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Statement of

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before the

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Improving Federal Student Aid to Better Meet the Needs of Students

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Chairman Guthrie, Ranking Member Davis, and members of the committee, thank you for the opportunity to testify today about our nation's federal student aid programs. I appreciate the committee's interest in these important programs.

I am an education policy researcher at the Urban Institute here in Washington, DC, and the coauthor of two books on higher education: *Game of Loans: The Rhetoric and Reality of Student Debt* and *Crossing the Finish Line: Completing College at America's Public Universities.* My publisher has provided copies of *Game of Loans* as background information for the committee members. The views expressed in this testimony are my own, not those of any organization with which I am affiliated, its trustees, or its funders.

The student loan crisis you have read about in the news is largely a distraction from the real problems facing student borrowers and taxpayers. The poster child for the crisis narrative is an unemployed college graduate, usually with a graduate degree as well, who is struggling to find a well-paying job and is living in his parents' basement. But, in reality, most undergraduates borrow less than $40,000, and the average economic return to a college degree is as high as it has ever been, despite the well-documented rise in tuition prices.[1] The borrowers most likely to struggle are those who never complete a degree, many of whom have relatively small amounts of debt.

There is No Broad-Based Student Lending Crisis

Student borrowing *has* increased dramatically, with total outstanding debt rising from about $300 million in 2003 to more than $1.3 trillion today.[2] This increase, which continues a trend that began in the early 1990s, partly reflects that more Americans are going to college and completing more degrees. My research with Beth Akers estimates that rising college attendance and degree attainment explain about 30 percent of the increase in borrowing since 1989.[3]

Three federal and state policy changes have also contributed to the increase in student debt:

1) Federal loans are available on an essentially unlimited basis (up to total cost of attendance, including living costs) to graduate students. Indeed, graduate students took out 34 percent of federal student loans in 2013–14, despite making up only 14 percent of US students.[4]

2) The 1992 reauthorization of the Higher Education Act made federal loans available to all students, rather than limiting them to students with demonstrated financial need. This policy change was followed more or less immediately by a rapid acceleration in the amount borrowed per student.

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[1] Beth Akers and Matthew M. Chingos, *Game of Loans: The Rhetoric and Reality of Student Debt* (Princeton, NJ: Princeton University Press, 2016) pp. 68–75.
[2] *Game of Loans*, p. 2; *Quarterly Report on Household Debt and Credit* (New York: Federal Reserve Bank of New York, February 2017).
[3] *Game of Loans*, p. 44.
[4] *Game of Loans*, p. 16.

3) State governments have decreased their support of public colleges (on a per-student basis), leading to rising tuition. As a result, students are now paying for part of their educational expenses that state taxpayers used to cover.[5]

Despite large increases in student borrowing, the available evidence suggests that the typical student borrower today is in a stronger financial position than she was a generation ago. Between 1992 and 2013, the average household with education debt saw an increase of $23,000 in debt and $7,000 in annual wage income. At first glance, that larger increase in debt than in income appears to indicate that the average household is worse off. But the debt is incurred once, and income is received every year. So the increase in debt can be paid off with just a few years of the higher incomes that households with debt now receive.[6]

A larger debt load could squeeze borrowers in the short run if monthly payments are unaffordable. But this does not appear to have occurred: most US households with education debt pay 4 percent or less of their income each month toward student loans, a statistic that has changed little since the early 1990s.[7]

The Real Student Loan Crises

The fact that the typical borrower is in a reasonably strong financial position does not mean that all is well with student lending in the United States. In fact, we have five crises in student lending that are too often overshadowed by the exaggerated media narrative discussed earlier.

First, we have **a completion crisis**. Only 59 percent of students who start at four-year public colleges earn a bachelor's degree from any institution within six years (the corresponding figure for private, nonprofit colleges is 72 percent). Among students who start at community colleges, only 39 percent earn any degree from any institution within six years.[8] Students who complete degrees receive far more economic return to college attendance than those who do not.[9]

Second, we have **a default crisis.** Every year, more than 600,000 borrowers default on their student loans within three years of starting to repay them.[10] This likely hurts their credit and ability to borrow in the future. But the millions of borrowers in default tend to be those with the

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[5] *Game of Loans*, pp. 58–59.
[6] *Game of Loans*, pp. 77–78.
[7] *Game of Loans*, pp. 79–80.
[8] *Completing College: A National View of Student Attainment Rates – Fall 2010 Cohort* (Herndon, VA: National Student Clearinghouse, 2016), figure 12.
[9] Thomas Hungerford and Gary Solon, "Sheepskin Effects in the Returns to Education," *Review of Economics and Statistics* 69 (1987): 175–77.
[10] Michael Stratford, "Default Rates Drop," Inside Higher Ed, October 1, 2015, https://www.insidehighered.com/news/2015/10/01/student-loan-defaults-drop-obama-admin-again-tweaks-rates.

least debt, not the most.[11] That's because large balances often come with degrees that enable high incomes. Borrowers who do not graduate, and therefore are less likely to earn more money after attending college, are more than twice as likely to default on their loans as graduates.[12]

Third, we have **a repayment crisis**. Borrowers could avoid defaulting on their loans by enrolling in income-driven repayment. But too few do, because they do not know about these programs or find them too hard to understand or navigate. Well-intentioned efforts to expand access to income-driven repayment have created a panoply of programs: old income-based repayment (IBR), new IBR, pay as you earn, and revised pay as you earn, just to name four.[13]

Fourth, we have **an information crisis** that plagues both repayment and borrowing decisions. Most students don't know what they're getting into, or even how much they're borrowing. In a 2012 federal survey, only a quarter of first-year students could accurately report (within 10 percent) how much they had borrowed. Twenty-eight percent of students with federal loans said they had no federal loans, and 14 percent said they had no debt at all.[14]

Finally, policymakers and taxpayers may soon face **a cost crisis** in the student loan system. In particular, loan forgiveness programs may have larger costs than policymakers expected and budget agencies projected.[15] This concern is amplified by a recent Government Accountability Office report that raises serious concerns about the accuracy of cost estimates made by the US Department of Education.[16] It is impossible for Congress to make responsible policy choices without accurate data from the Department of Education.

Addressing the Real Problems

The prevailing media narrative of a broad-based student loan crisis is problematic because it leads to the wrong policy solutions by focusing on all borrowers—and especially borrowers with the most debt—rather than on those who most need the help. For example, proposals to reduce interest rates on all or most outstanding loans (often called "refinancing") would substantially benefit affluent households because the highest-income 20 percent of households hold 44

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[11] Meta Brown, Andrew Haughwout, Donghoon Lee, Joelle Scally, and Wilbert van der Klaauw, "Looking at Student Loan Defaults through a Larger Window," Liberty Street Economics, Federal Reserve Bank of New York, February 19, 2015, http://libertystreeteconomics.newyorkfed.org/2015/02/looking_at_student_loan_defaults_through_a_larger_window.html.

[12] "Two-Year Student Loan Default Rates by Repayment Cohort and Degree Completion Status, 1995–96 to 2011–12," *Trends in Student Aid*, College Board, https://trends.collegeboard.org/student-aid/figures-tables/two-year-student-loan-default-rates-degree-completion-status-over-time.

[13] *Game of Loans*, p. 118.

[14] Elizabeth J. Akers and Matthew M. Chingos, *Are College Students Borrowing Blindly?* (Washington, DC: Brookings Institution, 2014).

[15] Jason Delisle, "The coming Public Service Loan Forgiveness bonanza," Evidence Speaks Reports 2, no. 2 (Washington, DC: Brookings Institution, 2016).

[16] "Federal Student Loans: Education Needs to Improve Its Income-Driven Repayment Plan Budget Estimates," GAO-17-22 (Washington, DC: US Government Accountability Office, 2016).

percent of debt. At the same time, a borrower struggling to make a $50 payment will likely also struggle to make a $44 payment.

Perhaps even more wasteful are efforts to amend the tax code to provide additional preferential treatment for student loans, as in a recent bipartisan proposal to allow employers to provide tax-free student loan assistance. Because of the structure of the tax system and the nature of student borrowing, this move would provide a regressive handout to the wealthiest borrowers and do nothing to help those who are struggling to repay their loans.[17]

Instead, Congress should consolidate and simplify the federal student aid programs and make the best use of limited taxpayer dollars to help students attend and complete college. The current programs, which resulted from well-intentioned policy changes over many years, need to be streamlined and returned to their core missions: grants to needy students and loans that enable students to invest in their future success.

One Grant, One Loan

First, there should be one federal grant program and one loan program.[18] Eligibility should be determined automatically using tax records, eliminating the need for an application form. For example, eligibility for Pell grants could be based on students' average family income between when they were 10 and 16 years old. This would enable grant dollars to be delivered to families based on a careful analysis of financial need while communicating eligibility early and clearly.

The single grant program should deliver all federal grant aid to college students. We now have strong evidence that the federal higher education tax credits are a waste of taxpayer money.[19] These tax credits, which total about $23 billion, should be eliminated and the funds used (at least in part) to expand the $33 billion Pell program. However, doing so is complicated by the fact that higher education tax credits are outside the jurisdiction of this committee.

The single federal loan program should be a student loan program, not a parent loan program. The Parent Loan for Undergraduate Students (PLUS) program should be eliminated, as creditworthy parents can obtain consumer credit in the private sector. Policymakers seeking to expand access to credit for dependent undergraduate students should increase the loan limits for these students rather than continuing to make their parents choose between taking on debt they are going to struggle to repay and telling their children to look elsewhere for college.

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[17] Matthew M. Chingos, "Don't let student borrowers off tax free," *Urban Wire* (blog), Urban Institute, March 3, 2017, http://www.urban.org/urban-wire/dont-let-student-borrowers-tax-free.
[18] There are good reasons to divide the Pell program into two components, one aimed at young people (e.g., through age 24) and another for older adults who return to school (see Sandy Baum et al., "Rethinking Pell Grants," New York: College Board, 2013).
[19] George B. Bulman and Caroline M. Hoxby, "The Returns to the Federal Tax Credits for Higher Education," Working Paper 20833 (Cambridge, MA: NBER, 2015).

The federal loan program should focus on undergraduate students and rein in excessive federal borrowing by graduate students. The grad PLUS program should be limited or eliminated. Graduate students attending programs with a return that justifies the cost will be able to obtain funding in the private market, while low-return programs will no longer be able to operate at taxpayer expense. Policymakers seeking to support programs with low economic returns but high social returns (e.g., social work) should subsidize those programs directly, such as through targeted grant programs.

All federal higher education subsidies should be delivered through the Pell grant program. This means that taxpayers should not pay interest on loans while students are in school, as they currently do on subsidized loans, and instead use those subsidies to provide up-front grants that directly reduce the prices students pay (e.g., by reinstating year-round Pell). It also means that the loan program should break even fiscally—and not make profits off students or entail significant costs for taxpayers.[20]

One Automatic Income-Driven Repayment Program

There should be one income-driven repayment program, which allows borrowers to make loan payments as a percentage of their income through the tax-withholding system. Borrowers could automatically be placed in this program upon leaving college (unless they choose to pay off their loans more quickly), thus significantly reducing defaults and limiting the need for loan servicing.[21] Income-driven repayment must tie the percentage of income paid toward loans to the amount borrowed, so students remain sensitive to the prices charged by institutions and to the amounts they borrow.[22]

As with the student loan program, the repayment program should not be used to deliver subsidies to broad groups of borrowers. Instead, it should be used to insure borrowers against the risk that they will be unable to repay their loans. Forgiveness should only be provided as a last resort (e.g., after 25–30 years), if at all, and the Public Service Loan Forgiveness (PSLF) program should be eliminated. Policymakers seeking to subsidize employment in certain sectors should do so directly, such as through targeted grant programs, rather than through loan forgiveness.

Eliminating PSLF and reducing the generosity of other forgiveness provisions for future borrowers is not only a matter of ensuring that subsidies are delivered fairly. It is also critical to the fiscal sustainability of the student loan programs. PSLF, in particular, is likely to be far more costly for

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[20] Breaking even is difficult to accomplish in practice owing to uncertainty about future borrowers' repayment behavior. For more on this subject, including the debate over accounting methods, see Matthew M. Chingos, "End government profits on student loans: Shift risk and lower interest rates" (Washington, DC: Brookings Institution, 2015); and Donald B. Marron, "The $300 Billion Question: How Should We Budget for Federal Lending Programs?" (Washington, DC: Urban Institute, 2014).

[21] Susan Dynarski and Daniel Kreisman, "Loans for Educational Opportunity: Making Borrowing Work for Today's Students" Hamilton Project Working Paper 2013-05 (Washington, DC: Brookings Institution, 2013).

[22] Matthew M. Chingos, "Jeb Bush's student loan plan should outlive his campaign," Evidence Speaks Reports 1, no. 10 (Washington, DC: Brookings Institution, 2016).

taxpayers than previously anticipated, in part because roughly 25 percent of the workforce is employed in a PSLF-eligible job.[23]

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Student debt is not inherently good or bad. It enables students to make investments in their futures, but those investments do not always pay off. The key challenge facing policymakers is to reduce bad investments and the harm they cause while resisting political pressure to further subsidize students and parents who enjoy taxpayer subsidies but do not need them.

The upcoming reauthorization of the Higher Education Act provides an important opportunity for Congress to ensure that the federal student aid programs do less harm and more good for both students and taxpayers. I hope my testimony will contribute to that important effort. Thank you for the opportunity to testify today. I look forward to answering any questions.

[23] Jason Delisle, "The coming Public Service Loan Forgiveness bonanza."