The Student Debt Overhang: Concerns and Policy Options

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# Student loans are generally a good thing

More higher education, **more human capital**, higher output

Higher education is **critical for economic mobility**—a college degree helped 41% of individuals from the lowest family income quintile land in one of the top two quintiles as adults [Haskins (2008)]

Most people realize **large lifetime income gains** from attending college even accounting for the cost of a college education [Looney and Greenstone (2011)]

Without the federal student loan program, it would be prohibitively expensive or impossible for many people to fully fund their college educations

BUT—the share of households with student debt has risen sharply
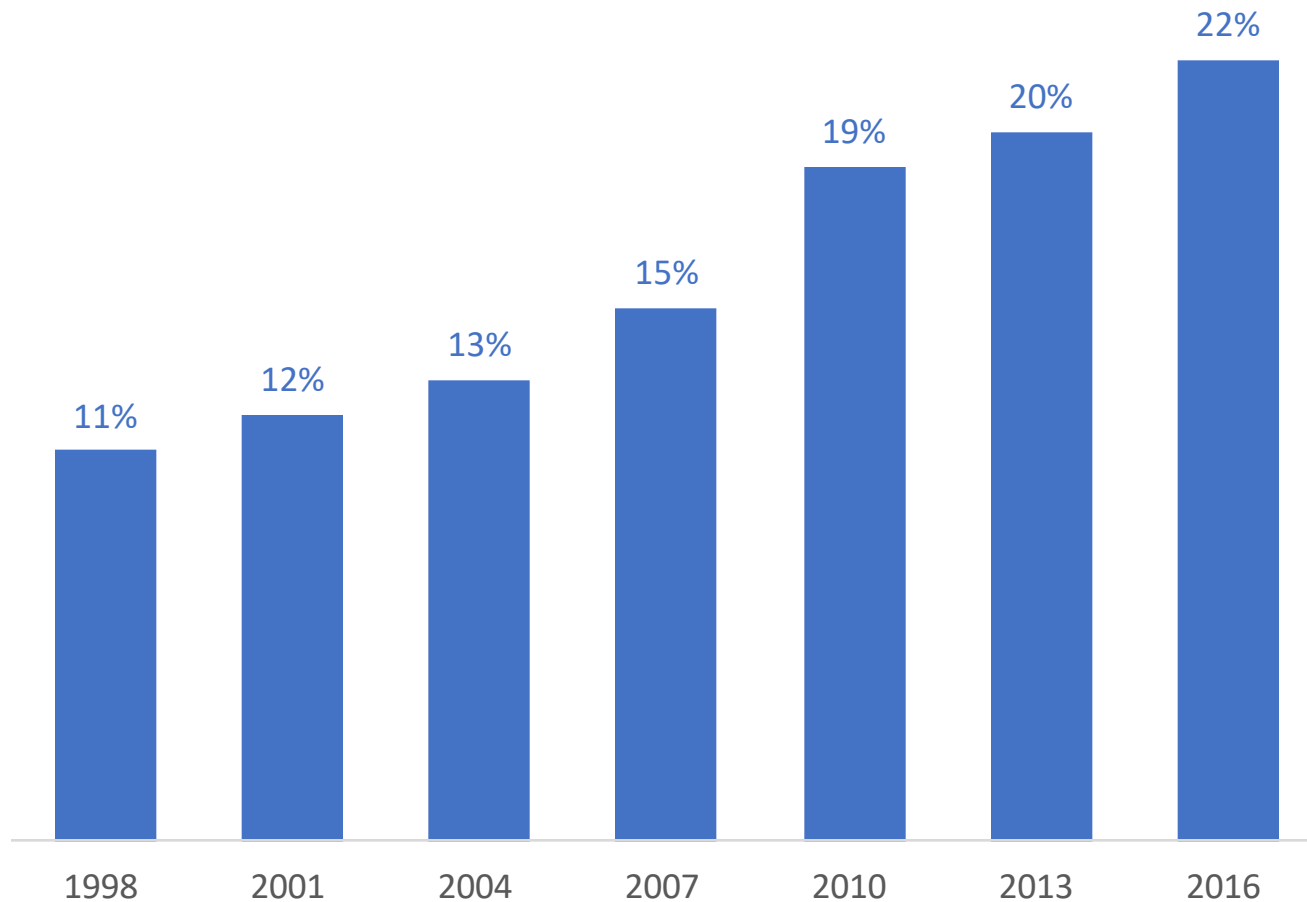
Data from Survey of Consumer Finances

AND—debt per borrowing household is way up

Median Student Debt for Households
with Student Debt (2016 dollars)

|	
1998	$10,328
2001	$10,839
2004	$11,700
2007	$13,896
2010	$14,369
2013	$17,529
2016	$19,000

Data from Survey of Consumer Finances

A very large share of borrowers are struggling to pay their loans

20% of borrowers are still in school or in their grace period (gray bars)

42% of the remaining borrowers are in default, forbearance, or deferment

Repayment Status of Federal Education Loan Portfolio: 2019:Q2
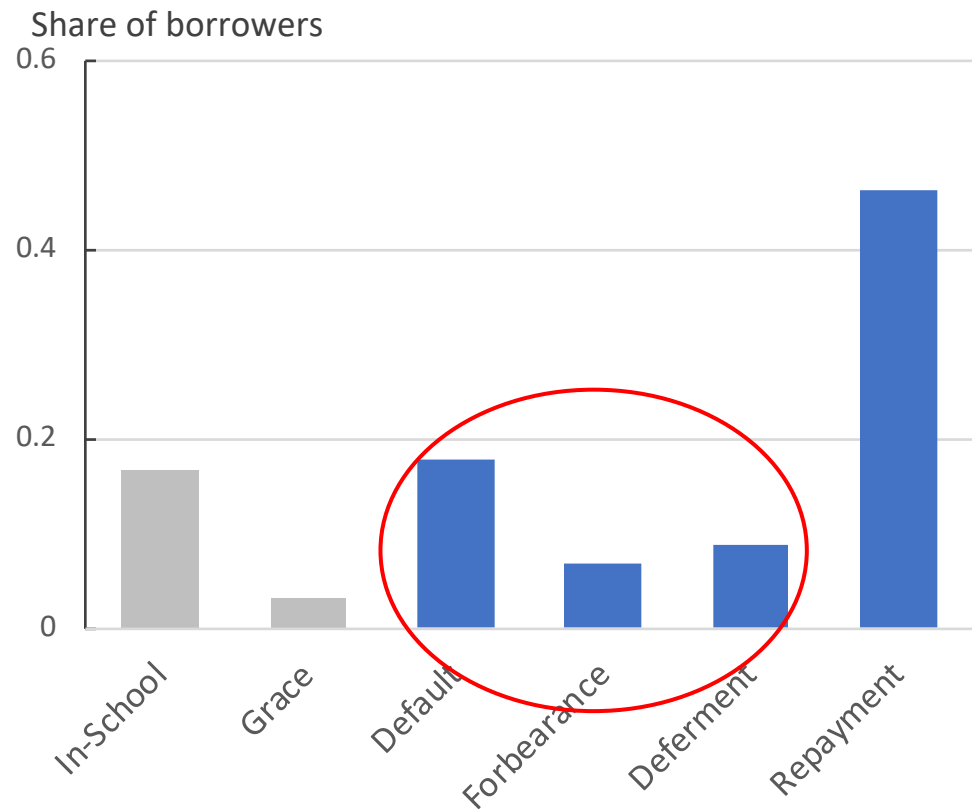
Share of borrowers

Data from College Board

Close to half of borrowers not in default are making slow (or backwards) progress

| Percent of Borrowers that are Current and Have the Same or Higher Balance than in Previous Quarter	
2012	43.7
2013	46.6
2014	45.9
2015	46.1
2016	47.5
2017	47.5

Data from Federal Reserve Bank of New York

The government's income-driven repayment program allows borrowers to pay less than the normally scheduled amount if their income is low

But interest accumulates on the shortfall, which slows progress paying back the loan
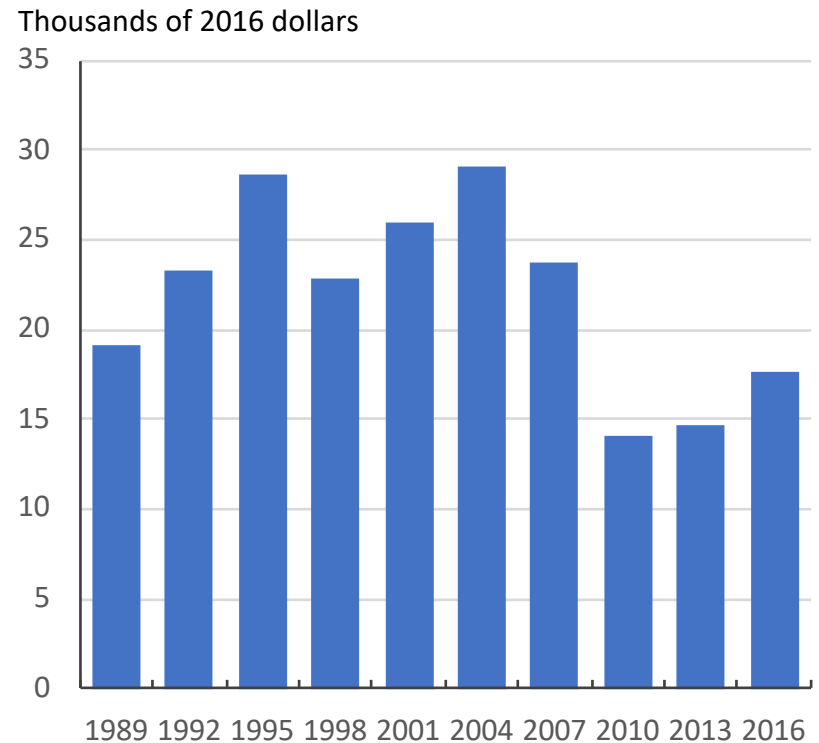
Worries about how student debt is holding back young households

Individuals 25-34 Living with Parents

Percent

Men

Women
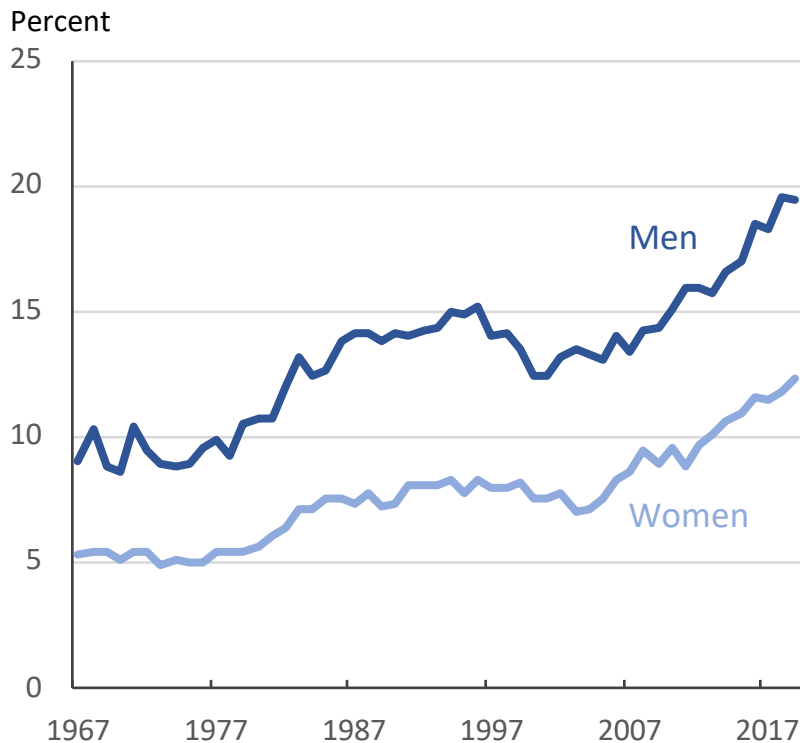
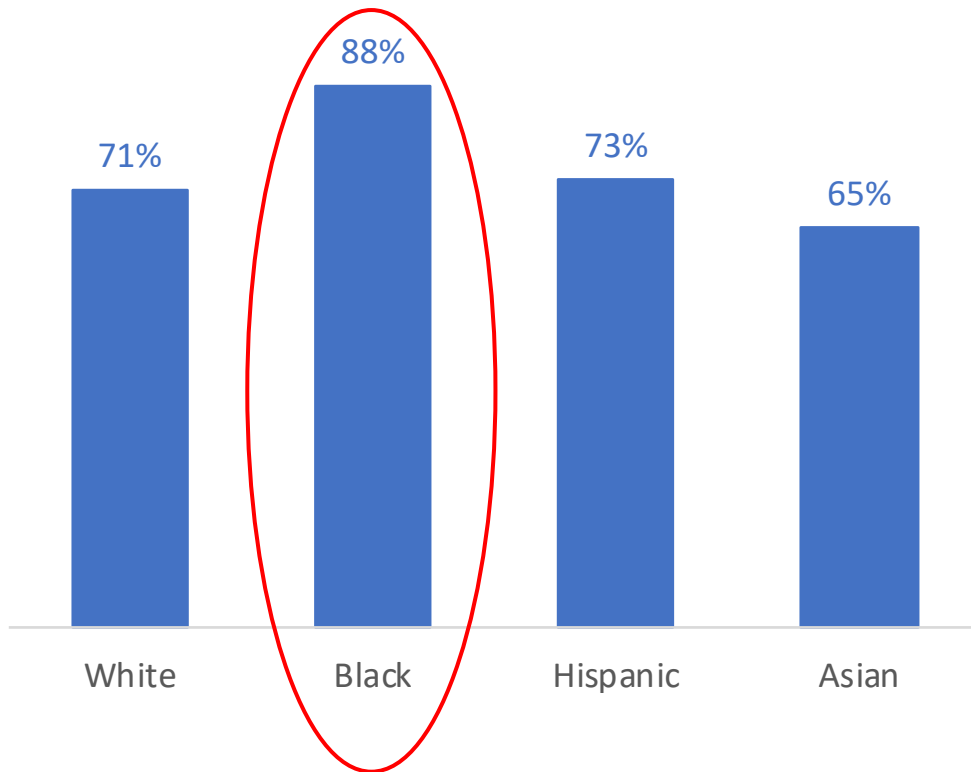Median Net Worth for Households 25-34

Thousands of 2016 dollars

Dynan - NABE economic policy conference

And suppressing mobility for some groups of concern

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)

Research about the effects of student debt on the overall economy

Many papers have been **reassuring**, e.g.

Mezza, Ringo, Sherlund, and Sommer (2020)—not a major factor suppressing homeownership

Cooper and Luengo-Prado (2018)—other factors (including high housing costs) are mainly holding back household formation

BUT:

Research on the *many ways* in which student debt might affect the economy has been **limited by data availability and identification struggles**

Problems may take years/decades to fully emerge

The policy issue getting attention now is forgiveness of federal student debt

Possible rationales for the federal government to forgive student debt:

Concern about **the direct effects on borrowers/the economy**

Concern about **the effects on political dynamics** (with indirect implications for the economy)

Fairness? There are **systematic patterns by school** of who struggles with debt—should the government have done more to protect borrowers?

Many for-profit schools charge high tuitions (5x that of community college) and deliver low-value added

The federal student loan program already allows for some forgiveness

The income-driven-repayment (IDR) program allows people having trouble managing their full loan payments to pay a given fraction of their income (typically 10%)

And, **under IDR, balances get forgiven after 20-25 years of reasonable payments** [10 years for people in public service]
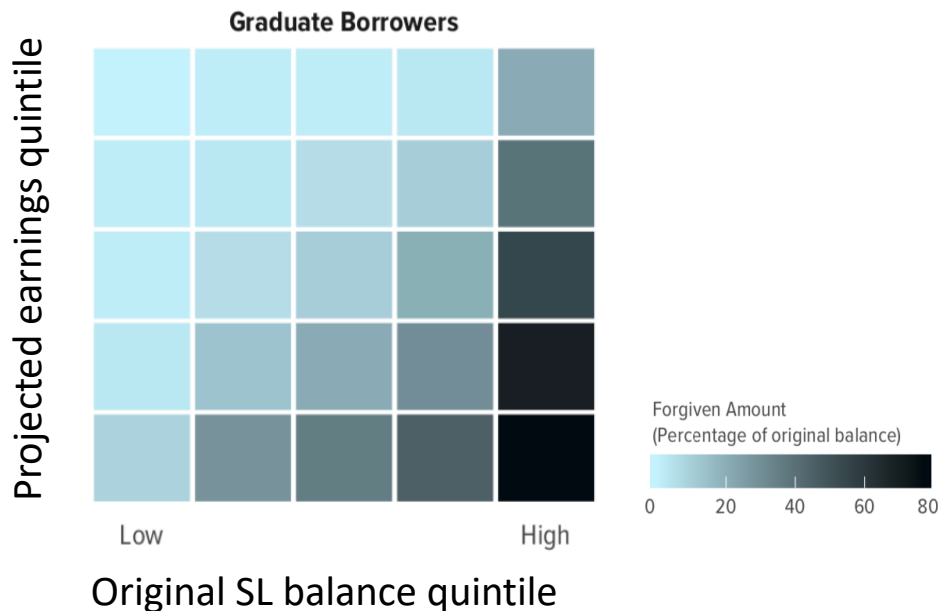
BUT:

The program is **administratively burdensome**—participants have to redocument their hardship every year

And 20 years is a long time to wait!

Furthermore

The biggest IDR beneficiaries are **those with high balances**—many of whom are high earners who borrowed to attend high-cost professional schools (law school, business school)

CBO estimates that graduate borrowers will ultimately have 56% of the amount originally disbursed forgiven

Screenshot from Congressional Budget Office (2020)

Other student loan options being discussed

Blanket federal student debt forgiveness:

Would be **expensive**—there are $1.5 trillion of federal student loans out there!

Not to mention the costs going forward, as presumably we'd switch to grants for would-be borrowers

Would be **regressive**—most of the dollars forgiven would be for households in the top half of the income distribution

Other options being discussed

Selective forgiveness:

Forgiveness **up to some limit**—could still be expensive and regressive

Forgiveness **for certain groups**, such as Pell grant recipients (i.e. those coming from low-income backgrounds)

Accelerated forgiveness:

Forgive some amount of principal for every two years of reasonable payments

Also—**allowing private student loans to be discharged** in bankruptcy

The other big policy issue is what we can do to impose more accountability on higher education institutions going forward

What can be done to **incentivize low-value-added schools** to teach better, provide better career guidance, make sure that students graduate?

Current policy—schools risk losing access to the program if student loan default rates for recent grads exceed some threshold

But, as already discussed, default rates are a **very limited measure of distress**

And any kind of 0/1 threshold is **gameable**

The other big policy issue is what we can do to impose more accountability on higher education institutions going forward

There are some good "**risk-sharing**" proposals that would address these problem

> e.g. schools for which borrowers collectively are making **poor repayment progress** are subject to **a continuum of penalties** depending on just how badly they have performed
>
> Effectively schools would have to pay back some of the loans if their students can't!

[See, for example, the proposal by Chou, Looney, and Watson, 2017]

Concluding thoughts

The big policy issues around **student loan debt forgiveness are hard and involve trade-offs**

The policy issues around what to do to reduce growth of the overhang going forward are not as hard—**we should implement a risk-sharing program** to better incentivize colleges to deliver value

Not discussed but I **would also recommend**:

More grants to low-income students and fewer loans (particularly since a chunk of loans won't be repaid anyways)

Support and reform the community college system so it's a stronger alternative to high-cost non-selective for-profit colleges