STUDENT TUITION

Unburdening the Debt for Youth in America

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Editor’s note: The authors undertook this research as 10th grade students at the Thomas Jefferson High School for Science and Technology, Alexandria, Virginia, and Langley High School, McLean, Virginia, respectively. This article is adapted from their paper that was chosen as a finalist for the 2016 MIT Inspire Competition for high school students.

This article seeks to comprehensively combat mounting student debt and defuse the next big financial time-bomb in the United States. As of mid-July 2016, outstanding U.S. student loan debt was almost $1.4 trillion (FinAid 2016), and by some estimates is expected to reach $2.5 trillion by 2025. Student debt is the second-largest household debt behind home mortgages (Dynarski 2015). Currently, more than 43 million Americans (13.3 percent of the overall population) have outstanding college debt (Student Loan Hero 2016), and for those with college debt, the household average was $48,172, much greater than the average for those with credit card ($15,762) and auto ($27,141) debt (Issa 2015). During 2002–2012, the number of student loans grew by 77 percent and the average student loan increased by 60 percent (Greenstone and Looney 2013). Unlike other types of debt, it is nearly impossible for student debt to be discharged or reduced in bankruptcy.

An effective solution should address the following three key issues: (1) get rid of existing student debt, (2) cap tuition increases to contain costs, and (3) pre-empt students from further debt. Unless all three are addressed, the United States risks another financial crisis, as broad and widespread as the Great Recession of 2008.

Causes
Rising student debt is the result of the following: (1) rising tuition, (2) easily available loans, (3) financially naïve students, and (4) lenders interested in profit over student success.

Rising tuition. Rapid tuition increases are the main reason for the student loan problem. Since 1995, the number of students enrolled in undergraduate, graduate, and professional programs has grown by 50 percent (Campos 2015). This larger number of college entrants, combined with government’s slashing of public funds for higher education, has fueled tuition increases. Yet median income during 1990–2010 was stagnant. Similarly, education inflation has outstripped consumer inflation (Commonfund 2015). If tuition increases tracked the inflation rate, tuition at Harvard for the 2015–2016 academic year would have been $15,189 instead of $45,278 (Schoen 2015).

Easily available loans. Assuming no shift in the demand curve, Economics 101 teaches that when the price of goods rises, the quantity demanded should decrease. But in the past 40 years, college costs have risen and U.S. college enrollment has more than doubled to 19.5 million as of 2013 census data. Just as easily available mortgage loans and financially naïve borrowers stoked the Great Recession, student loans are readily handed out, often without a co-signer (Federal Student Aid, n.d.). According to Lucca et al. (2015), “On average, for a $1 increase in the subsidized-loan cap, tuitions rose by as much as 65 cents.”

Financially naïve students. Only 24 percent of first-year students with federal loans were able to estimate their loan amount within 10 percent of its actual value; instead, 51 percent underestimated the amount (Akers and Chingos 2014). In a multitude of YouTube videos, students discuss how they had no idea about their financial obligations or how onerous their debt would be.

Lenders interested in profit over student success. In 2010, the government forced commercial banks out of the federal student loan market. In October 2014, Sallie Mae spun off its federal loan servicing business into Navient, now the third-largest federal student loan servicer (after FedLoan Servicing and Great Lakes Educational Loan Services, Inc.). Sallie Mae and Navient used to lend students money backed by the government, assuming almost no risk in the process (Herszenhorn and Lewin 2010). This, combined with abuses such as overstating minimums, wage garnishing, and other forms of deceit (Lewis 2014), led to the government taking over the functions of these student-loan predators and forcing them to hand out private loans with their own capital. The 2016 graduating class is the most indebted ever. The average debt per graduate is more than $37,000, up 6 percent from 2015 (Student Loan Hero 2016). In 2013, the U.S. government made more than $41.3 billion in student loan interest, a higher profit than all but two companies: Exxon Mobil and
Apple (Jesse 2013). The government makes money by using an income-based repayment plan, in which debt may be stretched over a longer period of time. This makes it affordable to the student in the short term, but the interest on the loan compounds and crushes students in the long term.

Consequences
Young people are discouraged from pursuing a college education. Onerous debt is forcing students to question the tradeoff between a college education and the debt involved. But Carnevale et al. (n.d.) find that people who earn bachelor’s degrees earn $4 per cent more than high school graduates over a lifetime and that a bachelor’s degree is worth an average $2.8 million in additional income over a lifetime. The study concludes that a college degree is key to economic opportunity, but many students who are unwilling to take on debt forgo a preferred college or a college education altogether, along with its economic promise. Studies correlate the economic vitality of a country to the college-educated demographic of its population, and higher education provides opportunities and financial success.

Financial burden = lifetime consequences. Student loan debt leaves people with life-long financial burdens. Callis and Kresin (2015) found that, for Americans under age 35, homeownership rates fell 8.9 percent in the past decade. A survey by the National Association of Realtors (2014) found that 57 percent of respondents said student debt hindered their ability to buy a house. Unlike other debt, student loans cannot be discharged in regular bankruptcy. The logic behind this is that a student with limited assets experiences no consequences in filing for bankruptcy, so allowing student debt erasure through bankruptcy risks making college free at government expense. This debt burden also has implications for the jobs students choose. Rothstein and Rouse (2007) of the National Bureau of Economic Research found that ‘debt causes graduates to choose substantially higher-salary commercial jobs and reduces the probability that students choose relatively low-paying ‘public interest’ jobs.”

Detriment to students’ well-being. Debt may leave some students and graduates feeling helpless, hopeless, and with low self-esteem. Walsemann et al. (2015) conducted the first nationally representative study to specifically look at the effects of student loans on health. It provided preliminary evidence that student loans are associated with poorer psychological functioning and greater levels of depressive symptoms among students while they are enrolled in school as well as in early adulthood. The National Institutes of Health reported on a review of 33 peer-reviewed studies linking indebtedness to depression. It found that individuals with unmet loan payments had suicidal ideation and suffered from depression more often than those without such financial problems, and unpaid financial obligations were related to poorer subjective health and health-related behavior (Turunen and Hiilamo 2014).

The ballooning burden. In 2013, the Federal Reserve Bank of New York (Brown et al. 2014) found that 17 percent of borrowers were more than 90 days delinquent in paying their loans, compared to 6 percent in 2005. Most student loans are backed by the federal government, mainly through the Department of Education. If a student defaults, the burden reverts, inevitably, to the U.S. taxpayer. Student debt makes up 7 percent of the national debt, and this portion will grow if people continue to be unable to pay off student loans.

In our opinion, incentive structures need to change to ensure that all stakeholders—government, colleges, and students—have desirable outcomes.

Proposal: STUDY America
We present our three-pronged STUDY America plan or “Student Tuition: Unburdening the Debt for Youth in America,” which leverages proposals from both sides of the political spectrum.

STUDY America attempts to be equally advantageous for colleges, the government, and students regardless of student wealth, earning potential, or college attended. It focuses on (1) reducing current debt, (2) controlling tuition costs, and (3) pre-empting future debt. At its heart, it seeks to change the incentive structure for the various stakeholders.

Lessening Current Debt: Work for Debt Repayment
STUDY America offers graduates options for government, social work, or community service positions in the public sector. We call this Work for Debt Repayment (WFDR), inspired by President Franklin Delano Roosevelt, who said, “The test of our progress is not whether we add more to the abundance of those who have much; it is whether we provide enough for those who have too little.”

WFDR counteracts debt as well as the problem of graduates feeling forced into higher-paying jobs for financial solvency, causing a deficit of workers in lower-paying community-service sectors. STUDY America encourages people to take jobs they otherwise may not take by forgiving loans that may have never been paid off—and would revert to the government. Instead, the nation benefits from a more educated labor force and higher productivity in community service. This plan is similar to the Reserve Officer Training Corps, which pays for college in exchange for military service. Unlike military service, WFDR is voluntary; those struggling to pay debt may opt in, and those comfortable paying off debt can pursue other careers. WFDR gives students a chance to work where they may have the most interest and make the biggest contribution.
The third part of STUDY America is to Eliminate Future Debt: The IVY Approach.

Under STUDY America, that increase would have maxed out at $81.50 before incurring a tax penalty. Some colleges may find that incurring the tax is the best economic decision, whereas others may find that controlling costs to the tax-limited threshold is advantageous.

STUDY America proposes a carrot-and-stick approach to control rising tuition costs. Colleges would, through a tax threat (i.e., the stick), be deterred from increasing tuition costs by more than 1.5 times the rate of inflation. Tuition revenues earned beyond this threshold would incur a tax. As we know from Economics 101, if the value of a dollar increases by only x annually but the product you are trying to buy increases by 4x annually, it becomes increasingly hard to afford the product. Harvard, for example, will have a $47,074 tuition tab for 2016–2017, an increase of almost $2,000 from 2015–2016 (Harvard College 2015).

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Eliminate Future Debt: The IVY Approach

The third part of STUDY America is to control/discourage future debt. STUDY America’s “InVesting in Youth (IVY)” calls for institutional investors (e.g., pension funds, hedge funds, even colleges and university endowments) to invest in groups of students. Investors would earn a dividend based on the career success of students; greater the success, greater the return. These IVY rates will vary depending on group rating and loan amount.

For example, for a $40,000 loan, the AAA rate may be 5 percent, the AA rate 7 percent, and the A rate 9.5 percent, reflecting the differential risk for the investor. Rates for larger (smaller) loans will be proportionally adjusted up (down).

How investors make money: Investors make money because students are under contract for 15 years and pay the IVY rate based on their incomes. These IVY rates and length of contract could change over time based on prevailing economic conditions. Students who have no income in a given year are not obligated to pay.

Investors may create diversified portfolios of student equity based on their risk appetite. Because some of the best-paid chief executives didn’t graduate from top schools, investing in A or AA students may provide a very high return.

By grouping students into broad categories, STUDY America gives all students an even chance of getting funded. To encourage investors, their investments would be tax-exempt.

The carrot for colleges would be tax credits for every student they invest in, which may offset taxes incurred for raising costs more than 1.5 times inflation. This way schools bear some risk of future student success. After all, who would have a better knowledge and understanding of a student’s future prospects than the student’s institution? A school unwilling to invest in its students would signal a lack of confidence that its students will be successful.

This plan would apply for all U.S. college students, with an opt-out for those who do not want to participate. The plan also would require a financial literacy class for incoming college students that would cover the dangers of student debt and the risks of opting-out and taking out a student loan. Klapper et al. (2015) suggests that nearly 60 percent of U.S. adults are not financially literate, and improving financial literacy would help students make better financial choices.

Conclusions

Student debt is a time-bomb that needs defusing. Rising tuition, easy availability of loans, students’ financial naiveté, and lenders’ and government’s prioritization of profit over student success contribute to the problem. Students follow their dreams, go to college, and land in a heap of debt; or they forego college and financial advancement. STUDY America addresses the need to control current debt, tuition increases, and future debt. It offers loan forgiveness to graduates who take public-sector jobs and proposes legislation that would encourage colleges and universities to limit tuition increases to 1.5 times the inflation rate or incur taxes. It takes on future debt through the IVY program, where investors (including colleges and university endowments) may invest in groups of students and receive a guaranteed portion of their future income, similar to a dividend. All investments would be tax-exempt, making the student investment market as lucrative as the stock market. Schools that invest in their students would receive tax credits that could offset potential new taxes under our proposal, and they would signal to the market the confidence they have in the education they provide. We see this as investing in intellectual infrastructure.

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