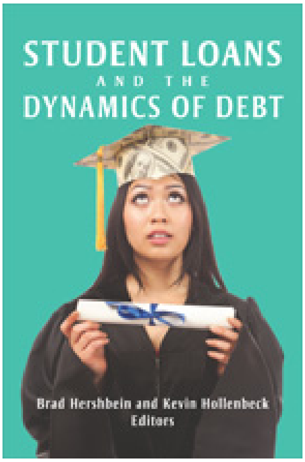
Introduction



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Introduction

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Student loans are instrumental in broadening access to postsecondary educational opportunities. For many individuals who want to develop their own human capital but who otherwise do not have the means, loans serve as an important supplement to governmental or institutional grants in making educational investments affordable and increasing the educational attainment of the population. 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 created a vigorous debate on whether public policy should further intervene in student loan transactions. In economic terms, do the benefits exceed the costs? As with many public policy issues, answering that question is not straightforward. Close examination of the data on cumulative debt, number and characteristics of borrowers, types of institutions, and repayment dynamics raises almost as many questions as it answers. 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. This volume includes the papers that were presented at the conference, held in Ann Arbor at the University of Michigan in October 2013.[1] The Spencer Foundation and the Education Policy Initiative at the University of Michigan Ford School of Public Policy cosponsored the event.

THE CONFERENCE BEGINS: MEASURING DEBT BURDENS

Much publicity has focused 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 chapter brings attention to several of them. She starts 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.

Further, student borrowers may be pursuing undergraduate or graduate education. Baum documents that both the levels and growth trends in per-student loans are much greater for graduate students than for undergraduates. She suggests that if public policy is to address loan availability or terms for students, it must certainly treat these two types of students differently. Finally, Baum compares nonfederal with federal loans. Both the volume and percentage of students taking out private loans have essentially halved since their peak in the 2007–2008 academic year.

Baum concludes by suggesting that the most pressing public policy concern is for students who may have unmanageable debt levels—in her analyses, these tend to be independent students, students attending for-profit institutions, and African American students—and to institute income-dependent repayment programs that shift risk from students to taxpayers.

Meta Brown, Donghoon Lee, and colleagues at the Federal Reserve Bank of New York document in Chapter 3 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. Commensurate with that finding, they note that the fraction of individuals with education debt and the average balance per borrower both grew unabated between 2004 and 2012. 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 Lee at al. examine repayment, they find that as of the end of 2012, 17 percent of borrowers are behind on their student loan payments by 90 or more days, surpassing credit card debt in the highest delinquency rate. The situation is even more dire for borrowers who are in active repayment (and not in deferment or forbearance): 31 percent of these borrowers are delinquent by 90 or more days. The rise in student debt and difficulty in repayment may have crowded out access to other forms of credit, the authors surmise, documenting that other debt—especially mortgages—fell sharply from 2005 to 2012 for young student loan borrowers.

REASONS FOR GROWTH

Undeniably, student debt—however you measure it—has been increasing over the past two decades, but it has not been growing at the same rate for all students, or even all graduates. Brad Hershbein and Kevin Hollenbeck in Chapter 4 address the questions of where in the entire distribution of college graduates has debt grown, when was it growing, and what factors, if any, can explain it. Using data from the National Postsecondary Student Aid Study for individuals who earned bachelor's degrees, they 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. They also find that the increase that did occur between 2000 and 2008 was mostly concentrated in the top fourth of borrowers and was entirely due to private loans.

Using statistical decomposition techniques, the authors find 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 in the 2000s. The surge in borrowing in the late 1990s, however, is not explained by costs or other observable factors. Instead, the chapter suggests that this growth was due to the introduction of new loan products, particularly unsubsidized Stafford Loans and private loans.

Chapter 5 by Elizabeth Akers, Matthew M. Chingos, and Alice M. Henriques also attempts to explain the surge in student debt over the last 20 years and looks at distributional changes. However, their analyses rely on the Federal Reserve Board of Governors' Survey of Consumer Finances (SCF) and cover the entire American population, not just recent bachelor's graduates. Akers, Chingos, and Henriques reach general conclusions that extremely large debt burdens are exceptional cases, and that rising educational attainment—in particular, graduate education—explains part of the increase in aggregate debt balances. They also find that tuition increases are perhaps the largest explanatory factor for increased debt, but that changes in behavior, such as greater substitution of debt for out-of-pocket financing of postsecondary expenses, also have contributed to the increase.

Akers, Chingos, and Henriques also review a number of recent studies on the return to higher education and note that the extent to which the increase in debt burdens is leading to financial hardship is an unresolved question.

STUDENT BORROWING AT FOR-PROFIT INSTITUTIONS

As noted by Baum in Chapter 2, one of the groups of students most likely to have unmanageable debt consists of individuals who attended for-profit institutions. Stephanie Riegg Cellini and Rajeev Darolia focus on these students in Chapter 6. Their analyses suggest that relatively high and rising tuition coupled with relatively low student financial resources are likely to be the key factors that explain the elevated debt levels of for-profit students relative to students in other higher education sectors. Costs and borrowing patterns in the for-profit sector are similar to those found in four-year nonprofit institutions; however, unlike the nonprofit sector, tuition hikes were not offset by increases in institutional grants.

Cellini and Darolia pose an interesting question: What motivates students to attend for-profit institutions? For the most part, characteristics and educational aspirations of students attending for-profits are similar to those for students attending two-year, nonprofit (public or private) institutions and who have relatively low levels of debt. Yet the financial burdens and loans that the for-profit students bear are most similar to those for students in four-year, nonprofit institutions.

IMPACT OF BANKRUPTCY NONDISCHARGEABILITY

A unique feature of student loans is their presumptive nondischargeability in bankruptcy. For many years, this feature was limited to government or nonprofit-originated loans. Xiaoling Ang and Dalié Jiménez in Chapter 7 look at the impact of congressional legislation in 2005 that amended bankruptcy laws to make private student loans nondischargeable as well. (Unlike federal student loans, private loans take into account the credit risk of the potential borrower.) The authors suggest that this change in the law has three theoretical implications. It should have, other things equal, 1) increased the volume of private student loans; 2) increased the "riskiness" of the borrowers (i.e., decreased their average credit score); and 3) decreased the interest rate charged to borrowers.

In fact, the analyses by Ang and Jiménez indicate a very large increase in the volume of private loans originated after 2005, which they attribute primarily to the law change. The credit score of borrowers skewed toward the lower end of the distribution, although the mean did not change appreciably. Finally, the average interest rate of private loans at four-year undergraduate institutions increased by 35 basis points. The first two findings confirm the theoretical hypotheses; however, the third finding is opposite of what was expected. While this result received ample discussion at the conference, it remained a puzzle.

DEFAULT AND REPAYMENT BEHAVIOR

Chapter 8 by Lance J. Lochner and Alexander Monge-Naranjo examines default and repayment behavior over the 10 years following graduation for individuals who earned a bachelor's degree. These 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. In particular, they analyze five outcomes: 1) the fraction of undergraduate debt still outstanding; 2) default; 3) nonpayment (default, deferment, or forbearance); 4) fraction of debt in default; and 5) fraction of debt in nonpayment. They relate these outcomes, at both 5 and 10 years after graduation, to individual and family background, college major, postsecondary institution characteristics, amount borrowed, and postschool earnings. Of these variables, they find the most important ones explaining repayment outcomes are the amount borrowed and postschool earnings. Perhaps surprisingly, college major and institutional characteristics are not correlated with repayment behavior once the other factors are accounted for, and among the individual and family characteristics, the only variable that consistently matters is race. As with Baum's chapter, Lochner and Monge-Naranjo's study reveals that African Americans have significant repayment difficulties relative to all other ethnic/racial groups, even after controlling for many other variables.

A somewhat surprising finding in Chapter 8 is that many borrowers who enter a nonpayment status eventually return to good standing. Over half of the individuals in default five years after graduation are in "repaying/fully paid" status five years later; and almost three-quarters of individuals in deferment or forbearance five years after graduation are in good standing five years later. The authors conclude that policy strategies that focus exclusively on short-term default, without considering rehabilitation, may be too narrow.

LONG-TERM OUTCOMES

In addition to causing difficulty for repayment, increased student loan burdens may affect other life-cycle behaviors of young adults as they enter careers or family formation. In Chapter 9, Dora Gicheva and Jeffrey Thompson look at long-term household financial stability. Isolating the causal impact of student loans on future behavior is problematic because the same set of factors that influence student loan behavior may also influence the type of education pursued, academic success, and later earnings. The authors employ an instrumental variable strategy to get around this problem. In particular, they use the national average amount borrowed per full-time equivalent student when an individual was 17 years old to predict that individual's borrowing amount.[2]

Gicheva and Thompson look at four indicators of financial stability after age 30: 1) being denied any type of credit, 2) late payments on loans, 3) bankruptcy, and 4) homeownership. In analyses that control for several demographic characteristics and local economic conditions, the authors find that borrowing amounts are positively related to bankruptcy and negatively related to homeownership and making on-time payments, with especially strong results for individuals who failed to complete college.

LOAN AVERSION

Public perception and the data agree: more and more students are taking on more and more debt. In an interesting twist of emphasis, however, Sara Goldrick-Rab and Robert Kelchen examine loan aversion in Chapter 10. They begin by noting that aversion may include individuals who have a distaste for borrowing, but it also may include students who lack information about loans or students who were not offered loan opportunities in their financial aid packages. In looking at data from a sample of more than 600 first-time undergraduates at Wisconsin public institutions who received a Pell Grant and from which the actual loan package offered was observable, the authors note several findings that accord with intuition and prior evidence, but they also point out several results that may seem surprising.

In particular, Goldrick-Rab and Kelchen find that the following characteristics are associated with greater propensity to turn down an offered loan: Southeast Asian ethnicity, greater parental education, lower net prices and less institutional prestige, family background with less financial strength, longer time horizons of the student, planning to work part-time while in college, and higher levels of social capital. They also document differences in loan aversion rates between survey data (student responses) and administrative data (college records), and these differences also vary across subgroups of students.

Goldrick-Rab and Kelchen's analysis further finds a lack of correlation between financial knowledge and borrowing behavior. While this may suggest that increased financial education of students, as some researchers and policymakers have proposed, may not substantively change students' borrowing behavior, the authors caution that their sample of low-income, Pell Grant recipients may not generalize to all undergraduate students.

THE CONFERENCE CONCLUDES: SPECIFIC POLICY RECOMMENDATIONS

Three chapters in the book have specific policy prescriptions, all touching on the issue of how to improve loan repayment. In Chapter 11, Lauren Asher and Debbie Cochrane, along with their coauthors at The Institute for College Access and Success (TICAS), 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.

In terms of repayment, the authors present a "Plan for Fair Loan Payments" for all federal borrowers that calls for affordable payments based on income, family size, and total federal debt, and that offers forgiveness after 20 years of payments. They recommend rigorous loan counseling before students commit to borrowing, not just at entrance and exit. Finally, the authors have a number of suggestions in the area of consumer protection, particularly in the area of collections.

Susan Dynarski and Daniel Kreisman also present a specific plan for an income-based repayment system, which they label "Loans for Educational Opportunity." (Chapter 12 contains an abbreviated version of their paper, which was originally commissioned by The Hamilton Project. See Note 1.) They document four facts about student loans and future earnings: 1) a moderate level of debt for the typical student borrower, 2) a high payoff to a college education, 3) high rates of default on typical loans, and 4) higher rates of default among young borrowers. They argue that in light of these four facts there is not a *debt* crisis, but rather a *repayment* crisis.

Under their Loans for Educational Opportunity proposal, payments would be automatically deducted from borrowers' paychecks, similar to the payroll tax for Social Security. 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. Dynarski and Kreisman suggest that this system will reduce the administrative costs of the current student loan system. The chapter also addresses how their proposed system would work for self-employed individuals or those who become unemployed.

In Chapter 13, Jason Delisle, Alex Holt, and Kristin Blagg examine how a loophole in the federal government's Pay As You Earn (PAYE) program for student loans can 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 amount of total repayments under PAYE because of the program's loan forgiveness benefit; the authors call this borrowing level the "no marginal cost threshold." If a borrower could predict this threshold with certainty, then she would have an incentive to increase the size of her loan because doing so would essentially be costless.

Using data from the National Postsecondary Student Aid Study and the American Community Survey, Delisle and his coauthors estimate that the majority of graduate and professional student borrowers will borrow more than the no marginal cost threshold. This suggests that PAYE effectively functions as a form of tuition subsidy. The most significant levels of subsidization occur in conjunction with the Public Service Loan Forgiveness program, in which loans are forgiven after only 10 years of payments if the borrower qualifies under a public service job. As a remedy for the unintended level of subsidy, the authors propose that the period of repayment before forgiveness be lengthened or that the amount that can be forgiven be capped.

CONCLUSION

The conference exceeded expectations. The papers presented there and included in this volume represent the most current research and knowledge about student loans and repayment. The conference agenda included comments from discussants and general discussion after each of the papers was presented. We thought that the discussants' comments and the general discussion added great value to the papers. We thank the discussants, who are listed at the end of this volume, for their thoughtful insights. We hope this volume serves 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.

We also thank our cosponsors, the Spencer Foundation and the Education Policy Initiative at the Ford School of Public Policy. The opportunity to convene a community of scholars has furthered our collective insights of the behaviors of students who are attempting to finance their investments in higher education.

Notes

1. Chapter 12 has an abbreviated version of the Dynarski and Kreisman paper, which was originally commissioned by The Hamilton Project. The full paper may be accessed from http://www.hamiltonproject.org/files/downloads_and_links/THP_DynarskiDiscPaper_Final.pdf.
2. As might be expected at a conference with a number of economists participating, much discussion took place around the validity of this instrument.

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