



Getting the Most Out of the Federal Student Loan Program

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Worked on student loans while at U.S. Treasury



What does the Assistant Secretary for Economic Policy do?

One role is keeping the Secretary informed about what is going on in the economy.

Another role is working to refine and develop economic policy.

Student loans matter to Treasury both because its role as “steward” of the American economy (and likewise the economic status of individual Americans) and because of its responsibility to protect the American taxpayer.

Much concern about student debt in recent years



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The Financial Crisis Isn't Over for Students

As housing prices collapsed during and after the recession, student loan debt rose. And the government wants its money back.

By Noah Smith

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Hope they don't have too much in student debt. Photographer: Drew Angerer/Getty Images

Outline for talk

1. Background on the federal student loan program
2. How did we get to where we are?
3. Is there a student loan “crisis”?
4. How can we improve outcomes for student borrowers?

Background on student loans

The federal student loan program

Covers about 90 percent of new student borrowing.

Different types of loans:

Subsidized Stafford loans—for undergrads, means-tested, government pays interest while you are in school, loan limits.

Unsubsidized Stafford loans—for undergrads and grad students, you pay all the interest, loans limits (but higher).

PLUS loans—for parents and graduate students, no loan limit, higher interest rates.

No underwriting—no premium charged to riskier borrowers.

How federal student loans generally work

Repayment deferred while you are in school.

Standard term is 10 years, with fixed monthly payments.

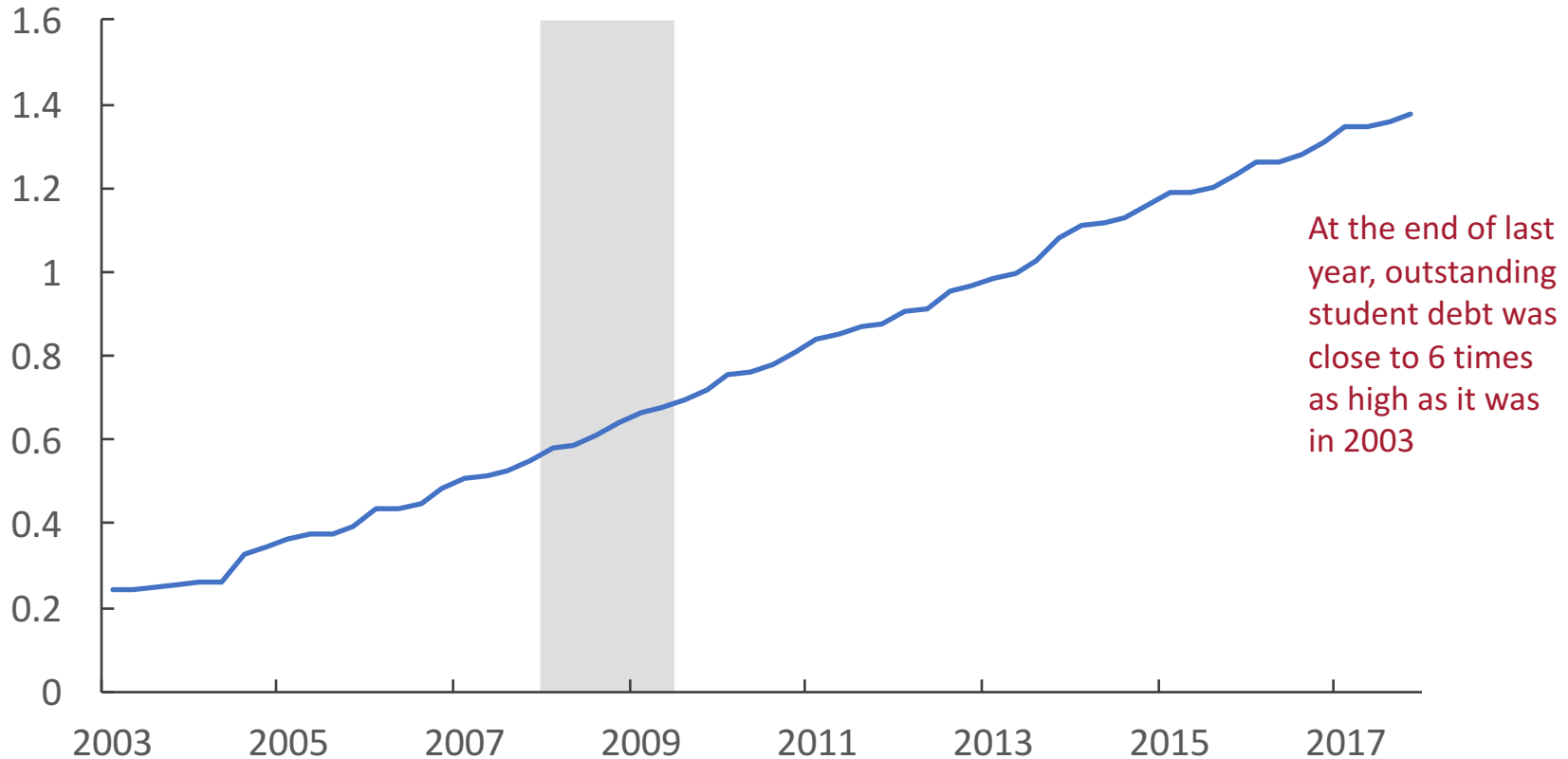
But if your income is too low to cover the payments, you can reduce your monthly payments by signing up for an **income-driven-repayment program** (no “magic” here—the payments are lower because the term of the loan is extended).

Federal student loans cannot be discharged in bankruptcy.

Schools must meet certain criteria to participate—student defaults can't be too high and other conditions (to be discussed).

Student debt has grown rapidly

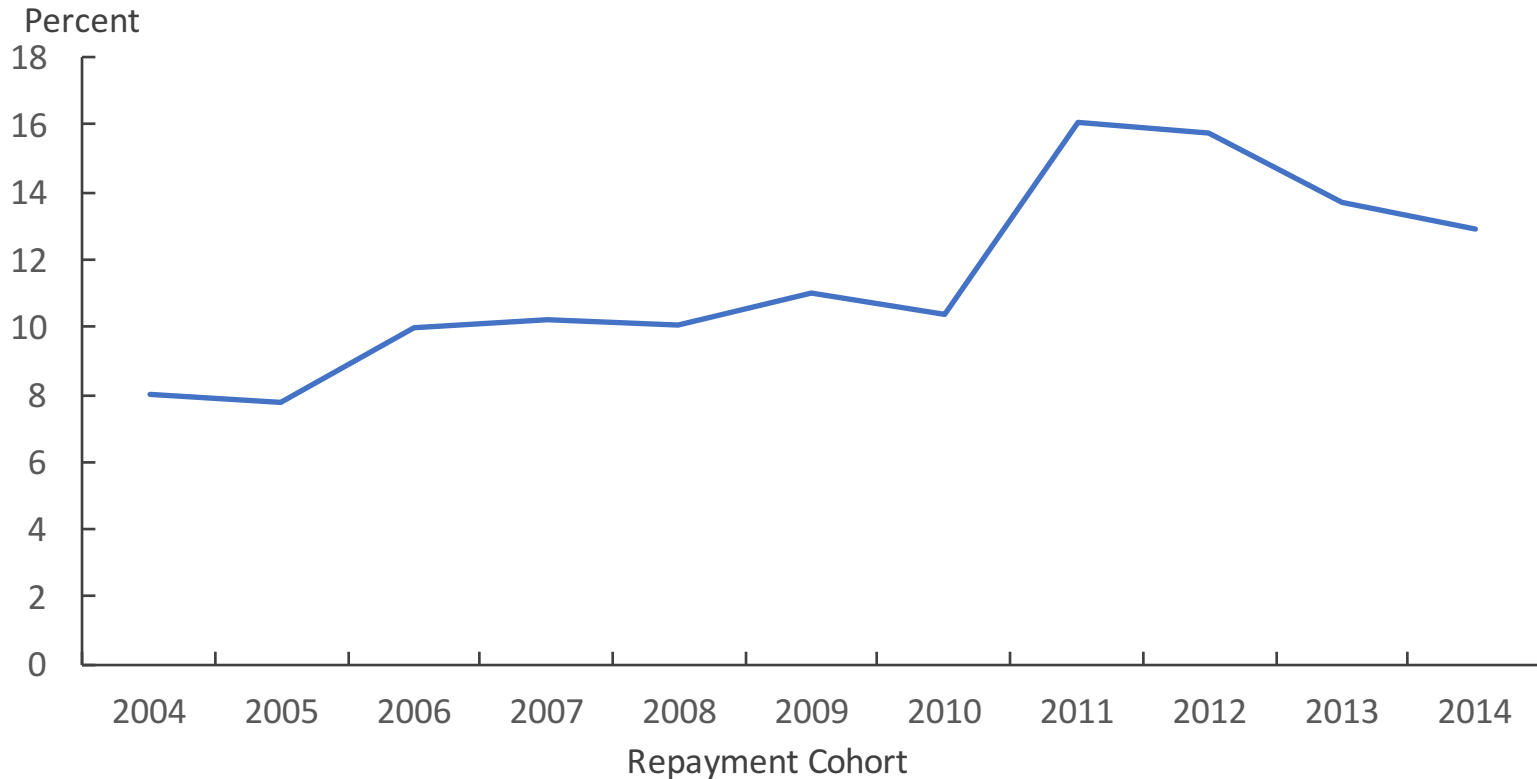
Trillions of dollars



Source. Federal Reserve Bank of New York. Shaded area shows recession.

Defaults on student loans are high

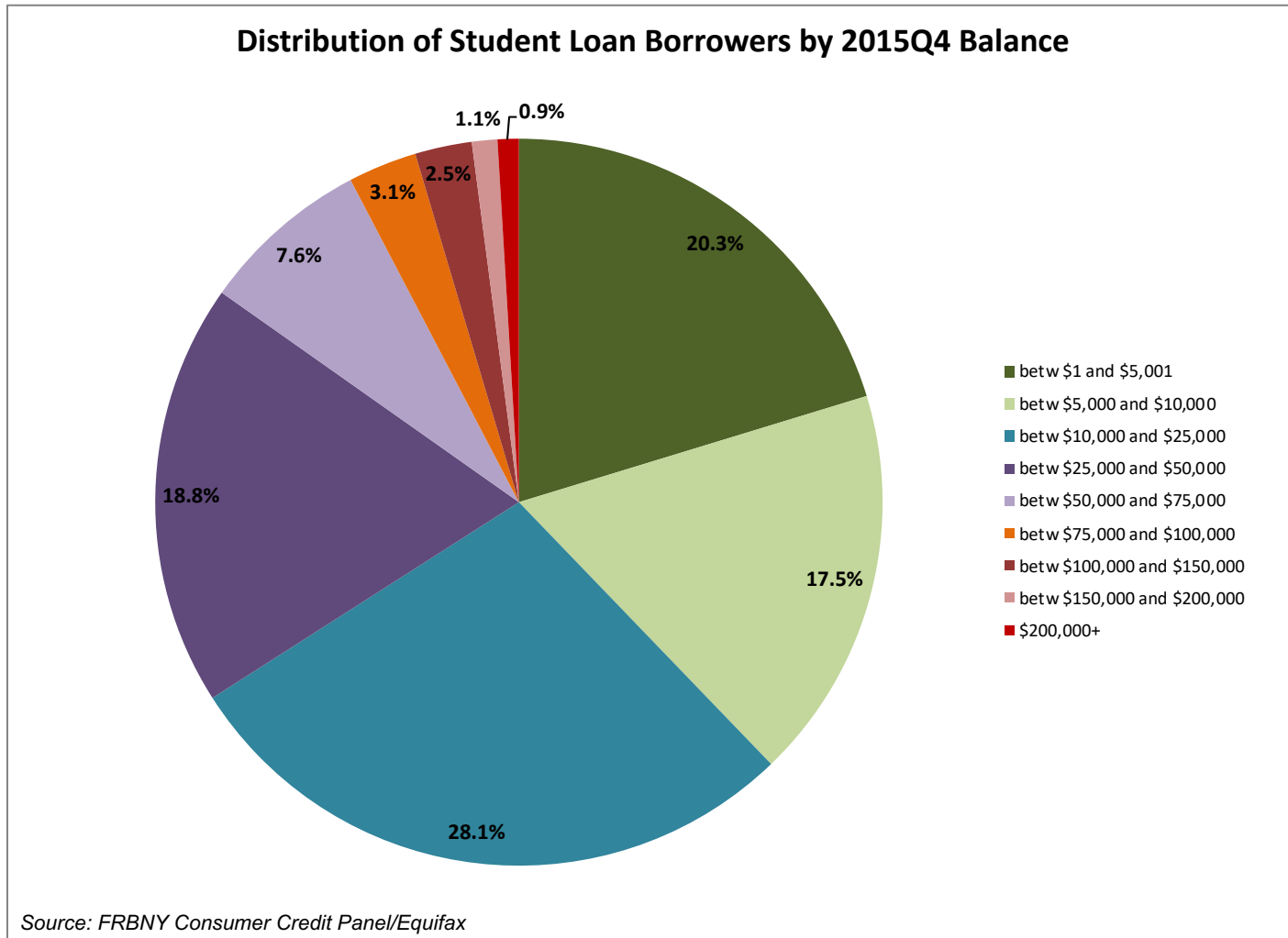
Two Year Cohort Default Rate (CDR) on Student Loans



Note. Two-year cohort default rate represents fraction of students who had defaulted on at least one loan two years after starting repayment.

Source. Federal Reserve Bank of New York.

About 2/3 of the 44 million student loan borrowers in 2015 had balances < \$25K



43 percent of “young” households had some student debt

Table A. Education debt outstanding among young families, 2013 and 2016 surveys

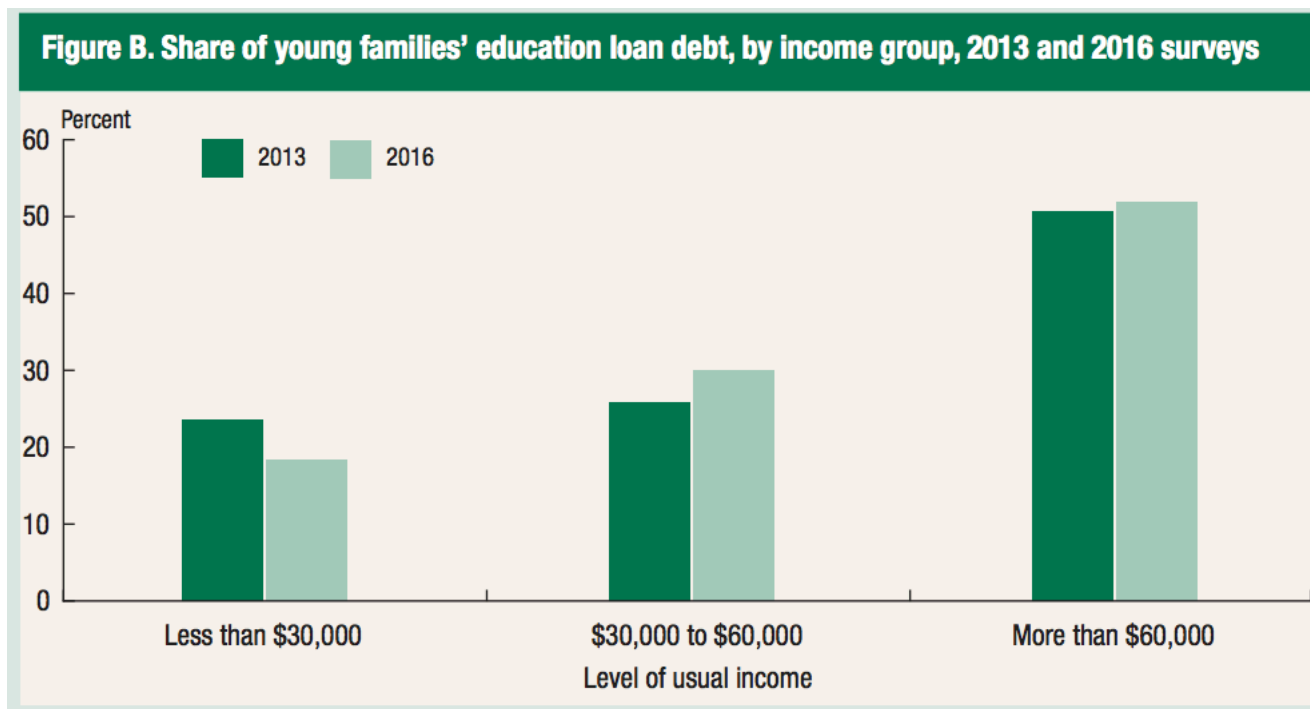
Thousands of 2016 dollars, except as noted

Measure of education debt	2013	2016
Percent with education debt	38.8	43.3
Mean education debt	30.7	33.3
Median education debt	17.3	19.0

Source. Survey of Consumer Finances. Young households defined as those with heads under 40.

Caveat: if you are still living with your parents because of student debt, you are part of their household so wouldn't be included in this calculation.

About half of younger-household student debt is held by households with income > \$60K.



Source. Survey of Consumer Finances.

However, a material share is also owed by households with incomes < \$30K.

How did we get to where we are?

Explaining the run-up in student debt

Between 2001 and 2016, the real amount of student debt owed by American households more than tripled, from about \$340 billion to more than \$1.3 trillion. The increase largely reflects an acceleration in student loan originations that was mainly due to a surge in college enrollment and ongoing increases in real tuition levels.

Feiveson, Mezza, and Sommer (2018)

Digging a little deeper on the surge in enrollment

In this paper, we examine the relationship between changes in access to student loan credit and student loan defaults over the modern history of federal loan programs. We show that expansions in the supply of federal credit and associated changes in the composition of borrowers explains much of the time series variation in loan volumes and loan levels.

Looney and Yannelis (2018)

Surely, some of the increase in enrollment reflects people trying to gain more skills in the face of a weak job market in the recession and the years that followed, but Looney and Yannelis make a good case that a loosening of standards on student loans are important to the story.

Policy-induced changes in supply of student loans

Mid-1980s. Eligibility for federal loans expanded to “independent” borrowers (graduate students and independent undergrads) and students without high school degree; borrowing ceilings were increased.

Looser

1989. Schools cut from program if 2-year CDR > 30% for 3 consecutive years (or > 40% in 1 year); no more than 85% revenue of for-profit schools could come from federal aid; no more than 50% of students could be doing “distance” or online education.

Tighter

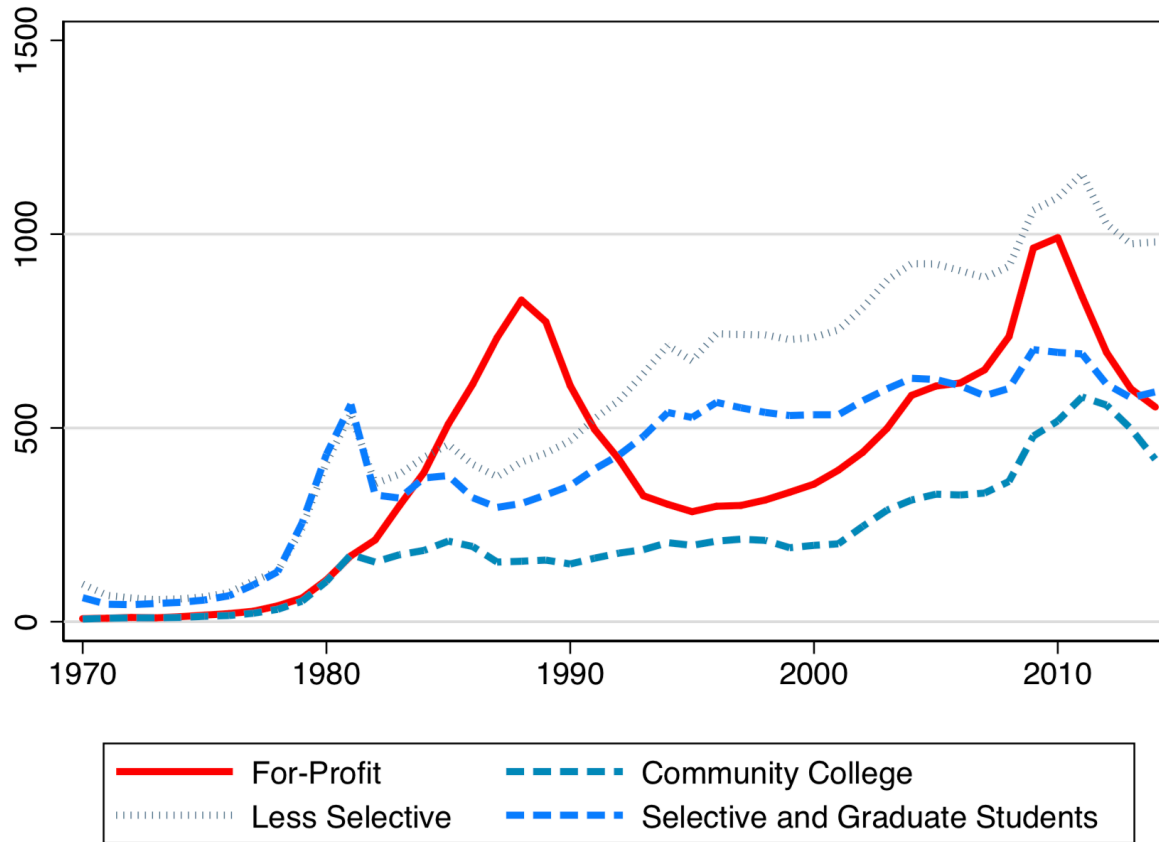
Late 90s. CDR threshold lowered to 25%; but, eligibility expanded, longer period of non-payment needed to count as “default,” for-profit schools could have up to 90% of revenues from federal aid.

Mixed

Mid 2000s.; 50 percent distance rule eliminated; PLUS loans expanded to grad students; loan limits increased.

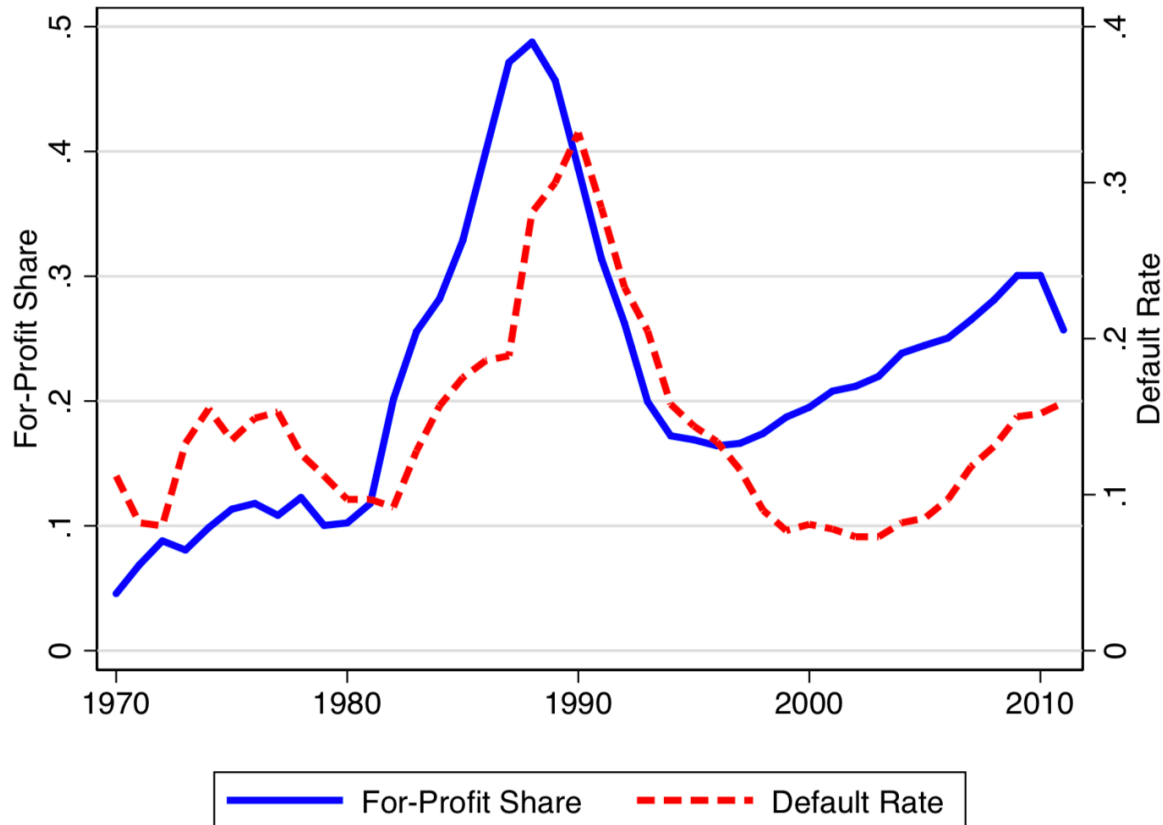
Looser

Patterns of new borrowers at for-profits highly correlated with changes in credit supply



Source: Looney and Yannelis (2018).

Patterns of new borrowers at for-profits lead 2-year cohort default rates



Source: Looney and Yannelis (2018).

Where Student Loans are Going:

Colleges whose students owe the most, 2000 vs. 2014

For-Profit Non-Profit or Public

2000

Institution	Total Debt (Billions)
1 New York University	\$2.2
2 University of Phoenix-Phoenix Campus	\$2.1
3 Nova Southeastern University	\$1.7
4 Pennsylvania State University	\$1.7
5 University of Southern California	\$1.6
6 Ohio State University-Main Campus	\$1.5
7 Temple University	\$1.5
8 Arizona State University	\$1.4
9 Michigan State University	\$1.3
10 University of Minnesota-Twin Cities	\$1.3
11 Boston University	\$1.3
12 The University of Texas at Austin	\$1.3
13 University of Florida	\$1.2
14 University of California-Los Angeles	\$1.2
15 University of Michigan-Ann Arbor	\$1.1
16 Columbia University in the City of New York	\$1.1
17 University of Pittsburgh-Pittsburgh Campus	\$1.1
18 Indiana University-Bloomington	\$1.1
19 Rutgers University-New Brunswick	\$1.1
20 University of Pennsylvania	\$1.0
21 University of Arizona	\$1.0
22 University of Wisconsin-Madison	\$1.0
23 Florida State University	\$1.0
24 Virginia Commonwealth University	\$1.0
25 University of Washington-Seattle Campus	\$1.0

2014

Institution	Total Debt (Billions)
1 University of Phoenix-Phoenix Campus	\$35.5
2 Walden University	\$9.8
3 Nova Southeastern University	\$8.7
4 DeVry University-Illinois	\$8.2
5 Capella University	\$8.0
6 Strayer University-Global Region	\$6.7
7 Kaplan University-Davenport Campus	\$6.7
8 New York University	\$6.3
9 Argosy University-Chicago	\$6.2
10 Ashford University	\$5.9
11 Grand Canyon University	\$5.9
12 Liberty University	\$5.7
13 University of Southern California	\$5.3
14 Pennsylvania State University	\$5.3
15 Arizona State University	\$4.9
16 ITT Educational Services Inc System Office	\$4.6
17 Ohio State University-Main Campus	\$4.4
18 Temple University	\$4.3
19 DeVry University's Keller Graduate School	\$3.9
20 American InterContinental University-Online	\$3.7
21 University of Minnesota-Twin Cities	\$3.7
22 Michigan State University	\$3.6
23 Rutgers University-New Brunswick	\$3.4
24 Colorado Technical University-Colorado Springs	\$3.3
25 Indiana University-Purdue U.-Indianapolis	\$3.1

The numbers on the shift in the amount of dollars going to the for-profit sector are fairly startling too.

BROOKINGS

NOTES: This figure ranks institutions by student loans outstanding in 2000 and 2014. For each year, the first column shows the institution name and the second column shows the total volume of student loans outstanding.
SOURCE: US Treasury tabulations of 4 percent NSLDS sample.

Source: Brookings (2015).

Is there a student loan crisis?

There are clear potential hardships for student borrowers whose income is low relative to required debt service payments

Constrained consumption.

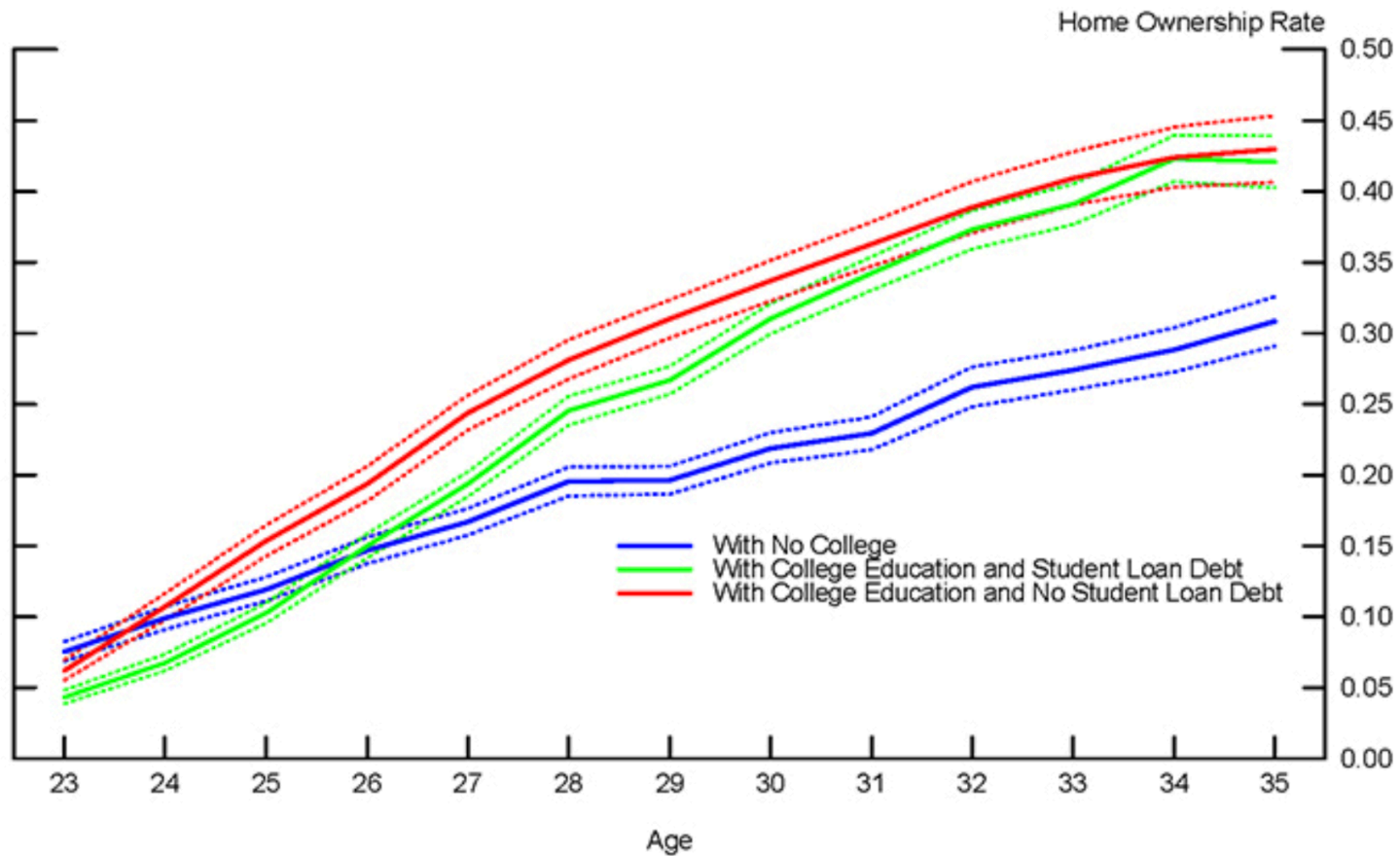
Inability to form an independent household (e.g. forced to live with parents).

Possible default on loans, leading to reduced access to credit.

Even without default, high levels of student debt may be an obstacle to acquiring new credit.

Student debt delays homeownership

Figure 2: Home Ownership Rate: Ages 23-35



Source: Mezza, Alvaro, Kamila Sommer, and Shane Sherlund (2014).

But it's **very important** to keep in mind that the pay-off from higher education still higher for most students

Do the Benefits of College Still Outweigh the Costs?

Jaison R. Abel and Richard Deitz

In recent years, students have been paying more to attend college and earning less upon graduation—trends that have led many observers to question whether a college education remains a good investment. However, an analysis of the economic returns to college since the 1970s demonstrates that the benefits of both a bachelor's degree and an associate's degree still tend to outweigh the costs, with both degrees earning a return of about 15 percent over the past decade. The return has remained high in spite of rising tuition and falling earnings because the wages of those without a college degree have also been falling, keeping the college wage premium near an all-time high while reducing the opportunity cost of going to school.

From Federal Reserve Bank of New York, *Current Issues*, 2014.

So the student loan problem is much narrower than often characterized in the press—student loans increase incomes and promote opportunity generally.

The problem is with higher education investments that don't pay-off.

Aside on quantifying the hardship (a bit of a rant)

Research that compares former college students without loans to those with loans and shows that the latter group has lower consumption or lower homeownership is problematic.

That's not the right comparison—without the loan, the latter group may not have had access to a college education at all. So many in this group are probably materially better off than they would have been in the absence of the program.

Although it seems fair to ask if their lives would have been better off with a better student loan program ...

What about macro effects?

Feiveson, Mezza, and Sommer (2018) argue evidence to date suggests not much direct or indirect effect on the macroeconomy:

Upper bound estimate of consumption crowd-out would reduce real GDP growth by 0.05 pp per year.

Effects of delayed homeownership/household formation probably small.

People with student loans are *more* likely to buy cars.

And note that threat to financial system much more limited than with mortgages because the government backs federal student loans—it's the taxpayer at risk.

How can we improve outcomes for student borrowers?

One relevant type of student loan policy

Income-driven-repayment (IDR) programs. These programs reduce defaults by lowering monthly payments through an extension of the loan term.

Most people coming out of college will have incomes that rise over time—IDR can produce a better alignment of what you need to pay and your ability to pay.

Programs were improved under the last Administration and there is some scope for further improvement (particularly by streamlining the process)—see Dynarski (2018).

Another relevant type of student loan policy

Measures to increase the accountability of higher ed institutions.

The requirement that institutions keep cohort default rates below some threshold is designed to increase the incentive to provide a good education. It was put in place to address the late-1980s student loan crisis—and many for-profits subsequently exited the program.

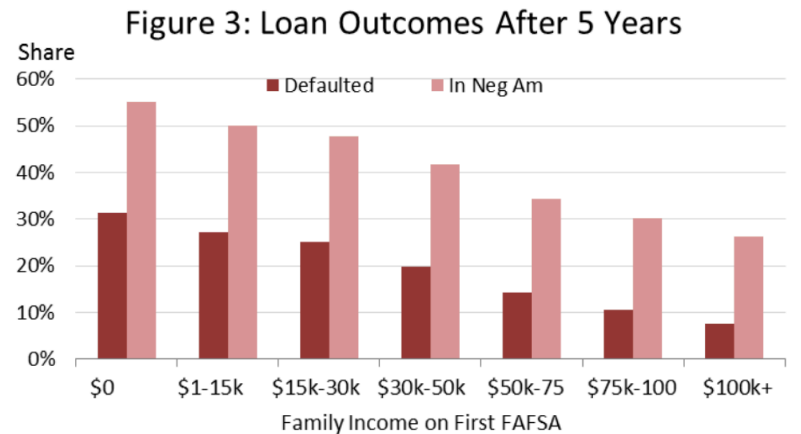
(The last Administration attempted to strengthen accountability with the Gainful Employment Rule—limiting certain schools' ratio of debt payments to income—but it looks like the teeth are now being taken out of that rule.)

But, **important tension** between IDR and current accountability measures

IDR is designed to reduce defaults but defaults are the metric by which we currently impose accountability!

Many students with large debt relative to income aren't defaulting but they aren't paying down their balances either, leaving them not much better off over the long run.

A substantially share of low income students are “under water” with their student loans after 5 years.



Source. Chou, Looney, and Watson (2017).

How to hold schools participating in the federal student loan program more accountable

Introduce “**risk sharing**”:

Assess schools based on cohort **repayment** rates.

Require schools with poor outcomes to **pay back some of defaulted loans**.

Chou, Looney, and Watson (2017) describe one such proposal.

Note that the Higher Education Act is scheduled to be reauthorized later this year—this feature could be incorporated into it.

However, care needs to be taken to design these programs right

Increasing accountability may protect students and taxpayers financially but risks reducing access to higher education.

For-profits, and schools with worse loan outcomes generally, tend to serve students from disadvantaged backgrounds. (And, some deliver valuable education.) See Deming, Golding, and Katz (2012) on the trade-offs with for-profits.

Imposing more accountability may reduce the willingness of schools to serve these students.

We need to design risk-sharing with this trade-off in mind.

Summary

Summary I

On the whole, the federal student loan program is raising incomes and promoting mobility. The problem is with loans that are funding (or have funded) educations that don't pay off.

Is there a student loan “crisis”?

Not at the macro level, but there is evidence that some people are suffering hardship.

Moreover, evidence of greater hardship may emerge over time.

And, a large amount of taxpayer dollars have been put toward existing losses (and probably toward future losses).

Summary II

The federal student loan program could be improved by streamlining the income-driven-repayment process.

But, particularly as we make IDR easier, it is critical to improve the existing measures that hold schools accountable. A well-designed risk-sharing proposal would be a good step in this direction.

Notes

Slide 6: For information about different income-driven-repayment plans, see: <https://studentaid.ed.gov/sa/repay-loans/understand/plans/income-driven>.

Slide 7: Data can be found here: <https://www.newyorkfed.org/microeconomics/hhdc/background.html>.

Slide 8: See <http://libertystreeteconomics.newyorkfed.org/2017/11/are-student-loan-defaults-cyclical-it-depends.html> for data and more discussion of trends in cohort default rates.

Slide 9: Data can be found here: https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/xls/sl_update_2016.xlsx.

Slide 10: Screenshot from Bricker, Jesse, Lisa J. Dettling, Alice Henriques, Joanne W. Hsu, Lindsay Jacobs, Kevin B. Moore, Sarah Pack, John Sabelhaus, Jeffrey Thompson, and Richard A. Windle (2017) “Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances” <https://www.federalreserve.gov/publications/files/scf17.pdf>.

Slide 11: Screenshot from Bricker, Jesse, Lisa J. Dettling, Alice Henriques, Joanne W. Hsu, Lindsay Jacobs, Kevin B. Moore, Sarah Pack, John Sabelhaus, Jeffrey Thompson, and Richard A. Windle (2017) “Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances” <https://www.federalreserve.gov/publications/files/scf17.pdf>.

Slide 13: See Feiveson, Laura, Alvaro Mezza, and Kamila Sommer (2018) “Student Loan Debt and Aggregate Consumption Growth” <https://www.federalreserve.gov/econres/notes/feds-notes/student-loan-debt-and-aggregate-consumption-growth-20180221.htm>.

Slide 14: See Looney, Adam and Constantine Yannelis (2018) “The Consequences of Student Loan Credit Expansions: Evidence from Three Decades of Default Cycles,” Manuscript.

Slide 15: See the Looney and Yannelis paper for a full listing of the changes in eligibility requirements for schools to participate in the student loan program.

Slide 16: Screenshot from Looney and Yannelis (2018).

Slide 17: Screenshot from Looney and Yannelis (2018). The authors have an earlier paper that digs further into what types of borrowers are more likely to default—see Looney, Adam and Constantine Yannelis (2015) “[A Crisis in Student Loans? How Changes in the Characteristics of Borrowers and in the Institutions they Attended Contributed to Rising Loan Defaults.](#)”

Slide 18: From Brookings (2015) “[Media Summary of ‘Students loan debt a selective crisis; Majority of recent borrowers and defaulters attend for-profit and non-selective schools’ by Adam Looney and Constantine Yannelis.](#)”

Slide 21: Screenshot from Mezza, Alvaro, Kamila Sommer, and Shane Sherlund (2014) “Student Loans and Homeownership Trends” <https://www.federalreserve.gov/econresdata/notes/feds-notes/2014/student-loans-and-homeownership-trends-20141015.html>.

Slide 22: See https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci20-3.pdf.

Slide 24: See Feiveson, Laura, Alvaro Mezza, and Kamila Sommer (2018) “Student Loan Debt and Aggregate Consumption Growth” <https://www.federalreserve.gov/econres/notes/feds-notes/student-loan-debt-and-aggregate-consumption-growth-20180221.htm>.

Slide 26: See Dynarski, Susan (2018) “Testimony before the Senate Committee on Health, Education, Labor, and Pensions: <http://fordschool.umich.edu/files/dynarski-financial-aid-testimony.pdf>.

Slide 28: See Chou, Tiffany, Adam Looney and Tara Watson (2017) “Measuring Loan Outcomes at Postsecondary Institutions: Cohort Repayment Rates as an Indicator of Student Success and Institutional Accountability”: <http://www.nber.org/papers/w23118.pdf>.

Slide 29: See Chou, Tiffany, Adam Looney and Tara Watson (2017) “A Risk-Sharing Proposal for Student Loans” Hamilton Project Policy Brief 2017-04: https://www.brookings.edu/wp-content/uploads/2017/04/es_20170426_risk_sharing_proposal_student_loans_pb_chou_looney_watson.pdf.

Slide 30: See Deming, David, Claudia Goldin, and Larry Katz (2012) “The For-Profit Postsecondary School Sector: Nimble Critters or Agile Predators?” <https://www.aeaweb.org/articles?id=10.1257/jep.26.1.139>.