Student Debt: Differing Approaches

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An economic framework for thinking about student debt

There are strong equity and efficiency arguments for public investment in higher education.

- Higher education has positive externalities but is not a public good.
- The private loan market will will not serve low-income students with no collateral or credit history well.

Education is an investment in human capital.

- Borrowing for investments with high expected return is rational.
- Investing in college education involves risk.
- Insuring against risk will reduce under-investment

Grants and loans are both important

- Grants base subsidies on pre-college circumstances
- Income-driven loan repayment bases subsidies on post-college circumstances.

Why the more common perspective a crisis of crushing debt?

- *Washington Post o*p-ed 2016: Higher education should be a public good, not a private commodity (from a philosopher and higher ed leader)

"The ideal of higher education as a public good — once inextricably linked to the American Dream — has been all but abandoned in favor of the college degree as a private commodity. The narrow focus on earning power, coinciding with demographic shifts in the number and diversity of college students, has fueled the understanding of college as a purely private benefit rather than a good for all."

- Higher education is a right and should be available to all without causing hardship;
- Some borrowers face unacceptable struggles (many non-completers, for-profit students, Black students);
- Repayment system is complicated and sometimes punitive.

Should we forgive student debt?

- Income-driven repayment, which now enrolls more than 1/3 borrowers holding more than ½ outstanding federal debt, includes forgiveness.

- Target some groups:

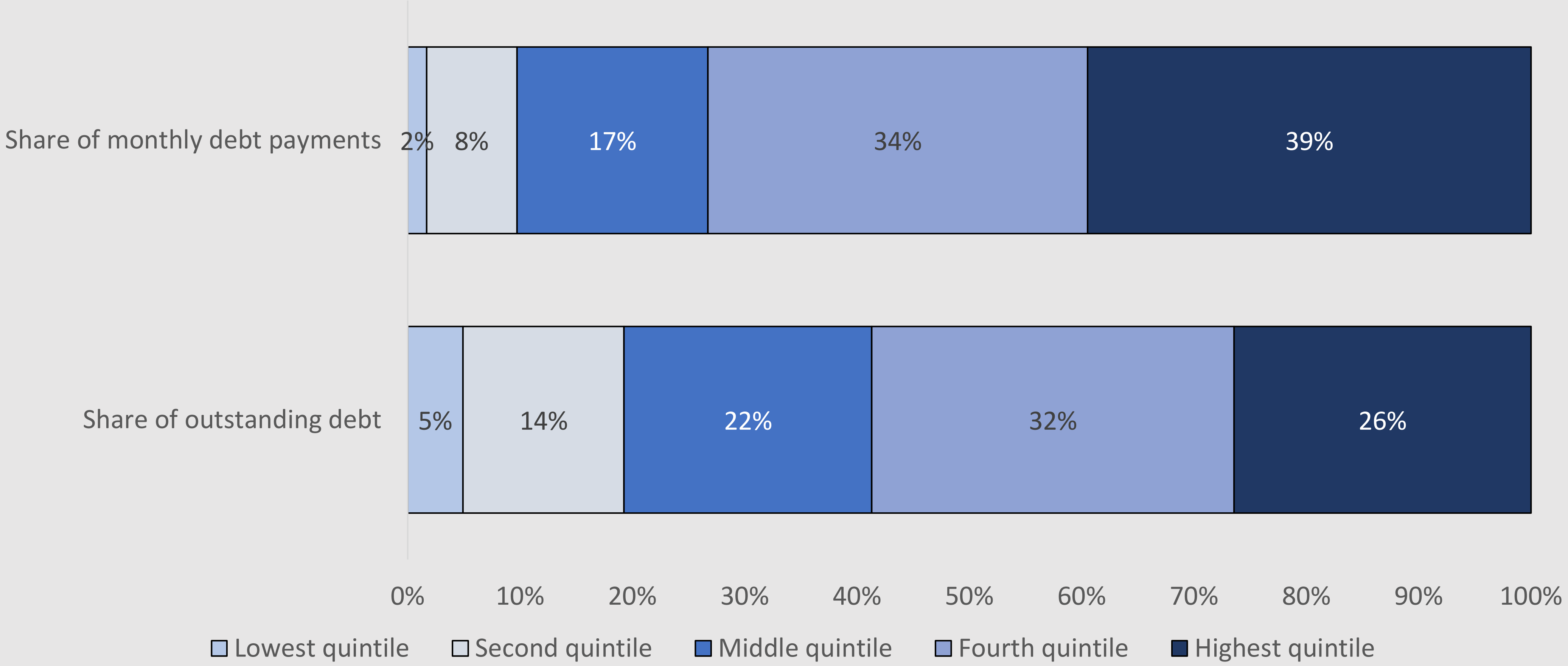
  -- victims of fraud/closed schools;

  -- low-income parent loans (20% of PLUS borrowers below poverty level);

  -- small debts for low-income borrowers.

Who would benefit most from broad debt forgiveness?

Education debt is concentrated in the upper half of the income distribution.



Notes: Households age 25 and older.
Source: Baum and Looney (2020) "Who owes the most in student loans? New data from the Fed?" *Brookings*..

Other issues:

- Equity:
  - students who have repaid
  - students who worked a lot instead of borrowing
- What about future students?
- Impact on federal debt

Improving income-driven repayment is a better solution.

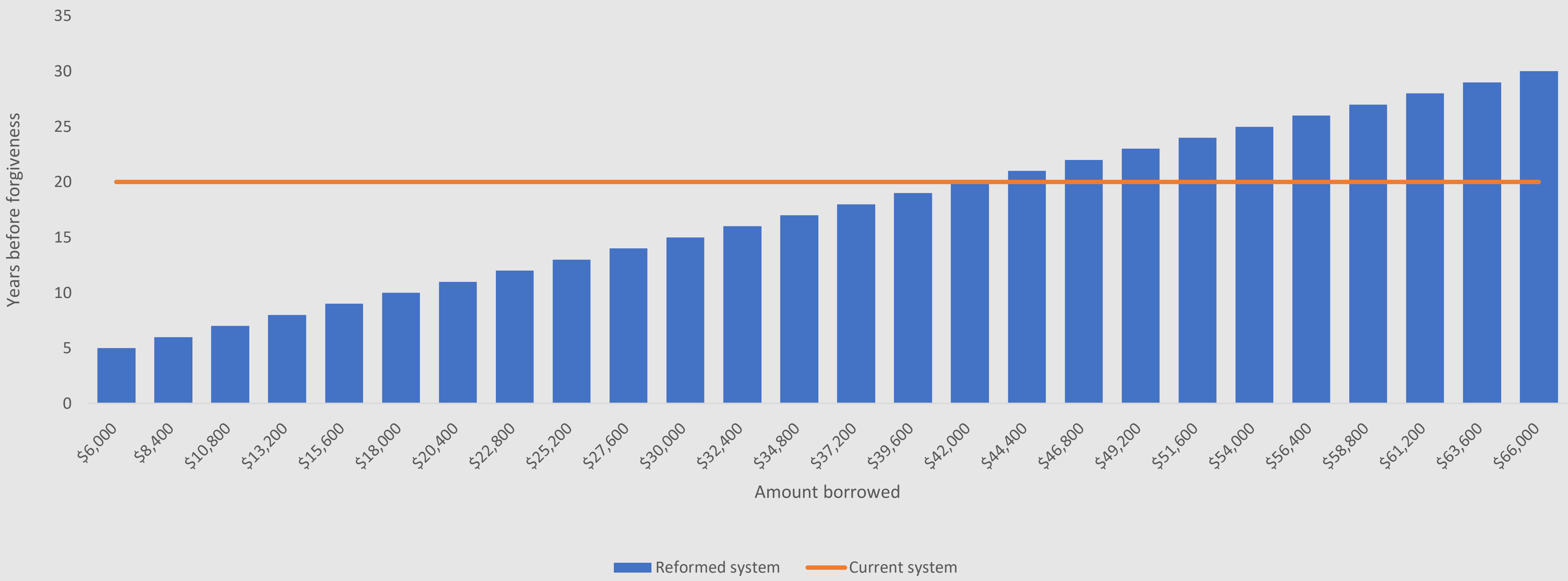
- One IDR plan
- Automatic enrollment
- Payroll withholding

Lowering the assessment rate would have unintended consequences.

Assessment rate	10%	5%/10%	5%
Debt	% of BA recipients meeting income requirement		
$10,000	78%	76%	73%
$20,000	73%	69%	61%
$30,000	67%	64%	49%
$40,000	61%	58%	35%
$50,000	54%	52%	37%

Notes: Incomes are assumed to increase 4% each year, 2 percentage points beyond the assumed 2% inflation rate.
A starting income of $22,000 would rise to $26,292 in year 10 and $35,050 in year 20, after adjusting for inflation.
A starting income of $36,000 would rise to $43,023 in year 10 and $52,445 in year 20.
A starting income of $59,000 would rise to $70,510 in year 10 and $85,952 in year 20.
The interest rate on loans is 4%

Time in repayment should depend on amount borrowed.



Small debts would be forgiven more quickly for those who cannot afford to pay them off. People who borrowed larger amounts would repay more than those with similar income paths who borrowed less.