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Is There a Student Debt Crisis?

The Claim:

"We have a student debt crisis—and we need to solve it now."[1]

HILLARY CLINTON

The Reality:

The monthly student debt burden on college graduates has not increased. The true crisis is the failure of low-quality institutions to provide a valuable education.

MAX EDEN
Senior Fellow, Manhattan Institute

Reality Check

Despite the rise in student debt, monthly loan payments as a share of income have remained steady, added earnings have more than offset the cost of debt for most borrowers, and Income-Based Repayment (IBR) plans offer borrowers protection from ballooning monthly payments. Student debt is a convenient target in a presidential election year, but it obscures the true crisis: high dropout rates from low-quality postsecondary institutions and the unmanageable debt borne by those students. Reforms to reduce student debt would provide marginal assistance to many financially secure graduates. The reforms would do little to help students who attended, but often did not graduate from, low-quality for-profit and two-year public postsecondary institutions.

Key Findings

- Even as overall student debt has been rising, the monthly burden on most borrowers has not increased.
  - The median borrower has spent a constant 3 percent–4 percent of his monthly income on debt payments for the past two decades, and the mean payment-to-income ratio has fallen from 15 percent to 7 percent.[2]
  - Fifty percent of borrowers have monthly payments of $203 or lower, and another 25 percent have payments between $203 and $400. Labor-force participants aged 20–30 with at least some college enjoy an average monthly earnings premium over high school graduates of $750, more than double the average monthly student loan payment. This suggests that the return on college easily exceeds the associated debt burden for most borrowers.[3]
  - The Obama administration's IBR program protects borrowers against severe financial hardship by allowing them to refinance and generally keep their monthly obligation at or under 10 percent of their discretionary income.[4]
- Those struggling with student debt are overwhelmingly "nontraditional borrowers" who took out loans to attend, but often did not graduate from, two-year and for-profit institutions.
  - Students borrowing to attend for-profit and two-year public institutions, where completion rates hover between 20 percent and 40 percent, rose from approximately 30 percent of new borrowers in 2000 to represent half of all borrowers in 2013.[5]
  - Seventy percent of the students who left school and started to repay federal loans in 2011—and then fell into default by 2013—were nontraditional borrowers.[6]
  - More than 20 percent of nontraditional borrowers in this cohort defaulted within two years, compared with 8 percent of traditional undergraduate borrowers and 2 percent of graduate borrowers.[7]
  - While graduates with more than $100,000 of debt may make the news, the majority of students whose loans end up in default leave school with less than $10,000 in debt.[8]
- The benefits of many proposals to reduce student debt burdens flow overwhelmingly to college graduates, the group least in need of government assistance.
  - While IBR plans offer protections to all borrowers, the former students who need these plans the most are not taking advantage of them; researchers suggest that this is due to the bureaucratic complexity of the process.[9]
  - Even as participation in IBR among nongraduates has floundered, the Obama administration modified the terms of the program to enable borrowers with graduate degrees to receive significant federal loan forgiveness.[10]
  - Hillary Clinton's proposal to refinance student loans at current interest rates would cost the federal government $58 billion over ten years—yet it would primarily benefit the 75 percent of all student borrowers who are not facing a financial crisis, while providing marginal assistance for those who are.[11]

On the Record

While rising tuition levels are a serious policy issue, most graduates who borrowed to attend a four-year university face no debt crisis. It is students who attended, but often did not complete, lower-quality for-profit and two-year public institutions who are facing financial hardship. Real reforms would focus less on covering the costs of a flawed system and more on aligning incentives to ensure that all students have access to an education worth paying for.

Max Eden, Senior Fellow, Manhattan Institute

Disaggregating the Debtors

Overall, student debt has quadrupled within the past decade, to over $1.3 trillion, and the average debt load of graduates has risen from $19,669 to $35,051.[12] There are major structural problems in American higher education, but debt is a symptom rather than the cause. By identifying student debt, rather than institutional quality and cost, as the problem, politicians are advancing reforms that would provide the most value to financially secure graduates while doing little to fix a system that's failing the rest.

Even as the net stock of debt has risen, the monthly burden for most borrowers has not increased. According to a Brookings Institution report by Beth Akers and Matthew Chingos, the median student borrower has spent a constant 3 percent–4 percent of his monthly income on debt payments for the last two decades, and the mean payment-to-income ratio has fallen from 15 percent to 7 percent.[13] A study by Federal Reserve economist Joel Elvery shows that 50 percent of the borrowers had payments of $203 or lower, and another 25 percent had payments between $203 and $400.[14] Labor-force participants aged 20–30 with at least some college earned on average $2,353 per month, $750 more than those with only a high school diploma. This is more than double the average monthly student loan payment, suggesting that the monthly earnings increase more than offsets the cost of student loan payments for most borrowers.

If these graduates aren't facing new hardships, how could five-year cohort default rates have nearly doubled in the past decade, rising from 16 percent of students entering repayment in 2000 to 28 percent entering in 2009? Simply: it's not the graduates who are in trouble.

A study by Adam Looney of the U.S. Treasury Department and Constantine Yannelis of Stanford University found that during the Great Recession, the number of nontraditional students—who borrowed to attend two-year public and for-profit institutions—swelled, to represent almost half of all new borrowers.[15] Seventy percent of students who left school in 2011 and had fallen into default by 2013 attended these institutions. An additional 12 percent of defaulters attended nonselective four-year universities. Fewer than one in five borrowers who defaulted had attended what Looney and Yannelis defined as a four-year selective university. Looney and Yannelis conclude that "the high rates of default among some borrowers combined with the sheer volume of higher-risk students starting to repay their loans explains most of the increase in default rates."

At for-profit and two-year public institutions, graduation rates average only 20 percent to 40 percent. Student debt may be the reason some of these students failed to graduate. Because most borrowers leave with relatively low debt loads, however, it seems likely that much of it can be attributed to a lack of academic preparation, inadequate institutional support, or simply the student realizing that the education being provided wasn't worth the further investment of time or money. Most students who defaulted on their loans in recent years left school with less than $10,000 in debt.

The Regressive Consequences of a Misplaced Focus on Debt

Federal Income-Based Repayment plans allow students to refinance their college debt and keep the monthly payment below 10 percent of their monthly discretionary income. Yet as University of Michigan economist Susan Dynarski points out, those who need an IBR plan the most are the least likely to take advantage of it, perhaps because of the bureaucratic complexity of the process.[16] This suggests that rather than a "student loan crisis" caused by high debt, an information and administrative bottleneck is preventing students with low debt but a high risk of default from obtaining borrower protections.

While nongraduates are failing to enroll in an IBR plan, the Obama administration has adjusted elements of the program to enable significant debt forgiveness for graduate-student borrowers with lucrative job prospects. New America analysts Jason Delisle and Alexander Holt project that when IBR is combined with the Obama administration's Public Service Loan Forgiveness program, "it could become common for the government to pay for a student's entire graduate education via loan forgiveness."[17] For her part, presidential candidate Hillary Clinton has promised to allow graduates to refinance at current loan rates. This poorly targeted $58 billion proposal would be a boon to the 75 percent of borrowers who aren't struggling, while providing little help to those who struggle most with student debt.

Bernie Sanders has called for a more radical approach: moving away from a loan-financed public higher-education system and making college free. But free college could prove regressive in practice. The Urban Institute's Matthew Chingos found that students from families in the top half of the income spectrum would receive 24 percent more in dollar value than students in the lower half, largely because they generally attend more expensive institutions.[18] Meanwhile, free college would not cover non-tuition fees, which are often larger than the tuition costs, leaving families from the lower half of the income distribution with nearly $18 billion in annual out-of-pocket costs.

Free college tuition may end up hurting the postsecondary prospects of low-income students. Andrew Kelly of the American Enterprise Institute notes that, barring a significant increase in efficiency, colleges that rely on taxpayer dollars rather than tuition fees may not have the resources to expand access without sacrificing quality.[19] State funding in recent years hasn't kept pace with demand; if this trend continues, free college would lead to shortages of seats. Middle- and upper-income students who may otherwise attend private universities will likely take up many of the free public seats, leaving low-income students out in the cold.

Align Incentives to Increase Quality and Decrease Cost

Treating the symptom of student debt in isolation will benefit those who have been served well by their four-year colleges but would do little to change the institutional incentives for the low-quality for-profit and two-year public colleges that have often left students worse off than before.

The Obama administration has cracked down on for-profit colleges through the regulatory process, while calling for further subsidies to make community college free, even though these public colleges often demonstrate similarly poor outcomes. But real higher-education reform wouldn't regulate and reward by tax status; it would realign the incentives of all schools to better serve students. Colleges, public or private, nonprofit or for-profit, should have skin in the game on loan repayment; if students can't pay back their loans, the school should be on the hook for a portion of the unpaid balance. Even a small amount of risk would give postsecondary institutions a reason to contain their costs and offer a better education. A bonus for colleges that educate low-income students who pay off their loans could offer postsecondary institutions an incentive to expand their offerings with an eye toward equity.

High student debt is not the problem; the dearth of high-quality, low-cost options for low-income and nontraditional students is.

Endnotes

[1] See http://www.huffingtonpost.com/hillary-clinton/we-need-to-solve-americas-student-debt-crisis_b_9354868.html.

[2] See http://www.brookings.edu/research/reports/2014/06/24-student-loan-crisis-akers-chingos.

[3] See https://www.clevelandfed.org/newsroom-and-events/publications/forefront/ff-v7n02/ff-20160516-v7n0204-is-there-a-student-loan-crisis.aspx.

[4] See https://studentaid.ed.gov/sa/sites/default/files/income-driven-repayment.pdf.

[5] See http://www.brookings.edu/~/media/projects/bpea/fall-2015_embargoed/conferencedraft_looneyyannelis_studentloandefaults.pdf.

[6] Ibid.

[7] Ibid.

[8] Susan Dynarski, "Why Students with Smallest Debts Have the Larger Problem," *New York Times* (August 31, 2015), http://www.nytimes.com/2015/09/01/upshot/why-students-with-smallest-debts-need-the-greatest-help.html.

[9] Ibid.

[10] See https://www.newamerica.org/education-policy/policy-papers/zero-marginal-cost.

[11] See http://www.wsj.com/articles/andrew-kelly-and-kevin-james-the-democrats-student-loan-weapon-1410997498.

[12] See http://studentaidpolicy.com/excessive-debt/Excessive-Debt-at-Graduation.pdf.

[13] See http://www.brookings.edu/research/reports/2014/06/24-student-loan-crisis-akers-chingos.

[14] See https://www.clevelandfed.org/newsroom-and-events/publications/forefront/ff-v7n02/ff-20160516-v7n0204-is-there-a-student-loan-crisis.aspx.

[15] See http://www.brookings.edu/~/media/projects/bpea/fall-2015_embargoed/conferencedraft_looneyyannelis_studentloandefaults.pdf.

[16] See http://www.nytimes.com/2015/09/01/upshot/why-students-with-smallest-debts-need-the-greatest-help.html; a fuller account of Dynarski's diagnosis and prescription for IBR can be found here: http://www.brookings.edu/~/media/research/files/papers/2014/09/economist_perspective_student_loans_dynarski/economist_perspective_student_loans_dynarski.pdf.

[17] See https://www.newamerica.org/education-policy/policy-papers/zero-marginal-cost.

[18] See http://www.brookings.edu/research/reports/2016/04/21-who-would-benefit-most-from-free-college-chingos.

[19] See http://www.nytimes.com/roomfordebate/2016/01/20/should-college-be-free/the-problem-is-that-free-college-isnt-free.