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Student Loan Debt Levels and Their Implications for Borrowers, Society, and the Economy

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Introduction

Upward mobility is a prized aspect of the American dream based upon the belief that those from humble origins can climb the socioeconomic ladder through education and hard work. Increasingly, postsecondary education is an essential component of that dream. However, many students, particularly those from low to moderate income families, find it necessary to rely upon student loans, which include direct loans from the U.S. Department of Education as well as those from private lenders, to finance their studies.[1] A growing concern among policymakers is the increasing amount of debt students incur to pay for their postsecondary education. This article provides an overview of the implications associated with the growing student loan debt burden for borrowers, society, and the economy.

Background

Federally sponsored student loans are not a new phenomena in the United States. In 1958, the U.S. Congress passed the National Defense Education Act (NDEA)[2] in response to Russia's launch of Sputnik. The NDEA focused upon preparing teachers in science, mathematics, and foreign languages by providing low interest loans and loan forgiveness, if, after graduation, students pursued a teaching career. Then, in 1965, the Higher Education Act created the Guaranteed Student Loan Program.[3,4]

The Higher Education Act dramatically expanded federal financial aid. Specifically, Title IV authorized need-based student grants, which would later become known as Pell grants, and the Guaranteed Student Loan Program, consisting of subsidized and unsubsidized loans.[5] The 1972 reauthorization of the Higher Education Act went further, expanding the Stafford loan program to students attending for-profit postsecondary institutions.[6] Later, in 1978, Congress passed and the President signed into law the Middle Income Student Assistance Act.[7] It removed needs-testing for unsubsidized guaranteed student loans, again greatly expanding access. In 1979, technical amendments to the Higher Education Act increased aggregate loans amounts and allowed students without a high school diploma to be eligible for student loans.[8]

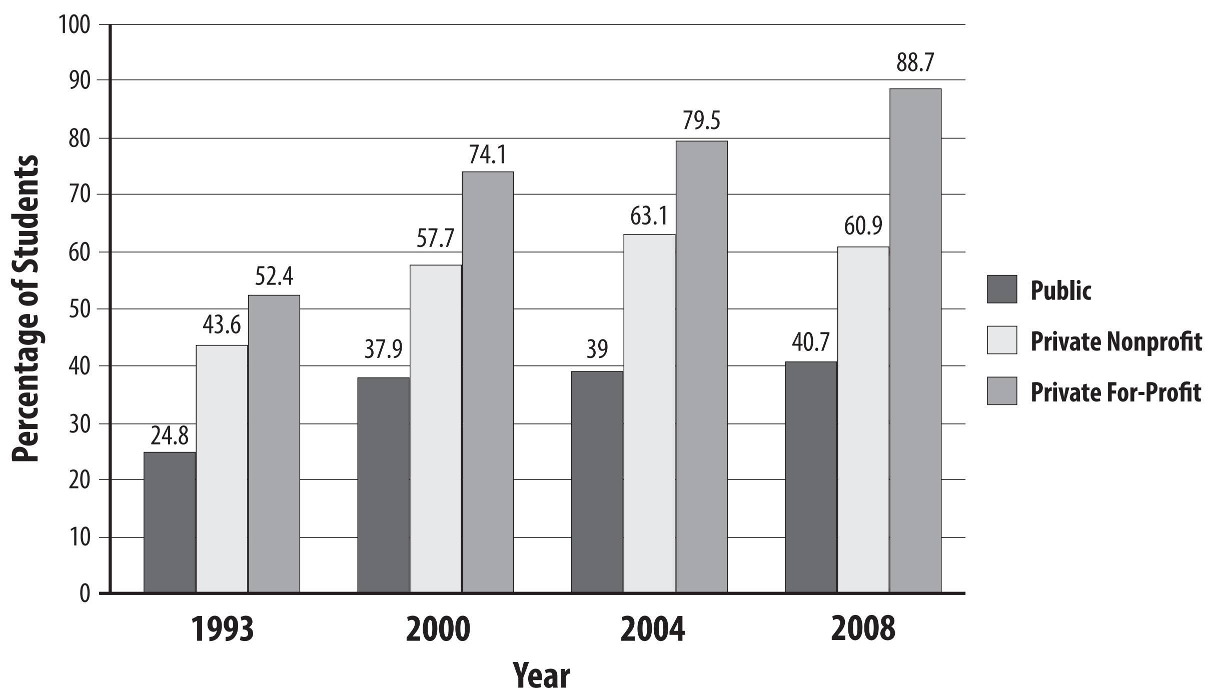
As a result of decades of expanding access to student loans along with the increasing cost of college and the failure of federal grants to keep pace with such costs, the percentages of students with student loans has increased dramatically.[9] Figure 1 provides a comparison of the percentage of full-time students in public, private nonprofit, and for-profit postsecondary institutions receiving federal student loans between 1993 and 2008.[10] In 1993, approximately one-quarter of full-time students in public postsecondary institutions took out student loans. By 2008, this percentage had risen to 41%. For full-time students attending private nonprofit postsecondary institutions, approximately 44% had student loans in 1993. This percentage rose to nearly 61% in 2008, a slight decrease from 2004. Most startling, however, was the increase in the percentage of students with federal student loans in for-profit postsecondary institutions. Even in 1993, over half of students (52.4%) attending for-profit postsecondary institutions financed at least a portion of their education with student loans; and, by 2008 approximately 89% did so. The rate of increase for for-profit institutions over this time period was more than double that of public and private nonprofit institutions.

Figure 2 provides a comparison of average amount per student of federal loan by type of institution attended between 1993 and 2008. In 1993, the average federal loan for a full-time student attending a public postsecondary institution was $3,270. By 2008, it had almost doubled to $6,450. With regard to the average federal loan for students at private nonprofit postsecondary institutions, the scenario was similar. In 1993, the average loan amount per student was $4,190, rising to $8,220 in 2008. Nonetheless, on average, students attending public institutions borrowed significantly less than their counterparts at private nonprofit colleges and universities. In 1993, full-time students attending for-profit institutions borrowed on average $4,680, the highest amount across the three types of institutions. However, the average loan amount per student rose less over time. By 2008, it was $7,230. This amount was approximately $800 higher than the average amount borrowed by students at public institutions, and it was almost $1,000 per student more than the amount for private nonprofit schools.

Student Loan Debt Concerns

Policymaker concern about levels of student debt is not new.[11] As early as the mid-1980s, federal lawmakers expressed concern about the growth in student loans and the change in the ratio of grants to loans, in the sense that the proportion of grants was diminishing while that of student loans was increasing. More recently, a major concern about student debt revolves around borrowers' ability to repay. Specifically, higher levels of student loan debt reported in the previous section have translated into a lower percentage of borrowers in repayment one year post-graduation, from 65% and 66% of 1994 and 2001 graduates, respectively, to 60% of 2009 graduates.[12]

Figure 1 | **Percentage of Full-Time Students in Public, Private Nonprofit, and For-Profit Postsecondary Institutions Receiving Federal Student Loans: Selected Years 1993-2008**



Source: U.S. Department of Education, *Digest of Education Statistics, 2011*, Table 358. Washington, DC: National Center for Education Statistics, Institute of Educational Statistics, 2012.

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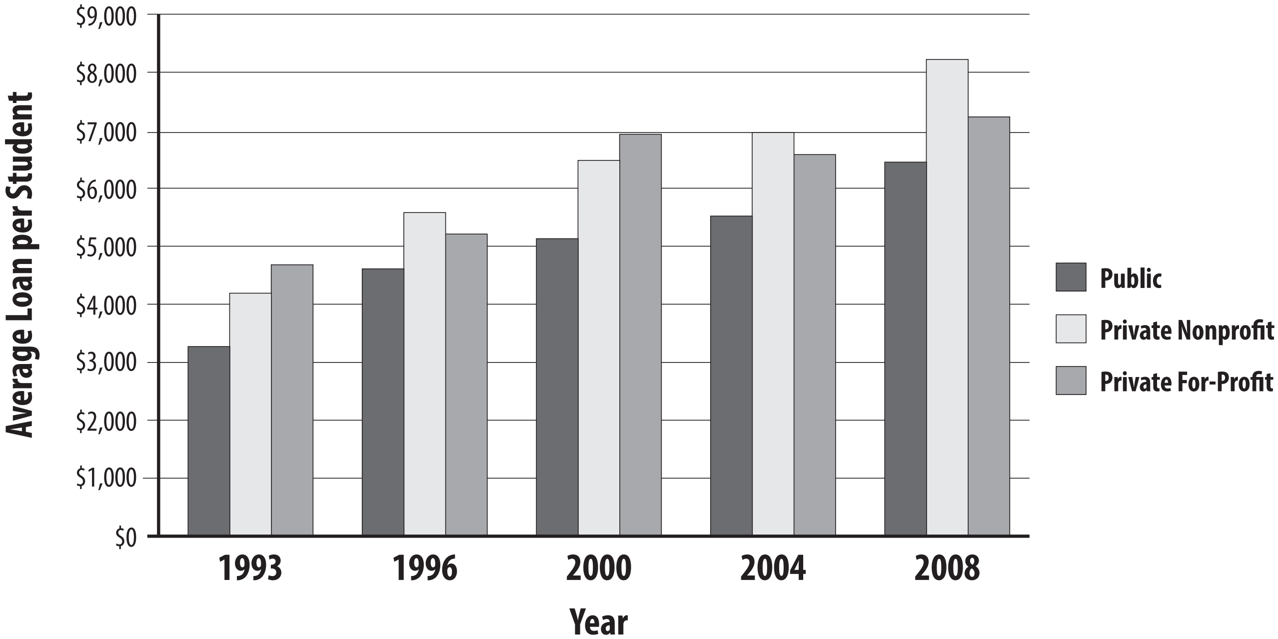
Figure 2 | **Average Annual Federal Loan Amount per Full-Time Students in Public, Private Nonprofit, and For-Profit Postsecondary Institutions: Selected Years 1993-2008**



Source: U.S. Department of Education, *Digest of Education Statistics, 2011*. Table 359. Washington, DC: National Center for Education Statistics, Institute of Educational Statistics, 2012.
Note: Amounts are in unadjusted dollars.

The most serious issue related to student loan debt is default, defined as failure of a student borrower to make a payment for 270 or more days.[13] Here, too, concerns about default rates are not new.[14] Between 1987 and 2011, default rates fluctuated between a high of 22.4% in 1990 to a low of 4.5% in 2003. However, since 2005, default rates have risen steadily to the 2011 rate of 10.0%.[15] Recently, the U.S. Department of Education moved from a two-year calculation of default rate to one that spans three years. Using this approach, default rates would be significantly higher: 13.4% and 14.7% for 2009 and 2010, respectively, rather than the two-year approach to calculation which yields a rate 8.8% and 9.1%, respectively.[16]

Implications for Borrowers, Society, and the Economy

In addition to the potentially negative implications of debt levels for students, it is also important to consider the broader implications for society and the economy. First, the level of student loan debt may affect individuals' career choices, for example, by leading them away from public service careers to more lucrative employment in the private sector.[17] Such choices have profound implications for filling positions in education, public administration, and social welfare. Second, the magnitude of individual borrowers' student loan debt burden may affect their consumer decisions. Faced with a large monthly student loan payment for a decade, newly employed college graduates may delay major purchases, such as a car or home, not to mention even basic purchases to set up a household after graduation. In 2011, the interest rate for Stafford loans was 6.8%. With a normal ten year repayment schedule, a $30,000 student loan would require a yearly repayment of $4,140, or $345 per month, a significant amount for many new graduates. College graduates in this position might decide to postpone marriage or starting a family.[18] Reduced consumer spending affects the U.S. economy at all levels–local, state, and national. Finally, filing bankruptcy to discharge student loans is difficult except in those cases where failure to do so would amount to "undue hardship" as defined in law.[19] As such, the notion of a “fresh start” that a bankruptcy would normally allow is rarely available to student borrowers regardless of their debt burden.

Conclusions and Policy Implications

There are obviously a large number of policy issues that revolve around student loans. This policy perspectives article has focused on the growing burden of student loan debt on borrowers, society, and the economy. That is not to say that other policy issues, such as those related to for-profit postsecondary institutions, are unimportant.[20] The same can said for affordability and equity of access to postsecondary education.[21] A third, and related issue, is diminished state aid to public universities and colleges which has created a vicious circle as these institutions often react to state funding cuts by raising tuition, hence pricing out more students.[22] Importantly, student loan debt burden is interwoven with the other policy issues outlined above. The need for policy solutions at both the federal and state levels is urgent in order to ensure opportunities for upward mobility and maintenance of a robust economy.

Endnotes

1 The analysis presented in this article is limited to federal student loan debt which represents the majority of student debt and is federally guaranteed in the case of student default.

2 Pub. Law 85-864 (1958).

3 Pub. Law 89-329 (1965).

4 In an effort to make higher education more accessible, several federal financial aid programs were created with the 1944 Servicemen's Readjustment Act (Pub. Law 346, Ch. 268). Also known as the "GI Bill," it provided direct aid to veterans returning from World War II to attend college.

5 Federally guaranteed student loans were renamed "Stafford loans" in 1998. Today they are referred to as "direct loans."

6 Pub. Law 92-318 (1972).

7 Pub. Law 95-566 (1978).

8 Pub. Law 96-149 (1979).

9 William Zumeta, David W. Breneman, Patrick M. Callan, and Joni E. Finney, *Financing American Higher Education in the Era of Globalization* (Cambridge, MA: Harvard Education Press, 2012).

10 Public postsecondary institutions include four-year doctoral, other four-year, two-year, and less than two-year. Private, nonprofit postsecondary institutions include four-year doctoral, other four-year, and less than four-year. Private, for-profit institutions include two-year and above, and less than two-year.

11 Lawrence E. Gladieux, "Federal Student Aid Policy: A History and an Assessment" (Washington, DC: U.S. Department of Education, October 1995), https://www2.ed.gov/offices/OPE/PPI/FinPostSecEd/gladieux.html.

12 Jennie H. Woo and Matthew Soldner, "Degrees of Debt" (Washington, DC: U.S. Department of Education, October 2013), 9, http://nces.ed.gov/pubs2014/2014011.pdf.

13 Ibid., 18.

14 Delinquencies, or late payments, of student loans also have serious repercussions for borrowers. They result in higher interest payments over the life of the loan, and they negatively affect borrowers' credit ratings. For every one default there are two delinquencies. See, Alisa F. Cunningham and Gregory S. Kienzl, *Delinquency: The Untold Story of Student Loan Borrowing* (Washington, DC: Institute for Higher Education Policy, 2011), http://files.eric.ed.gov/fulltext/ED517424.pdf.

15 Specifically, these refer to "two-year" default rates, defined as "the percentage of borrowers who enter repayment in a fiscal year and default by the end of the next fiscal year." See, "National Student Loan Two-Year Default Rates" (Washington, DC: U.S. Department of Education), https://www2.ed.gov/offices/OSFAP/defaultmanagement/defaultrates.html.

16 Sridharam (2012) asserted that default rates are even higher after the three year time frame. See, Vassanth Sridharam, "The Debt Crisis in For-Profit Education: How the Industry Has Used Federal Governmental Dollars to Send Thousands of Students into Default," *Georgetown Journal on Poverty Law & Policy* 19: 30-58.

17 Jesse Rothstein and Cecelia Elena Rouse, "Constrained after College: Student Loans and Early-Career Occupational Choices," *Journal of Public Economics* 5 (1-2): 149-163. The authors examined the results of a unique social experiment by a highly selective university, whereby the university introduced a no-loan policy for any student who would have normally taken out student loans. Instead, the amount of financial need was replaced by grants. The job choices and starting salaries of two cohorts were compared, one from 1995 with loans and one from 2002 under the no-loan policy. Rothstein and Rouse concluded that graduates with higher debt levels were less likely to accept lower paying jobs, which included ones in the public sector.

18 Ibid.

19 Rafael I. Pardo and Michelle R. Lacey, "The Real Student-Loan Scandal: Undue Hardship Discharge Litigation," *American Bankruptcy Law Journal* 83 (1): 179-235; Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109–8, 119 Stat. 23 (2005), http://www.gpo.gov/fdsys/pkg/PLAW-109publ8/content-detail.html; Kyle L. Grant, "Student Loans in Bankruptcy and the 'Undue Hardship' Exception: Who Should Foot the Bill?" *Brigham Young University Law Review* 3: 819-847.

20 Nicholas R. Johnson, "Phoenix Rising: Default Rates at Proprietary Institutions of Higher Education and What Can Be Done to Reduce Them," *Journal of Law & Education* 40 (2): 225-271; U.S. Senate. "For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success" (commonly referred to as the "Harkin Report"), Majority Committee Staff Report and Accompanying Minority Committee Staff Views (Washington, DC: Senate Committee on Health, Education, Labor, and Pensions, July 30, 2012), http://www.help.senate.gov/imo/media/for_profit_report/PartI.pdf.

21 Michael P. Lillis, "High-Tuition, High-Loan Financing: Economic Segregation in Postsecondary Education," *Journal of Education Finance* 34 (1): 15-30; Michael B. Paulson and Edward A. St. John, "Social Class and College Costs: Examining the Financial Nexus Between College Choice and Persistence," *Journal of Higher Education* 73 (2): 189-236.

22 Mary P. McKeown-Moak and Christopher M. Mullin, *Higher Education Finance Research: Policy, Politics, and Practice* (Charlotte, NC: Information Age Publishing, 2014).

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