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Policy Paper

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Alleviating the Student Debt Crisis

THE NEW AMERICAN DREAM

The New American Dream: Alleviating the Student Debt Crisis

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ABOUT THE NEW CENTER

American politics is broken, with the far left and far right making it increasingly impossible to govern. This will not change until a viable center emerges that can create an agenda that appeals to the vast majority of the American people. This is the mission of The New Center, which aims to establish the intellectual basis for a viable political center in today's America.

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Executive Summary

NEW CENTER SOLUTION:
Alleviating the Student Debt Crisis

Higher education has never been more important for Americans looking to get a good job. In 2018, college graduates earned weekly wages that were 80% higher than those of high school graduates. The U.S. is home to some of the best colleges and universities in the world, but the cost of attending them is burdening students and their families as never before. Increasingly, young people are pushing back many milestones of adulthood—like starting a family or buying a home—because they are buried under mountains of student debt.

The student debt crisis is easily recognized, but agreeing on a solution is not. 2020 Democratic presidential candidates have already begun unveiling their solutions to the problem, including going as far as to suggest making college tuition-free or debt-free for students and their families. The Trump administration has suggested capping the total student debt that can be held per person and deregulating the college accreditation process, but so far the administration has been unable to translate these ideas into concrete policy changes. Here is how the next president, leading from the center, could.

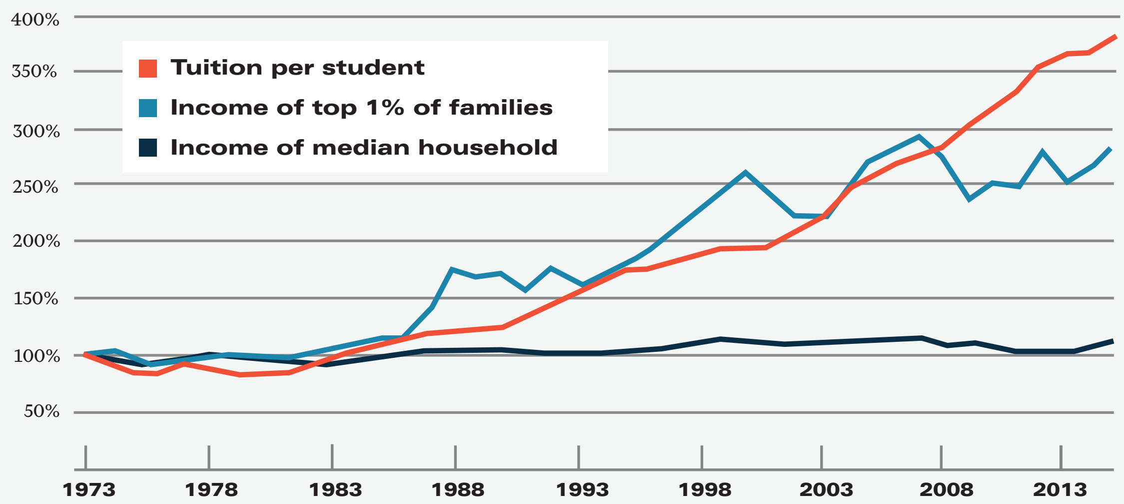
- Tuition **jumped 36%** between 2008 and 2018, while real median income grew just over 2.1% in the same period.[2]
- There are **$1.6 trillion in student loans,** which is the second-largest consumer debt total after mortgages.[3]
- More than **one million** people default on their student loans every year. The average monthly payment is close to $400, or $4,800 per year. Some economists say nearly 40% of current borrowers could default on their loans by 2023.[5]
- Education **costs have gone up 65%** in the last decade. The average public four year college tuition in 2008 was $7,560 per year. Today the cost is $10,230 per year. The average private four-year college tuition in 2008 was $28,400 per year. Today the cost is $35,830 per year.[6]
- Including the contributions of individual families and the government (in the form of student loans, grants, and other assistance), Americans spend about **$30,000 per student a year**—nearly twice as much as the average developed country.[7]

The Problem

Why Is College So Expensive?

Tuition Growth Has Vastly Outpaced Income Gains

Inflation-adjusted average tuition and fees at public four-year institutions and income for selected groups (1973 = 100%)



Source: Center on Budget and Policy Priorities based on the College Board and Census Bureau. Tuition per student and income levels, adjusted for inflation, as a percentage of 1973-1974 price levels. Years shown and income data are for the calendar year. Tuition data cover the school year beginning in the calendar year.

Identifying the primary cause of rising college costs is contentious. Even assessing the value or quality of a college education is difficult due to its intangible nature. The demand for a college education and overall attendance continues to rise while costs skyrocket, so it would also seem that college is still somehow worth the steep price. Republicans typically blame colleges for rampant spending and a reliance on federal financial aid, while Democrats often blame state governments for cutting funding for higher education. The reality is that both are right, to a point.

THE CONSEQUENCES OF THE STUDENT DEBT CRISIS

The net worth of the average 18- to 35-year-old has plummeted 34% since 1996, according to a study from Deloitte.

Increasingly, young graduates are unable to clear many of the traditional hurdles of adulthood—buying a car or a house, saving for retirement or starting a family—because of the massive burden of their college debt. Since loan repayment begins almost immediately after graduation, many young graduates are also incentivized to take the first job they're offered even if it means potentially missing out on a better paying job or chance to start their own business or enter public service.[9]

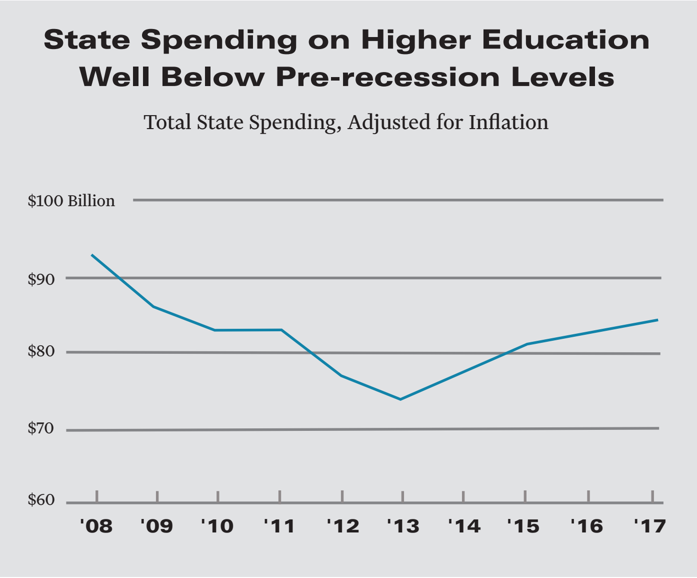
1) THE BENNETT HYPOTHESIS

William Bennett, the former Education Secretary under President Reagan, wrote an influential op-ed in 1987 entitled "Our Greedy Colleges," which attempted to answer why college was so expensive. At the time of its publication, students at a public four-year college paid an average of $3,190 per year in tuition. Over thirty years later the average tuition has grown to $10,230 per year, a 220% increase.[10] Bennett's article helped set the foundation for the Bennett hypothesis, which posits that colleges can continually raise their tuition knowing that students will be subsidized by the federal government and still be able to afford the cost. However, years later, Bennett himself conceded in an interview the story is not so simple, agreeing that the government still has an important role to play in providing aid to poor and middle-class students.[11] Still, Bennett said that, at minimum, "federal student aid makes it easier for colleges to do what they're going to do anyway, which is raise tuition."[12]

2) REDUCED STATE FUNDING

Why do colleges have such a strong incentive to raise tuition? The first reason is that overall state funding for public two- and four-year colleges in the 2018 school year was more than $7 billion (16% lower per student) below its 2008 level, after adjusting for inflation.[13] With many state governments operating their public university systems with less money, the schools have been forced to shift some of the cost to students in the form of higher tuition. While overall spending on education has risen, it has not kept pace with the increase in the number of students, leading to a decline in state government funding on a per-student basis.

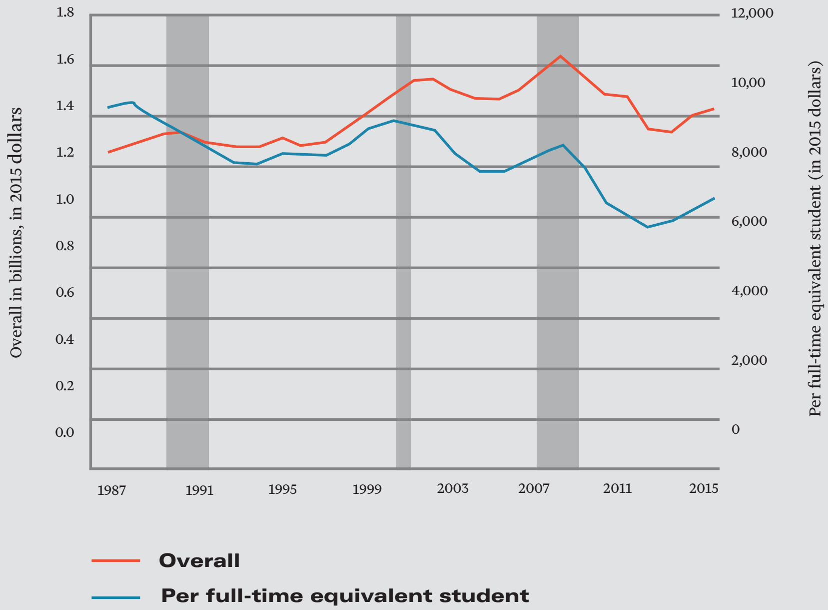
A report by the College Board found that prices at public colleges and universities rise faster as government funding per student declines. In the 2015-16 school year, state government funding per full-time enrolled student was 11% lower than a decade before, when adjusted for inflation.[14]



Source: CBPP analysis of data from Grapevine survey and State Higher Education Executive Officers Association, 2017

Less State Money per Higher Ed Student

Although states are spending more overall on higher education today than in 1987, these spending increases have not kept pace with student enrollment growth. State and local funding for higher education has declined to $7,152 per student enrolled in a public two- or four-year school in 2015, down from $9,489 per student enrolled in 1987.



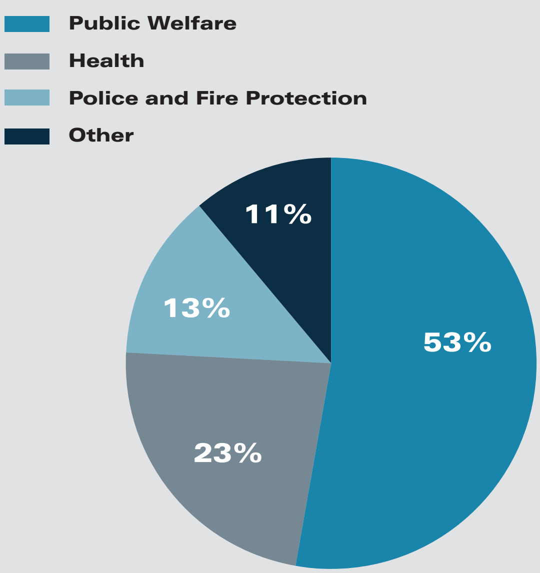
Note: Shaded areas in chart space denote periods of contraction in the business cycle. There is a clear relationship between state and local financial support for higher education and the business cycle, with money shifted away from higher education during recessions and typically restored (although not completely) once the economy has recovered.

SOURCE: U.S. Department of Education, National Center of Education Statistics, Integrated Postsecondary Education Data System

Public Welfare Crowding Out Higher Ed

A statistical model tracking changes within states over time reveals that increased public welfare spending explains roughly half of the decline in higher-education appropriations, with the other half divided among health (23%), police and fire (13%), and other categories (11%).

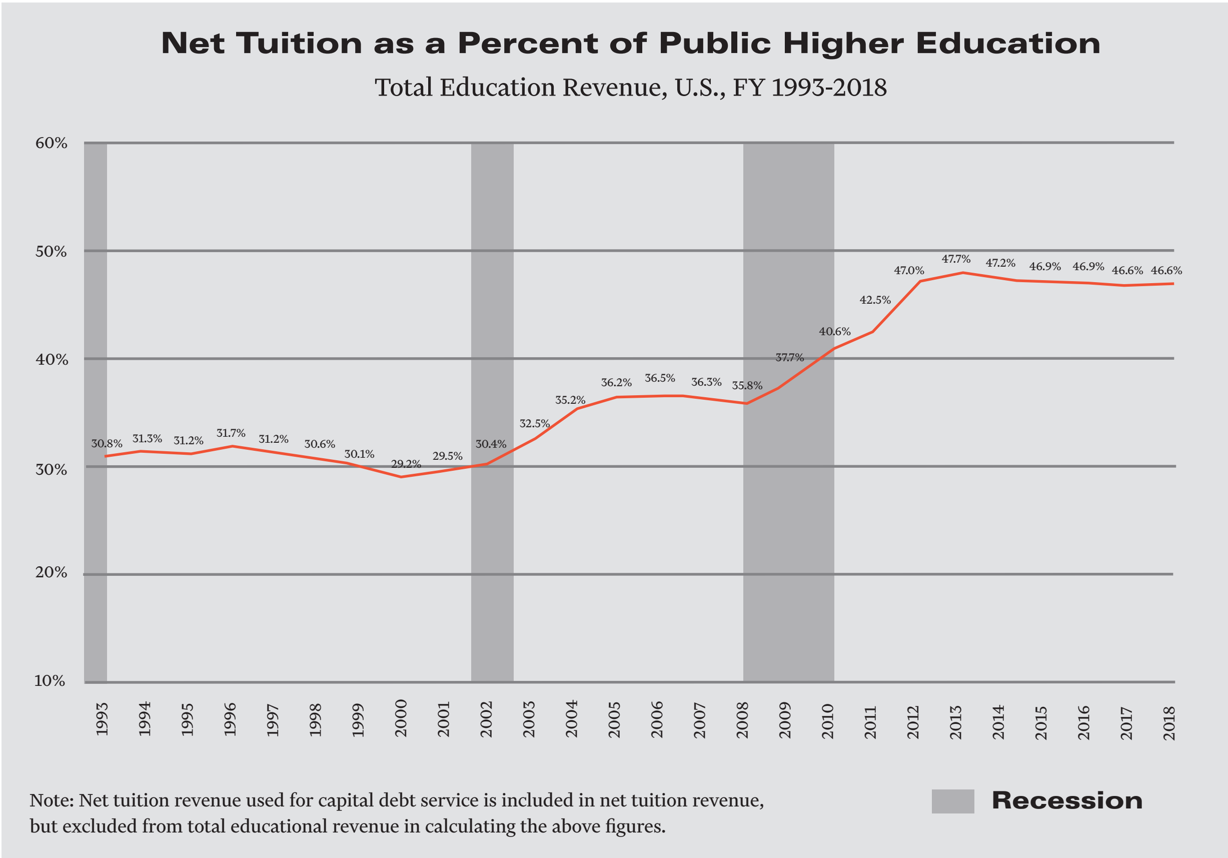
Percentage of higher-education spending decline explained by...



SOURCE: Author's Calculations

Note: Results are based on analysis of the relationship between higher-education funding per student and spending in other areas within each state, from 1987 to 2015. "Public welfare" includes Supplemental Security Income, food stamps, Temporary Aid for Needy Families, and most Medicaid expenditures, although some types of Medicaid spending are categorized as "health." "Other" includes corrections, highway and roads, utilities, sanitation, and interest payments on debt. Analysis based on per-capita state spending and higher education funding and relying on variation across in addition to within states yields substantively similar results.

As shown in this chart, state spending on public welfare and other services such as health care have crowded out spending on higher education. Each state government has its own budgetary constraints; however, the decline in average funding per student suggests that state legislatures are struggling to balance the immediate needs of its most vulnerable citizens and future investment in education.[15]



Source: State Higher Education Executive Officers Association

3) TUITION AS AN UNRESTRICTED REVENUE

The second key driver of increased costs is universities' desire to bring in more "unrestricted revenues." Public colleges and universities have four main revenue streams:

1. State Appropriations
2. Research Funding
3. Gifts and Endowments
4. Student Tuition

The first three forms of revenue come with significant restrictions regarding their use. Generally speaking, state appropriations can only be used for educational expenses, research funding is largely spent on specific research projects, and endowments often go toward specific donor projects. Only student tuition can be used for anything university administrators want such as construction projects, real estate, interest payments, and administrative salaries. Chris Newfield, author of *The Great Mistake*, argues that this is the biggest culprit of rising tuition. In recent decades, university administrators have sought, like all businesses, to maximize their revenues. But they have sought above all else

to maximize their unrestricted revenues—and as a result have become ever more reliant on student tuition. And as Newfield observes, as administrators made tuition increasingly central to their budgets, state governments have been more and more willing to cut university funding.[16]

4) REGULATORY OVERLOAD

In 2013 and 2014 alone, the Department of Education released rules and directives on ten new sets of issues, ranging from proposed rules on teacher preparation programs to Net Price Calculator requirements to specific regulations for Free Application for Federal Student Aid (FAFSA) verification.[17] Complying with all these rules requires additional staff and additional money. The resources required are substantial; a Vanderbilt study of 13 colleges and universities found that regulatory compliance comprises 3-11% of schools' non-hospital operating expenses, taking up 4-15% of faculty and staff's time.[18]

5) HOW COLLEGES ARE LIKE CHIVAS REGAL

The hike in tuition of private colleges and universities requires a different explanation, since these schools don't rely on state funding. This drastic increase in tuition amongst private universities can be explained by, of all things, scotch whiskey. In an effort to increase sales and market share in the 1940s, Chivas Regal reportedly doubled the price of their whiskey without changing anything about the actual whiskey in the bottle. Their unit sales doubled. Private universities have used a similar strategy in which they raise tuition to increase positive perception surrounding the quality of the school. Raising tuition gives the appearance that the school is better and more competitive than its peers, leading to a higher position in annual college rankings.[19]

Since college is an "experience good"—you can't fully gauge its benefits until you experience it—prices suggesting high quality can be one tantalizing way for colleges to make themselves more appealing.

6) THE DANGER OF FOR-PROFIT COLLEGES

One of the worst offenders of the higher education system are for-profit colleges. Although some students have derived benefits from and reported positive experiences with these institutions, most of them cost more than public colleges, spend less on education per student, and have higher dropout rates and default rates.[20] One particularly egregious example was ITT Technical Institute. In 2019, the federal Consumer Financial Protection Bureau and a coalition of 44 states and the District of Columbia reached a settlement with ITT that discharged $168 million in private debt for 18,000 students who had essentially received worthless degrees.[21] It's likely many of the students attending these for-profit colleges could get the same educational benefits from attending vastly cheaper community colleges.

THE WARREN-SANDERS PLANS FOR FREE COLLEGE HAVE SOME PROBLEMS

2020 presidential contender Bernie Sanders proposes canceling all $1.6 trillion of student debt held by 45 million Americans, in addition to making public universities, community colleges, and trade schools tuition-free. In order to pay for it, Sanders proposes creating a new financial transactions tax, which would include a 0.5% tax on stock transactions and a 0.1% tax on bonds.[22]

Fellow presidential contender Elizabeth Warren wants a move in the same direction, though she doesn't go as far as Sanders. She proposes canceling $50,000 in student loan debt for every person with household income under $100,000, while also providing substantial debt relief for every person with household income between $100,000 and $250,000. Her plan to pay for the program is to implement a wealth tax of 2% on wealth above $50 million and 3% on wealth above $1 billion.[23]

There are a few glaring problems with both these plans.

First, they spend an enormous sum of scarce government money to pay the debts of mostly middle- and upper-income students. Under Senator Warren's debt relief plan, the bottom 60% of households receive only 34% of the benefit.[24] Under Senator Sanders' plan, much of the benefit would go towards high-income households that hold graduate degrees.[25]

Second, these plans do nothing for the millions of people who paid for school, and those who already paid for their loans.

Third, they do nothing to address why college is so expensive in the first place; they just pour more money into a fundamentally broken system.

The Solution

College Debt: Fix the Cause and the Symptoms

A comprehensive solution to the college debt crisis requires immediate help for the millions of Americans being crushed by their college debts. But that's only half the solution. Policymakers also need to deal with the forces that are making college so expensive in the first place so future payers—be it parents, students, or the federal government—don't face the same debt burden as the current generation.

How Should We Deal with College Debt Now?

1. INCOME-BASED REPAYMENT PLANS NEED TO BE THE NATIONAL STANDARD

Today, some borrowers participate in the income-based Revised Pay as You Earn (REPAYE) plan, in which borrowers pay 10% of their discretionary income (income minus 150% of the poverty line) for 20 years (25 years if a graduate borrower). Any remaining balance is forgiven, but is potentially subject to income tax. REPAYE is available to students who have loans directly from or subsidized by the federal government. Only private, defaulted, and Parent PLUS loans are ineligible to qualify for REPAYE.[26]

In March 2018, among income-driven repayment plans, about 30% of borrowers and 30% of the total outstanding debt were in the REPAYE plan.[27]

REPAYE should be the default repayment plan, and the Department of Education should immediately convert all borrowers to it. (This should include an opt-out for borrowers actively making higher payments under a standard ten year plan if they want to repay their loans faster.) Universal and automatic REPAYE would help address the hardships borrowers face, cost less, and offer a sustainable way to offer loans to future students. Enrollment in income-driven plans like REPAYE reduces delinquency, improves credit scores, and increases the likelihood of homeownership among delinquent borrowers.[28]

Reforming the student loan repayment system appears to have some bipartisan support with President Trump having already advocated for a similar policy that would consolidate the number of offered student loan repayment plans.[29] However, private student loans represent a separate problem. These private loans often do not include income-based repayment or loan forgiveness, and encouraging banks and financial institutions to adopt REPAYE as a standard could prove to be difficult since they have no incentive to provide borrowers with financial assistance. However, changing the standard for private student loans could be considered unnecessary since private loans only make up approximately 7% of the total outstanding student loans. The adoption of REPAYE as a national standard would provide students with a more sensible repayment plan, and therefore the use of private student loans would be expected to decline even further.[30]

2. TARGETED LOAN FORGIVENESS

An alternative approach to providing universal student loan forgiveness is to target it to low-income students who are in most need of help. Democratic presidential candidate Julián Castro has proposed such a loan forgiveness program that would use participation in means-tested federal benefit programs as a qualification for assistance.[31] Using the same qualification as Castro, an alternative targeted loan forgiveness program could forgive all student loans for individuals who qualify for and receive benefits from programs such as Supplemental Security Income (SSI), Supplemental Nutrition Assistance Program (SNAP), or Medicaid. This alternative targeted student loan forgiveness program would be substantially more beneficial to low- and middle-income students, with the majority of forgiven loans (60%) going to the bottom two income quintiles. Although such a plan would only forgive a total of $138 billion in student loans, which is 11.6% of total student debt in the country, it would get help to those who need it most.[32]

3. PUBLIC SERVICE LOAN FORGIVENESS

The Public Service Loan Forgiveness Program (PSLF), which was established under the College Cost Reduction and Access Act of 2007, permits direct loan borrowers to have the remainder of their loans forgiven if they work full-time for a qualifying public service job and have made 120 qualifying monthly payments (ten years worth of payments). While the PSLF should reward students for their contributions in public service, in reality the program has had little to no impact.

A March 2019 report from the U.S. Department of Education highlights this point. According to the newest data, 73,554 unique borrowers have applied for Public Service Loan Forgiveness (PSLF) since its inception through March 2019. Since then, only 864—or 1% of applicants—have been approved by the loan servicers processing the applications.[33] Most of the denials have been due to a lack of qualifying payments (53%) and missing information in their applications (25%). Additionally, the American Federation of Teachers (AFT) has launched a lawsuit against the Department of Education over the mismanagement of the PSLF program. The AFT has claimed that incorrect information about qualifying loans was given to public service workers, which caused them not to qualify for loan forgiveness.[34]

In other words, far too many applicants didn't quite meet the program requirements for PSLF, they didn't have the right type of loans to qualify, or they were misled of their qualification by the Department of Education. This just goes to show that the PSLF is not working as intended, and requires reevaluating our approach to rewarding public service.[35]

The PSLF has been a failure, and the program should be scrapped. But, the underlying idea of rewarding young adults for public service is a sound one. The Serve America Together Campaign offers a unique policy idea of expanding national service opportunities for young people with the benefit of earning college tuition for participating.[36] Rather than rewarding a narrow set of public service employees with loan forgiveness, a separate national service program could be authorized by Congress based on the Serve America Together Campaign. Such a program would directly reward high school students who have done community service with college tuition. This would avoid the complications of the PSLF (filling out extensive paperwork and repaying loans for a decade before receiving any benefit), and also extend the reward to young individuals who give back to their community through expanded national service opportunities before college.

How Do We Make College More Affordable in the Future?

1. KEEP COLLEGES ACCOUNTABLE FOR RAISING TUITION

It will be a Pyrrhic victory if government manages to reduce college debt now only to allow them to keep growing exponentially in the future. We need policies that deal with how and why college is so unbelievably expensive in the first place. One way the government could incentivize public universities to maintain lower tuition would be to use its influence over the federal student loan market, as the Department of Education owns 92% of all college loans.[37] Colleges that increase their tuition faster than an index of inflation (such as the Personal Consumption Expenditures price index) could lose access to federal student loans, or the colleges would have to pay for the overage in tuition prices themselves.[38]

2. EXPAND (AND REFORM) COLLEGE PROMISE PROGRAMS NATIONWIDE

America needs better solutions for graduating high school students who don't want to go to a four-year college. One is the College Promise Campaign, a national nonprofit initiative that aims to make community college education free and accessible. More than 200 of these programs have been implemented by state and local governments in 41 states, operating with strong bipartisan support.[39] Promise programs are distinct from existing state financial aid in that they provide free or debt-free tuition to a significant subset of students who attend college in close proximity to their local community. Although these programs have only recently been implemented since the College Promise Campaign's launch in 2015, early evaluations of their impact show promise.[40] Making several changes to the design of these college promise programs would make both access and affordability a reality for students who currently don't have the same opportunity to pursue higher education.

Most College Promise programs are currently designed for last-dollar funding, meaning that students must use all other available public funding, such as Pell Grants, before being awarded College Promise funds to cover the remaining tuition.[41] The issue with College Promise programs being last-dollar funded is that low-income students receive less assistance by virtue of the fact that Pell Grants or other programs might already cover part of their tuition. Instead, these College Promise programs should be redesigned by state and local governments to have first-dollar funding, which would allow low-income students to use Pell Grants or other aid to cover expenses such as books, housing, and food. The most positive findings on college enrollment from College Promise programs comes from the Kalamazoo Promise Scholarship, which is a first-dollar funded program.[42]

In addition to redesigning the College Promise programs to be first-dollar funded, careful evaluation of these programs has shown that more students would benefit if strict eligibility requirements were removed.[43] College Promise programs with merit-based requirements suffer from inequitably benefiting higher income students, and can incentivize students to avoid math, science, and other majors that tend to be more difficult.[44] Many College Promise programs also exclude nontraditional students due to requirements that scholarships can only be awarded to full-time students and recent high school graduates, which leaves out many individuals who work or are looking to go back to school. Removal of these eligibility requirements should not come at the expense of keeping useful student resources such as mentorship and tutoring in current College Promise programs.

3. PERSONAL FINANCIAL EDUCATION FOR EVERY HIGH SCHOOL KID IN AMERICA

Personal finance education in high school provides students with the knowledge and skills to manage financial resources effectively for a lifetime of financial well-being. But according to a 2016 survey, only 31% of young Americans agreed that their high school education did a good job of teaching them healthy financial habits.

Here are just some of the reasons high school students need to learn more about personal finance:

1. Most students are not financially literate.
   - A recent study by the National Center for Education Statistics found that a majority of eleventh graders did not know the cost of tuition and fees at a public four-year college.[45] One in five American high school students lack even basic financial skills such as the ability to interpret a pay stub.[46]
2. Schools aren't teaching personal finance.
   - Only 20 states require personal finance courses to graduate high school.[47] The adult financial literacy level in the U.S. is only slightly better than that of Botswana, whose economy is 1,127% smaller.[48]
3. Parents aren't teaching personal finance either.
   - A 2017 T. Rowe Price Survey noted that 69% of parents have some reluctance about discussing financial matters with their kids. Only 23% of kids surveyed indicated that they talk to their parents frequently about money, and 35% stated that their parents are uncomfortable talking to them about money.

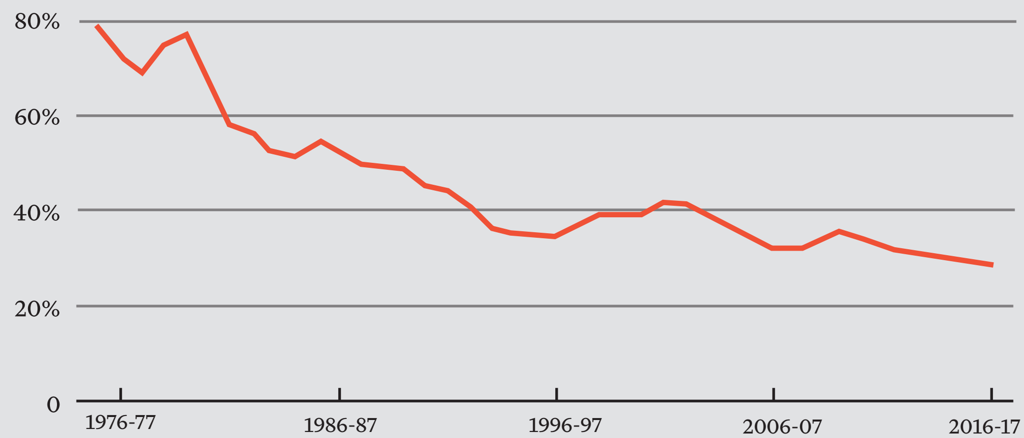
Given this lack of knowledge about personal finance—and the negative impact this will inevitably have upon students' lives—states and localities should make it a priority to ensure that every high school student receives a course in personal financial education.

4. INCREASE THE MAXIMUM FEDERAL PELL GRANT AWARD

Federal Pell Grants are subsidies provided to students based on financial need. Pell Grants are a critical and effective way to increase college access and completion, making higher education possible for seven and a half million Americans each year. Yet 2019's maximum grant covers the lowest share of college costs (28%) in the program's history and is no longer automatically adjusted for inflation each year, at least partly as a result of cuts made in the wake of the recession.[49] The Institute for College Access and Success (TICAS) suggests that the maximum Pell Grant needs to be roughly doubled to close income gaps in access and attainment of a college education, which persist even for students with similar levels of academic preparation.

Pell Grants Cover Shrinking Share of College Costs

Share of attendance costs covered by maximum Pell Grant by academic year



Note: Attendance costs are the average undergraduate tuition, fees, room, and board rate for public four-year institutions.

Source: CBPP based on college pricing data from College Board

5. ENCOURAGE BUSINESSES TO PROVIDE LOAN REPAYMENTS AS AN EMPLOYEE BENEFIT

The Retirement Parity for Student Loans Act, introduced by U.S. Senator Ron Wyden from Oregon, would permit 401(k), 403(b), and SIMPLE retirement plans to make matching contributions to workers as if their student loan payments were salary reduction contributions. This proposal addresses the growing problem that many young people burdened by student loans aren't able to invest in tax-protected savings vehicles like a 401(k), which are critical to achieving a secure retirement.[50]

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