for offspring • Better consumer decision-making • Increased personal status • More hobbies, leisure activities

(Merisotis, 1998)

Studies of college graduates vs. non-graduates suggest that there is a relationship between college attendance and income, personal control over life and perceived social support. College graduates are known to have a positive relationship to a personal sense of health and well-being. (Pascarella & Terenzini, p. 553., Ross & Mirkowsky, 1989, 1991; Ross & Van Willigen, 1997, Ross & Wu, 1995).

College education has been identified as a critical component of the future workforce, and college attendance is said to be an important factor in the nation's competitiveness in the world. John Chambers, CEO of Cisco Systems said "the jobs are going to go where the best-educated workforce is with the most competitive infrastructure and environment for creativity and supportive government. It is inevitable." (Friedman, p. 323)

Parents support the idea of college attendance by communicating their expectations to children throughout the elementary and secondary years. Our society works to plant the idea early in life. Families, friends, neighbors and teachers often tell children they are expected to attend college. Laurie Wolf (2007, p. 215) discovered how important early awareness is when she studied Latino families in Iowa. Wolf found that the majority of those interviewed listed their parents' view of education as being *somewhat* or *very necessary*.

The advocacy occurs in conversations within the family unit, in presentations by teachers and counselors in the K-12 system, and for this analysis, via federal and state appropriations. The appropriations are delivered in a variety of ways, including direct awards, loans, and special incentives for people to enter specific areas of need.

The difficulty arises when policy-makers consider how the national priority of a college education is to be implemented by government. Colleges and universities are expensive operations. They require substantial funding to pay for buildings, utilities, state-of-the-art computers, libraries, faculty, and support staff. Although federal and state government policy-makers believe strongly in the importance of education, they struggle to find a balance between funding for education and other priority issues like defense and human services.

In our culture, the cost of college support is shared among the federal government, state governments, benefactors, students, and families. Families often save for many years and/or borrow considerable amounts to ensure that their children are able to attend college. A change in federal policy seemingly reflected a change in attitudes toward the American Dream of college attendance when, in 1965, federal appropriations were shifted to education after enactment of the Higher Education Act, and then again, in 2004, when elementary and secondary support was increased with the No Child Left Behind Act.

In 1962, the U. S. budget administered by the Defense Department was 46.9% of the federal budget, while the portion administered by the Department of Human Services was 3.3% and the portion administered by the U. S. Department of Education (and its predecessor) was 0.8%. By 1965 the percentage of the federal budget directed to education increased to 1.0%. By 1967 the percentage increased to 2.3%. The second growth period, is bounded by the 2001 budget when 1.9% of the federal budget was applied to education, and by 2005 when 3.0% was applied to this part of the budget. Conversely, the percentage directed to the Defense Department declined. In 1962, 46.9% of the budget was directed to defense, and in 2007. The Defense share is estimated to be 18.2%. During this same period of time the appropriations for Health and Human Services increased from 3.3% to 26% (White House, 2007).

Figure 1 shows the historical percentage of the federal education budget from 1962 to 2006. The figure supports the observation that the percentage remains less than 3.5% throughout, major increases occurred in 1965 when many of the baby boom generation entered college and the Higher Education Act was approved.

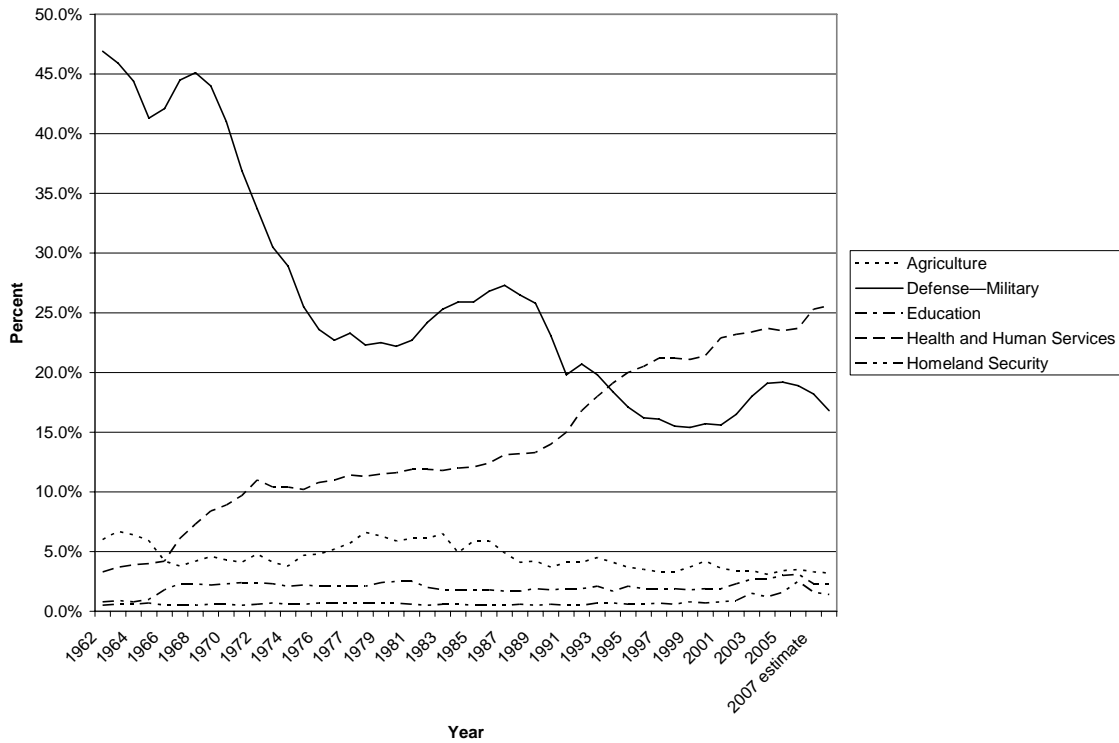
Figure 1. Historical Federal Budget Allocation to Education: Percent to the U. S. Department of Education.



(White House, 2007)

Figure 2 shows the percentages of the federal budget directed to agriculture, defense, education, health and human services, and homeland security. It indicates a primary change between 1972 and 2006 when the portion directed to defense declined while the portion directed to human services increased. The portion directed to education also increased, but to a lesser extent than human services.

Figure 2. Selected Percentages of the Federal Budget.



(White House, 2007)

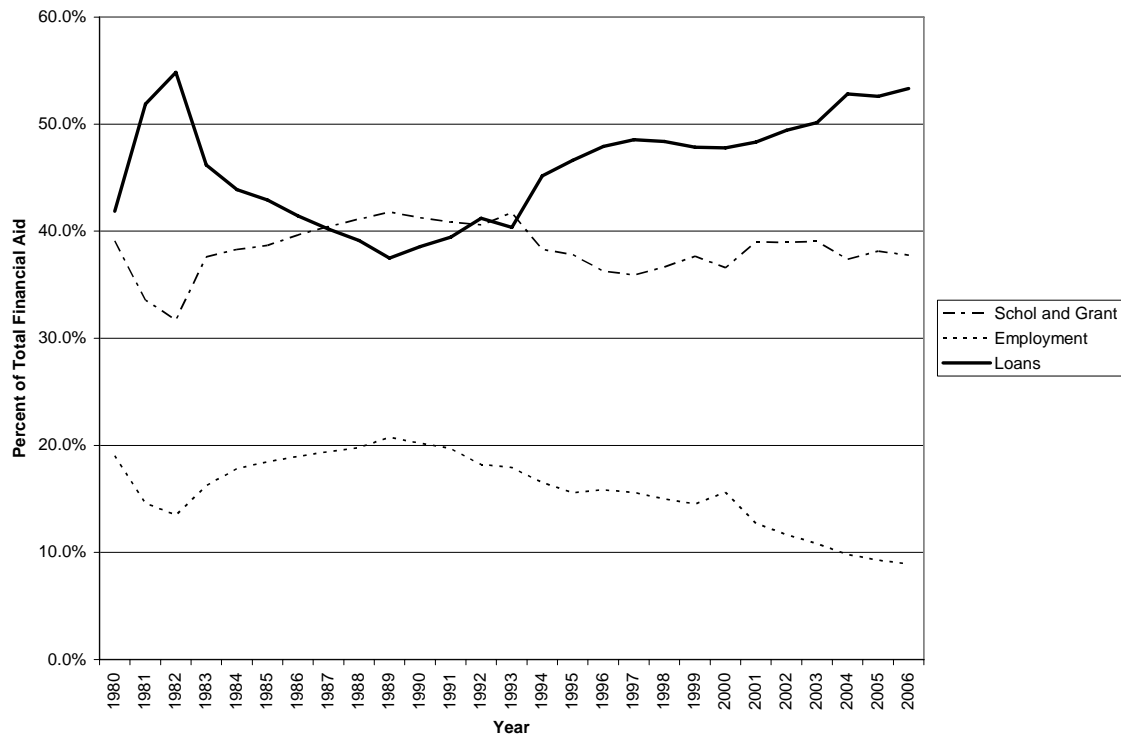
2. Changes in Amounts Directed to Federal Higher Education

This section presents highlights of the changes in funds directed toward higher education and includes data for which long-term trends are available. The data suggest that there have been considerable changes in the amounts directed to financial aid in the forms of scholarships and grants versus loans.

Federal policy toward financial aid also changed dramatically in the 25 years between 1980 and 2005: years for which data are presently available. A history of the changes is shown in Figure 3a. In 1980, 39.1% of the total Iowa financial aid was directed to scholarships and grants, while 41.9% was directed to debt aid. By 1982 the percentage that supported scholarships and grants declined 7.4 percentage points to 31.7% while the percentage of debt aid increased 12.9 percentage points to 54.8%. The third category, employment, declined 5.5 percentage points to 13.5%. By 1989 the relationship reversed with scholarships

having a larger share of aid than debt with loans providing 37.5% of the aid and scholarships providing 41.8%. By 1994 the relationship reversed again with debt having a greater share than scholarships. The relative share of debt has continued to increase. As of 2005 debt was 53.6% and scholarships were at 37.2% and employment was only 9.3%. Figure 3a suggests there was a belief that the cultural necessity of a college education was best funded by scholarships, grants and employment between 1987 and 1994. Before and after that period, the policy emphasized debt. The national distribution of financial aid shows a remarkably similar pattern and is shown in Figure 3b.

Figure 3a. Historical Distribution of Financial Aid: Iowa.



(ICSAC, 2007)

Figure 3b. Historical Distribution of Financial Aid: United States.



(College Board, 2006 and previous years)

Iowa appropriations for education, excluding the vast majority of student debt, is \$4.2 billion for FY 2008 for students of all ages. The amount is 35.9% percent of the total state appropriations of \$11.7 billion. (Iowa L.S.A., 2007, p. 44). This is a substantially greater proportion and seemingly greater reflection of educational values than is seen in the federal budget, although the Iowa data includes some federal funds, and reflects a perspective of the role of a state for educational support versus the role of the federal government. It suggests that the federal government has other important priorities that include Health and Human Services (25.3%) and Social Security (both on and off budget, 22.5%). Figures 3a and 3b show that the emphasis has changed since 1962, and clearly demonstrates the change in values that occurred with the passage of major reforms in 1965. These reforms included the Higher Education Act of 1965 which, today, provides the guiding principles that influence both federal and state support for higher education.

3. National Economic Trends Associated with College Financing

The following text describes selected economic trends that may be associated with family financing of college expenses. The data available suggest a long-term decline in the personal savings rate, while the family debt ratio and financial

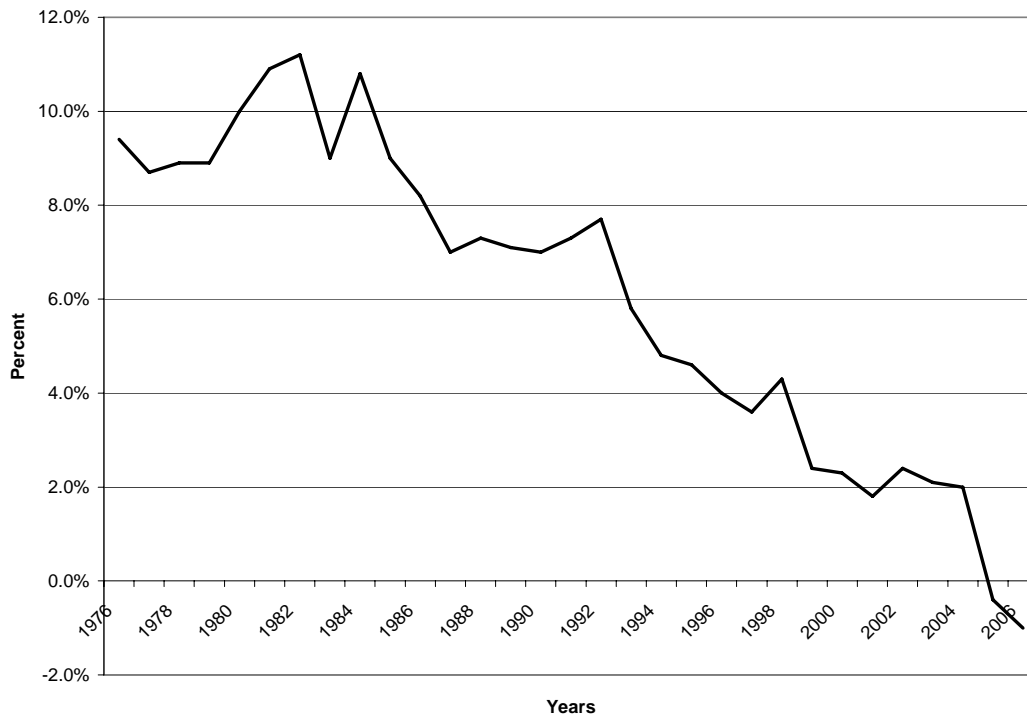
obligations ratio increased. As financial obligations and bankruptcies increased, student loan defaults decreased. However the decline in student loan defaults might be based more on changes in federal policies including the definition of a default and efforts to change the behavior of colleges and lenders rather than a real change in the ability to pay. While secured debt for automobiles and mortgages declined, the government-backed student loan rates declined and then rose. Despite the changes in loan policies, the percentage of Americans with college degrees continues to rise.

While changes were taking place in the federal budget summarized above, important changes were also occurring in personal savings rates that reflect values of families toward frugality and personal sacrifice. The Bureau of Economic Analyses (BEA) long-term series of personal savings rate data describes these changes.

According to the BEA (2007a) the highest level of personal savings as a percent of income was 26.1% in 1944. In that year, the national focus was on the accumulation of resources to fund World War II and the national emphasis was on War Bonds. Celebrities endorsed the purchase of War Bonds, popular songs encouraged savings, movies ended with the announcement to “buy war bonds,” and posters promoted savings. The lowest savings rate, -1.5%, occurred in 1933 when the nation was in the middle of a bank crisis (Bernanke, 2004).

The trend in more recent times, between 1977 and the present, showed a peak savings rate of 11.2% in 1982 and has since declined to -1.0% in 2006.

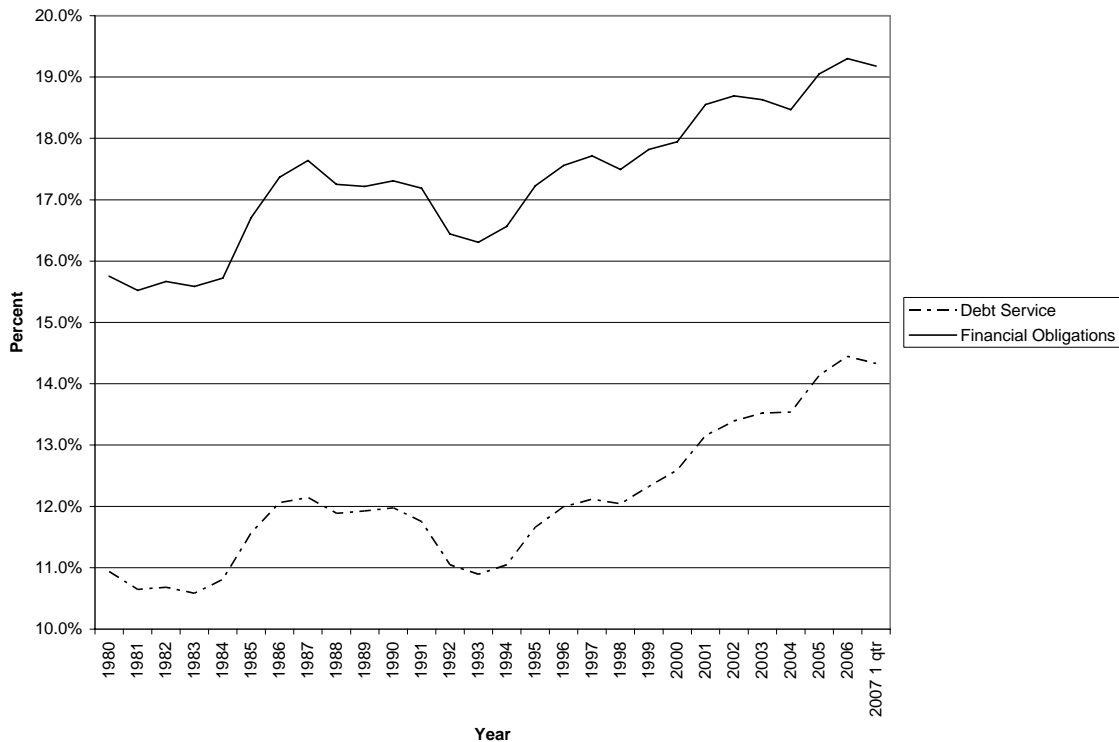
Figure 4. Historical U. S. Savings as a Percent of Income.



(BEA, 2007b)

Two BEA data trends shown in Figure 5 describe the history of personal interest payments as a percent of disposable income (the Debt Service Ratio) and total financial obligations including both rent and mortgage payments (the Financial Obligations Ratio). Both ratios include student loans as part of a general household survey. Although the percentage of student loan payments can vary substantially, a Commission study found that student loan debt is likely to be too much if annual payments exceed 8% of income (Greiner, 1996). Between 1980 and 2006 the debt service ratio (DSR) of family debt payments increased from 10.9% to 14.4%. With rent and mortgage payments included, the Financial Obligations Ratio (FOR) increased from 15.8% in 1980 to 19.2% in 2006, and can be expected to exceed 20% by 2015 (BEA, 2007b).

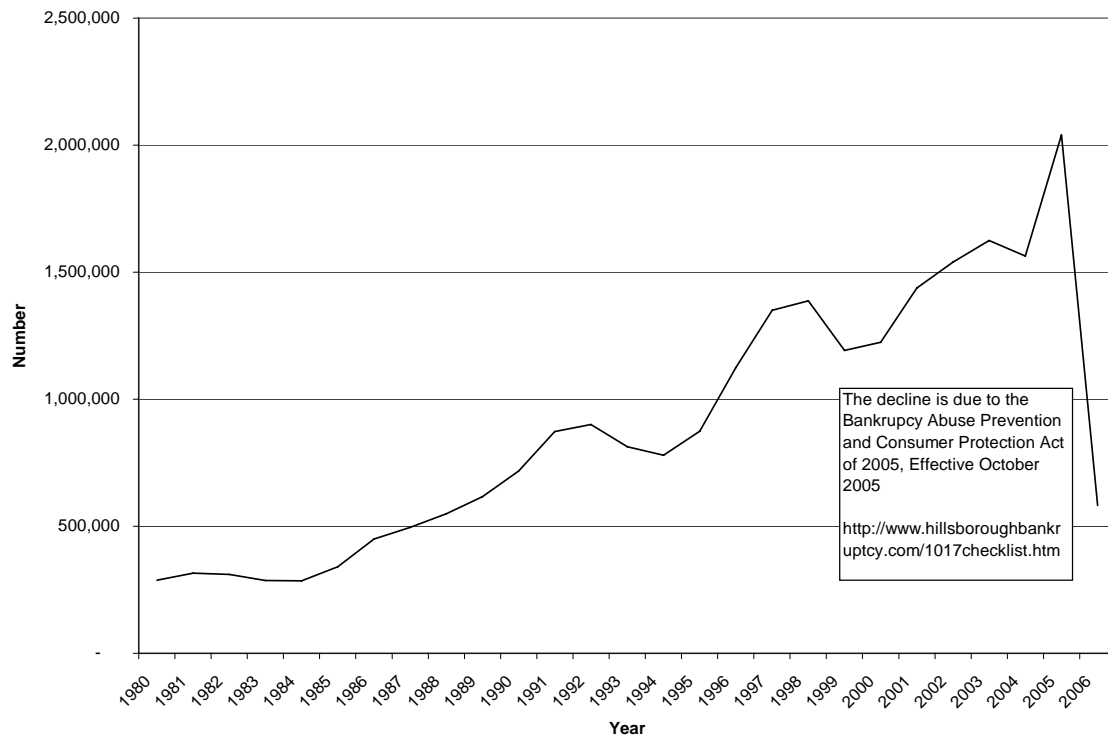
Figure 5. Historical Debt Service and Financial Obligations as a Percent of Income.



(Federal Reserve, 2007b)

As debt service and financial obligation ratios increased, so did bankruptcies. Between 1980 and 2005, bankruptcies in the United States increased from 287,564 to 2,039,214. In 2005, Congress enacted legislation to protect lenders and the number since declined to 582,042 in 2006. Figure 6 shows the trend in bankruptcies and the decline that occurred in 2006.

Figure 6. Historical Non-Business Bankruptcies.

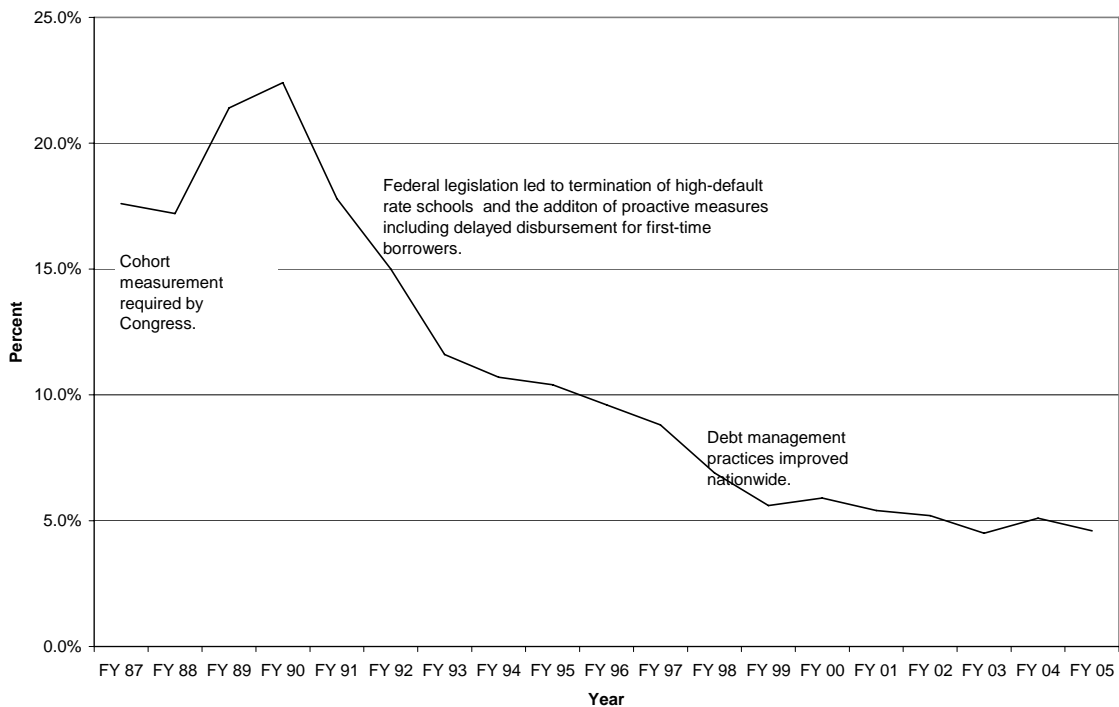


(American Bankruptcy Institute, 2007)

Student loan defaults reached a peak in 1990, and have since declined. The general decline has been attributed, not just to changes in behavior, but rather to the efforts of the federal government, lenders, colleges and universities, and guaranty agencies to improve the default rate. In 1989 a series of increasingly stringent requirements and limitations were added to federal regulations. The provisions were introduced to reduce the overall default rate in the federal student loan programs.

The Federal Family Education Loan Program (FFELP) cohort default rates for lenders and loan holders were introduced in the 1992 reauthorization of the Higher Education Act of 1965 as amended, and were expanded in the Omnibus Budget Reconciliation Act of 1993. Default rates for FFELP and the Federal Direct Loan Program were implemented in 1996. Default rates are now calculated using a two-year cohort formula. High-default colleges were eliminated from participation in loan programs, and efforts were stepped up to encourage borrowers to meet their student loan obligations (NCHELP, 2007).

Figure 7. Historical National Student Loan Cohort Default Rates.

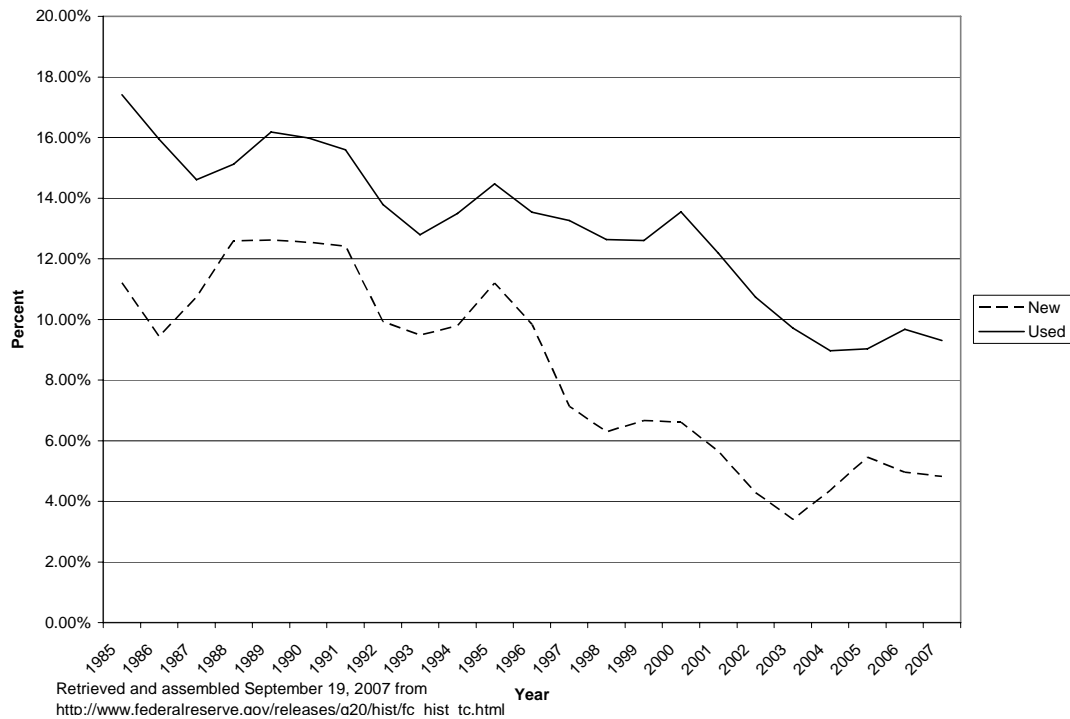


(NCHELP, 2007)

The decline in savings, increase in financial obligations and increase in bankruptcies occurred at a time when rates for secured loans declined. Examples of secured loans include mortgages and automobile loans, for which the trends are shown in Figures 8 and 9.

In 1985, the average rate on a used car was 17.4% and the average rate for a new car was 11.2%. Figure 8 shows how the rates declined over the years and as this report is being prepared in 2007, the partial year average is 9.31% for a used car and 4.82% for a new car. Figure 8 shows the trend of a 30-year fixed rate mortgage that was 13.4% in 1983 and is now approximately 5.99%.

Figure 8. Historical U. S. Automobile Loan Rates.



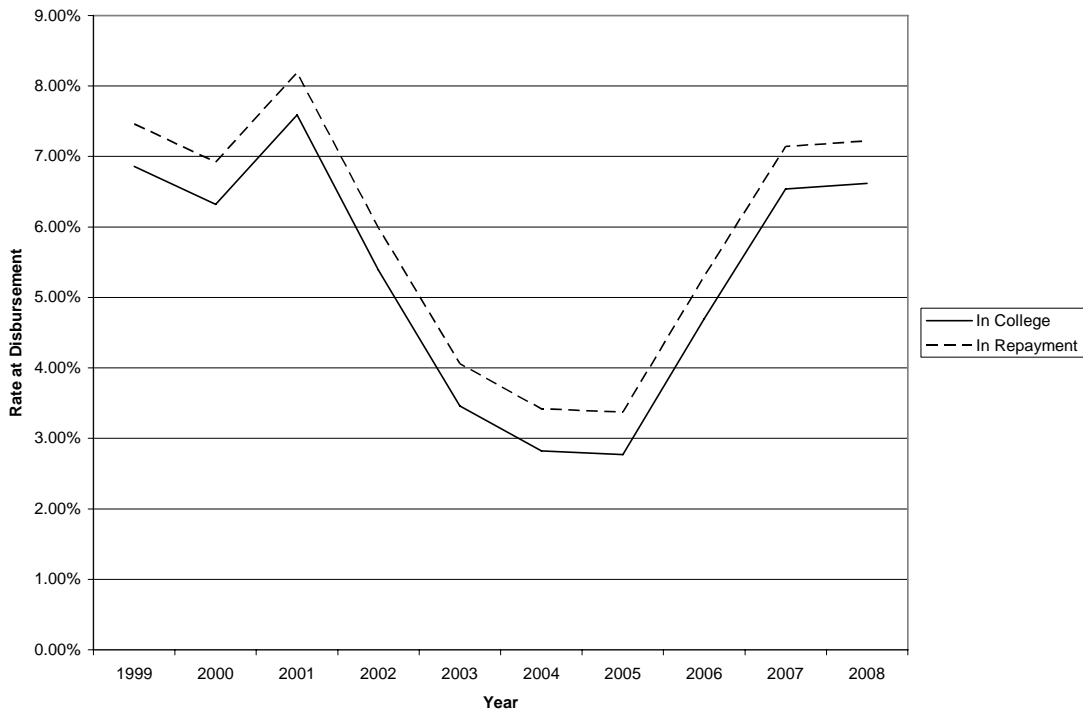
(Federal Reserve, 2007c)

Figure 9. Historical U. S. Mortgage Rates.



(Federal Reserve, 2007d)

Figure 10. Historical Stafford Loan Interest Rates: 1999 to 2008.



(NCHELP, 2007)

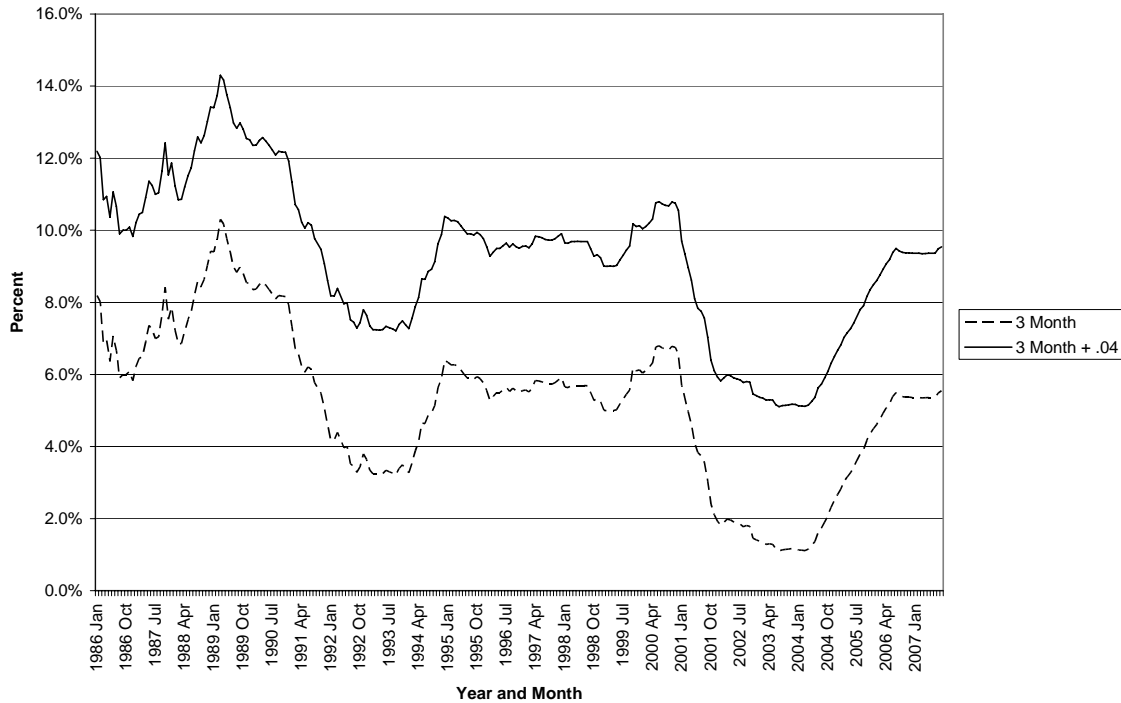
As mortgage rates and auto rates declined, student loan rates declined, and then rose. Interest rates for student loans have been established in federal law either as a specific rate or by formula. In January 1981 the rate for new borrowers was specified in federal law at 7% and in September of that year was raised to a 9% fixed rate. In July of 1988 it was lowered to 8%. Although there were some exceptions, the rate remained essentially the same until 1992 when annual variable rates set at the 91-day Treasury Bill rate plus 3.10 percentage points, with a cap of 9%. Since 1998, the variable rate for new Stafford loan borrowers has been established by formula as the 91-day treasury bill plus 1.7 percentage points for students enrolled in college, and the 91-day Treasury Bill plus 2.3 percentage points for students in repayment or forbearance with a cap of 8.25% (NCHELP, 2007, July). Figure 9 and Table 3 show the rate on an annual basis since 1998, with the rate that will be in effect through June of 2008.

Table 3. Historical Stafford Student Loan Interest Rates: 1999 to 2008.

	<u>In College</u>	<u>In Repayment</u>
1999	6.86%	7.46%
2000	6.32%	6.92%
2001	7.59%	8.19%
2002	5.39%	5.99%
2003	3.46%	4.06%
2004	2.82%	3.42%
2005	2.77%	3.37%
2006	4.70%	5.30%
2007	6.54%	7.14%
2008	6.62%	7.22%

Student loan rates for private loans can be expected to be higher than those of a secured loans because private loans have no assets to back them up. Private loans do not have the security backup provided in the federal guaranty that backs up loans in the Federal Family Education Loan Program. Many private student loans are tied to the *British Bankers' Association, London Interbank Offered Rate* (LIBOR).

Figure 11. Historical LIBOR and LIBOR + 4 Percentage Points: Examples for Private Loans.

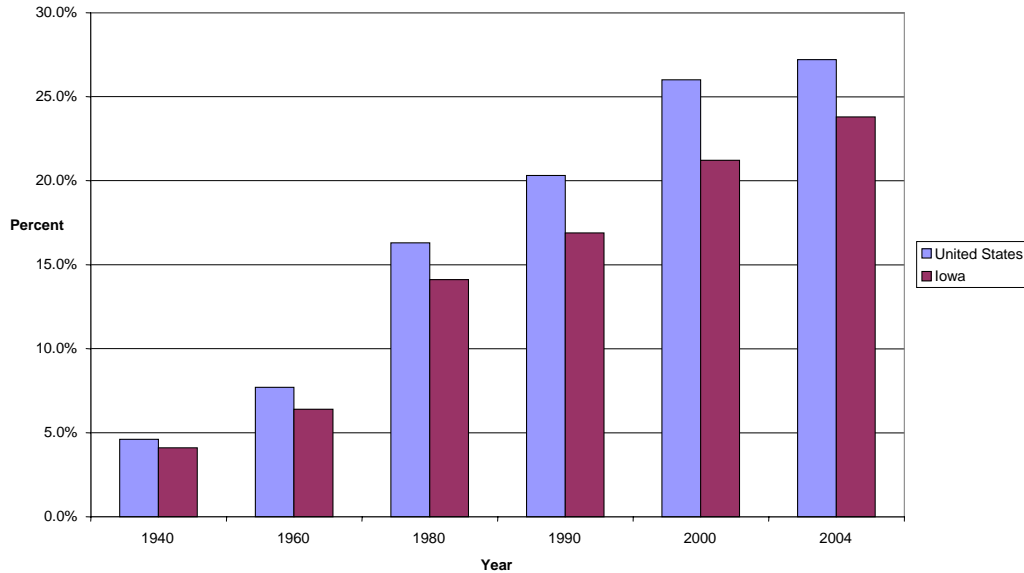


(BBA, 2007)

The rate for private student loans in Iowa often is may be the LIBOR rate plus a mark-up established by the lender based on the anticipated risk of the borrower. For example, some private loan rates might be based on the current three-month average LIBOR rate plus 4 percentage points.

As savings rates declined and financial obligations increased, Americans developed new patterns of college attendance. The changes suggested a growing belief that Americans should attend college, and that access is possible. The U. S. Census reported that between 1940 and 2005, the educational attainment of people in the United States increased from less than 5% to nearly 25%. Iowa followed the trend at a slightly lower rate: 4.1% in 1940 and 23.8% in 2004 (Iowa Census Data Center, 2006). Figure 12 shows the trend for the United States and Iowa.

Figure 12. Historical Educational Attainment: U.S. and Iowa, Persons Age 25 and Over with a College Degree.



(Iowa Census Data Center, 2007 and previous, and U. S. Census, 2007 and previous)

As college attainment increased, so did the cost of attendance. In Iowa, the tuition and fees at Regent universities were \$3,846 in 1983, and for 2008 they are expected to be \$17,172: an increase of over 346% percent. After adjusting for inflation, the increase is about 121%. From 1983 to 2005 (the latest available year), the median income of Iowans increased from \$25,800 to \$54,971, which is 113% before inflation adjustments, and 8.7% after the adjustments.

4. What College Students Perceive

This section summarizes a selection of data trends that originate with college students. In response to an annual survey of college freshmen, we see a growing percentage expecting the college experience to be a stepping stone to increased income or a professional degree. An increasing percentage of students anticipate using private debt to finance their education. In Iowa, the annual survey of colleges and universities indicates that the use of private debt has substantially increased.

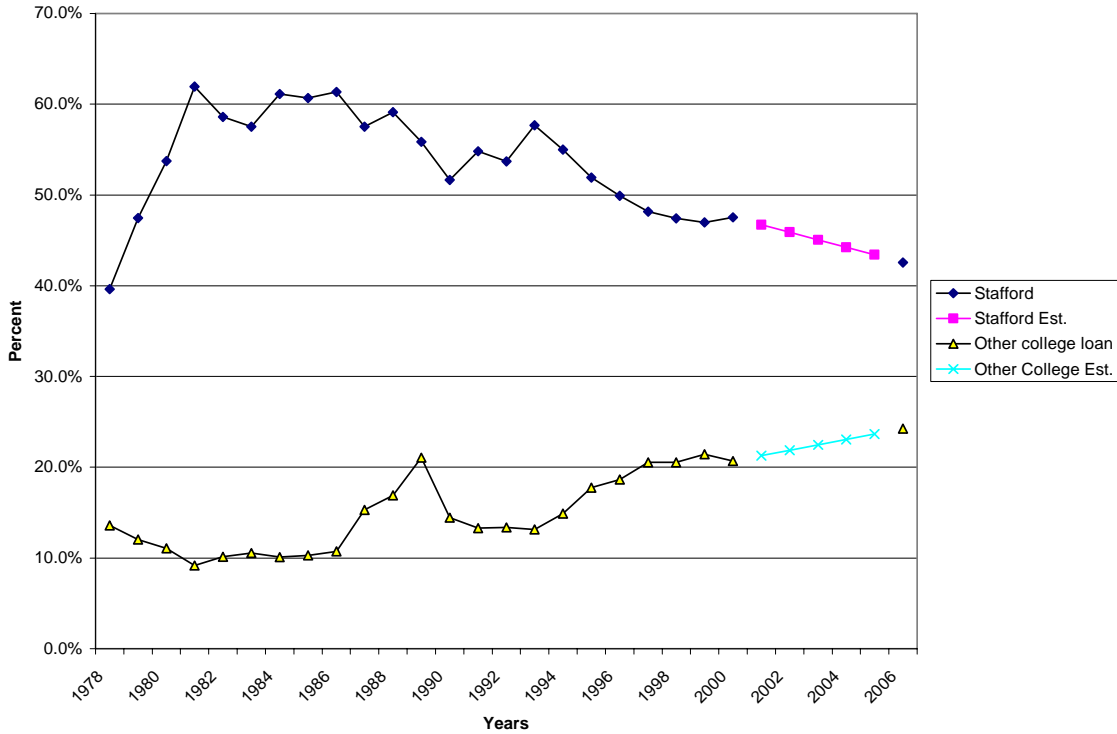
The annual survey of college freshmen conducted by the Higher Education Research Institute at UCLA reported that between 1976 and 2006 students reported that their main reason for attending college was to be able to make more money increased from 49.9% to 69%. The percentage who saw undergraduate college as a stepping stone to a professional degree increased from 49.3% to 57.7% (Pryor, 2006). At the same time, the highest ranking reason for attending college, to learn more about things in general, increased only two percentage points from 74.8% to 76.8%.

But the cultural expectation of greater income is likely to be a false promise if college is financially out of reach financially. The solution is a social construction that balances the belief that college leads to a better life, and resolves the problem of cost of attendance.

College and university students are aware of the cultural requirements of college, and the expectation that loans are “the way we do things.” In 1978, 53% of students who responded to the annual Survey of College Freshmen reported that they expect to use federal or other [private] loans to finance college. By 2006, the percentage increased to 67%. When the percentages are disaggregated to federal and other, the responses showed respondent attitudes toward borrowing. In 1978, one of every four students anticipated that they would use other [private] college loan [private] sources. By 2006, the number increased to 36%. The increase in acceptance, and indeed the anticipation, of borrowing occurred in an economy that seemingly encouraged debt leveraging by reducing interest rates.

Figure 13 shows the long-term trend in students' anticipated use of federal versus private loans. Data for the years between 2000 and 2006 were estimated because the question was not included in the survey.

Figure 13. College Freshmen Students Anticipated Loan Types.

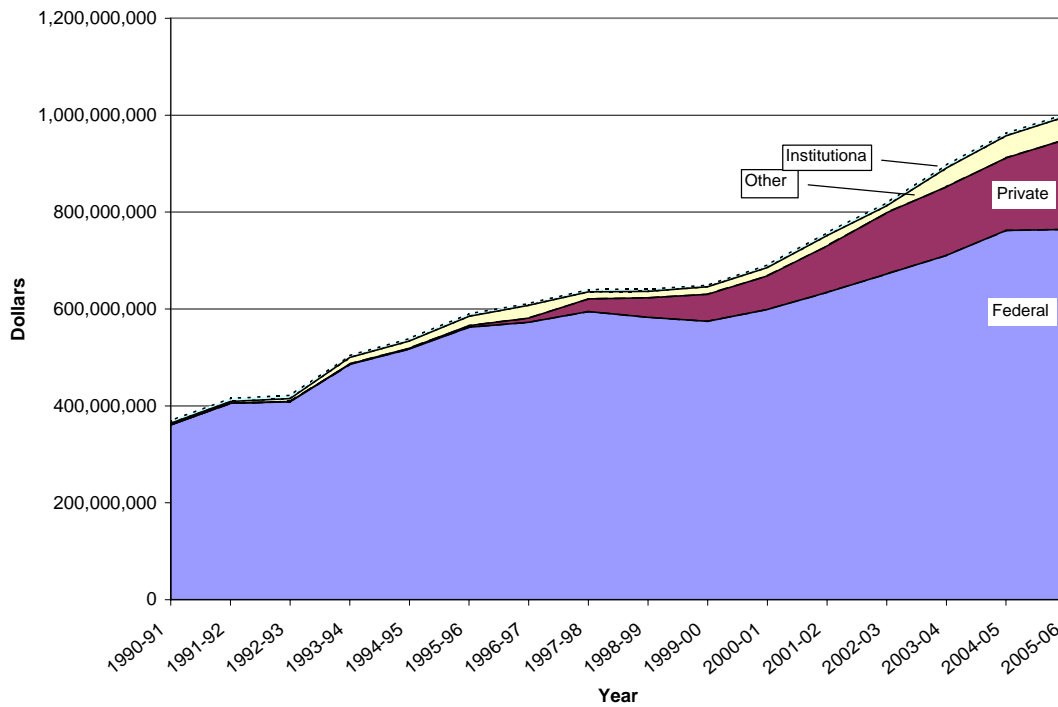


(Pryor, et. al., 2007)

For Iowa colleges and universities, the most recent data from the National Center for Education Statistics (NCES) are for 2004-2005 reported that for first-time first-year students, the percentages using federal Stafford loans were 79% at Iowa private non-profit colleges and universities, 78% at private for-profit colleges and universities, 56% at Regent universities, and 50% at community colleges (USDE, NCES, 2007). These numbers exclude federal PLUS loans for parents and private loans.

The private lending business is a substantial, growing market in Iowa and across the nation. In Iowa, a Commission survey showed that the use of private debt has grown since the first Partnership loan was introduced in 1992. The original Private loans now account for over 18% of the total student loan market in Iowa.

Figure 14. Historical Loan Volume by Federal, Private, and Other.



(ICSAC, 2007)

5. Implications

This paper suggests that today's families believe their children must attend college to achieve the American Dream. Families often assume that those students will need to borrow to pay for college. Financial obligations, including increased student debt on graduation, mortgages, credit cards and other family choices may cause families and student to determine that they cannot afford to attend college.

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7. Contact Information

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