

**Written Testimony of  
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Joint Economic Committee

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Chairman Coats, Ranking Member Maloney and members of the Joint Economic Committee, thank you for the opportunity to be here. In our economy, which now prizes information and skill more than at any time in history, there are few questions more important for growth than how we make higher education and career readiness affordable and accessible to all Americans.

The facts are already widely known, but no one understands them more pressingly than the nation's 43 million student debt holders. Nearing \$1.3 trillion, education debt has increased almost 3X since 2006, affecting not just students and graduates but increasingly their parents and grandparents. In the last year, student debt increased by almost \$86 billion, or 7 percent.<sup>1</sup> It now exceeds all other debt except home mortgages and of course, the biggest debt of all, the federal debt held by the public.<sup>2</sup>

Not dischargeable even in most bankruptcies, student debt obligations are a modern form of indentured servitude. The personal implications of the debt can be harsh throughout a borrower's life. The demands of loan payments, especially private loans, are normally unsympathetic to periods of unemployment or underemployment, serious illness, or new life callings.

The government's income-based repayment plans, which eventually forgive student debt after a period of low or non-payment, can offer some relief for some federal loans, but they are proving very imperfect. Among the early warning signs has been the decline of the student-loan bond market. Sensing danger ahead, investors are now hesitant to buy bonds backed by federal student debt for fear that the debts, which pre-date the 2010 shift to direct federal lending, will not be fully repaid. With buyers less interested and the market devalued, banks reportedly have less capital to lend for other new loans.<sup>3</sup>

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<sup>1</sup> July 2015. Board of Governors of the Federal Reserve System.  
<http://www.federalreserve.gov/releases/g19/current/#fn11b>

<sup>2</sup> August 2015. Federal Reserve Bank of New York.  
<http://www.newyorkfed.org/microeconomics/hhdc.html#/2015/q2>

<sup>3</sup> September 2015. Wall Street Journal. <http://www.wsj.com/articles/debt-relief-is-snarling-the-market-for-student-loans-1443035071>

But of course, the bigger problem is the deep financial cost for taxpayers. The Congressional Budget Office recently increased its estimate for the cost of student loans by \$39 billion over ten years, mostly because of the growth of such government-backed income-based repayment plans. Similarly, the Office of Management and Budget quietly wrote off \$22 billion in debt in the last budget, mostly because it had underestimated the FY16 costs of income-based repayment. As one media outlet reported, this is “larger than the annual budget for NASA, or the Interior Department and EPA combined.”<sup>4</sup> In the past, some have pretended that the loan program would be a financial net plus for taxpayers, but with more write-offs certain in the future, such claims can now be safely dismissed.

The societal and economic consequences of student debt make it a problem that impacts all Americans, not just those directly tied to higher education. Mounting evidence shows that students with education debt are more likely to delay vital life decisions that benefit us all at the macro level. Home buying, marriage, childrearing and even moving out of the family house are all now commonly delayed because of student debt. There is also compelling evidence that the business startup rate suffers when graduates take on too much debt as potential innovators pass on the uncertainty of the entrepreneurial lifestyle in favor of the safety of a traditional job at an established company with a consistent paycheck.

Earlier this week, our partners at Gallup released the results of the second annual Gallup-Purdue Index, the largest survey of college graduates ever conducted. Consistent with other smaller scale studies, the survey found that nearly half of recent graduates with student debt decided to postpone a graduate education because of their student loans. A third delayed purchasing a house or a car, and one in five put off starting a business. With higher debt levels, the rate and frequency of such delays only magnify.

The trend in student debt coincides with the trend in tuition prices, which have increased by 225 percent over the last 30 years, after inflation.<sup>5</sup> With such out-of-control pricing, there is a real threat that those in our nation’s lowest income brackets — those who have the most to gain from more education — might start to view college as an option only for the rich. Disturbingly, but perhaps not surprisingly, the percent of Americans who believe that a college degree is “very important” plummeted, from 75 percent in 2010 to 44 percent in 2014.<sup>6</sup>

State financial support for higher education, cut dramatically in many states over recent years, may have contributed to the rise in costs and debt, but this is far from a complete explanation. In at least half of the country, inflation-adjusted tuition increases have outpaced inflation-adjusted state funding cuts. In many cases, public universities in states

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<sup>4</sup> February 2015. Politico. <http://www.politico.com/magazine/story/2015/02/the-college-loan-bombshell-hidden-in-the-budget-114930#.VNjcamTaHaw>

<sup>5</sup> 2015. CollegeBoard. <http://trends.collegeboard.org/college-pricing/figures-tables/published-tuition-fees-relative-1984-85-sector#Key Points>

<sup>6</sup> October 2014. PDK/Gallup Poll. [http://pdkintl.org/noindex/PDKGallupPoll\\_Oct2014.pdf](http://pdkintl.org/noindex/PDKGallupPoll_Oct2014.pdf)

that increased higher education investments between the years 2008 and 2015 raised tuition just as much as states that cut funding.<sup>7</sup>

Two additional triggers of the debt problem multiply in force when combined. The first is a lack of information and financial literacy in regards to borrowers' expected salaries and payments; the second, a well-intended but complicated national policy of making large education loans exceptionally easy to acquire.

Economists and policymakers have long feared that the easy flow of loan dollars combined with pressures placed on college administrators to grow their budgets have made schools slow to rein in costs. Budget solutions usually follow the path of least resistance and when your customers have unlimited funds and insufficient information about the product they are buying, the easiest budget solution is often to raise prices rather than find operational efficiencies.

Over the years, various studies have supported this theory. The most recent was released by the Federal Reserve Bank of New York last July. The paper found that for every new dollar received by universities in subsidized loans, schools increased their tuition rates by about 60 cents. For every dollar of Pell Grants, sticker prices increased by about 40 cents.<sup>8</sup>

Such examples make a case for Congress to adopt a "first, do no harm" policy. The most specious and counterproductive of suggestions is to simply hand out even more public funds, a "hair of the dog" approach — if you're hung over have another — if ever there was one. As shown by the New York Federal Reserve study, this would risk decreasing the incentives for colleges and universities to run their programs efficiently.

Moreover, it is fallacious to term such an approach "debt-free"; borrowed by an already bankrupt federal government, the money will be all debt, merely shifted to taxpayers, including these very same students as they enter their working years. Already facing \$58,000 per person in federal debt, incurred not for their future but almost entirely for the current consumption of their elders, the last thing today's young people need is another massive federal entitlement program.

Therefore, guided by the principle that something needs to be done, but not something that will actually make matters worse, I suggest three areas ready for Congressional action.

### **Financial Transparency and Literacy**

At Purdue, we have made student affordability and debt reduction a primary objective. We froze tuition for at least four years, made textbooks more affordable, and reduced room and board costs. Each of these measures have helped bring down our student debt levels in the last three years by \$50 million or 22 percent.

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<sup>7</sup> May 2015. Center on Budget and Policy Priorities.

[http://www.cbpp.org/sites/default/files/atoms/files/2015\\_highered\\_download.xlsx](http://www.cbpp.org/sites/default/files/atoms/files/2015_highered_download.xlsx)

<sup>8</sup> July 2015. Federal Reserve Bank of New York.

[http://www.newyorkfed.org/research/staff\\_reports/sr733.pdf](http://www.newyorkfed.org/research/staff_reports/sr733.pdf)

But, one of the fastest and easiest ways to reduce the student debt load is to simply promote financial literacy. For example, we reformatted our financial award letters to more precisely communicate how much students will need to come up with after grants and scholarships and we provide all students with a payment plan scenario before they borrow so that they better understand how much they will really owe.

Doing more to help students clearly understand what a degree will cost and what they can expect to earn is the next phase of the movement for more financial literacy in higher education funding. The new online College Scorecard from the U.S. Department of Education is a good first step, but without data at the program level, it could mislead. Students with plans to major in a university's lowest grossing degrees are likely to get into financial trouble if they assume they will earn the average reported in the Scorecard. Congress should continue to build from this positive first step by encouraging universities to be transparent, honest and specific in the costs and earning potential of the degrees they offer.

### **Accountability**

More than 35 states use some form of performance-based funding to create an environment where universities are rewarded and held accountable for the results they generate with state funding.<sup>9</sup> In my state, the performance formula grades and rewards schools on several factors, including the graduation levels of at-risk students and the number of high-impact degrees awarded.

At the Federal level, by comparison, such incentives are almost non-existent. Current federal policy does threaten to cut off eligibility to federal loans when the 1-year and 3-year student loan default rates exceed 30 and 40 percent, but in practice, this has little impact as a motivating force. Of the thousands of schools receiving federal aid, fewer than 0.5 percent are ever seriously threatened with this sanction in a given year.<sup>10</sup> Further limiting the incentive, a school with a 3-year default rate of 25 percent is treated the same as a school with a 15 percent rate.

The current system is entirely one-sided. Colleges and universities receive taxpayer dollars with nothing at risk and no incentive to ask for less in tuition. Fundamental reform towards a system of shared accountability is clearly warranted. Colleges and universities should have more skin in the game. They should share in the risk with students and taxpayers that the education provided might not lead to positive life outcomes and they should be rewarded when results are good.

Of course, any efforts to promote shared risk should keep sight of the fact that not all good schools are the same — what's right for Harvard or Purdue might not be right for a community college or a vocational school. Likewise, a poorly crafted accountability measure could discourage schools from recruiting at-risk students. But these are manageable obstacles, not roadblocks. Shared-accountability proposals that avoid these

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<sup>9</sup> July 2015. National Conference of State Legislatures.  
<http://www.ncsl.org/research/education/performance-funding.aspx>

<sup>10</sup> 2015. U.S. Senate Committee on Health, Education, Labor and Pensions.  
[http://www.help.senate.gov/imo/media/Risk\\_Sharing.pdf](http://www.help.senate.gov/imo/media/Risk_Sharing.pdf)

pitfalls, such as the one recently outlined in a paper by the Lumina Foundation and in discussion in the Senate HELP committee, should be explored by lawmakers.<sup>11</sup> Purdue, for one, is eager to embrace a culture of accountability that asks us to share in these risks with students and American taxpayers.

### **Alternative funding**

About 60 percent of students who earn a bachelor's degree have education debt, most of it from the Stafford loan program. While these federally backed and subsidized loans are the most affordable for borrowers, more than \$26 billion is borrowed each year through less-forgiving private loans and PLUS loans.<sup>12</sup>

Private loans are used by less than 10 percent of students, but the use rate is much higher for big borrowers.<sup>13</sup> Over 80 percent of those who borrow more than \$40,000 have at least one private loan.<sup>14</sup> For government issued PLUS loans, available to graduate students and the parents of undergraduates, there are over 2 million Grad PLUS loans and 6 million Parent PLUS loans outstanding. The average value of a public university PLUS loan is about \$20,000 for parents and \$27,000 for grad students.<sup>15</sup>

Although private loans and PLUS loans are a minority of all outstanding loan dollars, these two loan options deserve a disproportionate amount of the blame for the nightmarish anecdotes that generate the most public alarm. It should be a priority of lawmakers to find alternatives to these two loan options, without losing sight of the recent research by the Federal Reserve and without aggravating the federal debt problem.

Into this dismal picture, a glimmer of a better idea has appeared. Income-share agreements (ISAs), under which a student contracts to pay funders a fixed percentage of his or her earnings for an agreed number of years after graduation, offer a constructive alternative to today's private and PLUS loans, both as an option for new originations and for refinancing existing debt.

In early August, our affiliates at the Purdue Research Foundation launched a search for a partner who could help us establish and manage such a program. We are currently reviewing six serious proposals from a range of groups with different backgrounds and experiences. We continue to weigh our options with a final decision expected before the end of next month.

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<sup>11</sup> September 2015. Kelchen, R. <http://www.luminafoundation.org/files/resources/proposing-a-federal-risk-sharing-policy.pdf>

<sup>12</sup> 2014. Collegeboard. <http://trends.collegeboard.org/sites/default/files/2014-trends-student-aid-final-web.pdf>

<sup>13</sup> 2013. Collegeboard. <http://trends.collegeboard.org/student-aid/figures-tables/percentage-undergraduate-and-graduate-students-borrowing-private-loans-over-time>

<sup>14</sup> 2013. CFPB, Chopra. <http://www.consumerfinance.gov/newsroom/student-debt-swells-federal-loans-now-top-a-trillion/>

<sup>15</sup> 2014. The Chronicle of Higher Education. <http://chronicle.com/blogs/bottomline/new-data-shed-light-on-use-of-plus-loans-and-controversial-loan-denials/>

If we move forward, students who need more than they receive from the Stafford program, or who simply wish to avoid the hazards of traditional loans, could enter into an ISA. When they do, any loan debt they already carry could also be refinanced into the agreement if they choose, permitting them to graduate free from any private or PLUS loan debt.

For students, the clear advantage is that their education payments will never be more than the agreed portion of their incomes, no matter what life brings including unemployment, underemployment and health issues. ISAs shift the risk of career shortcomings from student to funder: If the graduate earns less than expected, it is the funders who are disappointed; if the student decides to go off to find himself in Nepal instead of working, the loss is entirely on the funding providers, who will presumably price that risk accordingly when offering their terms. This is true “debt-free” college.

ISAs are neither a new nor untried idea. Milton Friedman proposed them more than a half-century ago, and there is a market for them today in Colombia, Mexico, Chile and other Latin American countries. A number of non-profit and for-profit providers are eager to develop a market for ISAs in this country. In a working ISA market, we expect that at least some contributors will not be investors in the traditional sense, but rather loyal alumni and philanthropists who see this as a way to do more with their charitable dollars than a traditional donation.

Our exploration of the idea is consistent with our desire to guarantee that a Purdue education will be within the financial reach of every qualified student. We are willing to put all options on the table as we consider how to do that. Inevitably, some ideas will make a difference and some won't; some will be practical, and some will be farfetched. I'm not ready to make any final statements about ISAs. But there is something very American and progressive about the idea that contrasts with the existing alternatives. Consider that with private and PLUS loans, access to higher education funding regressively depends on family wealth. With an ISA, family credit is irrelevant to one's worthiness to get funding. What matters is the future, and an individual's promise to work hard, and pursue the American dream.

I am grateful to Rep. Young and Rep. Polis for introducing HR 3432, the Student Success Act of 2015, as a bipartisan effort. This legislation will make it possible for us to test whether ISAs can give students a better deal than they now have. The legislation is needed because it will provide important protections for students and offer clarity for the ISA provider. It's also my hope that the final version of the bill will make it clear that ISAs should be dischargeable in bankruptcy, which will be an important distinction from the current offerings.

Without this legislation, we will never see ISAs in use at a large scale; with it, we have a chance to do something real for students. I encourage the Senate to introduce and pass similar legislation to HR 3432, and to do it quickly. Legislative clarity will open doors to develop this option in a way that is not currently feasible.

## **Conclusion**

The United States, to this point the global leader in higher education, has much to be grateful for in this economy that thrives on information and high skill. But our

competitiveness is threatened by out-of-control university costs and an administrative culture that avoids accountability. Increased transparency and honest advice about what students can expect to make and owe in specific programs would help, as would reforms to make sure universities have skin in the game. Finally, an aggressive assessment of the funding models in use today, combined with a series of reforms to open doors for the growth of an income sharing model would position our universities and our economy for continued success.