Testimony of Beth Akers
House Committee on Education and the Workforce
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"Challenges and Opportunity in Higher Education"

Good morning, Chairwoman Foxx, Ranking Member Scott, and members of the Committee on Education and the Workforce. My name is Beth Akers. I am a senior fellow at the Manhattan Institute where I research issues related to higher education policy, with a focus finance. I've been engaged in research in this field since 2008 when, in my role as Staff Economist at the Council of Economic Advisers, I assisted the Department of Education as they quickly implemented the Ensuring Continued Access to Student Loans Act. My testimony is informed by the time that I've spent researching this subject, first as a graduate student in the Economics Department at Columbia University, then as a Fellow at the Brookings Institution and now at the Manhattan Institute.

Perhaps among the most well known facts about higher education is that it's expensive and getting more so every year. Research from the College Board indicates that the average net cost for a year of attendance at a four-year public institution was $3,770 this year, up nearly 30 percent from $2,910 during the 2006-07 academic year (2016 dollars). This means that a student who completes their degree in four years at a public university must come up with $15,000 above and beyond what they need to cover their normal cost of living, all while taking a break from working or reducing their hours to fit in coursework. The tuition inflation that we've observed is a concerning trend, but it's important to realize that even with the large price tag, college is, at least on average, "worth it." The most recent estimates from the Federal Reserve Bank of New York place the rate of return on college degrees at approximately 15 percent; that means students will get back far more, through higher future wages, than they will spend upfront[1].

College is expensive, but it pays large financial dividends both to the student, in terms of heightened future wages and consistent employment, and to society through greater tax revenue and reduced reliance on social safety nets. We should be concerned about the trajectory of college costs, but we should also be concerned with building a system of finance that supports students in making investments in themselves, even in the current, high-price environment.

The "pay first, benefit later" pattern of cash flows for education means that in the absence of federal student loans, students without financial means would be left without access higher education. Student loans, which allow students to borrow from their future selves, are an invaluable tool for students to finance investments they would not have been able to afford otherwise. And they are a tool that works quite well for many borrowers.

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[1] Abel, Jaison R., and Richard Deitz. "Do the benefits of college still outweigh the costs?." (2014).

My research[2] shows that typical borrowers face loan balances that are modest compared to their lifetime earnings. The large balances we often hear about in the media are, in fact, exceedingly rare. Just 7 percent of young borrowers have balances greater than $50,000 and 2 percent greater than $100,000. And the large balances are most often held by borrowers with advanced degrees that provide the opportunity for very high earnings. The monthly expense of repaying these burdens is relatively small for the typical borrower. The average borrower in repayment on their student loans will spend only about 7 percent of their income on loan repayment; that's similar to what households spend on entertainment expenses like going out to the movies[3]. Perhaps needless to say, debt is an important instrument for ensuring that all young people have access to higher education, regardless of their financial means.

But those statistics aren't much of a consolation if you are one of the unlucky students who paid the price for college but saw no return. College is a gamble. It's always been a gamble, but in the current high-cost marketplace, the consequences of making a losing bet on college are bigger than ever before. We can't say exactly how many students end up "underwater" on their student loans, but the fact that almost half[4] those who start college degrees fail to complete them suggests that there is a large pool of former students who will see little to no return on their investment.

In addition to making it possible for young people to borrow from their future to enroll in college, we also need to ensure that adequate safety nets exist to support those who don't experience the anticipated returns. In doing so, we should recognize that it's not the high price of higher education that's a problem. Rather, it's that *some* students will pay that price but never see a return. Rather than using public resources to make college less expensive across the board, funds should be targeted to provide relief to those who made a losing gamble on college.

As the committee considers the reauthorization of the Higher Education Act, I'd encourage you to give consideration to the following challenges facing our system of higher education finance.

A Malfunctioning Repayment System and Safety Net

Many people are surprised to learn that our federal student loan program has a robust system of safety nets that protects borrowers from unaffordable student loans. The set of income-driven repayment plans offers borrowers the option of reducing their monthly payments, sometimes to zero, during periods of low earnings. These repayment plans also offer loan forgiveness to borrowers who maintain low earnings for an extended period. The lack of knowledge about

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[2] Akers, Beth, and Matthew M. Chingos. "Student Loan Update: A First Look at the 2013 Survey of Consumer Finances." *Washington, DC: Brown Center on Education Policy, Brookings Institution, available at http://www.brookings.edu/research/papers/2014/09/08-student-loan-update-akers-chingos* (2014).

[3] Akers, Beth. "The Typical Household with Student Loan Debt." *Washington, DC: Brown Center on Education Policy, Brookings Institution, available at https://www.brookings.edu/research/the-typical-household-with-student-loan-debt/.*

[4] Bowen, William G., Matthew M. Chingos, and Michael S. McPherson. *Crossing the finish line: Completing college at America's public universities*. Princeton University Press, 2009.

these safety nets likely stems from the fact that there isn't a single income-driven repayment plan, but rather a set of programs, each with different eligibility requirements and benefits.

The problem of complexity in the system of safety nets is compounded by the fact that borrowers must opt-in to these plans to reap the benefits. When a borrower enters repayment, they are automatically enrolled in a repayment plan with fixed monthly payments. A borrower who wishes to enroll in income-driven repayment must complete an initial application and then submit new paperwork to certify their income every year. The problem with this opt-in style safety net is that borrowers who are struggling to make loan payments are probably also the least likely to be aware of these benefits or to know how to take advantage of them. Not to mention, borrowers who are already in default are not eligible to enroll.

We need to do away with this malfunctioning system and replace it with a universal, income-driven repayment plan that is the default repayment option for all borrowers. Ideally, payment would be collected through income withholding so that payments could automatically fluctuate with income. This would eliminate the need for the Department of Education to rely on loan servicers to collect payments, a process that has long been plagued with complaints about service. Some object to making income-driven repayment the default option because it might cause some borrowers to pay off their debt more slowly than they would have otherwise, causing them to pay more interest over the life of the loan. This would probably be the case, but seems a small price to pay for getting struggling borrowers, who probably have relatively low levels of financial savvy, automatically enrolled in a program that will prevent them from facing unaffordable student loan payments. Borrowers who wish to pay back their debt more quickly than prescribed should be allowed to make prepayments on their debt.

With the enactment of a universal income-driven repayment plan, we should do away with the forgiveness provisions in the existing plans. Adjusting monthly payments in accordance with a borrower's income should be sufficient to ensure that a borrower never faces an unaffordable monthly payment. Beyond that, borrowers should only have their debts forgiven if they are, in fact, financially insolvent. The existing plans offer forgiveness once borrowers have made payments in an income-driven repayment plan for a fixed number of years. The problem is that this is an inadequate mechanism for identifying insolvent borrowers. Instead, alleviation of student loan burdens should occur through bankruptcy proceedings, which provide a far superior mechanism for determining financial insolvency. Currently, student debt is not dischargeable in bankruptcy.

Eliminate Needless Complexity

Our system of federal financial aid is needlessly complex. This might seem like a small problem, but research has shown that complexity is a significant barrier to college enrollment for students from our lowest income households. Since closing the achievement gap between rich and poor families should be among the highest priorities of federal education policy, simplifying the process of financial aid needs to be on the agenda.

The needless complexity of financial aid begins long before a student steps onto a college campus. Before a student learns about their eligibility for federal aid, they must complete the Free Application for Federal Student Aid (FAFSA). Studies have shown that lessening the barrier created by this aid application process would likely result in increased enrollment among students from low-income households[5]. Many have argued for a redesign of the FAFSA to make it easier to complete, but I believe that the best approach would be to eliminate the application altogether. Rather than requiring potential students to jump through hoops to find out how much aid they are eligible for, we should use data already collected by the IRS to determine eligibility. Information on aid benefits could be mailed directly to potential students and their families, perhaps being triggered by checking a box on the 1040 form. Using tax data to allocate aid would not be able to achieve the same targeting of benefits as the FAFSA because the IRS does not have all the same information on household finances, but research has shown that the loss in precision is extremely small. This cost is more than outweighed by the benefit of enrolling more low-income students[6].

The problem of complexity worsens further when students get to the point of considering the menu of aid available to them. The federal aid system provides subsidies to students through several channels, including: the Pell Grant, tax credits (American Opportunity Tax Credit and Lifetime Learning Credit), tax deductions (for tuition and fees and student loan interest), Federal Supplemental Educational Opportunity Grant (SEOG), and Work Study. The problem with this arrangement is that it makes it very difficult for students to understand how much aid is available and whether college is affordable for them. We subsidize higher education because we want to encourage people to attend college who would not have otherwise, or to encourage students to attend higher quality institutions than they would have been able to without aid. But scattering the federal aid dollars across these different channels is likely diminishing the impact of these dollars on student enrollment behavior. For this reason, subsidies in the tax code should be eliminated, and all federal aid dollars should be packed into a single grant program. The effectiveness of subsidies will be the greatest when they are as transparent as possible.

The lending system is equally complex, with several different loan products, including: Subsidized Stafford loans, Unsubsidized Stafford loans, Graduate Stafford loans, Perkins loans, Graduate PLUS loans, and Parent Plus loans. With this menu of lending options, in combination with the variety of subsidies, it is not a surprise that some students are confused about their college finances. Financial aid professionals often report that students do not always realize the difference between grants and loans. My recent work with Matthew Chingos confirmed the existence of this illiteracy among aid recipients by revealing that about half of all first-year students in the U.S. seriously underestimate the amount of debt they have taken on. And among those students with federal loans, 28 percent reported that they had no federal loans

[5]Bettinger, Eric P., et al. "The role of application assistance and information in college decisions: Results from the H&R Block FAFSA experiment." *The Quarterly Journal of Economics* 127.3 (2012): 1205-1242.
[6] For a detailed discussion of the implications for aid targeting see:
Dynarski, Susan M., and Judith E. Scott-Clayton. *The cost of complexity in federal student aid: Lessons from optimal tax theory and behavioral economics*. No. w12227. National Bureau of Economic Research, 2006.

and 14 percent reported that they had no student debt at all[7]. We should replace this set of programs with a single loan that is available only to students.

With these reforms, we should aim to pare back the federal aid program to satisfy its intended purpose. Subsidies to higher education are important. Without them the nation would suffer from insufficient investment in human capital. Productivity, competitiveness, and growth would suffer. Likewise, the federal loan program plays a critical role in our economy. Without it, welfare-enhancing educational opportunities would be left untaken because of credit constraints imposed by the private credit markets. Access to higher education is an important mechanism for social mobility, but the current system of student aid has expanded in some ways that are not justifiable.

First, we need to eliminate the Parent Plus loan program. Creditworthy parents can obtain financing for college in the private market, which means that the PLUS program simply serves as another mechanism for delivering a subsidy (through the below-market interest rate). The purpose of student loans is to alleviate the credit constraint that prevents young people from making investments in higher education that are likely to pay off. If the borrowing limits in the Stafford program do not achieve that goal, then those limits should be revisited.

Second, we need to eliminate the Public Service Loan Forgiveness program, which offers generous debt forgiveness benefits for borrowers who are employed in the government or at non-profit organizations. Encouragement of workers to participate in professions they would not otherwise have chosen can be a justifiable use of taxpayer dollars, but it should not occur through the federal student aid program. Offering these subsidies through loan forgiveness is unfair to workers who finance their educational investments through alternative means, like savings. If the goal is to increase participation in these sectors of the labor market, the subsidies should be as obvious as possible and available to all workers, not just those who financed their education with debt. Not only does PSLF deliver subsidies for public service in an inefficient manner, it also does a poor job targeting those funds. Studies have shown that most of the benefits of PSLF will go to workers that have earned graduate and professional degrees and have the potential for very high earnings. To make matters worse, these borrowers can anticipate that their debts will be forgiven, which means that they have an incentive to borrow more than is necessary. This will ultimately drive up the cost of graduate programs and put an unfair burden on taxpayers.

Before closing, I'd like to offer some remarks on the notion of restoring private sector participation in federal student lending. Bringing market discipline into federal student lending isn't a bad idea, but a return to the Federal Family Education Loan (FFEL) program would be a step in the wrong direction. Under this program, which was eliminated in 2007, federal student loans were originated by private lenders operating as contractors to the federal government. FFEL did not operate like a market. Interest rates were set by legislation, and lenders had no

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[7] Akers, Beth, and Matthew M. Chingos. "Are college students borrowing blindly?." *Washington, DC: Brown Center on Education Policy, Brookings Institution, available at http://www.brookings.edu/research/reports/2014/12/10-borrowing-blindly-akers-chingos* (2014).

discretion over who could borrow or how much to lend. Further, the contracts with lenders were poorly designed such that they were overcompensated and incented to participate in perverse business practices. There are better ways inject more market discipline into federal student lending than returning to a failed policy that created more problems than it solved.

The best approach is to redesign the federal lending program to focus on undergraduate students. Of the $100 billion of loans made by the government each year, $30 billion go to graduate students and another $10 billion to parents of undergraduate students. Scaling back or eliminating federal lending to graduate students and parents of college students would create an opening for private lenders to operate. This would almost surely reduce lending to students who attend graduate programs that are unlikely to produce a large enough economic return to justify the cost and risk. But such an outcome may be more desirable than taxpayers being on the hook for loans to graduate students that go unpaid or are forgiven under current policy.

Another smart approach would be to support innovations in the private education finance sector by establishing a regulatory framework for new financial products such as income share agreements (ISAs). Growth in this sector is currently inhibited by regulatory uncertainty. This is unfortunate because these innovative products, which offer incredible protections to consumers compared to existing products, have the potential to address many of the financial challenges currently facing students. ISAs are likely to remain a niche product, but could play a role in expanding access to higher education financing for some students, such as those who need to borrow more than the federal limits. They could also substitute for federal lending to graduate students if the availability of loans to graduate students were scaled back.

Thank for the opportunity to address you today. I am very pleased that the committee is devoting its attention to this issue, as a well-functioning system of higher education is critical to our collective economic and social wellbeing. I look forward to answering your questions today and serving as a resource in the coming months as Congress works on the long-awaited reauthorization of the Higher Education Act.