



## How Federal Policymakers Should Address the Student Debt Crisis

OCTOBER 16, 2017

Laura W. Perna, University of Pennsylvania

The number of 18 to 24-year-olds enrolled in college increases each year as greater emphasis continues to be placed on higher education. To pay for college, many students take out loans. In 2012, two-thirds of the seniors graduating with a bachelor's degree from a public, four-year institution had taken out loans – up from the 62% with loans in 2008 and the 46% in 1993.

Americans seem to take it for granted that college students can and should use loans to pay at least some of the costs of higher education – and loans do seem to work for students who borrow a reasonable amount, complete their degree programs, and obtain the high-paying jobs. A typical college graduate with loans owes less than \$30,000, and will earn at least half a million in today's dollars beyond the earnings of a typical high school graduate. But even though the return on investment looks good on average, many students are unaware of the risks and costs associated with borrowing and paying for college and graduate degrees.

### Off-Ramps on the Expected Road to Repayment

Although many students graduate, get good jobs, and are able to pay back their loans, for others the path to repayment is not so simple – because many students do not complete degrees and others earn insufficient postgraduate incomes.

- Fewer than six in ten students who first enrolled in higher education in fall 2009 completed a degree from any college or university within six years.
- Less privileged students are most at risk: Only 36% of students from low-income families, 33%

of students whose parents did not attend college, and 34% of Black and Hispanic students who enrolled in a public, four-year institution for the first time in 2004 completed a bachelor's degree within five years.

- Some prospective students try to reduce the need to borrow by enrolling part-time, which lengthens the time to degree and may reduce the likelihood of completing the program. Students working long hours also have less time for academic engagement.
- Students who complete their degrees but do not go on to earn high incomes also tend to have difficulty repaying their loans. One in ten college graduates between the ages of 35 and 44 earn less than \$20,000, which is less than the average income of most high school graduates.

Borrowers who default on student debts face serious consequences. More than a million students defaulted on their federal direct loans in 2015. Default rates were 24% for borrowers entering repayment in 2011-12 who had not completed their programs compared to nine percent for those who had earned their degrees. Defaulters can face wage garnishments or other requirements to pay the costs of collecting the loans. They end up with reduced credit scores and may be ineligible for federal financial aid in the future.

### **What Should Federal Policymakers Do?**

Reflecting on these data and other findings about student borrowers and the effects of various policies and practices, James Kvaal, Roman Ruiz, and I have developed three recommendations for federal policymakers:

***Give students comprehensive information about student loans.*** One reason that students make bad decisions is that many they lack complete or accurate information. Many are unaware of the availability of mechanisms like deferment and forbearance – which can allow students to temporarily stop making payments on federal loans or temporarily reduce the amount of payments and can prevent default. Improving information is not easy given the complexity of our nation's financial aid system, the many different colleges and universities, and variations in students'

personal circumstances. But more research could help discover improvements.

***Protect students against risks of non-repayment.*** Given low rates of completion at many postsecondary educational institutions and the possibility that post-college earnings will be too low to allow repayment, loans are risky for borrowers. Federal policymakers can reduce the risk of non-repayment by preventing institutions with low completion rates from disbursing federal loans. Another approach would be to create a form of risk-sharing, whereby institutions must help with repayments if they have high loan default rates. Such strategies could encourage improved institutional practices – but they might also prompt institutions to stay out of federal loan programs, avoid low-income or academically challenged students, or simply game the metrics.

The federal government can also protect students from the risks of non-repayment through income-driven repayment plans. Such plans are especially helpful for individuals who have low earnings, either early in their careers or over their entire working lives. Efforts to increase participation in income-driven repayment should recognize the potential downsides. Institutions might find it easier to hike tuition; and some students might borrow more funds than they really need or fail to make repayments they could afford. Repayment programs require careful administration – and administrative reforms might be in order. Unlike in England and Australia, U.S. student loan records are not automatically linked to the tax system. Consequently, borrowers in income-driven repayment must annually report their income to the U.S. Department of Education, a cumbersome system.

**Improve data and use research findings.** Many questions about student loans remain. More needs to be learned about the policies and practices that enable students to obtain the financial resources required to pay college costs, without facing too great a loan repayment burden. To improve federal student loan programs, the federal government should increase research funding. Equally important, federal agencies should make existing data and evaluations more accessible, especially when lawmakers and educators are considering refinements and reforms in existing loan and repayment programs.

Read more in Laura W. Perna, James Kvaal, Roman Ruiz, "**Understanding Student Debt: Implications for Federal Policy and Future Research,**" in the *ANNALS of the American Academy of Political and Social Science*, 671, 1, (2017), 270-286.