

Wellesley Goldman Economics Lecture¹

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October 16, 2019

Thank you for that kind introduction. It's really good to be here. As you already know, I'll be talking today about student loans—a topic I worked on while in the policy world.

But before I get to student loans, I wanted to share a little about my background and, in particular, how I came to be the Assistant Secretary for Economic Policy at the Treasury Department. Over the years, many Wellesley graduates have served in important public service roles—including one of my predecessors as Assistant Secretary, Alicia Munnell, as well as several special assistants in the Office of Economic Policy. I hope that Wellesley grads will continue to take on important public service roles so I thought it would be useful, particularly for the students here today, to share the path that I took.

I'll start with substantive themes in my career as an economist.

First, I have spent a lot of time studying households, as there are important issues around how they behave and why they behave that way. I have long been interested in questions such as: How do people make decisions about spending and saving. How do they get through hard times? Why do some people take on too much debt? Why do some people not save enough for retirement? And what obstacles do people face when it comes to investing in human capital?

Another important substantive theme during my career has been macroeconomics. In fact, my formal training is in macro. My students, particularly those who want to really help people, sometimes ask me why I chose macroeconomics. They wonder about this, I think, because it can seem like studying the dynamics of the system as a whole and thinking about abstract concepts like “the neutral rate of interest” and “potential GDP” isn't that closely related to helping people.

My answer is that I have never seen macro as removed from the day-to-day struggles of people. Research has documented that the human costs of an economic downturn are enormous. People lose jobs and their livelihoods. The groups most likely to become unemployed are already the most vulnerable.² The people who get laid off in bad downturns or, say, college students who graduate into a weak labor markets, can feel scars that last for years or decades.³ The children of people who lose their jobs perform worse in school, and there is even some evidence that these children have reduced earnings as adults.⁴

And I remember being particularly blown away in my first macro class when I learned that macro policymakers had these powerful tools that, when used right, could reduce the severity and length of downturns, speed economic recoveries, and maybe allow us to avoid recessions

¹ Thanks to my many former Treasury and White House colleagues who taught me so much about problems in this area, including Sandy Black, Tiffany Chou, Jordan Matsudaira, Tara Watson, Wes Yin, and especially Adam Looney. Thanks also to Kayla Jones for excellent research assistance.

² See [Hoynes, Miller, and Schaller](#) (2012).

³ See [David and von Wachter](#) (2011) and [Kahn](#) (2010).

⁴ See [Stevens and Schaller](#) (2011) and [Oreopoulos, Page, and Stevens](#) (2008).

altogether. So if you care about people, you should care about understanding how the macroeconomy works and how to use macroeconomic policy effectively.

Moving on to my career progression, my first job as an economist was at our nation's central bank, the [Federal Reserve Board](#), in Washington, DC.

It was a *great* first job as an economist. The questions couldn't have been more relevant to the real world. In my early years there, I was in the group that essentially monitored the pulse of the economy on a day-to-day basis. Later I joined the group that studies housing and mortgage issues, which put me right in the trenches as the Fed battled the financial crisis.

The Fed was also a truly technocratic place, and I mean that in the best possible sense. It was at the Fed that I realized that you could be a *policy person* without being a *political person*. Our job as economists *was simply to get the right answer*—and I think this is true of most federal government jobs for economists. I worked alongside many colleagues for years without even knowing their political persuasion.

I left the Fed in 2009 to join the [Brookings Institution](#), a think tank in Washington DC.

And I suddenly found myself in a much more outward facing job. I was no longer behind the scenes assisting the leadership of the Fed but rather selling my own policy ideas. It was at Brookings where I learned how to talk to the press. It was also there where I came to recognize how to talk to people in the real world—from business leaders, to consumer advocates, the general public. I'm not saying we shouldn't be relying on research to guide policy, but these conversations gave me insights about what going on with actual people and businesses that one simply cannot get by sitting down at the computer and opening up a data set.

In summer of 2013, [I was nominated by President Obama to be Assistant Secretary for Economic Policy at the US Treasury Department](#) and the Senate voted to confirm me 10 months later.

It was a true honor to serve [at Treasury](#)—and I loved the job. This is a picture of the US Treasury building, and, if you look closely, Alexander Hamilton statue that is in front of the building. I believe there was no cooler time to be a Treasury official than when the musical *Hamilton* (about [our first Treasury secretary](#)) exploded on to the scene.

It was also pretty amazing to have the responsibility of briefing the Treasury Secretary every morning about what had happened in the US economy over the past 24 hours.

At Treasury, I got to work on some of my favorite issues in the household area—such as getting people to save more—and macroeconomic issues—like the forecasting the economy for budget process. And, I also got to work on a huge range of other interesting and pressing topics—from worker protections to the crisis in Puerto Rico to affordable housing.

And, importantly, it was at Treasury that I gained a full appreciation of just how important economists are to the policy-making process. Policy development and refinement occurs in meetings that bring together people from all over the executive branch. Economists almost never

dominated the meetings in terms of numbers because there were so many other types of people who needed to be there—from the lawyers, to the public relations people, to the budget people, to the Congressional liaisons. That said, economists often dominated the meetings in terms of the substantive discussion because we were the people who understood the results from literature, how use the data, how weigh the trade-offs. In truth, I cannot say that the economists always prevailed with our recommendations, but I can say that, in my experience, nobody in the Administration wanted to make the decisions without understanding these things.

And it was in the policymaking process, where I learned so much about student loans and I became passionate about getting policy right in this area. That’s what I will be covering in the rest of this talk. In particular, I am going to focus on the federal student loan program which accounts for almost all of the new student lending in this country. I will organize my talk around 5 broad points.

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Point 1—it *is* desirable to have a federal student loan program.

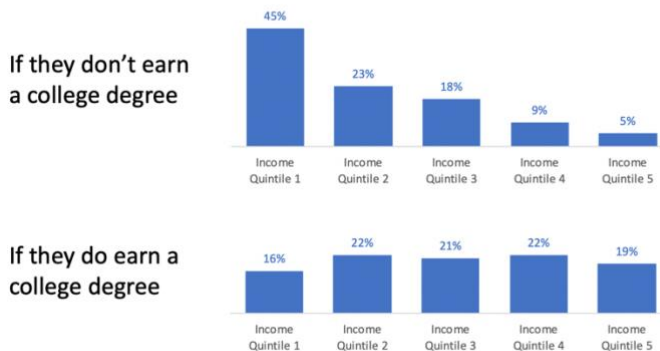
I will start by saying that I am going to take it for granted that we are not going to nationalize the higher education system any time soon—nor is the government going to pay for everyone’s education. It is reasonable to want to have a conversation about these ideas, and I will come back with a few broader points later, but these topics are outside the scope of what I am going to talk about today.

To paraphrase something that President Obama once said—it’s bad enough that so many children are born into poverty but it’s truly distressing that so many children struggle to escape that poverty. Low economic mobility is a pressing problem in this country.

There are lots of things that we should be doing to promote economic mobility, and making it easier for people to attend college is one of them.

Here’s a simple way to make the point—consider where children born into the lowest income quintile land in the income distribution as adults. If they don’t earn a college degree, the odds are almost even that they’ll stay at the bottom and very slim that they’ll get to the top. If the student does get a college degree, the odds of getting to one of those two quintiles are 41 percent.⁵

Where children born into the lowest income quintile “land” as adults



Source: [Haskins](#) (2008)

⁵ Data are from [Haskins](#) (2008).

For most people the gains to attending college are large even accounting for the cost of a college education. Adam Looney and Michael Greenstone calculated that the average college graduate earns close to \$600,000 more than her counterpart that stops with high school—which works out to be a sizable return relative to the average upfront investment of around \$100,000.⁶

And we can see the benefits from a college education in other ways as well. For example, the unemployment rates of college-educated people are generally lower and they tend to rise far less in recession than those of people with less education.

If there was no federal student loan program and people had to rely exclusively on the private loan market, it would be prohibitively expensive or impossible for some people to fully fund their college educations.

The way that private loan markets work is that in order to compensate for risk, borrowers with low incomes and limited credit histories tend face much higher interest rates, especially when the loan has no concrete collateral behind it like a home or a car. Or one might not be able to get a loan at all.

That’s why we have a federal program that charges low interest rates (less than 5 percent for undergraduates) and where access depends not on your own financial background or that of your family, but rather on whether you attend an accredited institution.

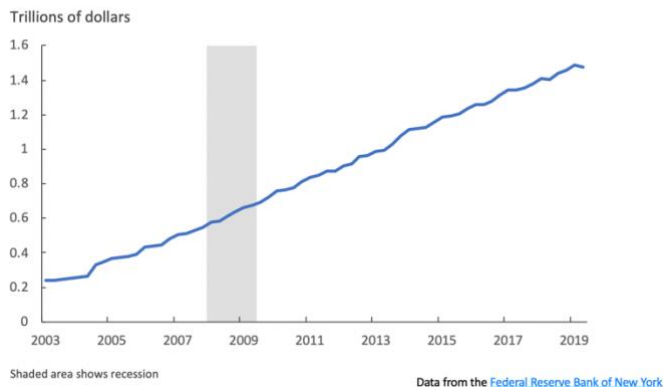
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Point 2—Too many student loan borrowers are struggling to pay their loans.

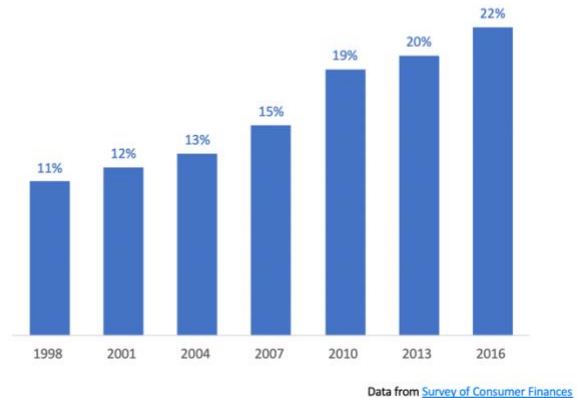
By way of background, as I’m sure you have heard, student outstanding debt has risen sharply in the last decade and a half—it has risen by more than six-fold since 2004.

Digging into more granular data, we know that the share of households *of all ages* with student debt has risen sharply—over the past two decades, it has about doubled to 22 percent.

Aggregate outstanding student debt has increased 6-fold since 2003



The share of households with student debt has risen sharply



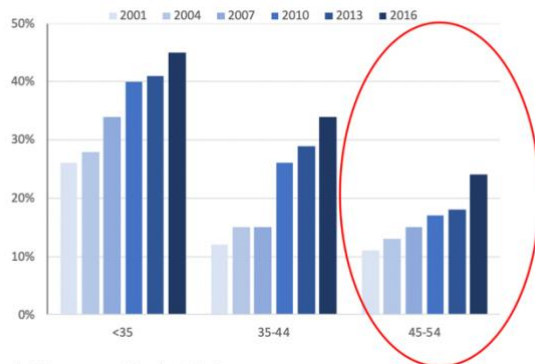
⁶ [Looney and Greenstone](#) (2011).

Data from the [Survey of Consumer Finances](#) also indicates that debt per borrower is up—the typical borrowing household in 2016 owed close to \$20,000, up from \$10,000 (adjusted for inflation) in 1998.

Once thing that I find particularly concerning is that we aren't just seeing higher debt among younger households, we are seeing it for people in their 40s and 50s. You can see in the graph at right that about a quarter of households in their late 40s and early 50s had student loans in 2016, up from just over 10 percent in 2001. I think most people in college now don't envision themselves still having to make payments decades at an age when they really should be doing a lot of retirement saving.⁷

I am also very concerned about the racial disparities. Judith Scott-Clayton and Jing Li looked at how people who graduated from college in 2008 were doing in terms of their debt four years later and found that black students were considerably more likely to take on student debt than other race groups and that they had more debt. I'm not sure we should be surprised because we know that there is a big wealth gap by race, which means that many of these students are coming from families that don't have the money to pay outright for college education. But, patterns like this should make us concerned that wealth gaps are reinforcing.

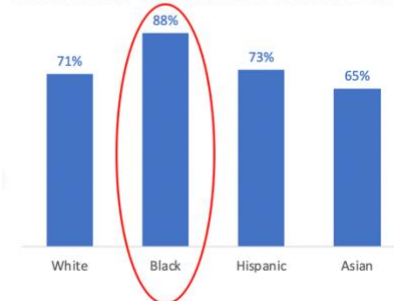
It's not just young households that have student debt



Share of households in age group with student debt; data from [Survey of Consumer Finances](#)

There are concerning racial disparities

2008 Grads with Student Debt in 2012



Average Debt for 2008 Grads (with Debt) in 2012

White	\$28,006
Black	\$52,726
Hispanic	\$29,949
Asian	\$26,253

Data from [Scott-Clayton and Li](#) (2016)

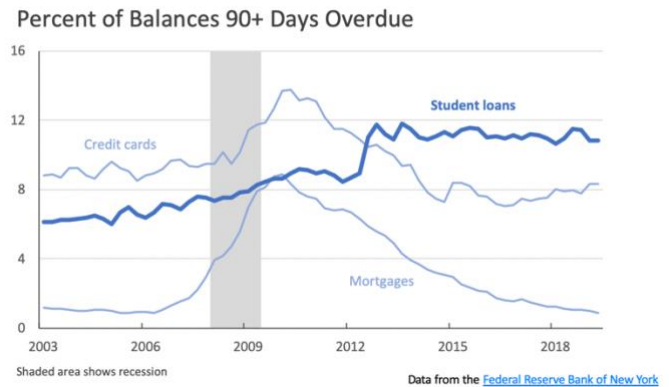
There is some research exploring how this debt affects people's lives but I think it will be many years before really understand the long-term consequences.⁸ But, I can tell you that there are patterns of data already hinting that young people are being held back by their student debt. [Homeownership among people in their late 20s and early 30s is much lower today for earlier cohorts.](#) Likewise, [the share of young adults living with their parents has risen markedly over the past two decades.](#) There are probably a number of factors driving this pattern, but greater student debt is very likely among them.

⁷ [Bricker, Volz, and Llanes](#) (2018) present results suggesting that about 2/3 of student debt held by households over the age of 40 was related to financing their own education (as opposed to their children's education).

⁸ For example, [Mezza, Ringo, Sherlund, and Sommer](#) (2016) explore the relationship between student loans and homeownership. In interpreting this research, it is important to understand that most studies explore how the situation might be different if households did not have student loans but still had the education they financed with these loans.

We also have direct evidence that many student borrowers are struggling to pay their loans. The statistic most frequently cited is the default rate. This chart shows the New York Fed version of that series, shown along with its mortgage and credit card counterparts for comparison purposes. You can see that defaults on student loans rose after the recession and have remained high—in contrast to the declines for other types of loans.

Defaults on student loans rose after the recession and have remained high

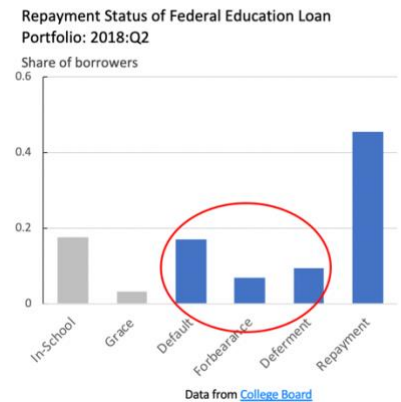


This pattern isn't so good, but what you need to understand is that just looking at the default rate vastly understates the struggles of borrowers. The key thing to recognize here is that borrowers facing hardship may be put into deferment or forbearance. Of student loans outstanding as of the middle of last year, 21 percent of borrowers were still in school or in the 6-month grace period that follows leaving school. If you sum up the borrowers that were in default, forbearance, or deferral, they represent 42 percent of the remaining group. So fewer than 60 percent of those who are supposed to be repaying are doing so.

Just looking at the default rate *vastly understates* the struggles

21% of borrowers are still in school or in their grace period (gray bars)

42% of the remaining borrowers (blue bars) are in default, forbearance, or deferment



Moreover, some of those who are repaying are only able to do so because they are in the [government's income-driven-repayment](#) (IDR) program. The IDR program allows people having trouble managing their full loan payments a given fraction of their income. About 30 percent of borrowers representing about 50 percent of balances are in IDR. It's good that these borrowers are avoiding the negative consequences of default. But they are extending their terms and paying more interest.⁹

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Point 3—The student loan program has some very specific problem areas

⁹ Data from [the College Board](#) (2018).

One problem area is for-profit colleges, which now account for around 7 percent of currently enrolled students, with the enrollment share having been as high as 11 percent earlier this decade.¹⁰

I certainly do not want to suggest that there is no good coming out of the for-profit sector—for-profits serve a more disadvantaged population, they are quicker to innovate, and they provide education and training in some fields that are not served by other types of higher education institutions.¹¹ But there are concerns about high tuitions (a year costs almost 5 times as much as for a community college education¹²), low value-added, and predatory practices at some institutions.

As a way of helping you understand how dramatically the role of for-profits within the student loan program has grown, consider this graphic from work by Adam Looney and Constantine Yannelis—a a list of the top 25 schools in terms of how many dollars of loans they accounted for, in 2000 (on the left) and 2014 (on the right).¹³ There are two things to notice. First, look at the increase in the amounts generally. The top school was associated with \$36 billion in 2014 versus \$2 billion in 2000. Second, notice the huge rise in for-profit representation on the list (compare the yellow in the two columns)

The Top 25 Colleges by How Much Student Debt (in 2014 \$\$) They Accounted For

2000		2014	
Rank	Total Debt (\$Billion)	Rank	Total Debt (\$Billion)
1	2.0	1	35.3
2	1.8	2	19.4
3	1.7	3	16.7
4	1.6	4	16.2
5	1.5	5	16.0
6	1.4	6	15.7
7	1.3	7	15.1
8	1.2	8	14.7
9	1.1	9	14.2
10	1.0	10	13.8
11	0.9	11	13.5
12	0.8	12	13.2
13	0.7	13	12.9
14	0.6	14	12.6
15	0.5	15	12.3
16	0.4	16	12.0
17	0.3	17	11.7
18	0.2	18	11.4
19	0.1	19	11.1
20	0.1	20	10.8
21	0.1	21	10.5
22	0.1	22	10.2
23	0.1	23	9.9
24	0.1	24	9.6
25	0.1	25	9.3

Screenshot from Looney and Yannelis, 2015

NOTICE:

The increase in amounts (top school associated with \$36B in 2014 vs \$2B in 2000)

The huge rise in for-profit representation (highlighted in yellow)

A growing literature formally documents the various problems associated with for-profits. There is not time to take you through it in detail, but there are hyper-links in the slides if you are interested. This literature finds that for-profit schools are associated with (1) more student debt,¹⁴ (2) much higher default rates on that debt,¹⁵ (3) slower repayment of student loans,¹⁶ (4) lower graduation rates,¹⁷ and (5) worse labor market outcomes, both in general¹⁸ and even after controlling for the more disadvantaged backgrounds of their students.¹⁹

Some problems are also emerging among high-balance borrowers.

¹⁰ Data from the [National Center for Education Statistics](#).

¹¹ See [Deming, Goldin, and Katz](#) (2012) for more discussion.

¹² See [Goolsbee, Hubbard, and Ganz](#) (2019).

¹³ Graphic from [Looney and Yannelis](#) (2015).

¹⁴ See [Looney and Yannelis](#) (2015).

¹⁵ See [Department of Education](#) (2019).

¹⁶ See [College Board](#) (2018).

¹⁷ See [National Center for Education Statistics](#) (2019).

¹⁸ See [Looney and Yannelis](#) (2015).

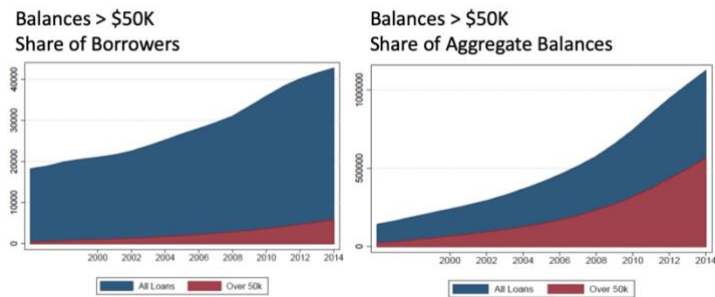
¹⁹ See [Cellini and Turner](#) (2018), [Armona, Chakrabarti, and Lovenheim](#) (2018), and [Cellini and Koedel](#) (2017).

To understand why problem are occurring, you first need a little background about how loan limits work in the federal student loan program. One portion of the program—the direct part—has limits that keep undergraduates in particular from taking on too much debt (with [dependent students currently capped at \\$31,000 and independent students capped at \\$58,000](#)).

Another portion of the program—the PLUS part—allows parents and graduate students to borrow more and has no traditional limits. PLUS loans are limited by “[the cost of attendance \(as determined by the school\)](#)”.

High-balance borrowers have been on the rise as you can see in these graphs. The share of borrowers with balances over \$50,000 (in 2014 dollars) rose from 5 percent to 14 percent between 2000 and 2014. And high-balance borrowers now account for more than half of the debt outstanding.²⁰

High-balance borrowers have been on the rise



In 2014 dollars; screenshot from [Looney and Yannelis \(2018\)](#)

Traditionally, most high-balance borrowers were funding degrees at professional schools (think doctors and lawyers). They earned good incomes and had low default rates. As a group, high balance borrowers still have low default rates (less than 5 percent in 2014). BUT, they account for a disproportionate share of defaulted dollars (close to 30 percent of dollars in 2014). Moreover, the repayments rates of high-balance borrowers are slowing, suggesting they are increasingly struggling. And the profile of high-balance borrowers is slowly changing, with greater shares accounted for by undergraduates, parents, for-profit students have risen.²¹ ([Almost a third of students](#) receiving bachelor degrees from for-profit colleges in 2016 owed more than \$50,000.)

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Point 4—Well-designed reforms to the federal student loan program could significantly improve outcomes.

There is a lot we should be doing, but I’m going to stick with reforms in three basic areas.

The first set of reforms involves the income-driven repayment program—that is, the program I discussed before that limits one’s monthly payment to a given fraction of income. Studies show the program is basically good—it does help people avoid default. It slows down progress toward repaying the loan, but the remaining balance gets forgiven after 20-25 years of reasonable payments.

²⁰ Data from [Looney and Yannelis \(2018\)](#).

²¹ Results are from [Looney and Yannelis \(2018\)](#).

The problem is that the program is administratively burdensome in ways that limit take-up by the people it is designed to help. One need to recertify one's information every year and because the information you are providing pertains to the previous year's income, it might not help when you really need it to, such as when you've just lost your job.

We should consider switching to a system where IDR is the default and it is done through payroll withholding, as they do it in the United Kingdom and Australia.²² Doing so would not be without trade-offs but it's something we should at least explore.

The second set of reforms involves the PLUS program. I think we should impose some explicit limits on the amount that can be borrowed through the program instead of having the limit being the cost of attendance as determined by the school. Presumably the limits on the "direct program" were put in place partly to protect unsophisticated borrowers from taking on too much debt and also partly to put some pressure on schools to contain costs. I do not see why that logic does not apply to the PLUS program.

We also need to *at least explore* the fact that the PLUS program is extending loans to parents, particularly minority parents, that have little or no ability to repay them. Rachel Fishman broke down Parent PLUS borrows by the "Effective Family Contribution" metric that is used by the college financial aid system.²³ This graph shows the results it's bad enough that 1 in 10 white parent borrowers have insufficient assets and income to make *any* family contribution to the cost of college, but 1 in 3 black parent borrowers are in this position.

Remember that parents aren't the ones who will gain a college degree that (in principle) should bring in more income. I don't know that there's an easy fix to this situation but it is certainly something that we should be thinking about.

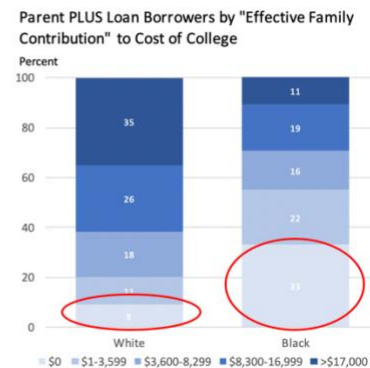
The third and most important set of reforms involves imposing more accountability on the higher education institutions that participate in the program. We do have some rules already that should put pressure on institutions to deliver value to their students. For example, a school risks losing its access to the program if student loan default rates for recent grads exceeds some threshold.

The Obama Administration took some steps to strengthen accountability further along these lines by putting in place [the "Gainful Employment" rule](#) which penalized programs if their grads had

Problem in Parent PLUS that needs to be explored

What to make of the program lending to parents that have little or no ability to repay?

(Especially minority parents!)



Data from [Fishman \(2018\)](#)

²² [Sue Dynarski](#) at the University of Michigan has written extensively about the advantages of a system like this.

²³ See [Fishman \(2018\)](#).

excessively high student loan burdens relative to the income they earn after leaving school. But the Trump Administration is now, unfortunately, [in the process of rescinding that rule](#).²⁴

Even if we weren't rescinding the Gainful Employment Rule, I would argue that we need to do more. We should be concerned about the potential to game rules where you are either in the program or not based on some exact threshold. Moreover, to use a phrase that came up often in the post-crisis financial regulation discussions, it's a real problem that higher education institutions have virtually no "skin in the game."

To address these problems, good proposals have been developed, including one that some of my former colleagues developed at Treasury, that call for something termed "risk-sharing."²⁵ The idea is to assess schools based on the progress that recent graduates have made repaying their loans. Schools for which borrowers collectively are not making good progress are subject to a continuum of penalties depending on just how badly they have performed.

Effectively, these policies would be requiring poor-performing schools to pay back some of the loans that have not been repaid. The proposals would protect taxpayers but, more importantly, they would incentivize schools to deliver more value—and we think there is a lot of scope for schools to do so by teaching better, matching students better with programs, encouraging graduation, and assisting with job placement.

I should also note that by looking at progress paying back their loans rather than simple default rates, you are catching the fact that many non-defaulters are also struggling, as evidenced by their being in deferral, forbearance, or income-driven repayment.

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Point 5—There may be trade-offs between making the federal student loan program safer and promoting access to higher education.

Here's what I mean. As discussed, we need to impose more accountability on higher education institutions to encourage them to change practices such that fewer student struggle to pay their student loans.

The problem is that the more you penalize schools for the poor loan performance of their former student, the more incentive schools have to avoid admitting riskier prospects. And, the riskiest prospects are likely to be the prospective students who come from the poorest and most disadvantaged families, so we are talking about the group for whom it is most important to break down obstacles to economic mobility.

Now, for people with financial regulatory backgrounds (like me), it's not a shocking point that when you take steps to make lending safer, you restrict some access. When new mortgage-related regulations were devised after the crisis, policymakers were essentially weighing the

²⁴ Sandy Black, Stephanie Cellini, David Deming, Sue Dynarski, Adam Looney, Jordan Matsudaira, and Jesse Rothstein provide a powerful defense of the rule in their [2018 comment](#) on the proposal to rescind the rule.

²⁵ See [Chou, Looney, and Watson](#), 2017.

benefits of reducing the odds of another financial crisis and all of the hardship associated with it against the costs of probably blocking some credit-worthy households from homeownership.

The choices about where to draw the line are never easy, but it's really hard choice when you are talking about potentially limiting already disadvantaged young people's access to education and economic mobility. I can assure you that we spent many hours in meetings wrestling with this possibility.

There good news would be that you can do to limit these kinds of trade-offs. For example, when you are designing a risk-sharing program, you can add "carve-outs" or rewards for schools that serve low-income students and other disadvantaged populations.

And, there is some comforting evidence from the literature that when you chase bad actors out of the system you do not cut off options for the students they serve. One paper that that studied sanctions put on for-profit schools in the 1990s showed that most of the 70 percent drop in enrollment at these schools was made up for by increased enrollment at public-sector schools.²⁶

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I hope I have persuaded you that our federal student loan program serves a valuable purpose but there is considerable scope to make the federal student loan program better. In concluding, I want to leave you with a few final thoughts.

First, I have not covered all the student loan issues we need to think about. Much of what I have talked about is how to make the system better for the borrowers of the future. There are people who are understandably frustrated now because they have already borrowed considerable amounts to fund educations that were not valuable because we didn't have enough accountability in the system. The policy community needs to think more on the issue of debt forgiveness (through the IDR program or even through bankruptcy). There are already indications that such topics will feature prominently in the 2020 presidential campaigns.

Second, what I discussed is only a subset of what we need to do on the broader higher education issue. There is a really good case for the government investing more in higher education, particularly in an era when federal borrowing rates are so low.

If it were up to me, I would have the government do a much larger amount of grants to low-income students (also known as Pell Grants) so that there was less need for student loans. Loans traditionally have been appealing because they get paid back, but we have been overly optimistic about the degree to which this happens.²⁷

²⁶ See [Cellini, Darolla, and Turner](#) (2019).

²⁷ [Scott-Clayton](#) (2018) estimates that 40 percent of the 2004 cohort of borrowers may default by 2023.

We should also think seriously about making community college free or at least greatly increasing the resources going into community colleges (there's a good Aspen proposal along these lines). A century ago, we made huge strides helping the workforce adapt to changes in society and labor markets by increasing access to secondary education through what was called [the "high school movement."](#) We should consider whether more recent developments in society and labor markets warrant another big change like this.

Thank you and I look forward to your questions.