Testimony for Hearing "Breaking the System: Examining the Implications of Biden's Student Loan Policies for Students and Taxpayers."

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Chairman Owens, Ranking Member Wilson, and Members of the Committee, thank you for the opportunity to testify today.

Our system of higher education financing is in crisis. Tuition is too high. Many students enroll in programs that don't result in a degree, or their degree doesn't lead to a good job, leaving them saddled with debt they can't afford. The flaws in our student lending system impose huge costs on taxpayers, and cause many students to miss out on a chance for upward economic mobility. The problems students face with student debt are ultimately caused by well-intentioned, but flawed, federal policies, and any solution to our crisis requires federal legislative action to fix.

At the same time, however, the current system also finances high-quality education for millions of college, graduate, and professional students, and the educational investments they make help most student loan borrowers achieve good jobs, high incomes, and a host of other benefits associated with a college degree. Today and in the future, a well-functioning, fiscally sustainable student lending system will be necessary to finance such investments.

Further complicating the matter is the fact that not only do most students leave college with a good education and headed toward a good career, they also come from more affluent backgrounds to begin with. As a result, there are important issues of equity and fairness that should be taken into account when deciding whose education should be subsidized by taxpayers.

For all of these reasons, the efficacy of recent and proposed policy changes, regulatory or legislative, should be judged by their budget cost, distributional effects, and intended and unintended economic consequences.

Based on those considerations, recent executive and regulatory actions are costly, poorly targeted to help Americans who struggle financially, provide substantial benefits to highly educated and well-off borrowers, and exacerbate negative incentives in the market for institutions of higher education. Ultimately, the blunt tools available to the executive branch are insufficient to implement nuanced and targeted policies and fix the misguided incentives that caused this crisis. Legislation is needed.

Budgetary Cost of Recent Executive and Regulatory Actions in Perspective

Since the onset of the Pandemic, the cumulative cost of the suspension of loan payments, executive action to forgive student loan debt, the proposed regulatory changes to Income-Driven Repayment (IDR) plans, and other regulatory and executive actions is expected to cost more than $920 billion.[ii]

To put this cost in perspective relative to the federal budget and cost to the taxpayers, the increased subsidies for student borrowers ranks among the largest transfer programs in American history. The cumulative cost exceeds the cumulative amount projected to be spent over the next decade to supplement the wages of low-income, working parents through the Earned Income Tax Credit (EITC) ($739 billion).[iii] It's about equal to the amount in food assistance provided to families in poverty through the Supplemental Nutrition Assistance Program (SNAP or food stamps; $1,076 billion).[iv] It is almost three times more cosly than the cost of the Pell grant program over the next decade ($322 billion), which is offered only to low- and middle-income college students pursuing undergraduate degrees upon analysis of a detailed financial aid application.[v] In comparison to the programs, however, subsidies for student loan borrowers are far less targeted toward low-income, economically disadvantaged, or historically marginalized gorups.

Another way to put these costs in perspective is to compare them to the cost estimates at the time the programs were enacted. The legislation that authorized the Public Service Loan Forgiveness Program and Income-Driven Repayment plans anticipated that their combined 10-year cost would be $8 billion.[vi] The cost of the proposed regulatory changes to IDR plans alone are projected to be $230 billion.

Who Benefits from Student Loan Forgiveness Policies?

A key way to evaluate a subsidy or a transfer program is to examine who benefits. Compared to other Americans, student loan borrowers are better educated, earn higher incomes, are wealthier, and grew up in more affluent families.[vii] According to the Department of Education's proposed IDR regulation, for instance, among all federal student loan borrowers leaving school in 2024, 70 percent of debt will be owed by students who went to graduate school, and 39 percent of the total will be owed by graduate students expected to earn more than $100,000 annually over their careers.[viii] (Only 14 percent of Americans age 25 and over have a graduate degree.[ix] About 12 percent of Americans earned more than $100,000 in 2021.[x])

Likewise, student loan borrowers—including those expected to benefit from student loan forgiveness and reduced repayment under proposed changes to IDR—are better off than beneficiaries of other federal programs intended to reduce economic hardship.[xi] The SNAP program, for instance, serves households whose median income is about $19,000 a year (half are in poverty), and pays an average annual benefit of $2,300. Families that claim the EITC—the largest cash income support for working families—earn about $36,500; their average annual benefit is about $2,200. In contrast, the median income of households with student loans is

$76,400, and 7 percent are below the poverty line. Among those making payment on their loans (and who benefit directly from forgiveness and IDR changes), the median income is $86,500, and 4 percent are in poverty.

Looking specifically at the Department's recent debt forgiveness program, the average borrower is expected to receive a benefit of approximately $9,000 and the program is not well targeted to disadvantaged or struggling borrowers. The program would provide up to $20,000 in forgiveness to Pell grant recipients and up to $10,000 for borrowers who did not receive Pell. Despite the higher threshold for relief offered to Pell grant recipients—a group that is vastly more disadvantaged based on family income and parental education, less likely to complete an undergraduate degree, and more likely to come from an underrepresented group—both Pell and non-Pell groups would receive roughly the same amount of forgiveness. That's because many Pell grant recipients owe small amounts (and thus don't use even $10,000 of debt relief, let alone $20,000), are more likely to have subsidized loans, and are less likely to make full payments under existing plans. As a result, by failing to target relief exclusively to Pell recipients, the program diluted its effectiveness and increased its cost by awarding roughly $140 billion to relatively well-educated, mostly white students from affluent family backgrounds.

Another way to assess whether the debt forgiveness is well targeted to addressing the hardship of borrowers is to consider how much borrowers who slated to receive forgiveness would have paid under the proposed IDR plan. According to CBO estimates, if the Supreme Court invalidates the executive action to forgive student debt, borrowers would be expected to repay $354 billion of the total $400 billion in total forgiveness, even under the Department's generous new IDR program. In other words, almost 90 percent of the forgiveness program's benefits would go to borrowers whose incomes the Department deems high enough to be able to repay their loans under the prospective IDR plan.

Under the proposed IDR rules, borrowers will make no student loan payments (and no interest will accrue) if their income is below $32,805 in 2023. For perspective, that is about the median annual earnings of workers who paid Social Security payroll taxes in 2021. Under the Social Security and Medicare system, however, young workers today who earn the average wage owe about $649,000 in payroll taxes over their lifetimes in order to qualify for their retirement benefits.[xii] In other words, the proposed IDR system applies a different standard for college students than do other programs that support other American workers.

Unintended Consequences for the Market for Higher Education

There are several dimensions in which the proposed changes in Income-Driven Repayment plans are likely to have significant, unintended, negative effects on students and at educational institutions.

Increased borrowing and indebtedness
Today, virtually all American undergraduate and graduate students are eligible to borrow federal student loans, but those students borrow only about 31% of the amounts available to them because loans have typically been a costlier way to finance education. In 2016, undergraduate students left about $105 billion in unused borrowing eligibility on the table, and graduate students another $79 billion.[xiii]

In the past it made sense for students to minimize borrowing in most circumstances. As recently as 2017, CBO projected that student loan borrowers would, on average, repay close to $1.11 per dollar borrowed (including interest). Borrowing was often (accurately) perceived to be the least favorable way to pay for college.

But under the Administration's IDR proposal, borrowers who enroll in IDR are expected to repay less than $0.63 for each dollar borrowed, on average, and estimates from the Penn Wharton Budget Model suggest that more than 70 percent of borrowers would benefit from enrolling in the plan.[xiv] Undergraduate borrowers are expected to repay much less than the amounts they borrow. In these circumstances, it would be financially prudent to use loans rather than pay for college through other means.

Under the proposed IDR rule, most students would benefit from paying for college or graduate school with loans because it would cost less than paying out of savings or income. Those new borrowers are likely to be more affluent than existing borrowers. This raises the cost of the regulation and makes it less progressive.

Clearly, many students did not borrow because either they or their parents paid for college in other ways. Some borrowed for tuition but not for non-tuition expenses (living expenses). Some were eligible for loans despite not having financial need to borrow, because their costs were paid for by the GI Bill or other sources that are ignored for purposes of Title IV aid. But such students are eligible for loans and could take them if they wanted. (Even if the GI Bill pays for a student's entire tuition and living expenses, the student is still allowed to borrow against the same expenses.)

While the magnitude of the potential increase in borrowing is uncertain, a recent CBO analysis projects that the proposed IDR regulations will increase annual student loan borrowing by 12 percent or about $10 billion per year.[xv]

By encouraging students to enroll in IDR plans rather than the standard 10-year amortizing plan, borrowers will repay more slowly and hold balances longer, which may result in borrowers carrying student debt over a long time period.

It subsidizes low-quality, low-value, low-earning programs
Because the IDR subsidy is based primarily on post-college earnings, programs that leave students without a degree or that don't lead to a good job will get a larger subsidy. Students at good schools and high-return programs will be asked to repay their loans nearly in full. This is a

problem because most student outcomes—both bad and good—are highly predictable based on the quality, value, completion rate, and post-graduation earnings of the program attended. IDR can work if designed well, but this IDR imposed on the current U.S. system of higher education means programs and institutions with the worst outcomes and highest debts will accrue the largest subsidies.

Automatic enrollment of delinquent borrowers will increase borrowing among high-risk students and institutions because it effectively eliminates the Cohort Default Rate accountability system
Because delinquent borrowers will be placed into IDR before they technically default under the proposed IDR, the Cohort Default Rate rules will generally no longer apply, allowing high-risk institutions to participate in the loan program and enroll more borrowers.

The potential effect is substantial. Institutions enrolling roughly 1 million community college students did not participate in the loan program, largely because of concerns that their students are at such a high risk of default that participation in student lending would jeopardize the institution's eligibility to receive other Title IV funds.[xvi] Roughly 243,000 students at these institutions receive Pell grants annually, indicating that there are potentially hundreds of thousands of borrowers who would be newly eligible each year, likely to borrow, but who would be at high risk of nonpayment because of their low earnings. Outside of community colleges, these changes would allow low-quality, high-risk programs currently threatened with sanctions under existing rules to enroll high-risk borrowers. Given the generous terms of IDR for low-balance undergraduate, community college borrowers—most of whom would be eligible to make no payments and have debts discharged in 10 years—the Department should expect most institutions to offer federal loans and for students to take up loans at similar rates as at other community colleges.

The Department of Education intends to propose new Gainful Employment regulations that tie an institution's eligibility for federal Title IV funding to ensuring their students' success. It is anticipated that these regulations will prohibit programs whose students systematically experience poor employment outcomes and/or high debt-to-earnings ratios from participating in federal aid programs. Such accountability systems are a necessary and effective means to prevent taxpayer funds from being wasted on poor-quality institutions and for increasing the value that students get from the programs they attend.[xvii] However, the Gainful Employment rule only applies to a narrow set of programs including all for-profit programs and all non-degree programs at public and private non-profit institutions. As a result, there will not be any effective outcome-based accountability rules that apply to undergraduate, graduate, or professional degree programs at public and private non-profit institutions, which are collectively responsible for the vast majority of Pell grant recipients, student loan borrowers, and total federal financial aid dollars.

The proposed rules will facilitate abuse of federal loans
A large share of student debt is not used to pay tuition, but is refunded to students in cash for rent, food, and other expenses. At public colleges and for-profits, living expenses represent

more than half the estimated cost of attendance (which sets the upper limit on how much students can borrow). At many large for-profit schools, more than 30% of student loans are returned to students in cash. For graduate students across all sectors, about 30% of borrowing is for expenses in excess of tuition and fees charged by the university.

While students need to pay rent and buy food while in school, under the Department's proposal a student can borrow significant amounts for living expenses, deposit the check in a bank account, and not pay it all back. Indeed, if they never bother to make a payment (and have provided the necessary consent), they will be automatically enrolled in IDR. Gaming the system like this wasn't possible when students were asked, on average, to repay loans in full, and it's not a problem in systems where loans are used exclusively for tuition. But that's not the system we have. Some people will abuse the system by enrolling in programs simply for the purpose of taking out a loan rather than pursuing a degree, which will increase the cost of the regulation but not advance the educational purpose of the program.

Institutions will respond by raising tuition, reducing institutional aid, expanding low-value programs, or increasing recruiting intensity

There is substantial evidence that expansions in financial aid caused increases in tuition and borrowing, and increased enrollment at low-value institutions and programs. Increases in federal aid increases prices at for-profit schools.[xviii] High-price law schools have designed schemes to take advantage of generous debt forgiveness plans called Loan Repayment Assistance Programs (LRAPs), plans under which universities and students effectively shift the cost of tuition to taxpayers by exploiting debt forgiveness programs. It is likely that some institutions will change prices to take advantage of more generous IDR rules. Likewise research suggests that increases in federal aid (such as increases in Pell grant amounts) cause institutions to reduce (or "crowd out") the amounts of aid offered by the institution.

At the graduate level, it is clear that many students will never repay their loans at existing tuition and borrowing levels, and thus students and institutions will be indifferent if those programs raise tuition. The evidence from the Graduate PLUS program, which eliminated loan limits for graduate students, is informative. Eliminating loan caps increased federal borrowing, increased tuition prices, but did not increase access to graduate study among historically undrerrepresented groups.[xix]

Policy changes that expanded eligibility for federal loans to broader groups of institutions and programs increased borrowing (and worsened borrower outcomes) by encouraging the entry and expansion of lower-quality programs and by increasing enrollment of students in those programs. (And, likewise, excluding low-quality institutions from federal aid improves borrower outcomes.)[xx]

State governments may choose to reduce funding for public institutions

The rate of subsidy implicit in the proposed IDR regulations effectively turn loans into grants for most undergraduate and many graduate students. States may respond by reducing state appropriations or state grants (which are paid by local taxpayers) to federal loans (which are paid by federal taxpayers). "Crowd out" is a well-known concern regarding proposals to increase grant funding and other aid to states. If states reduce their funding to take advantage of increases in federal subsidies, this would increase the cost of the proposed rule to the federal government.

Conclusion

Most of the problems that student loan borrowers face are predictable based on the institution they attend, the program they enroll in, and the tuition and other costs associated with the program. A key flaw in our current student loan system is that it regularly offers loans to students knowing full well that they will never be able to repay those loans, at institutions and programs where students rarely complete a degree; at low-quality institutions, online programs, or certain degrees that provide little value in the job market and no boost to earnings; but also at elite masters and professional degree programs, where the quality of education is strong but where the tuition charged is simply too high.

Looking backwards, I don't doubt that cleaning up this mess will require some degree of loan forgiveness for those harmed by bad government practices and, through IDR plans, for borrowers who made good educational choices but are unlucky. But for many borrowers, their loans financed valuable educational investments and helped them achieve economic success. Asking them to repay their loans is a way to pay it forward to future generations of students.

Looking forward, the fundamental problems that caused the student loan crisis—useless degree programs and exorbitant costs—can't be solved by encouraging students to take out bad loans with promises to forgive them later. To address these fundamental problems, Congress must decide which institutions and degree programs taxpayers should pay for, which students are wealthy or well-educated enough to pay their own way, and how to reign in adverse incentives for institutions to raise prices. That requires legislative action to restore some form of underwriting of the institution and program to screen out programs that waste taxpayer money. It also requires imposing incentives to reduce tuition costs, like restoring limits on graduate and parent loans, working with states to lower educational costs, and increasing targeted, means-tested grant aid for low-income students. Those measures require an act of Congress.

There are thousands of educational institutions that regularly provide upward economic mobility to their students—including for low-income, first generation, and minority students.[xxi] I am optimistic that federal policies can help more Americans enroll in such programs and move them up the economic ladder.

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[ii] These costs include approximately $95 billion in costs associated with regulations for Public Service Loan Forgiveness, borrower defense, closed school discharges, total and permanent disability, and interest capitalization; $400 billion of loan cancelation; changes to IDR of $230 billion, the cumulative cost of the payment pause of $147 billion; and roughly $50 billion in announced relief for borrowers at specific institutions.

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