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## Student Loans: A Multidimensional Public Policy Issue

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## Student Loans

### A Multidimensional Public Policy Issue

**S**tudent loans are instrumental in broadening access to postsecondary educational opportunities. For many individuals who want to develop their own human capital but lack the means, loans serve as an important supplement to governmental or institutional grants in making educational investments affordable and increasing educational attainment. The availability of student loans thus has great value for individual students and the country as a whole.

However, the burgeoning volume of debt and repayment difficulties that many people now experience have

#### **Education debt was the only major source of debt that increased during the Great Recession.**

created a vigorous debate on whether public policy should further intervene in student loan transactions. In economic terms, do the benefits exceed the costs? Even with close examination of the data on cumulative debt, number and characteristics of borrowers, types of institutions, and repayment dynamics, the answer to this question is not straightforward. In alignment with its mission of investigating the underlying dynamics of the labor market, a component of which is the educational preparation of the workforce, the W.E. Upjohn Institute for Employment Research organized a conference on student loans to catalyze careful and

informed analysis of this understudied but increasingly important public policy. Approximately a dozen papers were presented and discussed at the conference, held in Ann Arbor at the University of Michigan in October 2013. The Spencer Foundation and the Education Policy Initiative of the University of Michigan Ford School of Public Policy cosponsored the event.

#### **Measuring Debt Burdens**

Much publicity focuses on the size of outstanding student debt, which has surpassed \$1 trillion. However, this aggregate number taken out of context can obscure, rather than enlighten, the policy debate. Measuring debt is complicated and can be done in different ways. Sandy Baum's conference paper brought attention to several of them. She begins by examining trends in total student loan debt, number of borrowers, and average balances. In the case of average balances, the denominator matters, as the average could be over all students or over the students who borrow. Interestingly, the former has declined over the past two years.

Baum also notes that student borrowers may be pursuing undergraduate or graduate education, and that loans may come from federal or nonfederal sources. She documents that the levels and growth trends in per-student loans are much greater for graduate than undergraduate students. Further, both the volume of private loan disbursements and the share of students

taking them halved since their peaks in the 2007–08 academic year.

Baum concludes that the most pressing public policy concern is for students who may have unmanageable debt levels—these are disproportionately independent students, attendees of for-profit institutions, and African Americans—and to institute income-dependent repayment programs that shift risk from students to taxpayers.

The paper presented by Donghoon Lee and colleagues at the New York Federal Reserve Bank looks at trends in aggregate student debt and repayment vis-à-vis other forms of debt. Drawing on a longitudinal database of consumer credit reports that covers the entire country, they show that total education debt tripled between 2004 and 2012, and that it was the only major source of debt (among mortgages, credit cards, auto loans, and home equity lines of credit) that increased during the Great Recession. Some of this increase was due to more people pursuing education, but some of it was also due to interest accumulation from low repayment and high delinquency during the recession.

When the authors examine repayment, they find that as of the end of 2012, one-sixth of borrowers were behind on their student loan payments by 90 days or more, a delinquency rate greater than that for credit card debt. The rise in student debt and difficulty in repayment may have crowded out access to other forms of credit, the authors surmise, as other forms of debt—especially mortgages—fell sharply from 2005 to 2012 for young student loan borrowers.

**Reasons for Growth**

Undeniably, student debt—however measured—has increased over the past two decades. But it has not grown at the same rate for all students, or even all graduates. The paper that we presented at the conference addresses where in the entire distribution of college graduates debt has grown, when it was growing, and what factors, if any, can explain the growth. Focusing on individuals who earned bachelor’s degrees, we find that debt—contrary to popular belief—grew faster over the 1990s than over the 2000s,

with the sharpest increase occurring between 1996 and 2000. We also find that the increase that did occur between 2000 and 2008 was mostly concentrated in the top fourth of graduates and entirely due to private loans.

These facts can perhaps be more directly seen in Figure 1, which displays the cumulative borrowing distributions of bachelor’s degree earners at graduation in today’s dollars. The top two lines in the figure come from the classes of 1990 and 1996. They show that just over 50 percent of the graduates had borrowed funds for their education, and that approximately 95 percent had loan balances of less than \$30,000. The fact that the distributions for the three later classes from the 2000s have shifted to the right relative to the earlier cohorts and are similar to each other illustrates how loan balances grew far more sharply in the 1990s than in the 2000s. The only part of the distribution that grew substantially in the last decade is the upper tail.

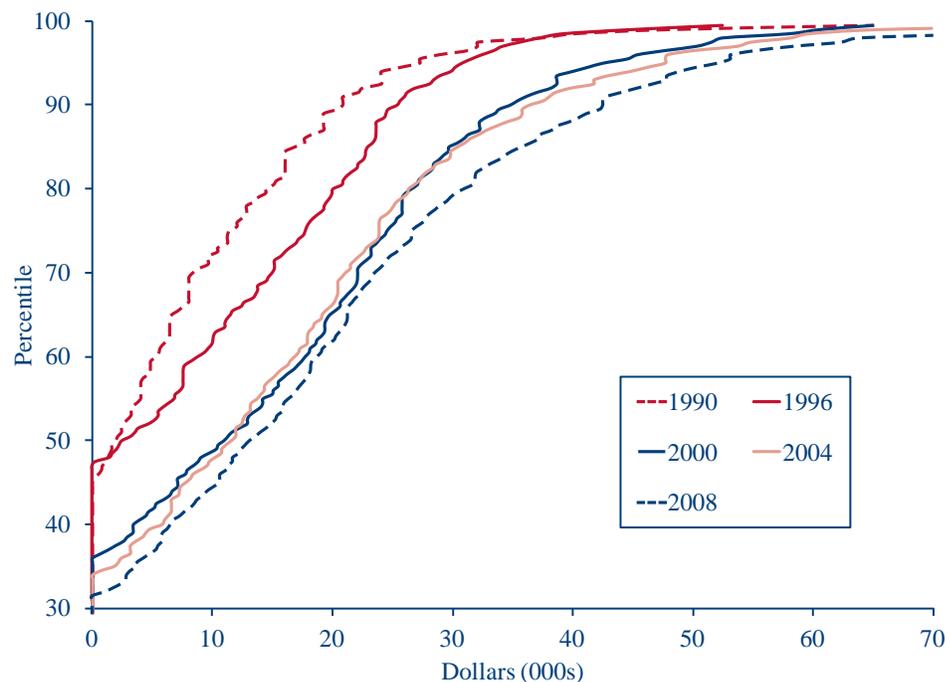
The analyses in our paper seek to understand the factors that shifted the borrowing distribution so dramatically

between 1990 and 2000, and the factors that shifted the upper tail of the distribution between 2000 and 2008.

Using statistical decompositions, we show that increases in tuition and fees and the expected family contribution (a proxy for ability to pay) can explain most of the increase in borrowing in the early 1990s and over the 2000s. The surge in borrowing in the late 1990s, however, is not explained by costs or other observable factors. Instead, the paper suggests that this growth resulted from the introduction of new loan products, particularly unsubsidized Stafford Loans and private loans.

Complementing our paper was a study by Beth Akers and Matt Chingos. They also seek to explain the surge in debt between 1989 and 2010 and to examine the distribution of borrowers; however, they focus on all adults, not just recent bachelor’s degree recipients. They infer, as we do in our paper, that extremely large debt burdens are exceptional cases, but they further demonstrate that rising educational attainment—particularly graduate education—explains a

**Figure 1 Cumulative Borrowing Distribution among College Graduates**



NOTE: All calculations use sample weights, are in constant (year 2012) dollars, and include student-level borrowing from all sources except informal loans from friends and family. SOURCE: National Postsecondary Student Aid Study, selected years.

considerable part of the overall increase in educational debt. Tuition increases play an even larger role, but behavioral changes toward greater substitution of debt for out-of-pocket financing also have contributed to the increase. Akers and Chingos review several recent studies on the return to higher education, noting that the extent to which the increase in debt burdens is leading to financial hardship remains an open question.

### Other Dimensions

The conference touched on many other issues and policy prescriptions related to student loans. Stephanie Cellini and Rajeev Darolia examine trends in debt among individuals who attended for-profit institutions. Their analyses suggest that relatively high and rising tuition, coupled with relatively low and stagnant student financial resources, explain the bulk of the elevated debt levels of for-profit students relative to those in other sectors.

The paper by Xiaoling Ang and Dalié Jiménez looks at the impact of congressional legislation in 2005 that amended bankruptcy law to make private student loans presumptively nondischargeable in bankruptcy. They find an increase in the volume of private loans originated after 2005, a skewing in the credit score of borrowers toward the lower end of the distribution, and a slight increase in the average interest rate of private loans at four-year undergraduate institutions. While the first two of these results are in line with theoretical hypotheses, the third is opposite of what was expected.

The paper by Lance Lochner and Alexander Monge-Naranjo examines default and repayment behavior over the 10 years following graduation for individuals who earned a bachelor's degree. The authors note that outcomes are not as simple as the binary case of repayment or default that is often the focus of media stories and creditors, including the federal government. They find that the amount borrowed and postschool earnings matter more for repayment outcomes than other factors, such as major and institutional characteristics, but their analyses also

reveal that many borrowers who at one point are in default or forbearance later return to good standing in repayment.

Dora Gicheva and Jeffrey Thompson investigate the impact of student loan debt on long-term household financial stability. In analyses that control for several demographic characteristics and local economic conditions, the authors determine that borrowing amounts were positively related to bankruptcy and negatively related to home ownership and on-time payments, with especially strong results for individuals who failed to complete college.

In an interesting twist of emphasis, Sara Goldrick-Rab and Robert Kelchen look at students who chose to avoid taking on debt. In their sample of first-time undergraduate Pell Grant recipients at Wisconsin public institutions, the authors correlate student characteristics with loan package decisions to reveal how family background influences loan

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aversion. Surprisingly, they find little relationship between financial knowledge and borrowing behavior.

### Policy Recommendations

Three papers presented at the conference had specific policy prescriptions, all touching on the issue of how to improve loan repayment. Lauren Asher and Debbie Cochrane, with their coauthors at The Institute for College Access and Success, offer specific recommendations in four areas: 1) consolidation and simplification of federal loans, 2) streamlined repayment options, 3) improvements in loan counseling, and 4) strengthened consumer protections. They advocate that the federal government offer a single undergraduate student loan with no fees, a low in-school interest rate, and a fixed rate in repayment that cannot rise much beyond the rate paid by current borrowers.

Susan Dynarski and Daniel Kreisman also presented a specific plan for an

income-based repayment system, which they label "Loans for Educational Opportunity." Under their proposal, payments would be automatically deducted from borrowers' paychecks, similar to the payroll tax for Social Security, except that rates would be tied to income. Instead of paying off loans during a fixed, 10-year period, borrowers would have up to 25 years, although they could opt to pay down the loan more quickly. The authors believe that this plan would reduce the administrative costs of the current student loan system.

Jason Delisle, Alex Holt, and Kristin Blagg demonstrate how a loophole in the federal government's Pay As You Earn (PAYE) program for student loans could affect graduate and professional students. The authors show that for many of these students, there is a level of borrowing at which increasing the loan balance has no impact on the total repayment amount under PAYE because of the program's loan forgiveness benefit. Using data from existing loans, they estimate that the majority of graduate and professional student borrowers will borrow more than the "no marginal cost threshold" and, as a result, that PAYE effectively functions as an expensive form of tuition subsidy.

### Postscript

The conference exceeded expectations, and the invited papers constitute the most current research and knowledge about student loans and repayment. The volume with the conference proceedings to be published this year will serve as a valuable reference for researchers and policymakers who seek a deeper understanding of how, why, and which students borrow for their postsecondary education; how this borrowing may affect later decisions; and what measures can help borrowers repay their loans successfully.

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➔ To access the conference schedule with links to the papers and presentations, visit <http://www.upjohn.org/stuloanconf/schedule>.