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Reauthorizing the Higher Education Act:
Financial Aid Simplification and Transparency

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Biography

Susan Dynarski is a professor of public policy, education and economics at the University of Michigan, where she holds appointments at the Gerald R. Ford School of Public Policy, School of Education, Department of Economics and Institute for Social Research.

She serves as co-director of the Education Policy Initiative. She is a faculty research associate at the National Bureau of Economic Research and a nonresident senior fellow in the Economic Studies Program at the Brookings Institution.

Dynarski earned an AB in Social Studies from Harvard, a Master's of Public Policy from Harvard and a PhD in Economics from MIT. Dynarski has been a visiting fellow at the Federal Reserve Bank of Boston and Princeton University as well as an associate professor at Harvard University.

Dynarski has served on the board of editors of the *American Economic Journal/Economic Policy*, *The Journal of Labor Economics* and *Educational Evaluation and Policy Analysis*. She has been elected to the board of the Association for Public Policy and Management and currently serves as president at the Association for Education Finance and Policy. The National Association of Student Financial Aid Administrators awarded her the Robert P. Huff Golden Quill Award for excellence in research on student aid.

Dynarski has testified about education and tax policy before the US Senate Finance Committee, the US House Ways and Means Committee and the President's Commission on Tax Reform. She has consulted broadly on student aid reform, including at the Federal Reserve Bank of New York, the Federal Reserve Board of Governors, Consumer Financial Protection Bureau, White House, Treasury, Department of Education, Government Accountability Office, and the Council of Economic Advisers.

Chairman Alexander, Ranking Member Murray, and members of the committee, thank you for the opportunity to testify today.

US Student Loans in International Context

Americans owe $1.3 trillion in student loans. Nearly five million borrowers are in default, and millions more are behind on their payments.

Borrowing for college is common across the globe.

- Sweden: While tuition is zero, students typically borrow $20,000 to pay living expenses
- Australia: Students borrow about $22,000
- England: Students borrow about $70,000

In the United States, typical undergraduate debt is less than $10,000 for those who don't complete a four-year degree and about $30,000 for those who do.

What's exceptional about the United States is therefore not student borrowing but a rigid, archaic repayment system that unnecessarily plunges millions into financial distress.

Millions of US borrowers with small loans - often less than $5,000 - are ending up in default. In fact, it is the smallest loans that are most likely to go into default.

The High Cost of Default

Default is costly to both government and citizens. It undermines the foundation of our system for funding college.

- Default does enormous damage to borrowers' credit ratings.
- Defaulters face higher interest rates on cars and credit cards.
- Employers regularly check credit reports, so those in default miss out on job opportunities.
- Landlords also check credit reports, so borrowers in default have a harder time finding housing.

It doesn't need to be this way. Students in England borrow far more than ours do, but they have a simple, flexible repayment system that keeps borrowers current on their loans. The same is true of Australia.

What do other countries do that makes their systems work better than ours?

Length of Repayment

In the United States, the typically expected repayment period is 10 years.

- In Sweden payments are spread out over 25 years
- In Germany, students pay their loans over 20 years
- In England, students pay their loans over 30 years
- In Australia, there is no time limit, with students taking as long as they need to pay

A longer repayment horizon makes sense. A core principle of finance is that the life of debt should align with the life of the asset. We pay for cars over five years and homes over 30 years because homes last a lot longer than cars. An education pays off over a lifetime, so student loans should be paid off over a long horizon.

Income-Based Repayment

In Australia and England, loan payments are set as a percentage of earnings. This is analogous to the process used in the US to collect Social Security contributions. Payments are deducted from paychecks, rising and falling along with pay.

- In England, loan payments are 9% of income above $30,000.
    - A person with an income of $50,000 would therefore pay $1,800 (9% of $20,000).
- In Australia, there are no loan payments while a person's income is below $46,000. Once that threshold is crossed, the loan payment is 4% of *all* income.
    - A person with an income of $50,000 would therefore pay $2,000 (4% of $50,000).

Automatic Adjustments to Payments If Income Changes

In England and Australia, the loan payment *automatically* changes if pay changes. These payments are set on a dynamic basis, with the rate applied according to the annualized value of a person's given weekly or monthly paycheck.

This is exactly as our payroll taxes and income taxes work. Payments are deducted directly from our paychecks, as a percentage of the pay period's earnings.

Payroll withholding is the only way to provide an *immediate* link between fluctuations in earnings and loan payments. Any other system delays the protections that low-income borrowers desperately need.

Automatic, Income-Based Repayment Is Effective Social Insurance

Some worry that payroll withholding gives student loans primacy over other expenses. Why should a student loan get paid before more basic needs such as food and rent?

No one facing economic hardship should have to choose between paying student debt and paying for basic necessities.

Prioritizing basic needs is exactly what the Australian and English systems do. When earnings drop, loan payments drop *immediately*, allowing borrowers to devote their shrunken paychecks to essential needs. Borrowers don't have to fill out an application to have payments adjusted, or even make a phone call.

Adjustment is Not Automatic in US If Income Changes

In the income-based plans in the United States, payments do *not* adjust automatically. Instead, payments are based on the previous year's income and are constant for a year.

- In the US, if a borrower's earnings fluctuate during the year and she wants to adjust her payment, she must fill out new paperwork. That can take months to process.

After a year, a borrower is ejected from the income-based plan unless she completes a re-application.

- In the US, even *staying* in an income-based repayment requires an annual, 12-page application. Many who successfully enter an income-based plan find themselves kicked out the next year, if they (or their loan servicers) don't complete the required paperwork on time.

In the United States, student loan bills keep coming, no matter how small the paycheck. It's up to the borrower to apply for a reprieve if their financial situation worsens. Getting on an income-based repayment plan depends on getting a loan servicer to complete the complicated paperwork. As shown by the Consumer Financial Protection Bureau, this is often a bumpy process that can take months. In the meantime, the bills keep coming — and millions of borrowers end up in default.

This is no way to protect borrowers — especially young, low-income workers — against shocks to their earnings.

Repayment Can End *Faster* with Automatic, Income-Based Repayment

While automatic, income-based repayment protects low-income borrowers, it also speeds repayment by high earners.

- The typical Australian borrower discharges student debt within eight to 12 years.
- Those with very high earnings (for example, lawyers) finish in as few as five years.

This is because payments rise automatically when earnings do. As a result, high earners pay down their debt more rapidly than they would in a system of flat repayments.

US Government Garnishes Benefits to Low-Income People for Student Loans

We have a system of automatic payroll deduction for student loans already, and it's brutal.

If a borrower goes into default, the Department of Education can direct Treasury to collect payments via the Treasury Offset Program. This program seizes federal payments to student borrowers who are in default.

In 2017, $2.8 billion in payments went to the Department of Education from this program. These payments were seized from:

- Tax refunds, including the Earned Income Tax Credit
- Social Security payments to retired and disabled workers
- Social Security payments to the dependents of retired, disabled, and deceased workers
- Black Lung benefits

These garnishments are far more punitive than the income-based withholding proposed in this testimony. The garnishment rate for Social Security beneficiaries in default on student loans is fifteen percent – far higher than the rate on any proposed income-based repayment program.

The Government Accountability Office has found that Social Security beneficiaries are being pushed below the federal poverty line by these garnishments. While beneficiaries can appeal to protect their benefits, these appeals must be repeated annually.

Make Loan Repayment Work for Borrowers…

The loan repayment program must be designed with borrowers in mind. Its goal should be to recoup the government's investment while causing as little financial distress as possible.

Calibrating the elements of the loan program requires care and attention. The critical elements of an income-based repayment program include:

- Threshold above which payments begin
- Percentage of income deducted for payments
- Interest rate
- Borrowing limits
- Maximum length of repayment
- Conditions for early repayment

These parameters can be set so that a loan program pays for itself. As we are putting such a program into place, the focus should be on getting these parameters right so that the system is sustainable for both borrowers and the loan program.

…And Only Then Turn to Accountability for Colleges

In a properly functioning income-based repayment program, there are no defaults. While we now use cohort default rates to hold colleges accountable for their performance, we should not fear the loss of this metric. To state the obvious, borrowers should not suffer the financial devastation of default so that we can hold schools accountable.

An effective, income-based program will naturally generate administrative data that link earnings and borrowing at the individual level. These data will allow the creation of detailed, accurate measures of repayment burdens by school, cohort, and demographic characteristics. These measures will allow for fine-tuning of the parameters of the loan repayment program discussed above.

These data can also be used in an accountability system to reward and punish schools, since they can be calculated by college and sector. These repayment-burden data are improvement over cohort default rates, since they arrive much faster and they are less easily gamed by schools.

What About Very High Debt?

An automatic, income-based loan repayment program will work for the 98 percent of undergraduates who borrow a manageable amount. For the other two percent, we need stronger consumer protection:

- Private student loans should not survive bankruptcy
- Loans that need a credit check should not be marketed as student loans
- Students should exhaust federal student loans before being allowed to take out any private loans

Conclusion

What's exceptional about the United States is not how much we borrow for college. What's exceptional is an antiquated, rigid repayment system that turns manageable debt into a financial disaster for millions.

The repayment system in the United States was built when students borrowed little to nothing. Other countries have overhauled their loan systems to reflect changing times. It is time for the United States to do the same.