POLICY FOCUS

The College Debt Crisis

RECIPES FOR RATIONAL GOVERNMENT FROM THE INDEPENDENT WOMEN'S FORUM

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WHAT YOU NEED TO KNOW

America's total student loan debt tops $1.3 trillion. It's hard to imagine a figure so large, but for many young adults, student loan repayment is not only a national problem, but also a very personal one. The burden of student debt keeps too many young workers on a financial treadmill – unable to climb out of the hole they are in, much less get ahead or put aside savings.

How did this come to be? It wasn't always so costly to get higher education. High tuition costs, spurred on by the nationalization of the student loan industry and government education subsidies, are the main culprit. A poor job market for recent grads has exacerbated the situation.

Some groups and policymakers have proposed fixing the problem of college debt with widespread, government-financed forgiveness programs. Another suggestion is to make public college available tuition-free.

These proposals, while well-intended, would come with significant costs and consequences: Debt forgiveness programs punish taxpayers and responsible borrowers and encourage ever-increasing tuition costs and wasteful spending. Tuition-free college might increase college enrollment, but would likely led to a lower on-time graduation rate. Universities would also have even less incentive to use resources efficiently and provide students with value once government shifts all costs to taxpayers.

There are better ways for policymakers to bring down college tuition and help students and young adults burdened with student debt.

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This policy focus is Part One in a two-part series on college debt.
To learn more about the right solutions to this problem, read Part Two.

WHY YOU SHOULD CARE

The college debt crisis is problematic, but so are some of the proposed solutions:

- **Student Debt Harms Young People:** America's youth are lagging behind on many financial and personal milestones as a result of student debt. Sadly, many never even finished their degree, making it impossible for them to earn college-graduate-level wages. Others with degrees also struggle in today's poor job market, and due to the declining value of a college education.
- **Debt Forgiveness Threatens Taxpayers and Responsible Borrowers:** Politicians are tempted to erase student loan debt through forgiveness programs. This would unfairly punish taxpayers – especially those who didn't attend college or who already paid for it – with the expenses of others. Taxpayers are already exposed to significant costs when debtors default.
- **Debt and Costs Increase in a Vicious Cycle:** Further subsidizing college or passing costs on to taxpayers encourages colleges to increase costs, which leads to greater debt.
- **Tuition-Free College Would Change Incentives:** Tuition-free college would come with unintended consequences and public costs. If students aren't invested financially in their education, we should expect dropout rates to increase and on-time graduation rates to decrease.

MORE INFORMATION

The Student Debt Crisis

America's student debt totals more than $1.3 trillion and grows by about $2,726.27 *every second*. Approximately 70 percent of today's students are graduating with debt, adding to the 40 million Americans who currently hold student debt. The average amount owed is over $30,000.

On the flip side, only about 37 percent of borrowers are actively paying down their loans, meaning most are using deferment plans or are behind on payments. This signals that many borrowers aren't in jobs that allow them to make regular payments. Importantly "borrower" and "graduate" cannot be used interchangeably, as many former students borrowed money to pay for part of a degree they never completed. This, understandably, makes repayment even harder.

But even for those who did finish college, today's economy offers disappointing prospects. According to a 2014 study by the Federal Reserve Bank of New York, more college graduates than usual are under-employed in jobs that don't require a degree: Historically this figure is one-in-three, but as of 2012, it was 44 percent.

Financial Consequences

With enormous debt and limited economic opportunity, many youth are left on a financial treadmill. This has consequences far and wide across our economy.

In their survey, "Life Delayed," the American Student Assistance organization found that 63 percent of debtors said their debt affected their ability to make larger purchases such as a car. Seventy-three percent have put off saving for retirement or making other investments. Perhaps most troubling, 27 percent found it difficult to afford daily necessities.

Starting a family and buying a home have traditionally been major life milestones, but student loans affect these decisions too, with 29 percent of young adults saying they were delaying marriage and 43 percent delaying starting a family due to student debt. An overwhelming 75 percent say their loans are affecting their decision or ability to purchase a home.

Clearly, this has downstream effects on our economy and society: The home and auto industries suffer when their consumer base shrinks. Not saving for the future – and struggling to make ends meet at present – puts more young adults at risk of poverty and increases their need for government assistance. Delayed family formation comes with serious societal consequences and can affect the personal happiness of Millennials eager to marry and parent.

The bottom line is that student debtors are unable to fully participate in the economy as consumers, investors, and business creators. Student loan debt is clearly a significant burden that is holding back our economy.

The Wrong Solution: Debt Forgiveness

Many Americans assume that student loans are owed to a bank, but they are actually owed to the federal government. In 2010, Congress voted to force commercial lenders out of the student loan business. Prior to this reform, private banks received federal subsidies to make loans to students. This system was seriously flawed, because the government (taxpayers) still bore all of the risk.

The 2010 reform significantly expanded government's role, making Uncle Sam the direct lender for all future loans made. But this didn't relieve taxpayers of the risks and costs associated with student loans at all, rather it placed the entire risk of default on taxpayers.

Many people understandably wish student loan debt could magically disappear, but various forgiveness proposals come with serious costs and consequences.

First, consider the forgiveness programs that are already available. In 2014, via executive action, President Obama expanded certain forgiveness options: If borrowers pay 10 percent of their monthly discretionary income toward their debt for 20 years, any remaining balance will be forgiven. This timeline can shrink to 10 years if borrowers work in what President Obama has called "the helping professions" (government, teaching, health care, non-profit work, etc.).

Income-based repayment may sound nice, but it can actually hurt more than it helps. These repayment plans extend borrowers' payoff dates, keeping them in debt longer and increasing their total interest bills. And when students make it to their forgiveness date, their balance doesn't disappear; taxpayers have to shoulder it.

The forgiveness option for "helping professions" unfairly favors some borrowers over others. It's absurd to suggest that just because someone goes to work at a for-profit company, she is not "helping" or contributing to our country. This program can significantly affect debtors' career decisions, and again, leaves taxpayers on the hook when they take advantage of forgiveness.

An even more aggressive form of forgiveness would be the cancellation of all outstanding debt, an idea supported by groups including Campaign for America's Future, Democracy for America, Working Families, and Student Debt Crisis.

Clearly, this plan would come with enormous costs, but even worse, it would result in egregious unfairness. Many students made responsible decisions to avoid or minimize debt: They chose to attend more affordable schools over more prestigious ones, worked part-time during college, and lived frugally to pay down their debt. To forgive all student debt would be to reward irresponsible choices and punish responsible ones.

Furthermore, *uncertainty* adds another burden to current borrowers. If borrowers do not know if Uncle Sam will forgive or renegotiate their debt upon the next election cycle, they will be discouraged from addressing their debt head-on. When lawmakers even *discuss the possibility* of forgiveness, borrowers are tempted to wait and see what will be offered instead of just paying off what they can.

Behind the Debt Crisis: Rising Costs

High student loan debt is driven by high college costs, which have exploded in just a generation. Today, one year of tuition, fees, and room and board at the average public in-state university costs more than $19,000 according to College Board. For public out-of-state schools, the costs climb to more than $34,000. At private colleges, annual costs exceed $43,000. Compared to thirty years ago, the cost of attending private and public colleges has more than doubled after adjusting for inflation.

Why have these costs risen so rapidly? Part of the problem is government policies that make it easier for colleges to charge students more. Policymakers may hope that subsidizing colleges through direct aid, special loan programs, or scholarships will bring down costs for students and families. Yet school administrators see these subsidies as an opportunity to increase prices and capture these new resources.

The result is that even as government spending on higher education goes up, so too does the cost to students (and the associated debt). For example, since 1990, the average amount of government benefits awarded to students has tripled, from $5,189 in 1990-91 to $15,941 in 2014-15. But rising aid has corresponded with rising tuition costs, which leads to more student loan debt, feeding a vicious cycle.

The Wrong Solution: Making College Tuition Free

President Obama and presidential candidates Bernie Sanders and Hillary Clinton all support making community colleges free. Sanders even wants to make all 4-year public colleges free. His campaign website points to Germany, Chile, and some Scandinavian countries as examples of government-financed tuition systems.

However, these countries also face much higher tax burdens than the U.S. Indeed, Sanders proposes to finance the $75 billion annual cost of his plan with new taxes.

But the cost of tuition-free college isn't just dollars. Research shows it would have a deleterious effect on education as well.

Many students cite their investment in tuition as a motivator for completing a degree. Researchers at Northwestern University interviewed graduates of two-year college programs and summarized: "They consistently, sometimes fervently, told us that paying for college made them grow up and work hard. Paying tuition … seemed to help unlock a new identity as a responsible student." And conversely, "As the cost of attending college drops to zero, so does the perceived cost of dropping out." Various other studies show that free college may increase enrollment, but not graduation rates.

Tuition-free college would change incentives for colleges as well. When students pay directly, colleges must be accountable to them. When a third-party (the government) pays, this can decrease accountability, efficiency, and quality.

While proposals to make college tuition-free may be well-intended, the reality is that these plans would destroy the important incentives that help students make responsible decisions and hold colleges accountable to their customers.

Student Loan Interest Rates

Some policymakers like Sens. Elizabeth Warren and Bernie Sanders have proposed to reduce student loan interest rates significantly and allow current debtors to refinance at lower rates. This may sound like a cost-free way to help out students, but it is really another way to transfer costs to taxpayers and responsible borrowers.

For other types of loans, like mortgages or auto loans, lenders examine the individual characteristics of the borrower and the collateral (the house or the car) to determine how much interest to charge.

When it comes to student loans, the government uses one interest rate for all undergraduate borrowers, regardless of their credit or risk. This means that some student borrowers are paying less than they would in a risk-based system, while others (such as some graduate students and parents who pay a higher interest rate) are paying more than they would in a risk-based system.

Federal undergraduate lending already operates at a loss, indicating that too many of these borrowers are already getting a below-market interest rate. Cutting this rate further would only result in more red ink for the government, and would ultimately hurt taxpayers.

WHAT YOU CAN DO

- **Get Informed:** Learn more about America's College Debt Crisis. Visit:
  - The Independent Women's Forum
  - Federal Reserve Bank of New York
  - StartClass by MarketWatch
- **Talk to Your Friends:** Help your friends and family understand these important issues. Tell them about what's going on and encourage them to join you in getting involved.
- **Become a Leader in the Community:** Get a group together each month to talk about a political/policy issue (it will be fun!). Write a letter to the editor. Show up at local government meetings and make your opinions known. Go to rallies. Better yet, organize rallies! A few motivated people can change the world.
- **Remain Engaged Politically:** Too many good citizens see election time as the only time they need to pay attention to politics. We need everyone to pay attention and hold elected officials accountable. Let your Representatives know your opinions. After all, they are supposed to work for you!

ABOUT THE INDEPENDENT WOMEN'S FORUM

The Independent Women's Forum (IWF) is dedicated to building support for free markets, limited government, and individual responsibility.

IWF, a non-partisan, 501(c)(3) research and educational institution, seeks to combat the too-common presumption that women want and benefit from big government, and build awareness of the ways that women are better served by greater economic freedom. By aggressively seeking earned media, providing easy-to-read, timely publications and commentary, and reaching out to the public, we seek to cultivate support for these important principles and encourage women to join us in working to return the country to limited, Constitutional government.

We rely on the support of people like you! Please visit us on our website www.iwf.org to get more information and consider making a donation to IWF.

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