**The Student Debt Burden and Its Impact on Racial Justice, Borrowers, & the Economy**
Testimony Submitted to the U.S. Senate Committee on Banking, Housing, and Urban Affairs' Subcommittee on Economic Policy
April 13, 2021

Constantine Yannelis
University of Chicago
Booth School of Business

Dear Chair Warren, Ranking Member Kennedy, and Members of the Committee, thank you for inviting me and the opportunity to testify today.

Education is the single highest return investment most Americans will make. Thus getting our system of higher education finance right is of fundamental importance for American households and to the American economy.

A key point that has to be made whenever discussing student loans is that the outcomes of borrowers vary widely. It is undeniable that a significant number of borrowers are struggling, and are sympathetic candidates for some kind of relief. Student loan balances have surged over the past decades. According to the New York Fed, last year student loans had the highest delinquency rate of any form of household debt.[1] At the same time, the majority of borrowers end up earning high amounts and do not have difficulties repaying their loans.[2] A college education is, in the vast majority of cases in America, a ticket to success and a high-paying job. A very large portion of the borrowers who struggle attend a relatively small number of institutions—predominantly for-profit colleges.[3]

The core of the problem in the student loan market lies in a misalignment of incentives between students, schools and the government. This misalignment comes from the fact that borrowers use government loans to pay tuition to schools. If borrowers end up getting poor jobs, and they default on their loans, schools are not on the hook- taxpayers end up paying the costs. How do we address this incentive problem? There are many options, but let me first comment on a commonly proposed solution, universal loan forgiveness.

One common proposal is some form of blanket student loan cancellation. This is an extremely regressive policy– it provides more assistance to higher income rather than lower income borrowers. This is primarily because people who go to college tend to earn more than those who do not go to college, and people who spend more on their college education—like those who attended medical and law schools—tend to earn more than those who spent less on their college education, like dropouts and associate's degree holders.

My own research, which is joint with Sylvain Catherine at the Wharton School of the University of Pennsylvania shows that most of the benefits of universal loan cancellation would accrue to high income individuals. Individuals in the top 20% of the earnings distribution would receive six to eight times as much debt relief as individuals in the bottom 20% of the earnings distribution.[4] These basic patterns are still true for policies that limit forgiveness up to $10,000 or $50,000.

Another problem with capped student loan forgiveness is that many struggling borrowers will still face difficulties. A small number of borrowers have very large balances, and very low incomes. Policies forgiving $10,000 or $50,000 in debt will leave their significant problems unaddressed. While income phaseouts make forgiveness less regressive, it is a very blunt instrument, and leads to many individuals who earn large amounts over their lives receiving substantial loan forgiveness, like medical residents and judicial clerks.

If the goal of policymakers is to make sure that funds get into the hands of borrowers at the bottom of the income distribution, in a progressive way, blanket student loan forgiveness does not accomplish this goal. Rather, the policy primarily benefits high-earners.[5]

While I am convinced from my own research that student loan forgiveness is regressive, this is also the consensus of economists. The panel of prominent economists run by The Initiative on Global Markets at the University of Chicago asked economists whether "Having the government issue additional debt to pay off current outstanding loans would be net regressive."[6] The panel included economists from both the left and the right at leading institutions. The results of the survey were telling. Not a single economist disagreed with the idea that student loan forgiveness was regressive. This is because the facts are clear on this issue—to borrow a phrase commonly used, 'the science is settled.' Student loan forgiveness is a regressive policy, that mostly benefits upper income and upper middle class individuals.

One of the topics of this hearing is the effect of student loan forgiveness on racial inequality. One of the most distressing failures of the federal loan program is the high default rates and significant loan burdens on Black borrowers. And student debt has been implicated as a contributor to the Black-White wealth gap. However, the data show that student debt is not a primary driver of the wealth gap and student loan forgiveness would make little progress closing the gap but at great expense. The average wealth of a White family is $171,000, while the average wealth of a Black family is $17,150.[7] The racial wealth gap is thus approximately $153,850. According to my paper, which uses data from the Survey of Consumer Finances, and not taking into account the present value of the loan, the average White family holds $6,157 in student debt, while the average Black family holds $10,630. These numbers are of course unconditional on holding any student debt.

Thus, if all student loans were forgiven, the racial wealth gap would shrink from $153,850 to $149,377, which is shrinking it by just under 3%. Thus the policy would cost about $1.7 trillion, and shrink the racial wealth gap by about 3%. Surely there are much more effective ways to invest $1.7 trillion if the goal of policymakers is to close the racial wealth gap. For example, targeted, means-tested social insurance programs are far more likely to benefit Black Americans relative to student loan forgiveness.[8] For most American families, their largest asset is their home, so increasing property values and homeownership among African-Americans would likely do much more to close the racial wealth gap, although the racial income gap is the primary driver of the wealth gap.[9] Wealth is ultimately driven by earnings and workers' skills—what economists call human capital.[10] In sum, forgiving student loan debt is a costly way to close a very small portion of the Black-White wealth gap.

How can we provide relief to borrowers who need it, while avoiding making large payments to well-off individuals? There are a number of policy options for legislators to consider. One option to provide relief is to bring back bankruptcy protection for student loan borrowers.

Another option is expanding the use of Income-Driven Repayment, or IDR. One fact which is often missed in the policy debate is that we already have a progressive student loan forgiveness program, and that is IDR. IDR plans link a borrower's payments to their income, they typically pay 10-15% of their income above 150% of the federal poverty line.[11] Depending on the plan, after twenty or twenty-five years, remaining balances are forgiven. Thus, if a borrower earns below 150% of the poverty line, he or she never pays anything and the debt is forgiven for these low income individuals. If the borrower earns low amounts above 150% of the poverty line, he or she makes some payments and receives partial forgiveness. If a borrower earns a high income, he or she fully repays their loan. Put simply, higher income people pay more and lower income people pay less.[12] IDR is thus a progressive policy.

IDR plans provide relief to struggling borrowers, who face adverse life events or are otherwise unable to earn high incomes. There have been problems with the implementation of IDR plans in the United States, but the problems are fixable, and some have been fixed by recent legislation.[13] Many countries such as the UK and Australia successfully operate IDR programs, that are administered through their respective tax authorities.

Beyond providing relief to borrowers, which is very important, we could do more to fix technical problems, and incentives. We could give servicers more tools to contact borrowers and inform them of repayment options like IDR, and we could also incentivize servicers to sign more people up for IDR. But, while we may be able to make some technical fixes, servicers are not the root of problems in the student loan market. A small number of schools and programs are accounting for a large portion of adverse outcomes.[14]

To fix this, policymakers can also directly align incentives between schools and borrowers. For example, Brazil has had similar problems with their student loan program. Recently, they gave schools "skin in the game" and required them to pay a fee based on dropout and default rates. This helps align the incentives of schools and borrowers. Making revenues go directly to schools from IDR plans, or Income-Share Agreements, where individuals pay an uncapped portion of their income, could also help align the incentives of schools, students and taxpayers.

In closing, I want to stress that federal student loans are an important part of college financing and intergenerational mobility. The roots of our student loan problem is a misalignment of incentives. Since the student loan problem has been so slow moving and continuous, I like the analogy of a frog slowly boiling in a pot of water over a flame. Policies like student debt cancellation are not extinguishing the flame—they aren't fixing the incentive problem. All you would be doing is moving the frog into a slightly cooler pot of water. And if we don't fix the core of the problem, even if you forgive $50,000 of debt for current borrowers, balances will continue to grow and we will be having another hearing with a similar theme in ten or twenty years' time.

---

[1] https://www.newyorkfed.org/microeconomics/hhdc/background.html

[2] Looney, Adam, and Constantine Yannelis. "A crisis in student loans?: How changes in the characteristics of borrowers and in the institutions they attended contributed to rising loan defaults." *Brookings Papers on Economic Activity* 2015, no. 2 (2015): 1-89.

[3] Looney, Adam, and Constantine Yannelis. "A crisis in student loans?: How changes in the characteristics of borrowers and in the institutions they attended contributed to rising loan defaults." *Brookings Papers on Economic Activity* 2015, no. 2 (2015): 1-89.

[4] Catherine, Sylvain, and Constantine Yannelis. *The Distributional Effects of Student Loan Forgiveness*. No. w28175. National Bureau of Economic Research, 2020.

[5] Catherine, Sylvain, and Constantine Yannelis. *The Distributional Effects of Student Loan Forgiveness*. No. w28175. National Bureau of Economic Research, 2020.

[6] https://www.igmchicago.org/surveys/student-debt-forgiveness/

[7] https://www.brookings.edu/blog/up-front/2020/02/27/examining-the-black-white-wealth-gap/

[8]https://www.brookings.edu/blog/up-front/2021/02/12/putting-student-loan-forgiveness-in-perspective-how-costly-is-it-and-who-benefits/

[9] Aliprantis, Dionissi, Daniel Carroll, and Eric R. Young. "The dynamics of the racial wealth gap." (2019).

[10] Heckman, James J. "Invest in early childhood development: Reduce deficits, strengthen the economy." *The Heckman Equation* 7 (2012): 1-2.

[11]Mueller, Holger M., and Constantine Yannelis. "The rise in student loan defaults." *Journal of Financial Economics* 131, no. 1 (2019): 1-19.

[12] Karamcheva, Nadia, Jeffrey Perry, and Constantine Yannelis. *Income-Driven Repayment Plans for Student Loans*. Vol. 2. *CBO Working Paper,* 2020.

[13] Mueller, Holger M., and Constantine Yannelis. "Reducing barriers to enrollment in federal student loan repayment plans: Evidence from the navient field experiment." *Working Paper*. 2020.

[14] Looney, Adam, and Constantine Yannelis. "The consequences of student loan credit expansions: Evidence from three decades of default cycles." *Working Paper*. 2020.