Is There a College Financing Crisis?

Jason Delisle and Preston Cooper

The 2020 elections showcased what was easily the most radical higher-education agenda the Democratic Party has ever endorsed. Mass student-loan forgiveness, $13,000 Pell Grants for undergraduates, and free-college programs were all on the wish list. This was a far cry from the Obama-era platform, which consisted largely of proposals to increase tax breaks for tuition and reduce interest rates on student loans.

Some credit for this leftward lurch belongs to senators Bernie Sanders and Elizabeth Warren. Sanders first proposed a national free-college program during his 2016 presidential bid, and the Democratic Party has since adopted his plan as its own. Then during the 2020 presidential primaries, both Warren and Sanders called for the government to forgive most of the outstanding $1.6 trillion in federal student-loan debt. Although the official Democratic platform calls for a slightly less radical $10,000 in forgiveness per borrower, mass loan forgiveness is now a central pillar of the party’s agenda.

Warren and Sanders can’t claim all the credit, however. A second impetus behind the party’s acceptance of increasingly radical higher-education policies is the fact that contemporary debates over the subject are dominated by claims that access to college is severely inequitable and unaffordable, and that matters have grown worse in recent years. This message, advanced by left-leaning advocacy groups and sympathetic media outlets, appears to have convinced many Democrats that their agenda of the not-too-distant past—one based on modestly more generous aid for students—has failed. This, in turn, has led them to endorse proposals that are more far-reaching than they were in the past.

Jason Delisle is a visiting fellow at the American Enterprise Institute, where he works on higher-education financing with an emphasis on student-loan programs.

Preston Cooper is a research fellow at the Foundation for Research on Equal Opportunity.
Yet empirical data do not suggest that higher-education access, equity, or affordability are at the crisis levels these narratives imply. In fact, both access and equity in our higher-education system have improved over the past 20 years. And thanks to policies already in place, tuition prices and student-loan payments are far more affordable than many assume.

Unfortunately, those seeking to advance the progressive agenda have drowned out these realities with talk of crisis. Radical solutions require radical problems, after all. The American higher-education system has its shortcomings, to be sure, but those problems are not nearly as great or as intractable as mainstream narratives would have us believe.

**Student Debt**

Proposals involving mass student-loan forgiveness are motivated in part by the belief that student debt has grown to crushing levels in recent decades. Debt-cancellation proponents claim that most borrowers are unable to afford their payments and that their debt acts as a drag on economic growth. They blame student-loan debt for all sorts of economic ills, from lower home-ownership rates to stifled consumer spending to reduced rates of small-business formation.

Given Americans’ collective student-loan debt, forecasts of imminent catastrophe are easy to believe. And there’s simply no denying that the overall debt burden has increased rapidly over the past 20 years. In 2000, outstanding federal student loans totaled approximately $318 billion in today’s dollars. That figure now stands at $1.6 trillion. More recently, student debt has eclipsed credit-card debt and auto loans to become the second-largest form of consumer debt in America — only home-mortgage debt is larger.

Yet several empirical studies reveal a far less alarming picture than the $1.6 trillion figure suggests. The reason? These studies use data about borrowers themselves rather than summary statistics about the entire stock of debt. This lens helps reveal that rising levels of overall debt do not necessarily translate into larger debt burdens on individuals. It also suggests that rising student debt may not be a categorically negative development.

A recent study by the J. P. Morgan Chase & Co. Institute, for instance, examined checking-account transactions of 4.6 million households to determine how much borrowers were paying monthly on their student loans before pandemic legislation put federal loans into forbearance. In
other words, rather than calculating the total outstanding debt students owe as a collective, the study examined students’ individual payments. Researchers also compared these payments to borrowers’ take-home pay to assess the financial burden they impose.

The authors of the J. P. Morgan study found that the typical borrower examined had a student-loan payment of $179 per month, which was just 5.5% of his monthly take-home pay. It’s hard to imagine student debt having a significant impact on household financial decisions when, for the majority of borrowers, payments are less than $200 per month. And at 5.5% of take-home pay, these payments are in line with what experts have argued are reasonable and affordable. Such statistics are hardly consistent with claims that borrowers are being overwhelmed by student-loan debt.

How do those payments compare to what borrowers paid 20 or even 30 years ago, before the more recent run-up in debt? Surprisingly, typical payments weren’t any lower back then. A 2002 survey of student-loan borrowers conducted by Nellie Mae—a financial institution that had a major presence in the market at the time—found that median monthly payments in today’s dollars were about $280 that year. This is considerably higher than the $179 in monthly payments that today’s borrowers typically pay.

Like the J. P. Morgan study, the Nellie Mae study also assessed payments relative to borrower earnings. It found that, at the median, monthly student-loan payments were about 8% of a borrower’s earnings. Again, this is higher than the 5.5% figure the typical borrower pays today.

Furthermore, a 2014 Brookings Institution study by Beth Akers and Matthew Chingos suggests that student-debt burdens relative to income have not increased over time. Using data from the Federal Reserve’s Survey of Consumer Finances, the authors found that student-loan payments relative to income were constant from 1992 to 2010—at about 4% of household income.

How could overall student-debt levels increase so dramatically while burdens on individual borrowers remain steady? One possible explanation is that rising incomes can support higher levels of debt. The Akers and Chingos study suggests that earnings among borrowers have increased at rates that have kept pace with rising debt, which is consistent with this theory. Interest rates on debt have also fallen considerably
over time, putting downward pressure on payments even as debt levels have increased. In the 1990s and early 2000s, interest rates on student loans for undergraduates stood at about 8%. Today, they are less than 5%.

Additionally, two demographic trends have contributed to rising cumulative debt in a way that does not necessarily translate into increasingly burdensome payments. One is that a greater share of the population is attending some form of higher education than in the past. Today, about 41% of young adults enroll in some form of post-secondary education, which is up from about 34% in the 1990s. Enrollment among older non-traditional students has increased at even higher rates. Given that a larger share of the population is pursuing a post-secondary degree, we should expect the outstanding stock of debt to rise, but per-borrower payments need not also increase.

The other demographic trend boosting levels of outstanding debt is more surprising— and largely missing from the debate over mass loan forgiveness. U.S. Department of Education data show that while students from low-income families are about as likely to borrow money to finance their education today as they were in the mid-1990s, students from upper-income families are almost twice as likely to borrow today than they were 25 years ago. The dynamic of a large new demographic group taking on student-loan debt is likely contributing to the rapid run-up of total outstanding debt—but again, this would not necessarily translate into larger per-borrower loan burdens than in the past.

New government policies have also played a role in helping keep borrowers’ payments low. In 2009, all borrowers in the federal loan program—through which the vast majority of student loans are issued—gained access to Income-Driven Repayment (IDR) plans. This change made monthly payments more affordable for low- to middle-income borrowers. Obama-era policies made the programs even more generous in 2012.

Currently, IDR plans allow borrowers to set their payments at 10% of their income over an exemption of $19,000 for a single individual or $40,000 for a family of four. For most of these borrowers, remaining debts are forgiven after 20 years of payments. About half of all outstanding federal student loans are repaid through an IDR plan, and the typical payment for borrowers enrolled in these plans ranges from $91 to $154 per month. If all borrowers in the federal loan program can
now make low payments based on their incomes—and the data show many have opted to do so—then it stands to reason that payments on the overall stock of debt would not have increased in proportion to the rise in overall debt.

Another body of research casts doubt on the claims that student loans are ineffective at increasing college access and do more harm than good for borrowers. Two separate studies using experimental designs—one conducted by Benjamin Marx and Lesley Turner, and another by Andrew Barr, Kelli Bird, and Benjamin Castleman—found that community-college students who took on more debt tended to see better outcomes in their schooling, including better grades, higher completion rates, and fewer loan defaults after leaving school. This suggests that, in the right context, some students are better off for having student debt than they would be if they had not borrowed for school.

A working paper from the National Bureau of Economic Research that focused on students attending four-year institutions reached similar conclusions. After controlling for multiple differences among students, the authors found that those who borrowed at higher levels were more likely to finish their degrees and had higher earnings later in life than those who did not. Moreover, borrowing more heavily to attend school did not result in higher loan defaults and had no effect on home-ownership rates.

Taken together, this evidence challenges the case for mass student-loan forgiveness. As we will discuss later on, there are reasons for concern over other student-debt trends. But these problems hardly suggest mass loan forgiveness as a necessary—or even a suitable—response.

AFFORDABILITY AND FINANCIAL AID

Politicians and advocates frequently pair their calls for student-loan forgiveness with proposals to double the size of the federal Pell Grant (currently set at a maximum of $6,495 per year, per student) or to enact a national free-college program. They justify these drastic proposals by claiming that financial aid has become less generous over time relative to college tuition and that public colleges have become increasingly unaffordable, especially for low- and middle-income families. Rising student debt, they argue, is a symptom of these problems.

As in the case of calls for student-loan forgiveness, advocates of a vast expansion of federal financial aid understate the degree of affordability
in our higher-education system. They do so most commonly by ignoring the effect of existing financial-aid programs. Senator Sanders and President Joe Biden, for instance, routinely quoted tuition prices during the 2020 presidential campaign without factoring in a single dollar of grant aid that the government provides to millions of students.

This sort of elision makes an informed debate impossible. The U.S. higher-education system operates on a “high-tuition/high-aid” model—that is, it awards many students substantial amounts of grant aid based on their financial circumstances to offset what would otherwise be unaffordable tuition rates. Need-based financial aid has grown significantly in size and scope over time, which has suppressed prices considerably.

This is particularly true among students at public universities—the very population Democrats would target for free-college programs. According to data from the Department of Education’s National Postsecondary Student Aid Study, in the mid-1990s, low- and middle-income students (those who received federal Pell Grants) who attended public four-year institutions in their home state received an average annual financial-aid package (excluding loans) worth a little over $4,000 in today’s dollars. By the 2015-16 academic year, that amount had grown to over $9,000. This aid comes from a variety of sources, including an average of $4,200 from the Pell Grant program, an additional $2,200 from state grant programs like the Georgia HOPE Scholarship, $1,600 from universities’ own grant programs, and $700 from federal tax benefits like the American Opportunity Tax Credit. Private scholarships add another $500 on average. Any assessment of tuition prices at public four-year institutions that excludes such substantial financial-aid packages is bound to conclude that prices are dramatically higher than they are in reality.

Aid programs also reach a much greater share of the student population than they did in the past. In the 1990s, less than 25% of students who attended public four-year institutions in their home state received a Pell Grant. Today, over 35% receive one, due in part to expanded eligibility rules. Moreover, the data suggest that rising financial-aid awards available to low- and middle-income students have largely shielded them from higher tuition prices at public universities over the past two decades. Again, this trend is invisible if one focuses on the so-called “sticker price”—the amount students are charged before student aid is factored in.
The sticker prices that public four-year institutions charge have indeed increased sharply—nearly tripling since the mid-1990s. Looking at prices after aid is applied, however, shows a far less alarming situation. After financial aid, but before student loans, Pell Grant recipients paid average in-state tuition prices of about $600 in the mid-1990s, adjusting for inflation. During the 2015-16 academic year, they paid a little over $1,000 to attend the same set of institutions. More generous financial-aid policies at the state and federal levels are thus holding down tuition increases for many.

For some students at public universities, total aid packages are even large enough to provide them with de facto free college. That is, their grants, scholarship aid, and tax credits are enough to fully offset the tuition and fees they are charged. Around 60% of students who received federal Pell Grants at in-state public universities during the 2015-16 academic year fit this profile. And that figure has actually increased slightly since the mid-1990s, meaning a greater share of public-university students paid no tuition in recent years than did over two decades ago.

So far, our discussion has focused on financial aid and prices at public four-year colleges, which are the institutions free-college proposals target. These schools are significantly cheaper than the highly selective and prestigious institutions many think of as the face of our higher-education system. This is not a bug, but a feature of the system: Consumers ought to pay more for higher perceived quality.

But even at selective schools, financial-aid policies and pricing practices by institutions themselves, in addition to state and federal grant aid, have helped keep tuition costs under control for low- and middle-income students. At the 200 most selective public and private colleges and universities, students in the bottom income quartile nationally pay about $4,600 per year in tuition after all non-loan sources of aid are applied. That’s substantially lower than the $15,000 sticker price at selective public institutions like the University of Michigan and the University of California, Berkeley. It’s also a mere fraction of the $50,000 in annual tuition many elite private institutions advertise. While the tuition that low-income students at selective schools paid after their aid was applied has grown over time in real terms (it was $3,200 per year in 2000, using today’s dollars), such changes are hardly consistent with the narrative that rising prices have put selective colleges completely out of reach for low-income students.
Highly selective schools are able to charge relatively low prices to less-affluent students partly because they use their own financial-aid programs to price-discriminate. This is the high-tuition/high-aid model at work. Institutions provide higher-income students with smaller discounts (if any at all), and then use those students’ tuition dollars to offset greater discounts to their lower-income peers. A student in the top income quintile, for example, pays about $21,000 on average per year in tuition after discounts and scholarships are applied if he attends one of the 200 most selective public or private colleges. That is more than four times what a student in the bottom income quintile pays after all aid is applied.

To be sure, families with above-average incomes are paying significantly more for college than they did two decades ago at institutions across the selectivity spectrum. This is because they are not the beneficiaries of more generous financial-aid programs and, crucially, because underlying spending at colleges and universities has risen faster than inflation. Given that American colleges spend more per student than most other developed countries, there’s a strong case that this additional spending is not socially optimal.

That said, arguments for free college and $13,000 Pell Grants never acknowledge how much our existing financial-aid policies have shielded low- and middle-income families from rising prices. That means current policies have been far more successful than is commonly understood. It also gives us a misleading picture of our current circumstances, which in turn tends to beget poor public-policy decisions.

**Equitable Access**

Advocates for mass loan forgiveness, free college, and other radical policies frequently claim that unaffordable college prices have exacerbated inequities in who attends college and earns a degree. In this view, students from low-income families are increasingly priced out of higher education and especially four-year institutions. They claim that even those students who are still able to attend four-year institutions cannot afford to attend the most prestigious and selective ones. As college becomes more costly, they argue, the student population inevitably leans ever more toward students from high-income families.

Yet access to higher education in the United States is more equitable across socio-economic groups than many believe. According to data
from the Department of Education’s High School Longitudinal Study, 77% of students attend some sort of post-secondary institution within two years of graduating high school. The number is even higher for students with the best grades: 97% of students with an “A” average in high school go on to attend college or a trade school shortly after graduation. This shows that America’s education system is especially adept at identifying academically inclined students and enabling them to pursue a post-secondary education.

These high rates of college attendance among the most academically prepared students transcend socio-economic status. Studies show that 92% of “A”-average poor students — those whose families earn less than $35,000 per year — attend college or trade school shortly after graduation, compared to 97% of non-poor students. In other words, high-achieving poor students are almost as likely to attend some form of post-secondary education as are their wealthier peers.

Some observers might question positive enrollment statistics like these, arguing that they mask other disparities. After all, if low-income students are more likely to drop out than higher-income ones, more equal college-attendance rates do not necessarily translate into more equal degree-attainment rates. Others insist there could still be a wide disparity in the types of degrees students earn, with students from low-income families more likely to obtain a two-year degree over a bachelor’s degree.

While those are legitimate concerns, the data support a more hopeful perspective. A comparison of the pool of students who obtain bachelor’s degrees now with those graduating in the late 1990s shows that the United States has made enormous progress in closing equity gaps. Low- and middle-income students — defined as those with parents in the bottom 40% of the income distribution — received just 22% of all bachelor’s degrees awarded in the United States in 1996. By 2016, that proportion had risen to 41%, matching these students’ share of the U.S. population. This is a remarkable change — one that suggests the mix of policies in place during that time were far more successful at improving access and equity than those who call for radical higher-education policies acknowledge.

The high college-attainment rate in the United States undermines another popular argument in favor of free college. Progressives often point to European countries that provide free college to make the case for the policy in America. The implication is that those policies have
been successful in increasing college enrollment and attainment rates. If tuition is free, they argue, then everyone who wants to attend college may enroll, and degree-attainment rates should increase in turn.

Yet many countries with free-college policies have lower college-attainment rates than the United States. Forty-eight percent of American young adults (ages 25 to 34) have a post-secondary degree, which is a higher share of the population than those of France, Germany, Greece, and Finland, where tuition is free or nominal. To be sure, some countries that offer free college have similar or even higher attainment rates than the United States, but the lack of correlation reinforces the point that free college does not automatically translate into greater college attainment. Moreover, many countries besides the United States, including England and Australia, have achieved high attainment rates while charging relatively high sticker prices at their public universities.

The reason free college is not positively correlated with college-attainment rates is that the price of free tuition is often limited college access. When public colleges are prohibited from charging tuition, they must raise all of their operating revenue from the government. That funding is often insufficient to support large higher-education systems with seats for all students who wish to attend. For example, the Finnish higher-education system offers free tuition at public institutions but has room to accept only one-third of the students who apply. Countries that have free college also tend to have top-down admissions processes where governments ration access to specific degree programs through national exams. This is the case in both Germany and Ireland.

In contrast to countries with free college, almost anyone in the United States can enroll in some form of post-secondary education. This means American students have more higher-education options than their peers abroad, especially when compared to the options available to students living in countries with free-college policies. In addition to top research universities and public flagship schools, America offers students open-access public community colleges, private liberal-arts colleges, trade schools, and online institutions. Our decentralized, heterogeneous system affords students the flexibility to choose the educational option that works best for them. It also deserves considerable credit for America’s strong performance on college access and attainment metrics.

One reason such positive statistics on college access in the United States often go unnoticed is that the discussion tends to focus on the
student body of a handful of highly selective institutions, not on the system broadly. Raj Chetty’s finding that several Ivy League schools enroll more students from the top 1% of the income distribution than the bottom 60%, for example, is far more widely known than any of the statistics cited in the discussion above.

Since selective schools are the reservoirs of society’s future leaders, this could well be cause for concern. But it doesn’t point toward any of the policies today’s progressives champion. Moreover, college admissions at selective schools are not as inequitable as one might think—and not nearly as stratified as the often-cited statistic from the Chetty study suggests. Our analysis of the 200 most selective schools in the country—including institutions such as the University of California, Davis, and the U.S. service academies, in addition to Harvard and Yale—shows that low-income students make up a much larger share of enrollment at elite schools than cherry-picked examples from the Ivy League suggest. About 30% of the student bodies at these institutions are drawn from families in the bottom two income quintiles nationally, a figure that has remained roughly constant since the year 2000.

**Problems to Solve**

Most of the concerns that progressives frame as major problems with our higher-education system are overblown. Digging beneath the surface of the standard narrative on challenges involving access and equity provides many reasons for optimism. But that doesn’t mean our higher-education system is perfect. There are problems with our system; they just aren’t the ones progressives like to focus on.

Most student-loan borrowers make affordable loan payments and have access to a generous safety net to help them through difficult times. But these benefits are not universal in practice. Millions of borrowers have slipped through the cracks and defaulted on their loans. They are then subjected to an ill-designed and costly system of wage garnishment and tax-refund seizure (including seizure of Earned Income Tax Credit benefits). Because the U.S. government offers loans to virtually every student who applies, default rates on student loans are far higher than they are on other consumer debt. But it is not borrowers with large debts who default; it is those who take on less than $10,000, attend college for a few semesters, and then drop out with debt but no degree. Greater awareness of the contours of this student-debt crisis would help build a
consensus around reforms that mitigate high default rates and impose a fair and rational collection system when defaults do occur.

Borrowers with the largest balances ($100,000 or greater) present an entirely different set of policy problems. In contrast to how it treats undergraduate loans, the federal government allows graduate students to borrow unlimited amounts while imposing few controls on the quality of the programs financed. The result has been a proliferation of expensive but questionable graduate programs, such as Columbia University’s one-year master’s degree in data journalism—the total cost of which is nearly $115,000 ($160,000 after factoring in living expenses).

Loan-forgiveness benefits remove any market discipline that might normally correct this problem. While IDR plans offer a sensible safety net, the terms are overly generous. Absent reforms, graduate students are set to pass the costs of their degrees on to the government to the tune of $167 billion in total forgiveness over the next decade, according to the Congressional Budget Office.

What’s more, while college tuition after financial aid has remained roughly flat for lower-income borrowers, the rise in underlying college spending is a concern. The government has increased student financial aid by billions of dollars, but that aid has not reduced tuition. And because tuition before aid has risen much faster than inflation—a trend driven by underlying spending increases—government-aid programs are having to run faster just to stay in place. In a counterfactual world where colleges did not raise pre-aid tuition, expansions of government grant programs could have eliminated tuition for most students whose families earn less than the median income. Students could have then used the leftover funds to defray their living expenses, which often pose a much larger barrier to access than tuition for the most disadvantaged students.

The real problems plaguing our higher-education system will not be solved by free-college programs, student-loan forgiveness, or a doubling of the Pell Grant. Tackling them will require solutions that are more creative and better aligned with how prices work. Meanwhile, many of the problems that left-wing higher-education policies aim to solve are either intentionally exaggerated or are not problems at all. The public perceives them as enormous challenges, however, thanks to the persistent “glass half-empty” message they receive from progressive politicians, advocates, and their media allies. With a “glass half-full” perspective, the
case for a radical overhaul of American higher education looks rather flimsy.