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Statement before the Senate Committee on Banking, Housing, and Urban Affairs' Subcommittee on Economic Policy on "The Student Debt Burden and Its Impact on Racial Justice, Borrowers, and the Economy."

Student Debt

Assessing Its Impacts on Individuals and the Economy

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Chair Warren, Ranking Member Kennedy, and members of the subcommittee: Thank you for inviting me here today to share my assessment of this important issue. The volume of student loan debt in the economy has now surpassed $1.6 trillion, which is an alarming milestone. Concern about student debt was once a niche issue, but with 45 million[1] Americans now holding student debt, it has rightly become an issue of national concern. Your attention to this subject today is apt.

I am honored to be able to share the insights I have collected about this issue throughout a number of years working in this space as a policymaker and researcher. I began working on this issue as a staff economist in the Council of Economic Advisers under the George W. Bush administration, while working toward a PhD in economics at Columbia University, and have since been researching the economics of higher education in the think tank industry, currently at the American Enterprise Institute and previously at the Brookings Institution and the Manhattan Institute. Throughout my career, my focus has been on studying the federal system of higher education finance, with a focus on student debt, with the goal of improving the efficacy of our system of higher education as a mechanism for social mobility.

The Impact of Student Loan Debt on Individual Borrower Well-Being

When considering the impact of student debt on individuals, it's important to recognize the appropriate counterfactual for the comparison. While borrowers in repayment would be unequivocally better off if they didn't have to make payments on their debt, most are better off with debt and a degree than they would be if they'd not pursued higher education. That's not only because college degree holders earn higher wages but also because they find themselves unemployed less often than peers without degrees. The act of borrowing to pay for college often lowers current wealth but will ultimately increase lifetime earnings and economic well-being.

While students completing bachelor's degrees with debt have average balances of approximately $30,000,[2] the degrees they hold will, on average, raise their lifetime earnings by $2.8 million.[3] The price tag for higher education can be high, but the returns are generally even higher. Economists from the Federal Reserve have estimated that students investing in associate and bachelor's degrees will earn a 15 percent rate of return, which is about twice the rate of return in the stock market, on the dollars spent on the cost of enrollment.[4]

The largest student loan balances, like the ones we often read about in the newspaper, are uncommon and most often held by borrowers with advanced degrees who also have access to very high earnings. Only 6 percent of borrowers owe more than $100,000.[5] A recent study authored by my two co-panelists for this hearing indicates that more than 40 percent of the outstanding student debt in this country was used to pay for graduate or professional programs, with MBAs and law schools being the largest sources of debt. These high-balance borrowers hold a surprising share—one third—of all outstanding student debt.[6]

For the typical borrower, access to student debt through the Federal Loan Program creates an opportunity for economic mobility that would otherwise be unavailable. Some students, however, are left worse off financially for having gone to college. Borrowers who find themselves in this situation often fall into two categories: those who start but don't complete a degree and those who complete a degree but find that it doesn't deliver the opportunities in terms of employment that would justify its cost.

We see that non-completers make up a disproportionate share of borrowers who struggle to repay their debt.[7] This explains why borrowers with small balances, less than $5,000, are finding themselves in default on their loans more often than borrowers with larger balances.[8] Debt without a degree is one of the most problematic trends of the current federal policy regime.

Another problem that needs to be addressed, especially for borrowers of color, is low-quality institutions that do not effectively prepare their graduates for the employment that would justify their often high cost of attendance. There are programs and institutions in every sector of the higher education industry that fail to prepare their graduates, but the problem of a low-quality education, which generates both worthless credentials and large numbers of indebted dropouts, has been concentrated in the for-profit sector.

Low-income, first-generation, and minority students are disproportionately represented in this group. Black students, for example, make up just 13 percent of students enrolled at public colleges but comprise 21 percent of students at for-profit colleges.[9] This is an important driver of the repayment crisis being faced by these borrowers. Half of black borrowers who began a degree program in 2003–04 had defaulted on their loan 12 years later, compared to just one in five white borrowers.[10]

The Inadequacy of Borrower Protection and Relief Programs

Ideally, borrowers who find their loan payments unaffordable due to lack of earnings opportunities would take advantage of the existing safety nets—namely, the set of income-driven repayment (IDR) programs including Public Service Loan Forgiveness—but evidence suggests that the safety net created by these programs is falling short.

Income Driven Repayment Is Too Complex. Despite IDR's appropriateness for the policy challenge at hand, the system hasn't been working well. The reason for this is largely that IDR is administered through a complex variety of programs, each with different eligibility criteria and a range of program parameters. The amount borrowers are expected to pay is calculated differently across programs, as is the number of years before borrowers can qualify to have their balance forgiven. The result is a system that is excessively complex to navigate, with many borrowers unaware of the benefits available to them. As of 2016, only 43 percent of undergraduates with loans reported that they were aware of their eligibility for IDR.[11]

While IDR is now universal for all federal student borrowers, it became that way only after a series of legislative and executive interventions,[12] between 1992 and 2015, stitched together a patchwork of loosely related programs. Factual evidence about how IDR has been used is limited, but anecdotes about the challenges of navigating the system, even by financially savvy consumers, indicate systemic problems. This rickety policy framework desperately needs to be replaced with a single user-friendly IDR plan that can be universally marketed and better understood.

The complexity of these programs is especially problematic for economically disadvantaged borrowers. Borrowers with large balances from graduate and professional degrees, which are most often white students from middle- to high-income families, seem to be navigating the programs successfully, perhaps because they have so much to gain from loan forgiveness. Of the loans disbursed from 2020 to 2029 and repaid through IDR, the Congressional Budget Office estimates that borrowers with debt only from undergraduate studies would have $40.3

billion forgiven, while those who borrowed for graduate school would have $167.1 billion forgiven.[13]

Widespread Student Loan Cancellation Is the Wrong Solution. Some might argue that these facts justify a blunt intervention, like mass loan cancellation, which would not require the borrower to jump through hoops to collect the benefit. But that's not the case. The complexity of the current safety net is not due to the income-based eligibility criteria; it is complex because of the manner in which it was created, through a combination of piecemeal, nonconforming policy changes. Borrowers who made their way through college and took out loans to do so are certainly capable of navigating an income-tested student loan relief program if it were designed with the intention of being user-friendly and accessible.

In addition to being an unnecessarily blunt fix to the problem of an inadequate safety net, widespread student loan cancellation would create additional problems. I am especially concerned about the distortion of borrower and institution incentives that would likely exacerbate the problems of ballooning loan balances and rampant tuition inflation.

Students enrolling in college after a student loan jubilee would have good reason to think that any debts they take on in pursuit of a degree would potentially be forgiven in the future. This would encourage students to borrow more than they would have otherwise, by financing a greater share of their costs or attending a more expensive institution. In response, institutions would likely be driven to raise their costs. While colleges and universities don't always act as firms would in economic models, they would likely raise their prices over time in response to the increase in demand and willingness to pay. If mass loan cancellation were implemented, we'd likely find ourselves having this same conversation again, but with larger balances to contend with.

Not only would widespread loan cancellation create moral hazard, but it would also deliver more benefits to well-off borrowers than to needy ones and would thus do little to address the inequality implicit in our economy. A comprehensive loan-forgiveness program would deliver 10 times more benefit to borrowers in the top 10 percent of earners than it would provide to borrowers in the bottom 10 percent of earners.[14]

Additional Solutions. Higher education is an essential mechanism for social mobility in our economy. Since alternative pathways to financial prosperity outside education after high school are not plentiful, it is crucial that our system of higher education finance offers a pathway through higher education that isn't riddled with financial risk. Aspiring students shouldn't have to fear that college will leave them worse off financially than where they started.

This goal can be achieved by a sweeping reform of the student loan safety net to make it simpler to navigate and more readily understood by potential beneficiaries. The set of IDR programs should be replaced with a single, universal program, and the process of application and income certification should be streamlined to support borrowers.

Policymakers might also consider reforming the parameters that determine benefits to reallocate benefits or alter their generosity. For example, it would be reasonable to require high-balance borrowers (who likely attended graduate or professional school) to make payments on their loans longer than borrowers with small balances before they become eligible for forgiveness. Policymakers could also decrease the amount of disposable income that borrowers are expected to devote to repayment or raise the threshold of income below which borrowers aren't required to make payments. Reasonable people can disagree about the appropriate level of generosity of the student loan safety net, so I'll refrain from providing a specific recommendation today and instead illustrate that there are multiple ways to tweak the repayment system and make it more equitable.

A regime for higher education finance that provides a robust safety net must also require that we not let borrowers continue to take on debts that are predictably unaffordable. Constraining borrowing among graduate students and parents would be a good start. Increasing the role of student employment and financial outcomes in assessing a school's eligibility for participation in the federal student loan program would also go a long way in this effort.

Student Debt and the Macro Economy

Since investments in higher education, on average, provide a net positive return (even taking into account the cost of borrowing), spending on education that is financed with federal student loans is generally a wealth-enhancing activity both individually and collectively. In other words, we are richer as a nation because of our public and individual investments in higher education. However, these benefits are not equally distributed, and some groups are being systematically made worse off by enrolling in higher education.

Many are concerned that student debt is causing borrowers to delay milestones such as homeownership, marriage, and parenthood. It does seem likely that alleviating borrowers of their debt would allow them to engage in these activities sooner (if they wish), but this does not mean that debt is causing a delay. The more apt question would be whether individuals with student debt are delaying these activities relative to what they would have done had they never gone to college in the first place. That is a much harder question to answer, but given that borrowing and college attendance are, on average, wealth-enhancing activities, how they would also be constraining these behaviors is unclear.

In this vein, many have argued that loan cancellation would provide a valuable stimulus to the economy. In theory, it could encourage borrowers in repayment to redirect their resources elsewhere, perhaps toward purchasing a home, getting married, or having children. It would likely have this affect; however, the magnitude would be small relative to the cost of the effort. This is because the benefits would be disproportionately delivered to higher-income borrowers and because the benefit would not be delivered immediately but rather through alleviating payments that were due monthly for decades into the future. There are far more effective forms of stimulus that could be immediately enacted if this were a priority.

Conclusion

The startling statistics in the student loan program and revelations of inequity might seem like cause for dramatic and immediate action, like student loan cancellation. However, the problems with our system of higher education finance cannot be repaired with such blunt efforts and must be addressed with more nuanced, incremental changes. I would urge you all to consider that smaller, and less politically exciting, reforms might better serve students and accomplish our collective goal of having our higher education finance system effectively and equitably support this pathway to economic prosperity.

Thank you for the opportunity to give testimony in this important hearing. I look forward to presenting these comments and evidence to the subcommittee and answering questions.

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