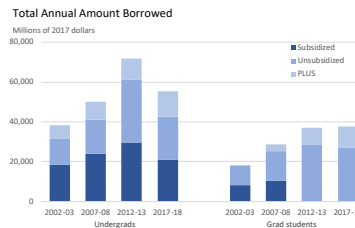




Improving Student Loan Outcomes through Better Policy



University of Wisconsin Institute for Research on Poverty Seminar

Karen Dynan

Harvard University

February 21, 2019

With thanks to Kayla Jones for research assistance

I worked on student loan policy while at Treasury as A/S for Economic Policy (2013-17)

Issues included the **College Scorecard**, **Gainful Employment** rule, **Income Driven Repayment**, and a “**risk-sharing**” proposal

Some at Treasury had access to **particularly useful data**—information about student loans from the Department of Education merged with IRS tax records

This talk will largely draw off **my own experience as well as work done by my former colleagues** (especially Adam Looney, Tara Watson, and Tiffany Chou)

Much concern then and now about student debt

Bloomberg View Markets Tech Pursuits Politics Opinion Businessweek

OPINION | EDUCATION

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](#)

64 March 27, 2018, 7:01 AM EDT *Corrected* March 28, 2018, 4:40 PM EDT



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

Outline

Background on the federal student loan program

Items of particular concern:

Default rates understate borrower struggles

For-profits

High-balance borrowers

Large and growing racial disparities

Improving student loan policy

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Modern program established by Higher Education Act of 1965 (altered over time, typically with reauthorizations of the Act)

Covers 90 percent of new student borrowing

Stock of student debt outstanding at the end of 2018 was [\\$1.5 trillion](#)

New borrowing over the 2017-18 school year was \$94 billion—[61% of total federal higher-ed aid](#)

KEY FEATURE: no underwriting in most cases—eligibility determined by enrollment at accredited institution

Current interest rates on student loans

Interest Rates for Direct Loans First Disbursed on or After July 1, 2018, and Before July 1, 2019		
Loan Type	Borrower Type	Fixed Interest Rate
Direct Subsidized Loans and Direct Unsubsidized Loans	Undergraduate	5.05%
Direct Unsubsidized Loans	Graduate or Professional	6.6%
Direct PLUS Loans	Parents and Graduate or Professional Students	7.6%

Source: [Department of Education](#) (2019)

For subsidized loans, interest does not accrue while enrolled

Direct loans have limits

	Dependent Students	Independent Students
Undergraduate limits:		
First year	\$5,500	\$9,500
Second year	\$6,500	\$10,500
Third year	\$7,500	\$12,500
Fourth year	\$7,500	\$12,500
TOTAL	\$31,000	\$57,500
Graduate limits:		
Annual	\$20,500	
TOTAL (incl. undergrad loans)	\$138,500	

The cost of **PLUS loans** for parents and graduate students is limited only by the cost of attendance

Source: [Department of Education](#) (2019)

Repayment

Standard repayment period is 10 years (high balance loans eligible for 25 years)

Repayment begins 6 months after graduation or separation

You are in default if payment is more than 270 days late—hurts your credit score, interest continues to accumulate, puts you at risk of garnishment

If you have difficulty making your payment

Your servicer may grant you **forbearance** or put you in **deferral**

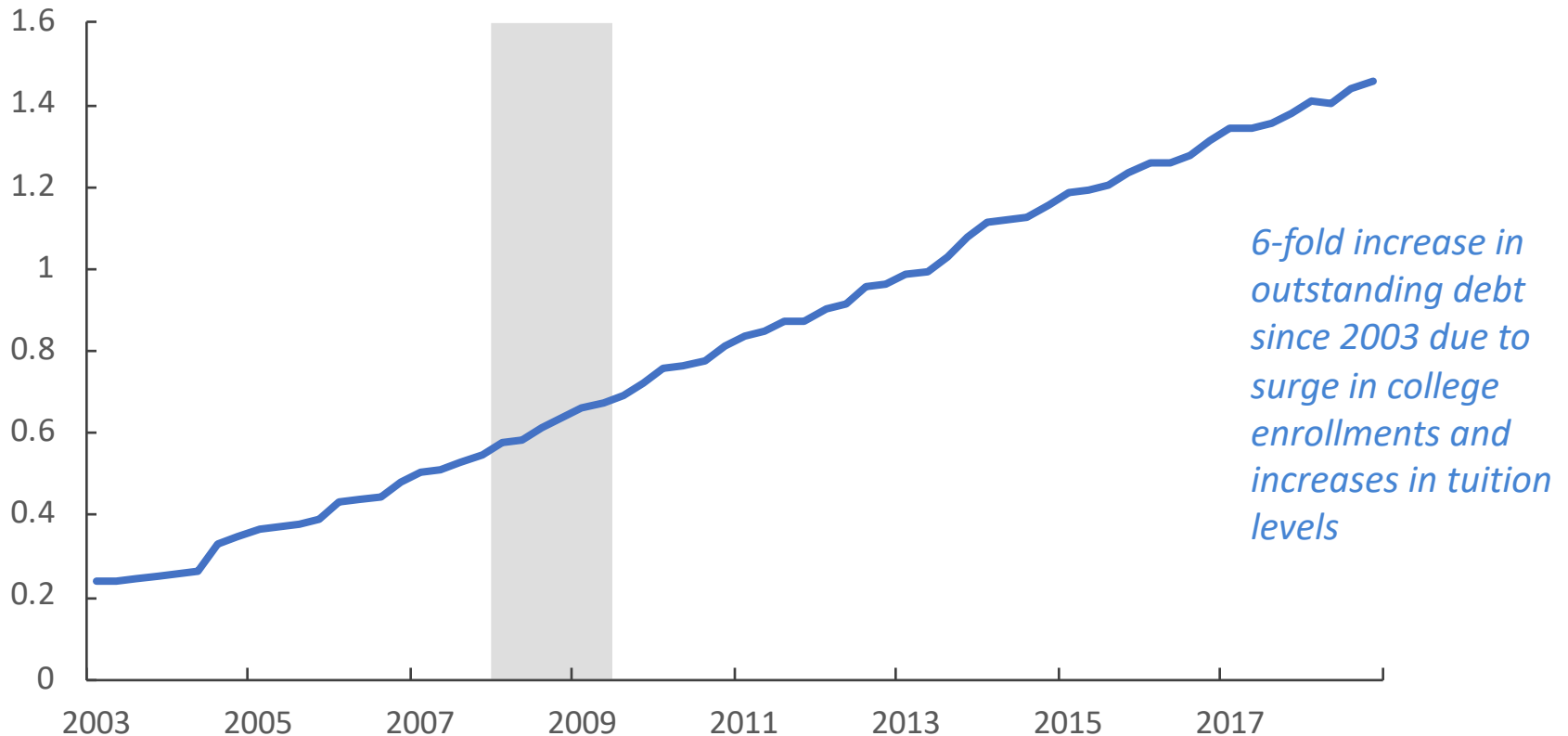
You can enroll in an **income-driven-repayment (IDR) plan** that limits your monthly payment to a given fraction of your income—and forgives remaining balance after 20-25 years of reasonable payments

(For both forbearance and IDR, you accumulate interest on the shortfall relative to the standard payment)

Much **more to come** on this topic

Outstanding student debt has grown rapidly

Trillions of dollars

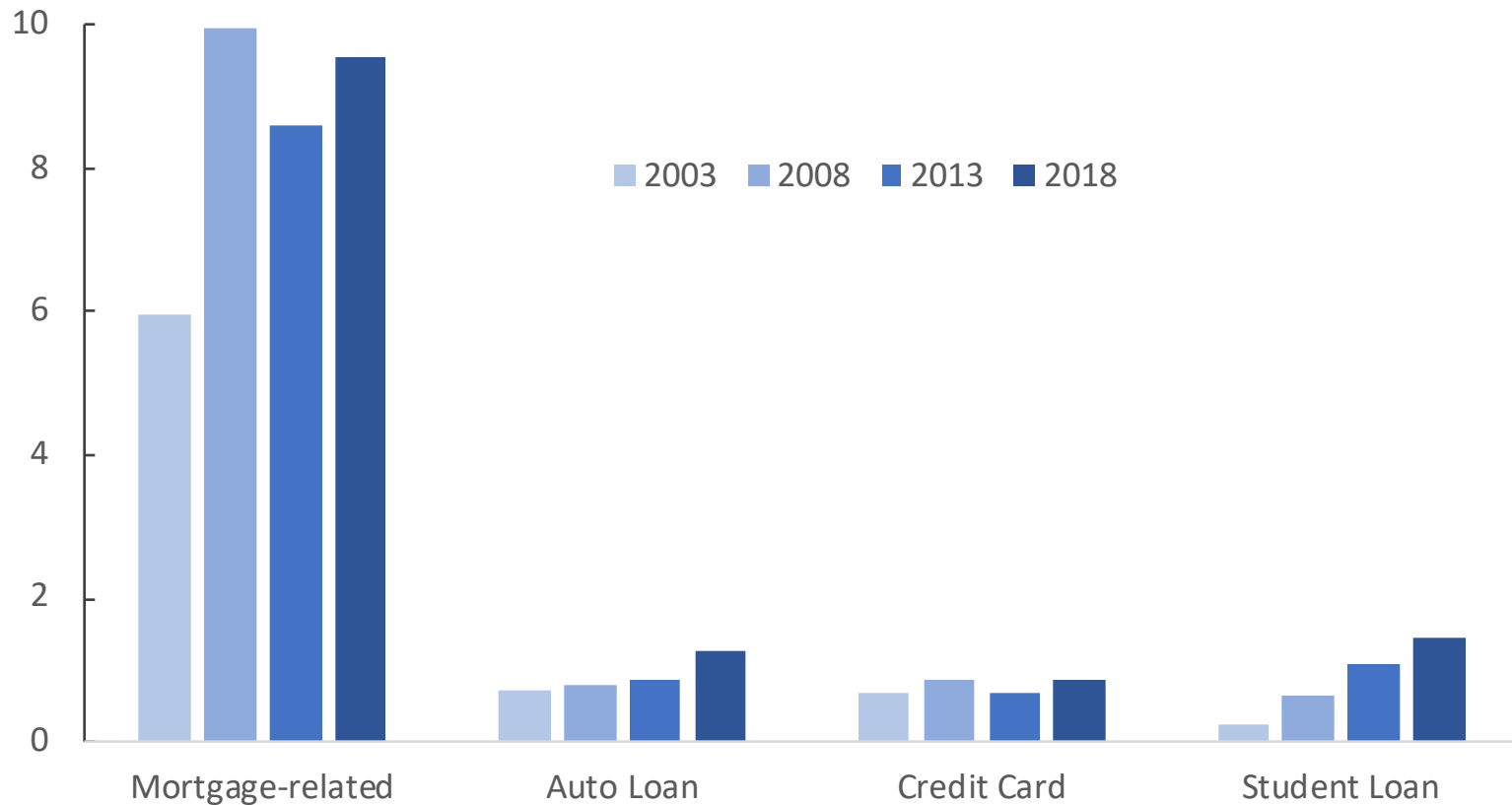


Shaded area shows recession

Source: [Federal Reserve Bank of New York](#)

Student debt is now the largest category of non-mortgage debt

Trillions of dollars

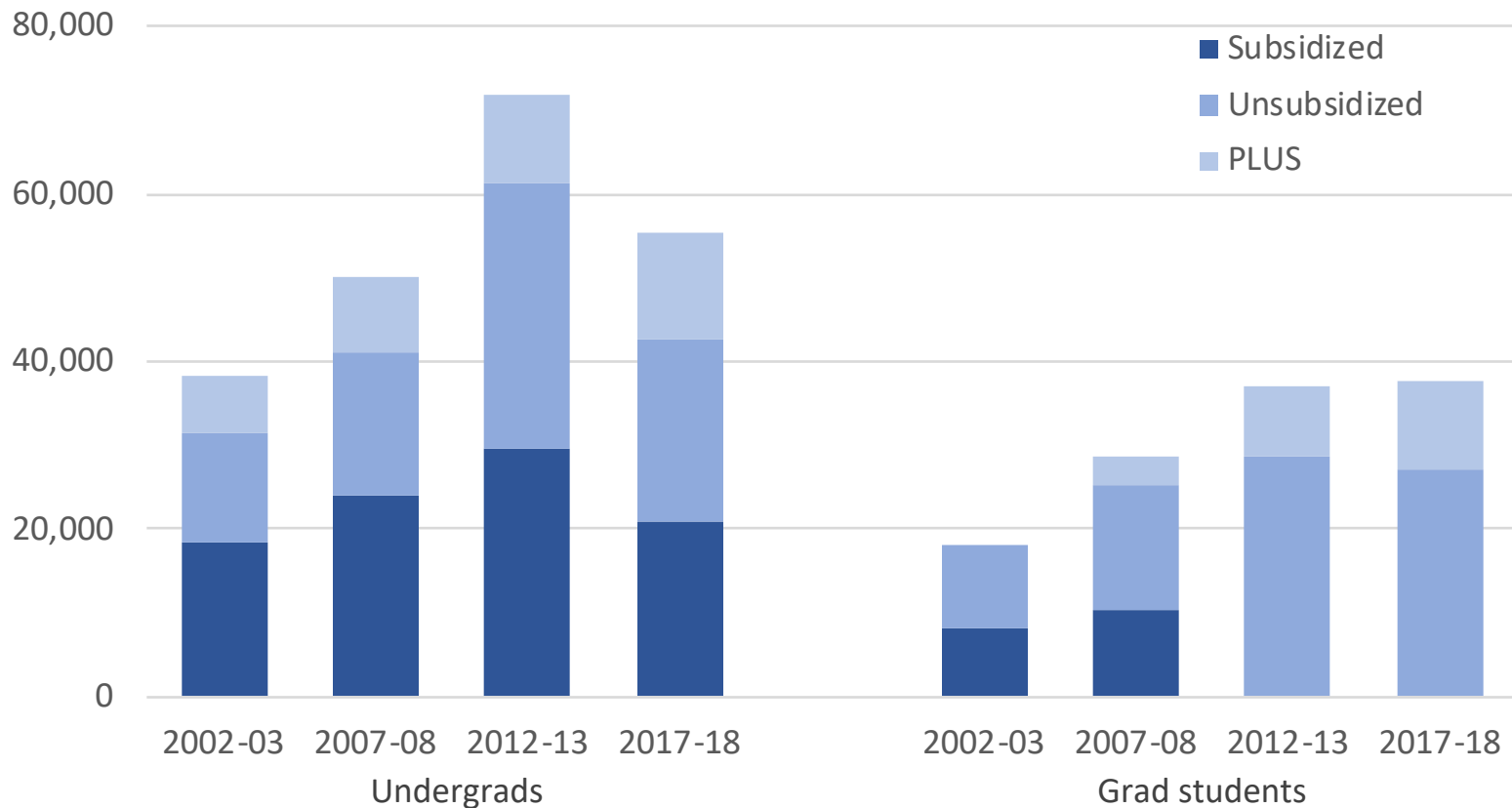


Source: [Federal Reserve Bank of New York](#)

Annual borrowing for undergrads has come down from peak but not for grad students

Total Annual Amount Borrowed

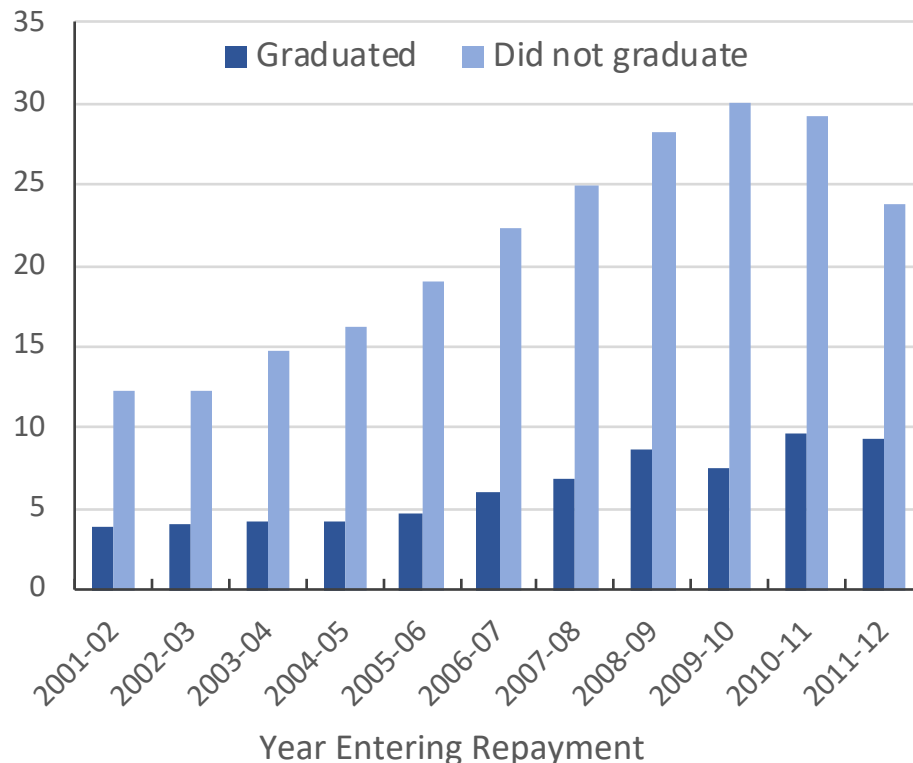
Millions of 2017 dollars



Source: [College Board](#)

Two-year cohort default rates up sharply, particularly for those who did not graduate

Percent



Note. Percent of students who had defaulted on at least one loan two years after starting repayment

Source. [College Board](#)

Research attributes much of the rise in CDRs to the recession and **a change in the composition of borrowers** (really a change in the higher-ed industry as I will discuss later)

[See [Mueller and Yannelis \(2016\)](#) and [Looney and Yannelis \(2015\)](#)]

Other facts and figures

Number of borrowers in 2018:	43 million
Average debt outstanding per borrower in 2018:	\$33,500
Share of households with student debt in 2016:	22%
Share of households age < 35	45%
Share of households age 55-64	13%
Median debt per borrowing household in 2016	\$14,369
Median for households age < 35	\$18,500
Median for households age 55-64	\$18,000

Sources: [Department of Education](#) and [Survey of Consumer Finances](#)

Generally desirable to have this program

Essential for economic mobility—given the lack of collateral and asymmetric information problems, loan supply from the private market alone would be much too low

Individuals are taking on more debt but the returns to a college degree have increased substantially over the decades

Net return on education still typically higher than that on other investments [[Avery and Turner](#), 2012; [Greenstone and Looney](#), 2011]

The problem is with the subset of education investments that don't pay off

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Background on the federal student loan program

Items of particular concern:

Default rates understate borrower struggles

For-profits

High-balance borrowers

Large and growing racial disparities

Improving student loan policy

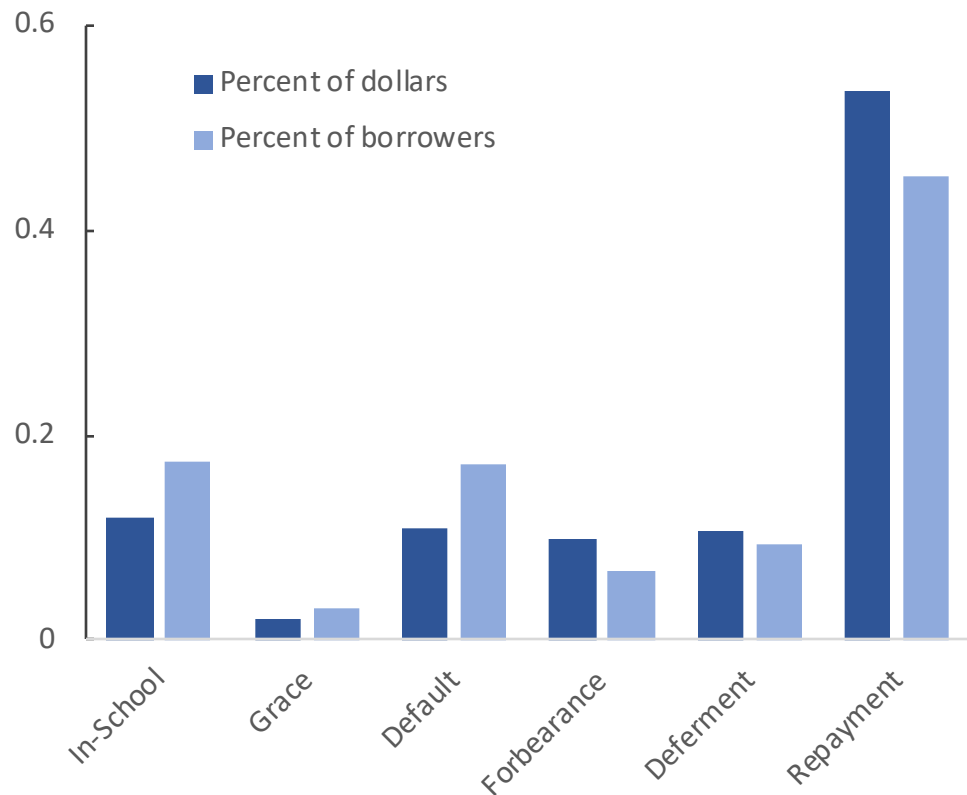
Student loan default rates grossly understate the struggles of borrowers

Borrowers facing hardship may be put into **deferment** or **forbearance**

21% of borrowers are still in school or in their grace period

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

Repayment Status of Federal Education Loan Portfolio: 2018:Q2



Source: [College Board](#)

ALSO

About 1/5 of borrowers (representing 2/5 of balances) are in income-driven-repayment plans:

Good that they are avoiding the negative consequences of default

But they are extending their terms and paying more interest

Given forbearance, deferral, and use of IDR plans, it's very important to look at repayment rates as well as default rates

The modest improvement in default rates since their peak in 2010 has coincided with an **increase in the share of borrowers not paying down their loans**

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

Source. [Federal Reserve Bank of New York](#)

Some research that tries to look beyond financial distress (but it's hard)

Student loans and homeownership rates—[Mezza, Ringo, Sherlund and Sommer](#) (2016), [Berger and Houle](#) (2015),

Student loans and auto ownership rates—[Kurz and Li](#) (2015)

Much of this research is **comparing former college students without loans to those with loans**

Important consideration is that without the loan, the latter group may not have had access to a college education at all

More interesting (but difficult) counterfactual is whether people would be better off in the absence of the program altogether

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Background on for-profit colleges

Enrollment share (of institutions in the student loan program) rose from 4% in the late 1990s to a peak of more than 11% in 2010 and has since come back down to 7% [[National Center for Education Statistics](#)]

Growth concentrated in **online institutions** and **chains**

Some valuable features—serve a more disadvantaged population, quicker to innovate, provide education and training in some fields that aren't served by other types of higher-ed institutions [[Deming, Goldin, and Katz, 2012](#)]

But concerns about **predatory practices**, **high tuitions** (and related run-up in debt), **low value-added**

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

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.

Fairly startling increase in for-profit share of the institutions that do a lot of borrowing

[Source: [Looney and Yannelis](#) (2015)]

More struggles with debt among for-profit borrowers

More likely to take on debt: For undergrads, borrowers per student much higher and originations per borrower a little higher than at other types of institution

Cohort default rates generally higher: 16% of FP borrowers in default 3 years after repayment started versus 7% at private non-profits and 10% at public institutions

Slower repayment of loans: FP degree completers had paid back 43% of loans after 5 years versus 67% for completers at all institutions (26% and 41% for non-completers)

They struggle because of worse labor market outcomes

[Less likely to graduate](#): 26% of students at 4-year FP institutions graduate within 6 years versus 57% at all 4-year institutions

[Looney and Yannelis](#) (2015)—lower median earnings, higher unemployment rates than for students at other types of higher-ed institutions

[Cellini and Turner](#) (2018)—less likely to be employed, 11 percent lower earnings compared with students at public institutions

[Armona, Chakrabarti, and Loveheim](#) (2018)—more loans, higher loan amounts, worse labor market outcomes for 4-year for-profit students

Unconditional results

Controlling for the more disadvantaged backgrounds of for-profit students

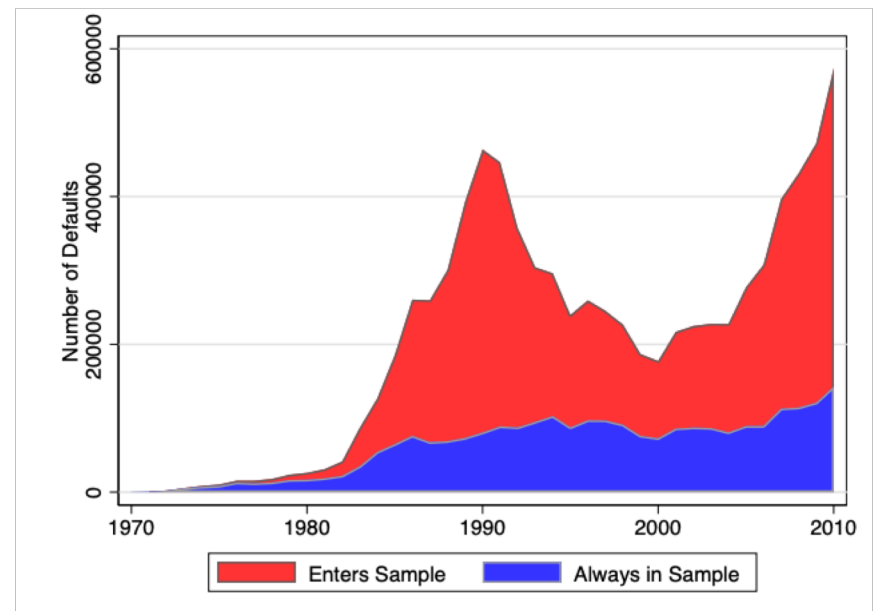
Relaxation of lending rules appears to explain much of the rise in for-profit borrower struggles

Cycles of federal rules imposing accountability on higher-ed institutions

Loosening of regulations in 1980s, then tightening (after default rates shot up) then gradual loosening

[Looney and Yannelis \(2018\)](#)— these cycles are highly correlated with for-profit entry and subsequent default rates

Defaults Broken Down by Whether School Initially in the Sample



Screenshot from [Looney and Yannelis \(2018\)](#)

Changes in federal regulations

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

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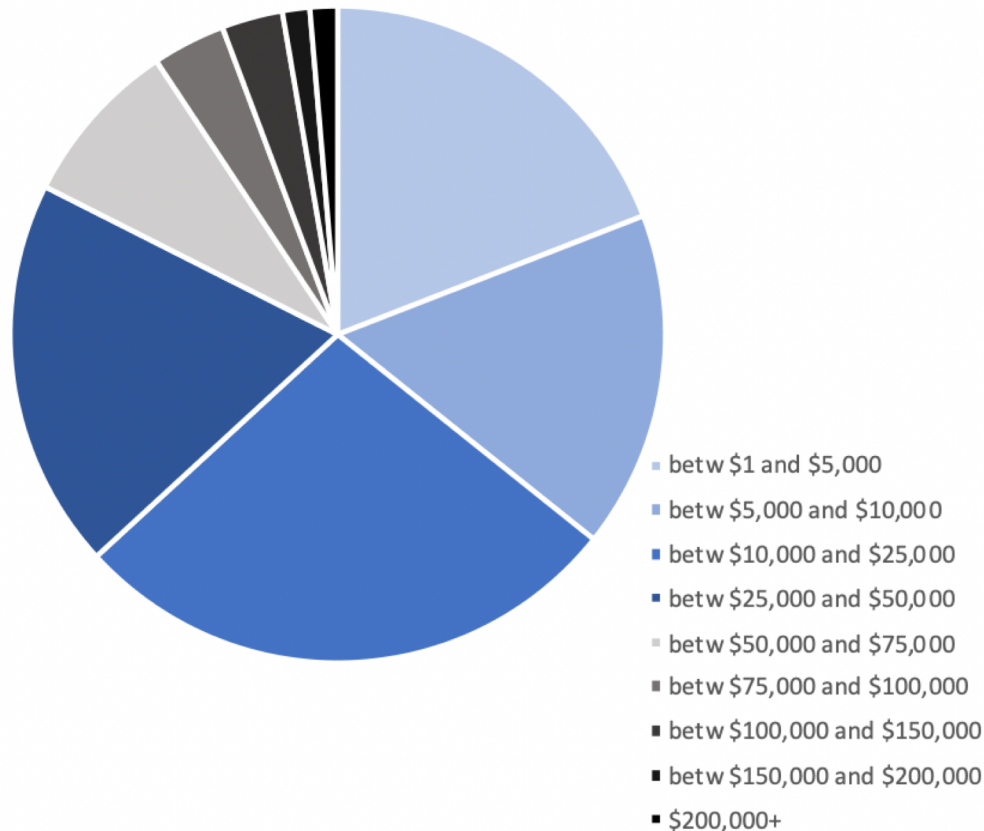
For-profits

High-balance borrowers

Large and growing racial disparities

Improving student loan policy

Distribution of Student Loan Balances: 2017Q4



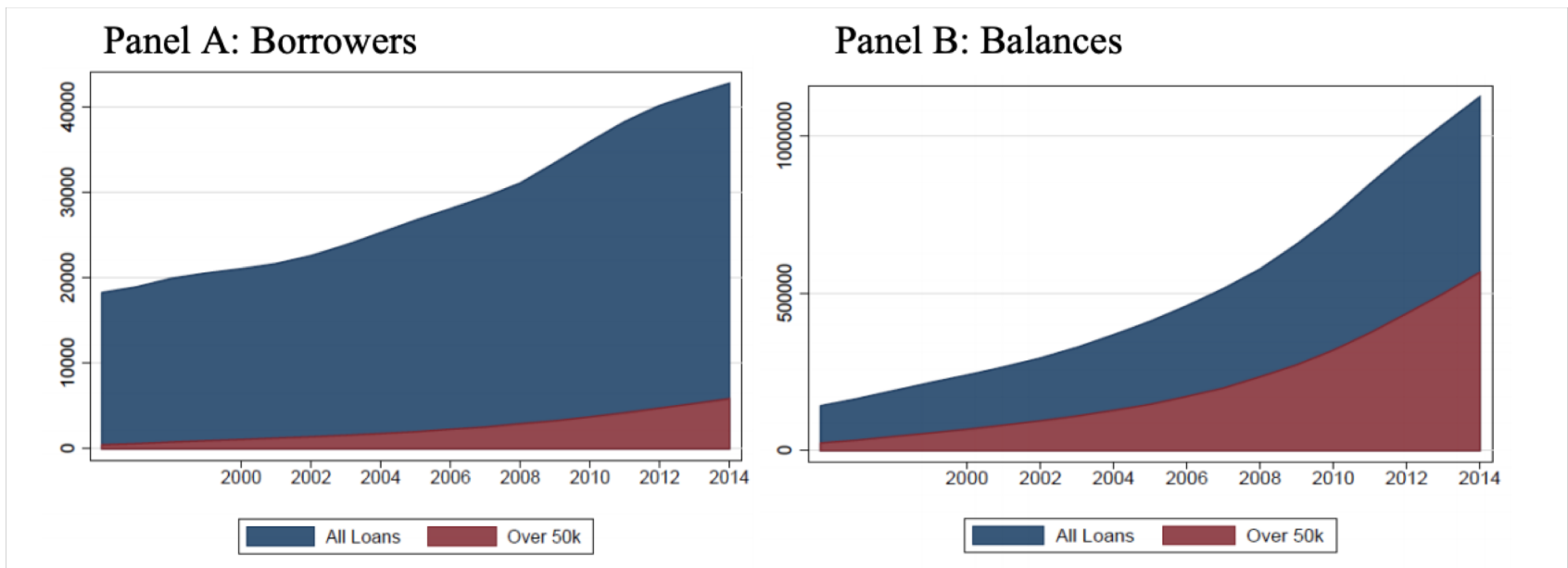
Most student loan borrowers have modest amounts of debt— $\frac{2}{3}$ had debt less than \$25,000 in 2017 (blue segments) [[Federal Reserve Bank of New York](#)]

But the $\frac{1}{8}$ borrowers who owed more than \$50K in 2014 (dark gray segments) accounted for $\frac{1}{2}$ of aggregate balances [[Looney and Yannelis, 2018](#)]

Source. [Federal Reserve Bank of New York](#)

The share of borrowers with balances over \$50K (in 2014 dollars) rose from 5% to 14% between 2000 and 2014

Their share of balances has also increased considerably



Screenshot from [Looney and Yannelis \(2014\)](#); dollar figures cited and charted are in 2014 dollars

Characteristics of high balance borrowers

61% of high balance borrowers in 2014 had taken out loans to attend **grad school**

In 2000 this share was 74% so we are seeing more high balances associated with funding undergrad education

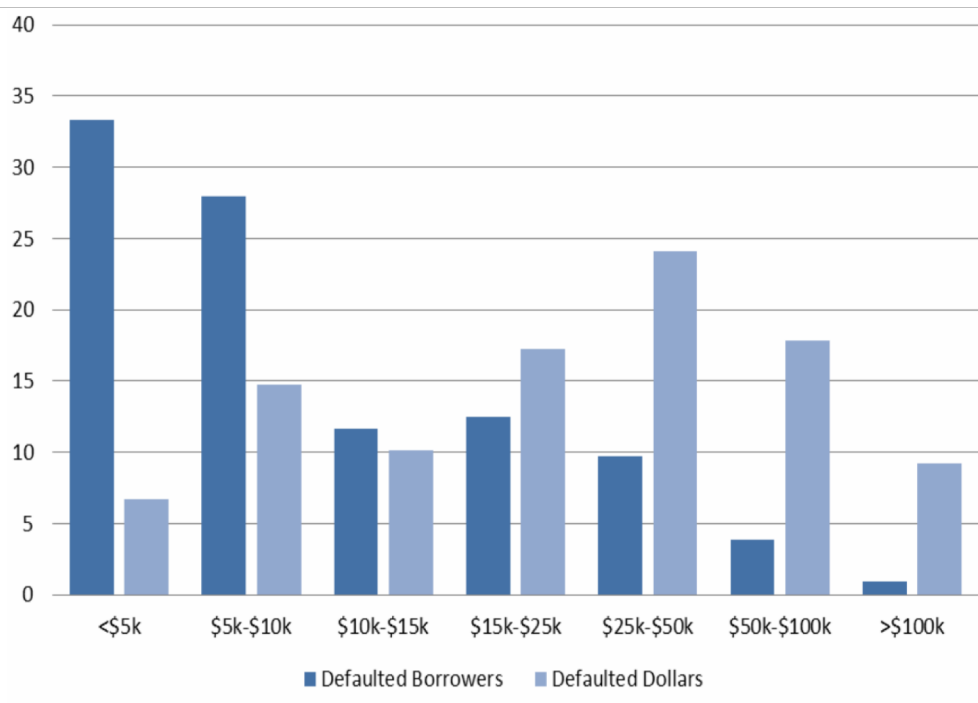
Parent PLUS borrowers represented 10% of high balance borrowers in 2014, up from 6% in 2000

Share borrowing to attend a **for-profit institution** was 15% in 2014, up from 5% in 2000

Source. [Looney and Yannelis](#), 2018

High balance borrowers tend to earn more income so less likely to default, but they disproportionately account for the \$s in default

Share of Borrowers and Dollars in Default



Screenshot from [Looney and Yannelis, 2018](#)

Moreover, the situation is worsening over time—**repayment rates have slowed more markedly** than for smaller-balance borrowers [[Looney and Yannelis, 2018](#)]

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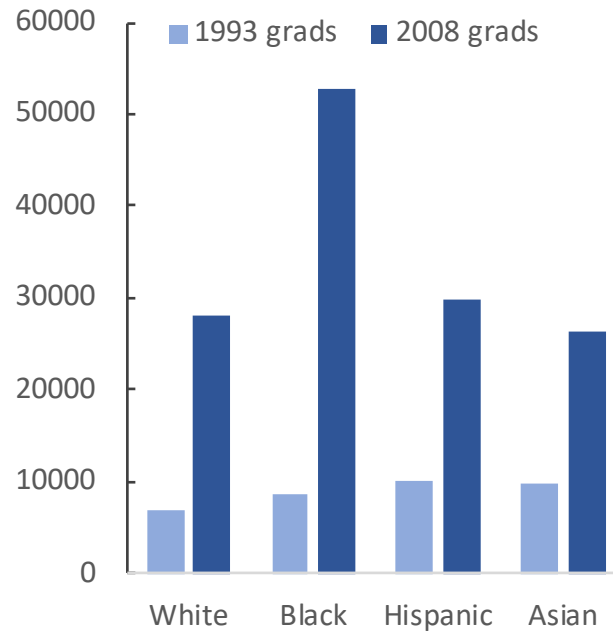
[Scott-Clayton and Li \(2016\)](#) find Black graduates more likely to have borrowed (90% of them have debt 4 years after graduating versus 71% of whites)

They also had much higher debt levels and were more likely to be in negative amortization

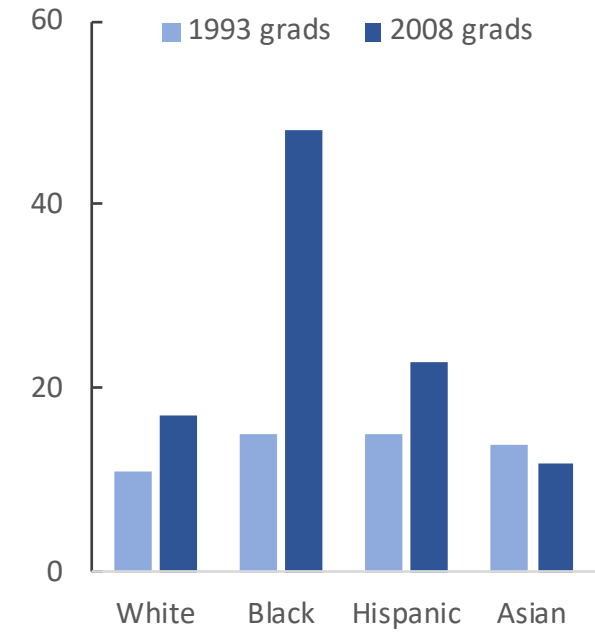
(Situation much worse than 15 years earlier)

Average Debt 4 Yrs after Graduation

2012 Dollars



Owed More than Borrowed 4 Yrs after Graduation
Percent



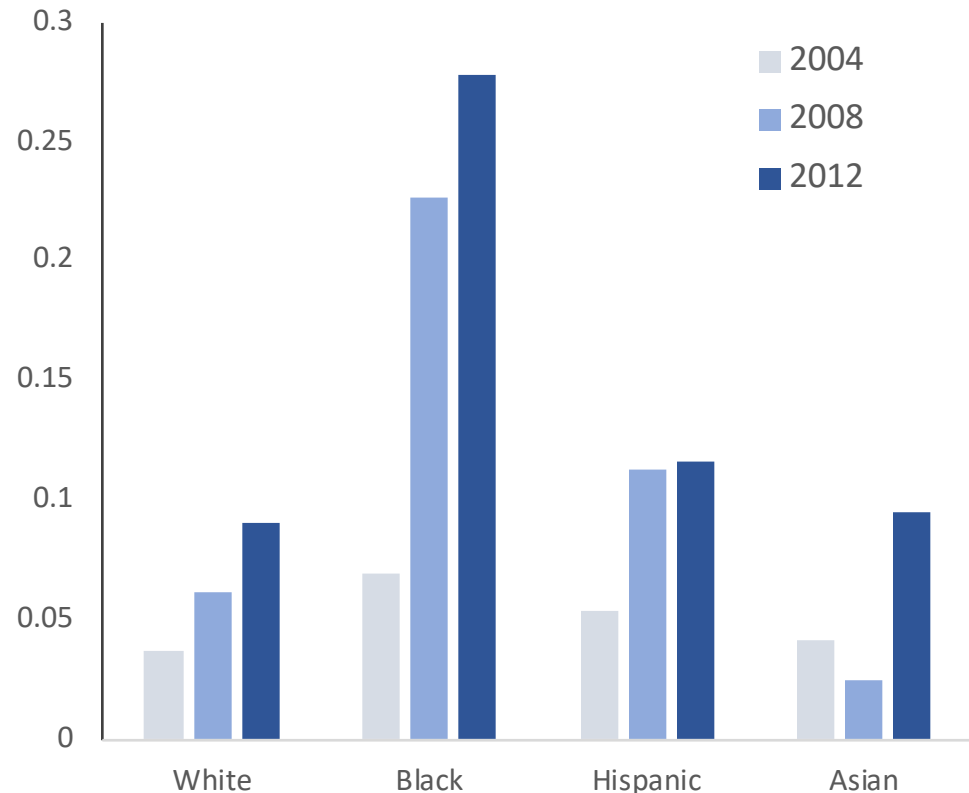
Source. [Scott-Clayton and Li \(2016\)](#)

Again some relationship to for-profits

Black graduates are more likely to have enrolled in graduate school within 4 years than white (47% versus 38%)

But more than ¼ of black graduate students are at for-profits

Share of Graduate Students in Different Race Groups Enrolled at For-Profit Institutions



Source. [Scott-Clayton and Li \(2016\)](#)

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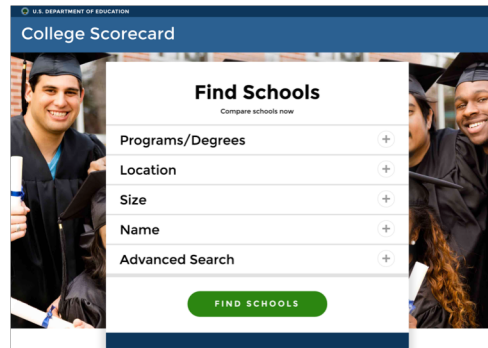
Improving student loan policy

Different types of policies

Policies to **relieve struggling student borrowers**

Policies to **impose accountability on higher-ed institutions**

Somewhere in between—[College Scorecard](#) which helps students, and helps with accountability



Current policy to relieve struggling borrowers is the **income-driven-repayment program**

Evidence that these plans do help borrowers avoid default [Mueller and Yannelis](#) (2019)

But **the IDR program has limitations:**

Administratively burdensome—borrowers have to recertify their information every year (documentation of family income, family size)

Based on previous year's income—doesn't help when it really might matter (e.g. when you've lost your job)

Inconsistent application across servicers

Ideas to address these IDR limitations

Switch to a system of **payroll withholding** (as in UK, Australia) as [Dynarski](#) has advocated:

- Avoids need for cumbersome paperwork

- Automatically adjusts with your earnings

- Takes loans servicers out of the process

Trade-offs—would be at the individual, not household level (more potential for moral hazard); would prioritize loan payments over other uses of earnings

More modest step would be to **switch to two-year recertification**

Also IDR has some problems when it comes to high-balance borrowers

Generally, **high-balance borrowers (many of whom have high earnings) benefit disproportionately from IDR**, especially given the potential for remaining balances to be forgiven after 20-25 years of reasonable payments

[Looney \(2018\)](#) example: orthodontist with \$1 million now in loans, earning \$255K per year, \$400K home, Tesla, paying only \$1,600 a month and **on track to have \$2 million in loans forgiven after 25 years**

Not clear how to fix this problem—but limiting the size of grad PLUS loans would be a starting point

Current policies to impose accountability

Schools with **high cohort default rates** (30% for 3 years, 40% in 1 year) risk losing access to the program

Schools limited to no more than 90% of revenues from federal aid (**90/10 rule**)

Borrower Defense Rule—*protections for borrowers who have been defrauded (Obama regulation; current Administration weakening)*

Gainful Employment Rule—*schools with systematically high debt-to-earnings risk losing access (Obama regulation; current Administration has announced it will rescind)*

I hope I have persuaded you that these accountability measures are not enough

Growing body of evidence that certain schools (especially in the for-profit sector) consistently deliver low-value educations to their students

First order of business is don't weaken Borrower Defense Rule and **don't rescind Gainful Employment Rule** [see recent [Black, Cellini, Deming, Dynarski, Looney, Matsudaira, Rothstein](#) letter to the Dept of Education]

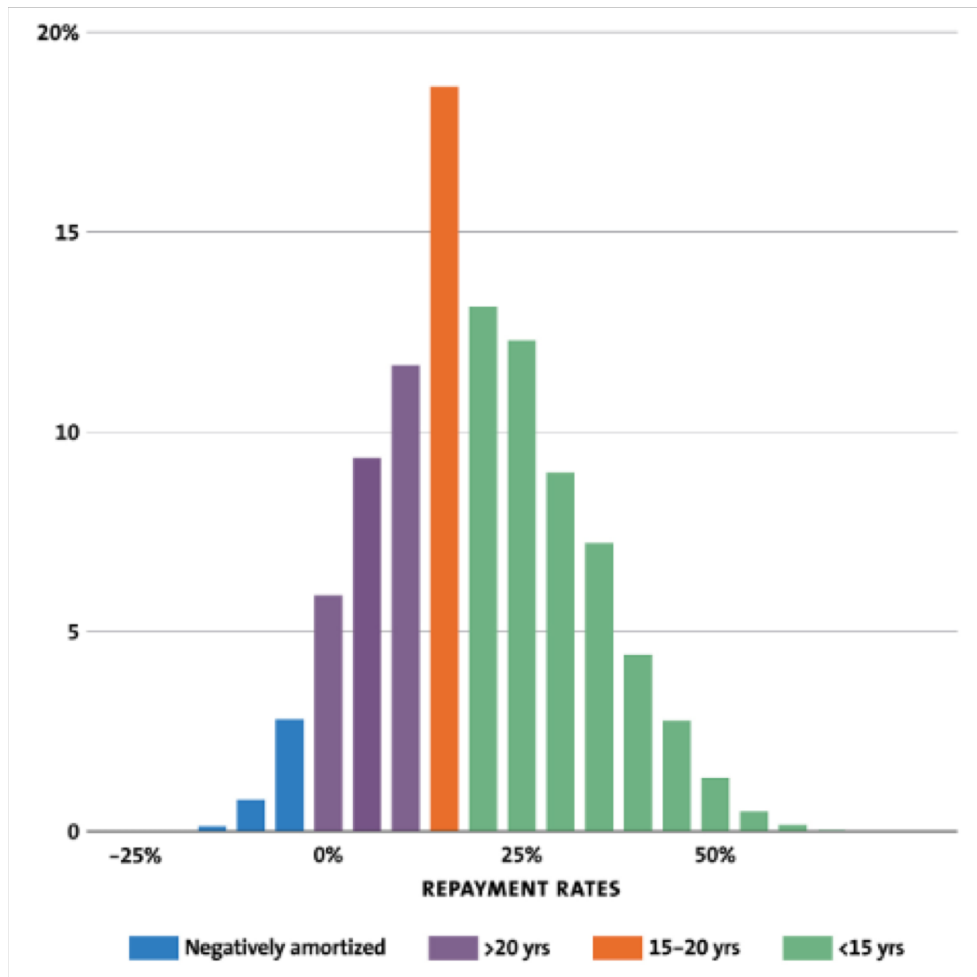
Also consider **reversing some of the relaxation of standards** that occurred in the last decade, e.g. allowing fully on-line institutions [evidence that [1/3 of rise in defaults due to online schools](#)]

Important limitation regarding current accountability focus on default rates

As discussed earlier, cohort default rates understate borrower struggles—partly because our IDR program masks them!

To address this limitations, we need to **sanction schools based on repayment rates**

Distribution of 5-Year Repayment Rates Across Institutions (for 2009 cohort)



[Looney and Watson](#)

(2018) evidence:

For 5% of schools, the borrowers collectively owe more than they borrowed 5 years after graduation (blue bars)!

For another 32%, the borrowers collectively won't pay off their debt in 20 years (purple bars)

Weighted by undergrad borrower count

A “risk-sharing” program based on repayment rates

[Chou, Looney, and Watson](#) (2017):

Assess schools based on **cohort repayment rates**

For schools where borrowers collectively not on track to repay loans in 15 years, impose **continuum of penalties depending on how badly schools perform**

Essentially requiring poor-performing schools to pay back some of loans that are not being repaid

A “risk-sharing” program based on repayment rates

Part of the idea is to **protect taxpayers**

But **incentivizing schools to provide more value-added**—match students better with programs, teach better, encourage graduation, assist with job placement

In addition to being based on a better metric, an advantages of this proposal relative to current CDR measure is that the **continuum means you aren’t just penalizing schools with extremely poor outcomes (more general incentive, less potential to game)**

Central tension with all of the accountability measures

The schools that have worse loan performance are generally the ones that serve the most disadvantaged students

How do you balance access to credit (and economic mobility!) with the financial risks to the federal budget and the students themselves?

Spurred much contentious debate when I was in the Administration

Central tension with all of the accountability measures

So, important to think about **carve-outs or rewards for schools serving low-income students** or other underserved populations as you design these measures

Some perhaps comforting evidence from [Cellini, Darolia, and Turner](#) (2016)—sanctions on for-profits in 1990s led to 40% drop in enrollment but most students absorbed by public-sector schools (only 3% drop in market enrollment)

Other ideas

Shift higher-ed aid toward grants—perhaps a better use of the taxpayer \$ than loans given all the payment problems

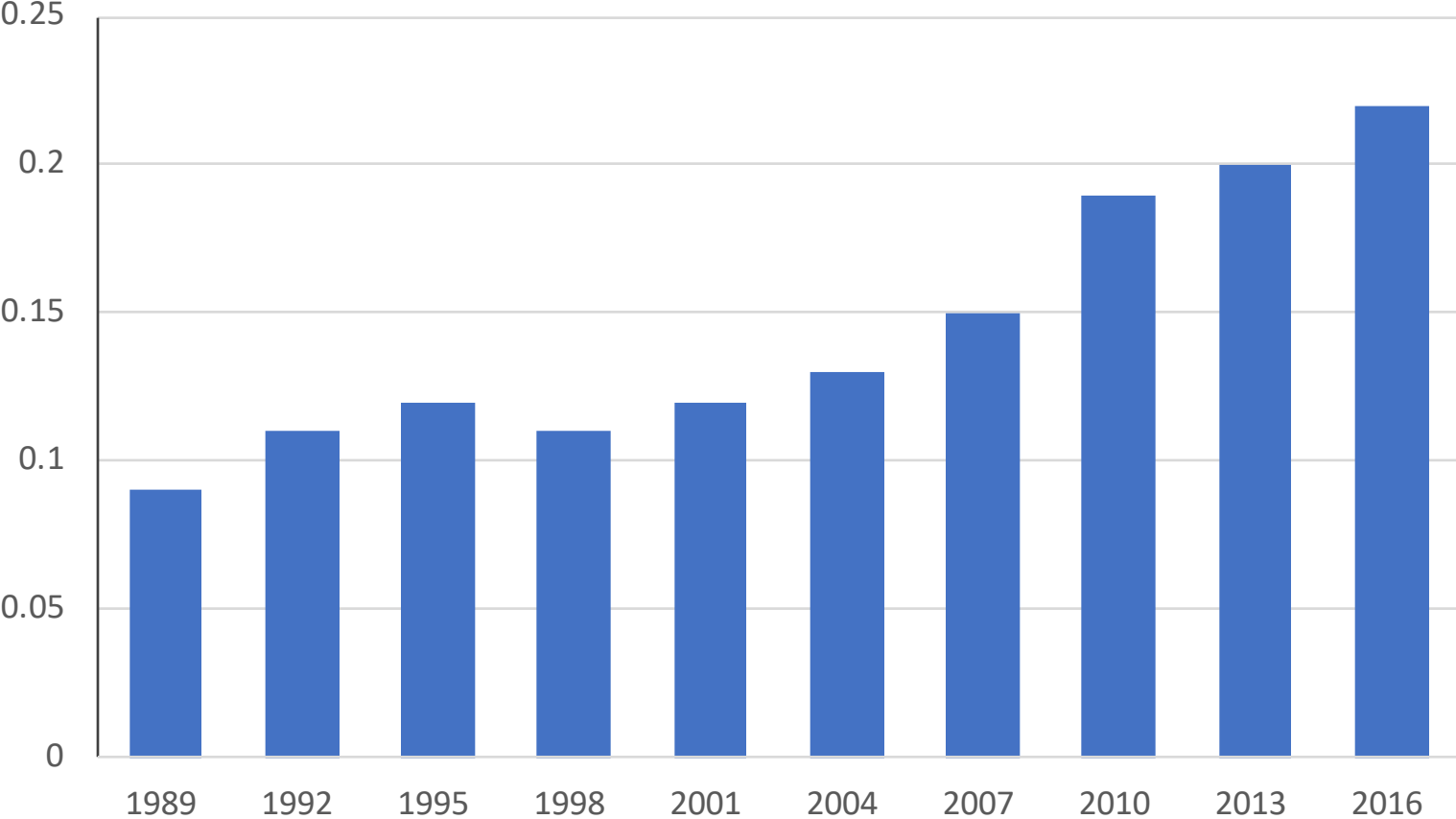
Free community college—in the last Administration's final budget

Income-share-agreements—some interesting experimentation in this area (Purdue) but we need to be wary of bad actors as the industry is almost entirely unregulated

Questions?

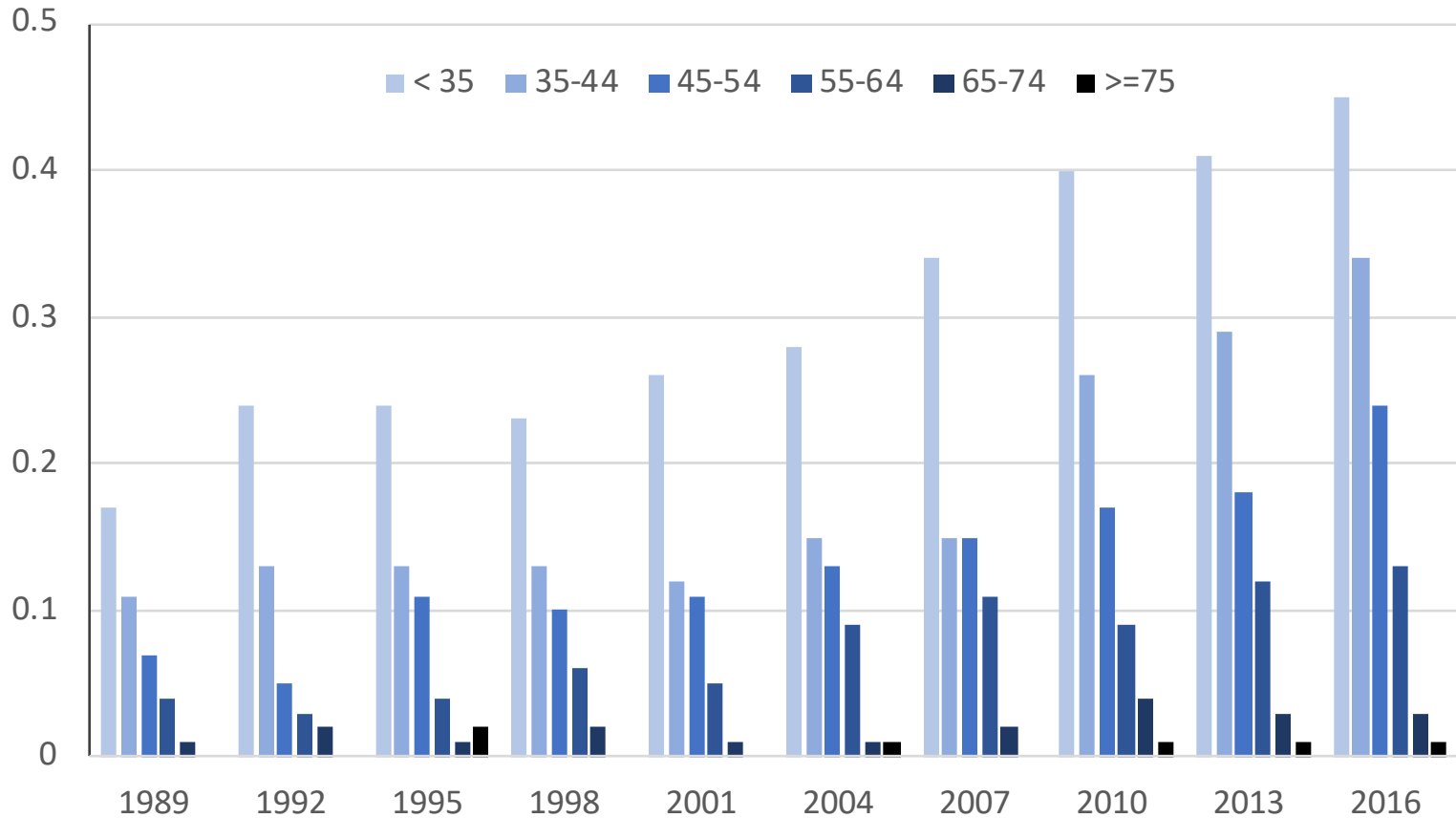
Extra slides

Share of Households with Student Debt



Source: [Survey of Consumer Finances](#)

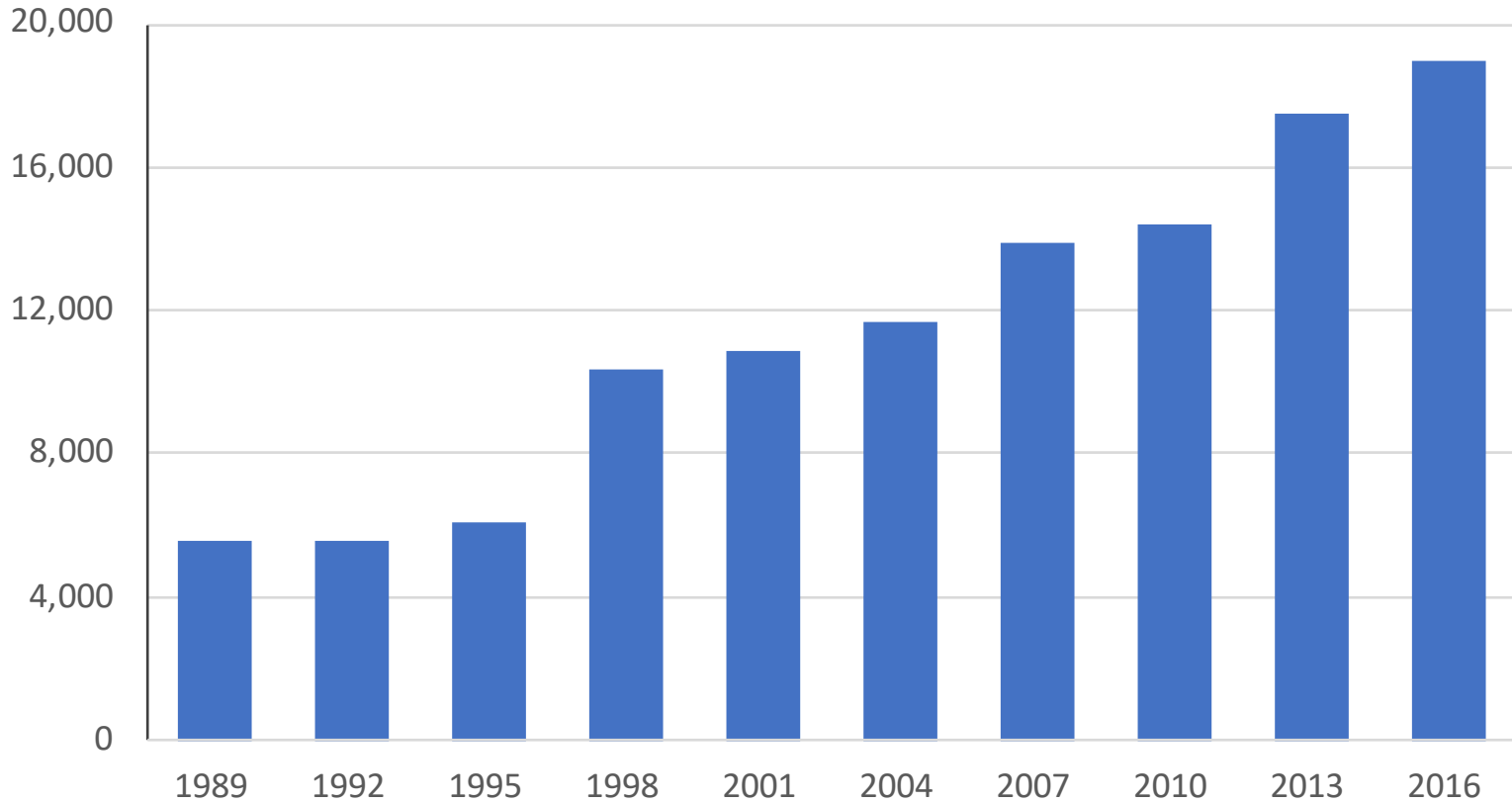
Share of Households with Student Debt by Age



Source: [Survey of Consumer Finances](#)

Median Household Student Debt for Those with Debt

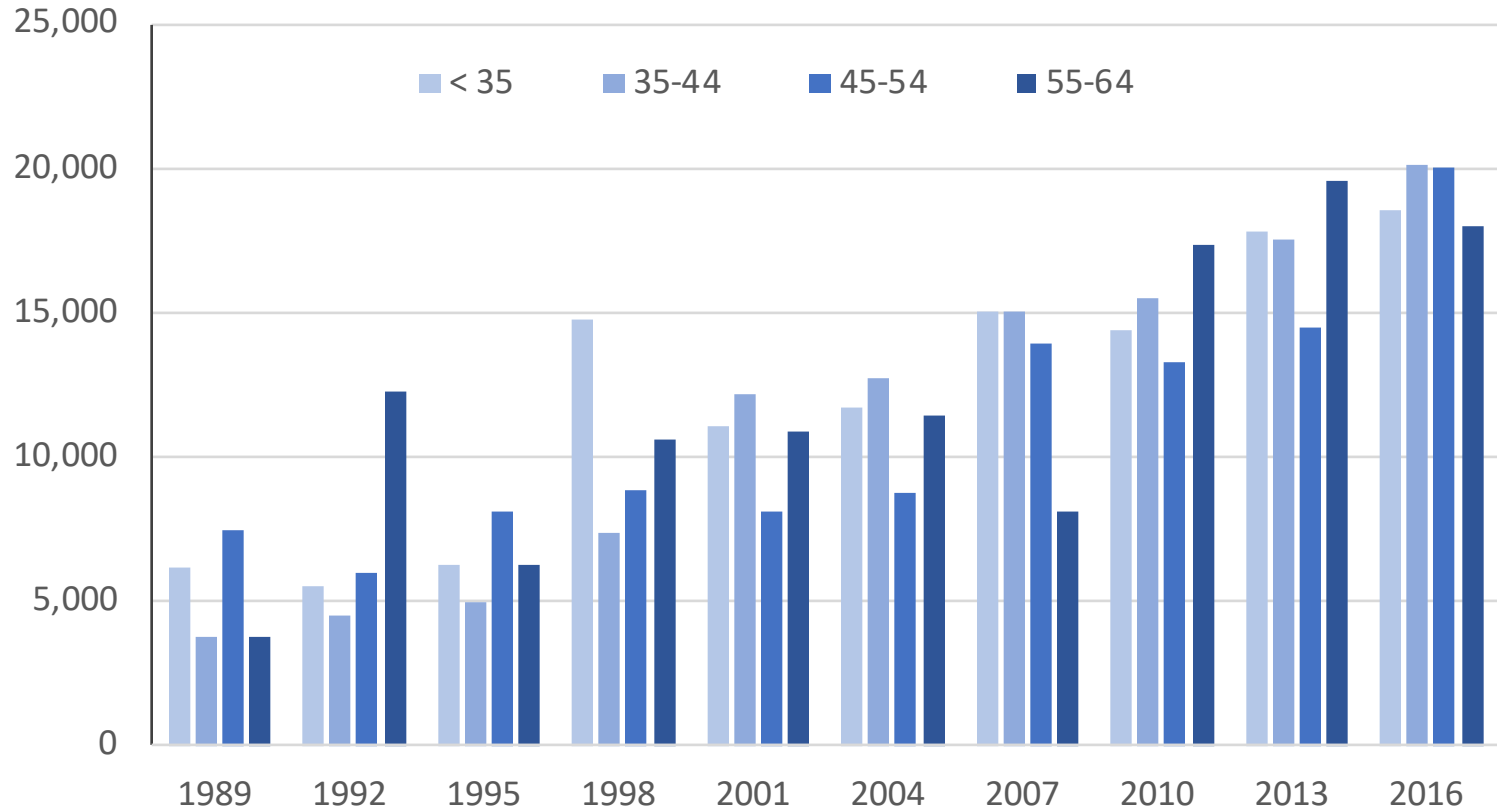
2016 dollars



Source: [Survey of Consumer Finances](#)

Median Household Student Debt for Those with Debt by Age

2016 dollars



Source: [Survey of Consumer Finances](#)