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CONGRESSIONAL TESTIMONY

Student Loan Servicing: The Borrower's Experience

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My name is Lindsey M. Burke. I am the Will Skillman Fellow in Education Policy at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

For many, earning a college degree is the way to climb the ladder of economic mobility. Higher educational attainment is associated with greater earnings. Median earnings for individuals whose highest degree was a high school diploma totaled $30,000 in 2011, compared to $45,000 for those earning a bachelor's degree.[1] College graduates, on average, earn $650,000 more than those with a high school diploma over the course of a 40-year career.[2] While a college degree isn't the only route to upward mobility, for many, it represents the most promising path for achieving their full earnings potential.

The value of earning a college degree is demonstrable. The cost of earning that degree, however, has become prohibitively expensive for many as college costs have risen. Average tuition at four-year public institutions for out-of-state students reached $22,200 this academic year, and at private universities, average tuition now exceeds $30,000 annually.[3] Many students leave with a bachelor's degree in hand, but burdened with tens of thousands of dollars in student loan debt. Worse still, many students leave college

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[1] U.S. Department of Education, National Center for Education Statistics. (2013). *The Condition of Education 2013* (NCES 2013–037), Annual Earnings of Young Adults, at http://nces.ed.gov/fastfacts/display.asp?id=77

[2] "The Monetary Value of a College Education," Pew Research Center, March 7, 2012, at http://www.pewresearch.org/daily-number/the-monetary-value-of-a-college-education/

[3] "Average Published Undergraduate Charges by Sector, 2013-14," The College Board, Annual Survey of Colleges, 2014, at http://trends.collegeboard.org/college-pricing/figures-tables/average-published-undergraduate-charges-sector-2013-14

without graduating, burdened with debt and lacking the paper credential they had hoped would put them on a path toward middle-class stability or better.

Well-intentioned federal policies have failed to drive down college costs. An easy flow of federal student aid has enabled students to take out sizeable student loans, with little if any credit check or consideration of their future earnings potential. Some have even argued that such policies have enabled universities to raise tuition,[4] creating a vicious lending and spending cycle.

Increases in Federal Higher Education Subsidies

Federal higher education subsidies have increased substantially over the past decade, and now represent 71 percent of all student aid.[5]

Federal student loans. According to the College Board, during the 2012-13 academic year, 43 percent of all student aid was in the form of federal student loans.[6] Thirty-four percent of undergraduate students took out federal student loans that year, up from 24 percent during the 2002-03 academic year. The College Board notes that, over the past 10 years, the number of students borrowing through federal student loans increased by 69

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[4] Former Education Secretary William J. Bennett posited, "If anything, increases in financial aid in recent years have enabled colleges and universities blithely to raise their tuitions, confident that Federal loan subsidies would help cushion the increase." See: William J. Bennett, "Our Greedy Colleges," *The New York Times,* February 18, 1987.
[5] Trends in Student Aid 2013, College Board, 2013, at http://trends.collegeboard.org/sites/default/files/student-aid-2013-full-report.pdf
[6] *Ibid.*

percent, from 5.9 million students during the 2002-03 academic year to 10 million in 2012-13.[7]

Federal grant aid. Since 2008, grant aid per full-time enrolled student has increased over 30 percent. Between the 2007-08 academic year and the 2012-13 academic year, federal grant aid doubled in real terms, and state grant aid increased 11 percent.[8] Pell Grant funding, which is available to income-eligible students and does not have to be repaid, has more than doubled in real terms since the 2002-03 academic year, increasing from $14.8 billion to $32.3 billion.[9] Increases in total Pell expenditures are due in large part to increases in the number of grant recipients, which has grown from 4 million during the 1992-93 academic year to 8.8 million during the 2012-13 academic year,[10] nearly doubling in the past decade.

Student debt. Approximately 60 percent of students who earned a bachelor's degree during the 2011-12 academic year left school more than $26,000 in debt.[11] Total cumulative student loan debt now exceeds $1 trillion, which, as is often noted, is more than cumulative credit card debt.

Increases in College Costs

Increases in debt have been driven by increases in college costs. In the last 30 years, inflation-adjusted tuition and fees at private colleges increased by 153 percent; tuition

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[7] *Ibid.*
[8] *Ibid.*
[9] *Ibid.*
[10] *Ibid.*
[11] *Ibid.*

and fees at public universities for in-state students increased 231 percent.[12] College costs have risen more than health care costs—by some estimates, twice as much[13]—and faster than increases in the price of food.

Increases in tuition and fees over the past 30 years suggest that growth in federal subsidies such as loans and grants has done little to mitigate the college cost problem.

A Better Path Forward

In order to make college more affordable, federal policy should do three things:

1. Stop the higher education spending spree;
2. Employ fair-value accounting to understand the cost of federal student loans; and
3. Decouple federal financing from accreditation

Stop the Higher Education Spending Spree

If history is any guide, continuing to increase federal subsidies will fail to drive down college costs. Some experts and economists even argue that such subsidies enable universities to raise tuition, confident that students will be able to access a virtually open spigot of federal funds.

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[12] "Published Tuition and Fees Relative to 1983-84 by Sector," Trends in Higher Education 2013, The College Board, at https://trends.collegeboard.org/college-pricing/figures-tables/published-tuition-and-fees-relative-1983-84-sector

[13] Chase Peterson-Withorn, "Rising Prices: College Tuition vs. the CPI," The Center for College Affordability and Productivity, March 19, 2013, at http://centerforcollegeaffordability.org/archives/9623

In 2014, the $33 billion Pell Grant program provided grants to 9 million college students, making it the largest share of the federal education budget.[14] Congress grew the Pell Grant program in 2007 by expanding eligibility and funding, resulting in a doubling of the number of Pell recipients since 2008. In order to control higher education spending, Pell Grant funding should be targeted to the low-income students the grants were originally intended to help.

In addition, as long as the federal government finances federal student loans, it should use fair-value accounting practices to get an accurate measure of what these programs are costing taxpayers, to ensure the loans use a non-subsidizing interest rate.

Fair-Value Accounting

In a report released last month, the Congressional Budget Office (CBO) calculated that the four largest federal student loan programs—Subsidized Stafford Loans, Unsubsidized Stafford Loans, PLUS Loans, and Parent PLUS Loans—will *cost* taxpayers money, not result in a net gain (a negative subsidy) for the federal government as is often claimed. While the report states that the four loan programs will yield a savings of about $135 billion from 2015-24, CBO calculates in the same report that using fair-value accounting measures, the four loans would actually have a net cost of $88 billion over the next 10

[14] "Federal Pell Grant Program," Project on the Budget, New America Foundation, at http://febp.newamerica.net/background-analysis/federal-pell-grant-program

years, not including administrative costs. In other words, the four largest student loan programs represent an $88 billion taxpayer-financed subsidy.[15]

CBO explains the utility of using a fair-value accounting model to fully understand the cost of federal lending, noting that "The government is exposed to market risk when the economy is weak because borrowers default on their debt obligations more frequently and recoveries from borrowers are lower."[16] Fair-value estimates take this market risk into account, and as a result, are a more accurate reflection of the cost of federal student loans.

Congress should not expand federal student loans without requiring that fair-value accounting be used to calculate the cost of those loans. Any loan program should use a non-subsidizing interest rate, e.g., the rate at which the program breaks even; absent fair-value accounting, it is impossible to tell the extent to which the student loan programs are providing a subsidy to borrowers. Specifically, the Department of Education should be required to use fair-value accounting estimates calculated by CBO and adjust loan rates accordingly going forward, on an annual basis. This would help determine whether the loan programs are costing money for taxpayers, and where to set interest rates to ensure the programs break even.

Decouple Federal Financing from Accreditation

If federal policymakers want to drive down college costs and *increase* access to higher education for those historically underserved by the traditional four-year system, the single

[15] "Fair-Value Estimates of the Cost of Selected Federal Credit Programs for 2015 to 2024," Congressional Budget Office, May 22, 2014, at http://www.cbo.gov/publication/45383
[16] *Ibid.*

most important reform to consider is decoupling federal financing from accreditation. College costs are at an all-time high at a time when access to knowledge is cheaper than at any other point in human history. Online learning and competency-based options that favor knowledge and skill acquisition over seat time have laid the groundwork to significantly lower college costs and increase access for students. In order to harness the potential of new learning modes, policymakers must free higher education from the ossified accreditation system.

Accreditation as it currently exists creates barriers to entry for innovative new start-ups to enter the higher education market, and it is a poor gauge of course quality and the skills students gain (or fail to gain) while attending college. What began as a voluntary system of accreditation in the 19th century became a *de facto* requirement in 1952 when federal financing and aid, which constitutes so much of colleges' budgets, became tied to accreditation.[17] Now it is a near requirement for colleges to operate, and as a result, being accredited has lost any real value.

Requirements for an institution to be accredited in order for students to access federal student loans and grants has put roadblocks in the way of models that hold the prospect of fundamentally restructuring higher education to bring down college costs. Unless accreditation is delinked from federal financing, that revolution could be postponed longer than it need be, while students continue to incur untenable levels of debt to pursue bachelor's degrees that may not be preparing them for the workforce.

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[17] American Council of Trustees and Alumni, "Why Accreditation Doesn't Work and What Policymakers Can Do About It," July 2007, https ://www.goacta.org/publications/downloads/Accreditation2007Final.pdf

In addition to favoring existing business models, accreditation rates entire institutions—not specific courses—and as a result, is a poor gauge of course quality and the skills acquired by students. State policies should be crafted to place a greater emphasis on credentialing skills and specific courses—not institutions—if higher education is to keep pace with the demands of future economies.[18]

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Continuing to simply increase federal subsidies for higher education will fail to solve the college cost problem. Moreover, such subsidies shift the responsibility of paying for college from the student, who directly benefits from attending college, to the taxpayer. Transferring the burden of student loan financing from university graduates—who will earn significantly more over the course of a lifetime than someone with a high school diploma—to the three-quarters of taxpayers who do not hold bachelor's degrees, is inequitable.[19]

In order to drive down college costs and increase access to higher education opportunities, policymakers should stop the federal spending spree, employ fair-value accounting practices, and ultimately, work to decouple federal financing from accreditation.

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[18] Lindsey M. Burke and Stuart M. Butler, "Accreditation: Removing the Barrier to Higher Education Reform," Heritage Foundation, *Backgrounder* No. 2728, September 21, 2012, at http://www.heritage.org/research/reports/2012/09/accreditation-removing-the-barrier-to-higher-education-reform

[19] Dan Lips, "Ways to Make Higher Education More Affordable," Heritage Foundation *WebMemo* No. 2785, January 29, 2010, at http://www.heritage.org/research/reports/2010/01/ways-to-make-higher-education-more-affordable

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