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THE LOOMING STUDENT DEBT CRISIS: PROVIDING FAIRNESS FOR STRUGGLING STUDENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

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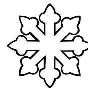

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THE LOOMING STUDENT DEBT CRISIS: PROVIDING FAIRNESS FOR STRUGGLING STUDENTS

TUESDAY, MARCH 20, 2012

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10 a.m., in Room SD–226, Dirksen Senate Office Building, Hon. Richard J. Durbin, presiding.

Present: Senators Durbin, Whitehouse, Franken, and Blumenthal.

OPENING STATEMENT OF HON. RICHARD J. DURBIN, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DURBIN. Good morning. This hearing of the Subcommittee on Administrative Oversight and the Courts will come to order. The title of today's hearing is "The Looming Student Debt Crisis: Providing Fairness for Struggling Students." I want to thank Chairman Leahy of the Judiciary Committee and Senator Klobuchar, Chair of this Subcommittee, for allowing me to convene this hearing where we will address the important issue of student loan debt and a bill which I have introduced, the *Fairness for Struggling Students Act*, which falls within the jurisdiction of this Subcommittee because it addresses the Bankruptcy Code. I am going to provide a few opening remarks, recognize the Ranking Member, Senator Sessions, who we hope will be returning from a press conference shortly, and then turn to our witnesses.

Our Nation faces a serious problem with student loan debt. Last month, the National Association of Consumer Bankruptcy Attorneys issued an eye-opening report entitled, "The Student Loan Debt Bomb." The report pointed out that American student borrowing exceeded $100 billion in 2010, and total outstanding student loans exceeded $1 trillion last year. There is now more student loan debt in this country than credit card debt.

Of course, when used prudently, student loans can be valuable. In many instances, student loans help Americans get a quality education and job skills that they need to repay their loans and have a rewarding life. Unfortunately, it is clear that too many students have been steered into loan arrangements that they will not be able to repay and never be able to escape.

According to an analysis by the Federal Reserve Bank of New York, 37 million Americans held outstanding student loan debt as of last year, the average balance $23,300. However, only 39 percent of those student loan borrowers were paying down their balances last year. The New York Fed study found that 14 percent of student loan borrowers—that would be 5.4 million Americans—were delinquent on paying their student loans while the remaining 47 percent of borrowers were either in forbearance or were still in school and adding to their debt.

Last month, Standard & Poor's issued a report saying that "Student loan debt has ballooned and may turn into a bubble." And Moody's Analytics recently said, "The long-run outlook for student lending and borrowers remains worrisome."

While the overall growth in student indebtedness is troubling, the most pressing concern are private student loans. According to the Project on Student Debt, the most recent national data shows that one-third of bachelor degree recipients graduated with private loans at an average loan amount of $12,550. These private student loans are a far riskier way to pay for an education than federal loans. Federal student loans have fixed, affordable interest rates. They have a variety of consumer protections built into them, such as forbearance in times of economic hardship. They offer manageable repayment options such as income-based payment plans.

On the other hand, private student loans have high variable interest rates, often two or three times the interest rate that a student pays on the federal loan, hefty origination fees, and a lack of repayment options. And private lenders have targeted low-income borrowers with some of the riskiest, highest-cost loans. Once a student takes out a private loan, the student is at the mercy of the lender. Every week my office hears from students who say private lenders will not work with them to consolidate loans or work out any manageable repayment plan. And if the student falls behind on payments, private lenders are aggressive with collection efforts.

In many respects, private student loans are just like credit cards, except unlike credit card debt, private student loan debt cannot be discharged in bankruptcy. In 2005, Congress changed the bankruptcy law and included a provision making private student loan debts non-dischargeable in bankruptcy except under very rare circumstances.

I ask myself: How in the world did that provision get in the law, giving to these private loans the same status as a federal student loan or payments that are owed for taxes, alimony, and child support? It turns out it was a mystery amendment. We cannot find out who offered it. We certainly know who benefited from it.

While the volume of private student loans is down from its peak in 2007 when it accounted for 26 percent of all originated student loans, we know that private lending is still being aggressively promoted by the for-profit college industry, and you will hear from the witnesses about that industry, particularly the Attorneys General who are here.

The Project on Student Debt reports that 42 percent of for-profit college students had private loans in 2008, up from 12 percent in 2003. For-profit college students also graduate with more debt than other students who graduate from public and private nonprofit col-

leges. For-profit colleges have a business model of steering students into private student loans, even when they still have eligibility left under the federal student loan, which has a fraction of the interest payment. And as a result, many students are pushed into taking out private loans when they are still eligible for federal loans, even when the lenders know the students are likely to default.

We need to take steps now to address this looming student problem. It is necessary to help struggling students and help our economy. We are going to have an opportunity come July. The interest rate on federal student loans will double without Congressional action. We cannot allow that to happen, but we need to not only use that as an opportunity to do the right thing for students in terms of interest rates, but also to address this looming crisis of student debt.

I have introduced legislation, the *Fairness for Struggling Students Act*, to restore the pre-2005 bankruptcy treatment of private student loans. There is no reason why private student loans should get treated any differently than other private debts in bankruptcy. And it is especially egregious that these private loans are non-dischargeable in cases where the student was steered into a loan while they were still eligible for safer, lower-cost federal loans.

I believe we should also require full private student loan certification to ensure that students take advantage of their federal student aid options before turning to private loans. We should push for meaningful accreditation for for-profit institutions. Wait until you hear the testimony, which I have read, about some of these for-profit schools, even in my State of Illinois, and what they are doing to these students. And we should encourage the Consumer Financial Protection Bureau, currently collecting data and complaints about private student loans, to use its authority to take corrective steps.

Today we have a distinguished panel of witnesses who will discuss the problems that we face and ways to address them, and I look forward to their testimony.

Senator Sessions has not arrived. We will give him a chance to make an opening statement when he does. But I am going to turn to our panel of witnesses for opening statements. Each will have five minutes for their opening statements, and their complete written statements will be included in the record.

The tradition of the Judiciary Committee is to swear in the witnesses, and I would like to ask you all to please stand and raise your right hand. Do you affirm the testimony you are about to give before the Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Ms. MADIGAN. I do.

Mr. CONWAY. I do.

Ms. JOKELA. I do.

Mr. COLE. I do.

Mr. MCCLUSKEY. I do.

Ms. LOONIN. I do.

Senator DURBIN. Let the record reflect that all the witnesses have answered in the affirmative.

Our first witness is a great friend and colleague from Illinois, Lisa Madigan, Attorney General of my State. In 2010, Attorney

General Madigan was elected to her third term as Attorney General. Initially elected in 2002, she was the first woman elected to serve in this position and is now the seniormost female Attorney General in the country. Congratulations. Before her service as Attorney General, she served in the Illinois Senate and worked as a private attorney, a teacher, and community advocate. She earned her bachelor's degree from the highly regarded Georgetown University and her J.D. from Loyola University Chicago School of Law.

Attorney General Madigan, thank you for coming here today. The floor is yours.

STATEMENT OF HON. LISA MADIGAN, ATTORNEY GENERAL FOR THE STATE OF ILLINOIS, CHICAGO, ILLINOIS

Ms. MADIGAN. Thank you very much, Senator Durbin, and let me thank the Committee for allowing me to testify on this very important issue of growing student loan debt.

As the Senator mentioned, I am currently serving my third term as Illinois Attorney General, and since the beginning, my focus has had to be fighting predatory lending in all sectors of the market—mortgage lending, auto lending, payday, and now student loans.

I have a wealth of experience with unfair and deceptive mortgage lending practices, having sued Ameriquest, Countrywide, and Wells Fargo. And recently I filed a lawsuit against Westwood College, a for-profit school operating in Illinois, for deceptive marketing and lending practices in its criminal justice program.

At the same time mortgage lenders were making unaffordable loans to homeowners, other private lenders were making unaffordable loans to students. After the financial crisis of 2008, third-party lenders stopped offering subprime loans to students, but another troubling trend emerged. For-profit schools expanded their high interest rate institutional loans. These loans pose a new threat to students, young and old, who are looking to gain skills and degrees to get ahead in this economy.

One reason for-profit schools offer private loans is that they have to comply with the federal 90/10 rule, which requires 10 percent of education funding to come from sources other than Title IV Government funds. These private institutional lending programs are either self-funded by the schools or funded by investors with a guarantee to repurchase by the schools.

To give you an idea of how exorbitant for-profit tuition costs can be, the criminal justice program at Westwood costs a student over $70,000. However, criminal justice programs at any number of Illinois community colleges cost a tenth as much. Prairie State costs $6,344; Joliet Junior College, $6,901; College of DuPage, $8,448.

I know we are not here to discuss why a student would enroll in a private, for-profit program that costs 10 times as much as a public one, but it will come as no surprise that we learned during our investigation of Westwood that in order for a student to pay for such an expensive program, students receive not only Government grants and loans, but Westwood signs students up for private institutional loans called "APEX loans," which the student piled on top of loans from Sallie Mae and government sources.

APEX loans carry whopping interest rates of up to 18 percent and require students to make monthly payments while still in

school. Compare that with a Government loan with a rate of up to 6.8 percent or a bank loan with rates between 9 and 11 percent.

Our investigations also found that students were completely confused about the purpose and the amount of these loans. Most had no idea what the interest rate was. Some thought the APEX loan was paying off their Sallie Mae loan. And some had no idea that they had even taken out an APEX loan.

In the end, Westwood graduates are left with tremendous debt for a virtually worthless criminal justice degree because Westwood did not and still does not have regional accreditation for its criminal justice program.

A regionally accredited degree is what most law enforcement agencies require for job eligibility. Yet Westwood graduates who had dreamed of becoming police officers learned from police departments that they could not apply because Westwood did not have the proper accreditation. So instead of starting the careers of their dreams, most Westwood graduates are saddled with over $70,000 of debt, and over 1,000 such people have contacted my office since we filed our lawsuit two months ago.

To top it off, because Westwood is not regionally accredited, almost none of the students' Westwood credits will transfer to another school. These abuses have convinced me that ongoing investigations of for-profit schools' unfair and deceptive practices is absolutely necessary, and I continue to pursue investigations in Illinois.

If the abuses we have uncovered continue, students should not be forced to pay for worthless degrees they cannot afford because of expensive tuitions, high interest rates, and inability to obtain jobs in their fields.

In addition, I support Senator Durbin's bill to allow private student loans to be discharged in bankruptcy primarily because private loans carry none of the protections afforded to students who take out federal loans, such as interest rate caps, loan limits, income-based repayment plans, deferment plans, and cancellation rights.

Again, I thank the Committee, in particular the Senator, for your interest in this issue, and I appreciate the opportunity to testify today.

[The prepared statement of Ms. Madigan appears as a submission for the record.]

Senator DURBIN. Thank you, Attorney General Madigan.

Our next witness is Jack Conway, Attorney General of the Commonwealth of Kentucky. He was re-elected last November to serve a second term as the 49th Attorney General of the Commonwealth. Prior to his service as Attorney General, he worked as a private attorney and in senior-level Cabinet positions in the administration of former Kentucky Governor Paul Patton. He is a graduate of Duke University, the National Law Center at George Washington University, and he has been actively involved in looking at for-profit schools in the Commonwealth of Kentucky.

We are glad you are here today, and please proceed.

STATEMENT OF HON. JACK CONWAY, ATTORNEY GENERAL FOR THE COMMONWEALTH OF KENTUCKY, FRANKFORT, KENTUCKY

Mr. CONWAY. Well, thank you, Senator Durbin. I want to go ahead and thank Ranking Member Sessions. Thank you for being here, Senator Franken. And, General Blumenthal, good to see you again. I hope you do not mind I still call you "General." I appreciate the opportunity to testify before you here at the hearing.

As you mentioned, Senator Durbin, we now have student loans outnumbering credit card debt in this country. The amount of loans taken out by parents for the education of their children has tripled in the last 20 years. Private student loan volume has tripled in the last six years. And you talked a little bit about the 2005 amendment making it so that private loans could not be discharged in bankruptcy. You called it "a mystery amendment." What I say is that it was actually a solution in search of a problem since we know from the data that far less than one percent of student loans are ever discharged in bankruptcy to begin with. The rationale has always been maybe the students will take out the loans and then default. But I can assure you the young people or anyone just finishing an education that I have talked to do not want to hurry into a bankruptcy court for some sanctions that could really damage them in the future.

As Attorney General of the Commonwealth of Kentucky, this issue of discharging private loans is linked to our investigation of the for-profit colleges.

I first became aware of the tremendous debt burden carried by some students at some proprietary colleges through an investigation of Decker College and the American Justice School of Law, a for-profit law school in Paducah, Kentucky.

Decker College was closed and forced into bankruptcy in 2005 following its loss of accreditation and its eligibility to receive Title IV funds. The students were left in a horrible, horrible situation. They had incurred thousands of dollars in debt to pay for certifications as heating and air conditioning technicians, electricians, and plumbers. This was an education promised to secure a higher-paying job, but the school closed before the training was complete. And to add insult to injury, the credits they had earned and paid for did not transfer to another school.

The American Justice School of Law and its successor, the Barkley School of Law, also closed and filed for bankruptcy. Most students in that institution had not completed their education when the school closed.

Students with federal student loans who are unable to complete their degree because a school closes are entitled to have those federal loans discharged. However, the same protection is not available for private institutional loans or loans from other private lenders. Both Decker and Barkley students had millions of dollars in those institutional and private student loans that were not dischargeable in bankruptcy under the closed school discharge rule.

The trustees in the Decker and Barkley bankruptcies began efforts to collect on those private loans that the schools had extended to their students. Ironically, these were students who were living on the financial edge, saddled with tens of thousands of dollars in

student loans that they likely could not discharge in personal bankruptcy.

In both instances, my office stepped in and was able to complete some successful work with the trustees to discharge loans that were owed directly to the schools. In the case of Decker College, we got about $4.5 million in relief for 2,200 students. Likewise, in Barkley, after being contacted by our office, the trustee released the student debts to the school. In that particular institution, we found that the predecessor to Barkley School of Law had a preferred lending arrangement and a questionable relationship with a company called SLX. We were able to put pressure on that particular company and get about $3.5 million in debt reduction on loan obligations. The average loan reduction in that case was about $25,000 per student.

But we continue to this day to get calls from students from Decker and from the Barkley school of law to help deal with their struggles to pay those student loans. And I ask this Committee: Do we understand, do we really understand how close to the line some of these borrowers are living? That working car means the difference between being able to get to work and keeping a job or losing a job. And that apartment that they may have to give up means safety and security for a family.

There are material differences between private loans and federal loans. Attorney General Madigan has pointed out the protections that are in federal loans, and certainly those protections do not extend to the private student loans.

After studying the cases of Decker College and the Barkley School of Law, I launched an investigation into seven other for-profit colleges in the Commonwealth of Kentucky. The students enrolled in most of these career schools are some of our most financially vulnerable students. They get Pell Grants, and they rely heavily on student loans.

According to most recent data available from the Project on Student Debt, an estimated 96 percent of graduates from proprietary schools have loans. That compares to 14 percent—excuse me, 42 percent of those students also have private loans. That compares to 14 percent at four-year public institutions and just four percent at public two-year institutions.

More troubling is that the Senate HELP Committee recently found that the for-profit schools account for 10 percent of the higher education body, but they account for about half of all defaults.

I would like to say that I have been working on this issue also with Holly Petraeus from the Consumer Financial Protection Bureau. We have found some troubling instances regarding recruitment at some of our bases, particularly Fort Campbell and Fort Knox in the Commonwealth of Kentucky. General Madigan mentioned the 90/10 rule. Because the 90/10 rule only applies to Title IV funds, we are seeing extraordinary pressure put on post on some of the veterans coming back from Iraq and Afghanistan. And, in fact, the Army Times reports that for-profit schools last year received about 37 percent of the cost for the GI bill—37 percent—and almost 50 percent of the $563 million spent last year by the Defense Department on tuition assistance for active-duty troops went to the for-profit schools. This is an issue that needs to be examined

to do right by the people who are coming back from these two wars abroad.

As I see, I am out of time, and I am actually over by about 50 seconds. I have two more pages of testimony that has already been entered into the record, but I will be happy to take any questions later on.

[The prepared statement of Mr. Conway appears as a submission for the record.]

Senator DURBIN. Thanks. Thank you, Attorney General Conway.

The next witness, Danielle Jokela—did I pronounce that correctly?

Ms. JOKELA. Yes.

Senator DURBIN. Ms. Jokela was raised in a working family in Minnesota, then relocated to Chicago, where she lives today with her husband. In 2007, she received a BFA in interior design from Harrington College of Design, which is a Career Education Corporation for-profit college located in Chicago. Throughout her life, Ms. Jokela has worked tirelessly to establish a productive and fulfilling career. However, like so many other American students, she has been burdened with tremendous student loan debt. Ms. Jokela reached out to me through my official Web site, where I have invited students and their families from across the United States to share their student loan stories.

Ms. Jokela, thank you for coming today to tell this painful story, but it is important that the people who are here and all who follow the business of Congress understand what you are going through. Please proceed.

STATEMENT OF DANIELLE JOKELA, CHICAGO, ILLINOIS

Ms. JOKELA. First, I would like to thank Senator Durbin for inviting me to speak today and thank the Members of the Committee for your time and patience while I tell you my story. It is my hope that through coming here today, I can serve as a voice for the countless students that find themselves in a situation similar to my own.

Both of my parents were high school dropouts. Of the five children that I grew up with, I am the only one who graduated from high school on a somewhat traditional path. I say "somewhat" because although I did graduate from a traditional public high school, when I was a junior, my mom told me that she could not afford to support me and I was out on my own. I finished my last year of high school living on my own, working a fast-food job that paid my rent and virtually nothing else. The odds were against me, but because of the personal value I have for education and my strong work ethic, I pushed through and managed to graduate in the top third of my class.

In 2004, I relocated from Minnesota to Chicago to attend Harrington College of Design, a Career Education Corporation school. With my background, I could not rely on my family for financial support or guidance. As a result, I fully trusted the staff at Harrington to give me the guidance I needed and to work in my best interests. They helped fill out the financial aid paperwork for my loans, made phone calls on my behalf, and worked diligently to ensure I had the funds I needed to pay for school. There was no dis-

cussion about what my interest rates were or what my actual debt load looked like. We never talked about what my monthly payments would be once I graduated. Compound interest was a concept I had never heard of, and of course, it was never explained to me. I had no clue what sort of salary I could expect to earn upon graduation, and while my school claimed a very high job placement rate, nobody told me what percentage of graduates actually were working in their chosen field or what their starting wages were.

In 2007, I graduated with highest honors and received my BFA in interior design. I could not have been more proud of my achievements. My pride soon became dismay when I struggled to find work as a designer and accepted a position doing admin work for a flooring contractor.

Six months after graduation, all pride was gone when I began repayment on my student loans. I realized then that I had graduated with $37,625 in federal loans and $40,925 in private loans for a combined total of nearly $79,000 that had ballooned to more than $100,000 after interest and fees. My minimum monthly payment was more than half of my income. I took a six-month forbearance and stretched the payback period from 15 to 30 years to make the payments more manageable. After the forbearance, I resumed paying my loans until 2009, when I found myself looking for work. When I did find work, it was as an independent contractor doing admin work, making far less than my previous salary. At that time I took a second six-month forbearance until I could get things stabilized. When I resumed payments, all progress I had made in the two years prior had been erased. Fees were assessed and added to my balance so that I could take the forbearance, and compound interest kept accumulating, despite my financial hardship. This pushed my balance back up to $100,000.

Today, five years after graduation, I have still not found work as a designer, and I still owe more than $98,000 in student loans. I have 16 separate private and federal loans with Sallie Mae. Sallie Mae will not allow me to consolidate my private loans. I make one combined payment each month of approximately $830. Nearly 28 percent of my current income goes toward student loan debt. Almost all of my loans have variable interest rates. The low interest on my federal loans makes them manageable, but my private student loans have interest rates ranging from 8 percent to 11 percent. If interest rates rise, so does my monthly payment and the total amount that I will have paid back over the lifetime of the loans. Twenty-five years from now, if interest rates hold, when I am finally done paying for my student loans, I will have paid nearly $56,000 for my federal loans and nearly $155,000 for my private loans. That is approximately $211,000 toward a $79,000 debt, a staggering 264 percent.

I am out of options. I cannot file bankruptcy because the vast majority of my debt is student loan and mortgage debt. I cannot negotiate a settlement with Sallie Mae, and I cannot stop paying my student loans. I do not want to destroy my credit. I do not want to have my wages garnished. Even more, I do not want to add more fees, interest, and other costs to a debt that is already a burden I cannot bear. My only option is to give up my home. I am literally

losing my home so that I can continue to pay my student loans and other monthly bills. It is the only option I have.

I am here today to advocate on behalf of myself and the rest of the students who are trapped in the same situation, carrying an unreasonable debt load for the opportunity to try to improve our lives. I am asking you to create legislation that will empower us to overcome this burden and prevent future students from falling into the same trap. I ask that private student loans once again be dischargeable in bankruptcy and that all schools be required to provide clear and full disclosure to students regarding the amount of their loans, interest rates, and expected payments.

Thank you.

[The prepared statement of Ms. Jokela appears as a submission for the record.]

Senator DURBIN. Thank you so much for your testimony.

Our next witness is Professor Marcus Cole, William Benjamin Scott and Luna M. Scott Professor of Law at Stanford Law School. Professor Cole is a scholar of the law of bankruptcy, corporate reorganization, and venture capital. He has been a national fellow at the Hoover Institution. Before joining Stanford Law faculty, Professor Cole worked at the law firm of Mayer, Brown & Platt, and clerked for Judge Morris Sheppard Arnold of the Eighth Circuit Court of Appeals. He graduated from Cornell University and the Northwestern University School of Law.

Professor Cole, thanks for being here today, and please proceed.

STATEMENT OF G. MARCUS COLE, PROFESSOR OF LAW, STANFORD UNIVERSITY, STANFORD, CALIFORNIA

Mr. COLE. Thank you, Senator Durbin, for inviting me. Thank you, Senators, ladies and gentlemen.

As Senator Durbin said, I teach bankruptcy law at Stanford University, and I have been asked to comment on the proposed changes to the Bankruptcy Code with respect to the dischargeability of student loans.

While I, like most other Americans, am sympathetic to the heart-wrenching stories of student borrowers who are in a situation now that seems hopeless, I am very concerned with the effects of the amendment that is proposed. And I think that what I would like to do is raise for your consideration what I think are the likely and undesirable consequences of the removal of the exemption from discharge for student loans because I think it is a blunt instrument, and I also think it is an unnecessary instrument to get at the problem that you are trying to address.

So to do this, I want to do three things. First, I want to explain why student loans are fundamentally different than any other kind of borrowing that takes place in our society. Second, I want to explain why I think the changes to the Bankruptcy Code making student loans dischargeable in bankruptcy would, in effect, raise the cost of student borrowing for all student loans and in the end would essentially dry up the entire student loan market and the availability of higher education for those who cannot afford it without student loans. And then if we have time or in the question-and-answer session, I would be happy to talk about more narrowly tailored alternatives to this amendment that might get at the prob-

lem. So, first, let me explain why student loans are fundamentally different.

In our society, we have essentially two types of borrowing: We have unsecured borrowing—credit card debt is an example of that—and we also have secured borrowing. A car note that someone takes out or a mortgage on a home is a secured obligation.

Now, these are two very different things in the sense that creditors who lend on an unsecured basis are lending against a borrower's ability to repay currently from their income, but also based on their current assets. A secured creditor does not want to take the chance that there are not going to be assets there or income coming in, so they want an asset that they can look to as collateral for their loan.

Student loans are fundamentally different than these other two because unsecured loans, credit cards included, look to the existence of a borrower's current assets and their current income to repay the loan. Secured credit looks to a particular asset. But student loans are a situation where the person is borrowing against their future income, and that future income is based on the human capital that the student loan makes possible.

Now, if you take away the exemption from discharge for student loans, you are essentially saying to the lender that they cannot look to that future income for sure because there is the possibility that this obligation could be discharged. In essence, you are saying to someone who has no assets and no current income because they are a student that they cannot credibly commit to a lender that they are going to repay this loan in the future. And because of that, that increases the risk premium that has to be charged by the lender across all loans, and that is going to increase the cost of student loans for everyone.

Now, a private market for student loans exists because the federal programs simply do not cover all of the demand that is out there for student borrowing.

Now, there are other ways to look at this. If the problem is private colleges taking advantage of people when they are not really building up human capital, well, that is a lot like a doctor writing a prescription and then selling the prescription drugs, and they are essentially profiting from the prescription that they are writing. Well, we do not ban prescription drugs because we do not like doctors benefiting from writing prescriptions. Instead what we do is we separate the doctor who is making the diagnosis from the pharmacist who is selling the drugs. And so if there is a problem with for-profit colleges benefiting from the system, there are ways in which we can internalize the costs that they are imposing on student borrowers without having to take the broad brush of eliminating the ability of people like me—I grew up in the Terrace Village housing projects of Pittsburgh, Pennsylvania. I would not have been able to go to school without student loans. My father worked in a steel mill. But student loans provided me an opportunity to get an education, and I am sitting here today because I was able to credibly commit to lenders that I would repay from my future income.

Thank you, Senator, for this opportunity.

[The prepared statement of Mr. Cole appears as a submission for the record.]

Senator DURBIN. Thank you, Professor Cole.

Our next witness is Neal McCluskey. He is the associate director of the Center for Educational Freedom at the Cato Institute, author of the book "Feds in the Classroom: How Big Government Corrupts, Cripples, and Compromises American Education." His writings have appeared in numerous publications such as the *Wall Street Journal*. Prior to working at Cato, he served in the United States Army, taught in high school, and was a freelance reporter. He received an undergraduate degree from Georgetown, a master's from Rutgers, and a Ph.D. candidate at George Mason.

Mr. McCluskey, thanks for joining us. Please proceed.

STATEMENT OF NEAL MCCLUSKEY, ASSOCIATE DIRECTOR, CENTER FOR EDUCATIONAL FREEDOM, CATO INSTITUTE, WASHINGTON, D.C.

Mr. MCCLUSKEY. Chairman Durbin, Members of the Committee, thank you for inviting me to speak with you today. My name is Neal McCluskey, and I am the associate director of the Center for Educational Freedom at the Cato Institute, a nonprofit, non-partisan public policy research organization. My comments are my own and do not represent any position of the institute.

As a result of decades of skyrocketing college prices, the Nation has begun to focus on the extraordinary cost of postsecondary education. And the Federal Government, as the primary supplier of aid to students, has a critical role to play in restoring sanity to college pricing: It must greatly reduce student aid. Unfortunately, what this Committee is contemplating—changing bankruptcy law concerning private student loans—will do almost nothing in this regard.

Now, the logic behind seeing federal aid as a primary cause of inflation is straightforward. First, subsidies drive increased demand, which increases prices. Second, colleges raise their prices if they know students will be able to pay them.

The facts support this. Between the 1981–82 and 2010–11 school years, inflation-adjusted aid per student rose 215 percent. Meanwhile, tuition and fee costs grew 268 percent at four-year public institutions and 181 percent at four-year nonprofit private schools. In addition to this evidence, a growing body of empirical research, which I itemize in my written testimony, supports this conclusion.

Perhaps, though, price increases are necessitated by State and local funding cuts to public colleges, and there is certainly some truth to this. But it is an inadequate explanation for rampant tuition inflation.

For one thing, of course, it does not explain inflation at private colleges. More directly, inflation-adjusted State and local outlays to colleges for general operations rose from $57.7 billion in 1986 to $74.2 billion in 2011.

Now, where it does appear that taxpayers have become less generous is expenditures on a per pupil basis, with real appropriations declining 22 percent between 1986 and 2011. That said, State and local appropriations rise and fall with the business cycle, and the overall trend is pretty flat. And over the past quarter-century, pub-

lic institutions have raised tuition revenue by about $2 for every dollar in cuts.

Which brings us to the root problem. Far too many people who do not benefit from it are enrolled in college. As much as we want to help all people by giving them money to go to college, it is doing few any real favors. That is, other than the colleges, which research shows are profiting mightily whether they are officially for-profit or not-for-profit institutions.

Let us look at completion rates. Only 57 percent of first-time, full-time bachelor's degree seekers finish their degree within six years. That is 150 percent of the expected time. At two-year institutions, the three-year completion rate is a puny 28 percent. Many enter colleges of all types. Few complete.

What about those who do finish? Does a degree confer major new earning ability?

That is the case on average, though how much is a matter of great dispute, with some estimates as low as $100,000 over a lifetime. And many graduates will not gain even that $100,000, depending on their field.

It also appears that the value of a bachelor's degree is shrinking, with weekly earnings for people whose maximum educational attainment is a B.A. having dropped about four percent over the last decade.

Now, is this a function of credential inflation or the economy increasingly demanding advanced skills?

Well, we have no comprehensive measure of what students are learning in college, but one of the few longitudinal studies we have suggests that the problem is credential inflation. The National Assessment of Adult Literacy shows that the literacy of people with at least a bachelor's degree dropped precipitously between 1992 and 2003, with generally only a third of those people—these are with at least a bachelor's degree—now considered proficient.

Finally, it is assumed that almost everyone will need some sort of postsecondary training to get a job in the new economy. But according to BLS projections, the large majority of the 30 occupations expected to see the greatest employment growth this decade will require no more than a high school diploma and on-the-job training. So the Federal Government should get out of the student aid business. The aid drives self-defeating inflation and massive overconsumption, and Washington has no constitutional authority to be involved.

Unfortunately, making private loans dischargeable in bankruptcy misses this gigantic root problem—federal aid—and would at best nibble around its edges. In 2010–11, only about $6 billion was originated in private student loans. In that same year, total federal loans were almost $104 billion, an amount almost 17 times larger. You throw in grants, tax benefits, and work study, and federal aid exceeded $169 billion.

What would changing bankruptcy laws for private loans do for affordability? If lenders know that borrowers can escape repayment through bankruptcy, they would likely raise interest rates to account for that risk, discouraging use of such loans. However, students might be more apt to take such loans—and pay still higher

college prices—if they think that they will be able to unload their debt without repaying it.

Both possible outcomes are concerning, but the change would still have a negligible effect on affordability because private loans are such a small piece of the pie. Ultimately the problem is too much aid, and most of that comes from Washington.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. McCluskey appears as a submission for the record.]

Senator DURBIN. Thank you, Mr. McCluskey.

Our final witness is Deanne Loonin, staff attorney with the National Consumer Law Center and director of the NCLC Student Loan Borrower Assistance Project, author of NCLC publication "Student Loan Law: A Guide to Surviving Debt." And she also provides direct representation to low-income student loan borrowers, served as legal aid representative at numerous Department of Education negotiated rulemaking sessions, graduated from Harvard-Radcliffe, and the University of California-Berkeley School of Law.

Ms. Loonin, the floor is yours.

STATEMENT OF DEANNE LOONIN, NATIONAL CONSUMER LAW CENTER, BOSTON, MASSACHUSETTS

Ms. LOONIN. Thank you, Senator, and thank you, all of you, for inviting me here to testify today. I am here today on behalf of NCLC's low-income clients. We provide direct representation to low-income borrowers in Massachusetts, as Senator Durbin mentioned. We also have a Web site where we hear from thousands of borrowers every day, and we work with advocates across the country, so we are very familiar with how widespread the problem of student debt burdens are across the country.

Our clients and the people we hear from are a very diverse group. I think it is important that we focus on not just the traditional students that we hear a lot about, and they are a very important population of young people who are graduating from college having trouble finding jobs in this economy. But our clients are in their 20s, 30s, all the way up into their 80s and 90s, all races, and all class levels, all of whom share one thing in common, and that is that they were all trying to better their lives through education. And they also share that they are mired in debt when they come to see us.

When they come in to see us, the focus is on the future at this point. We are trying to figure out prospectively what we can do to either provide relief and in many cases to help people go back to school because it did not work out for them the first time around.

The first thing we do is look at non-bankruptcy alternatives, whether it is a federal loan or private loan. This makes sense both because in many cases, particularly for federal loans, those options are more accessible, but also because that is what our clients tell us they want. I have never had a client tell me that their first choice is to file for bankruptcy. They see it as a failure. They see it as something that is very humiliating. There is a stigma associated with it, and there are consequences, credit report consequences and other things, that students borrowers are very aware of.

So we look at the non-bankruptcy alternatives which are available in many cases on the federal student loan side—not for everyone, but there are good options for a lot of people. We try on the private loan side, and we find that it is virtually impossible to get relief outside of the bankruptcy system.

So bankruptcy is not the first option, not necessarily the best option for everybody, but in many cases it is actually the only option that people can consider to get relief. But, again, because of the changes in the law, this, too, is not an option for many borrowers.

So I am here to support the bill, S. 1102, for these borrowers, but also because, as I want to go through quickly, the rationales that have been mentioned for not restoring bankruptcy relief do not stand up.

The first rationale that we generally hear is that there was a lot of abuse of the system and student borrowers were filing bankruptcy more than other debtors. There is simply no evidence that that is true, and I can tell you again from my clients, as I mentioned, who are not seeking out bankruptcy, certainly not thinking about that when they enter school and optimistically are hoping that it is going to improve their situations. And there are safeguards in the bankruptcy system to address these exact problems if we think that people with too many assets are trying to file for bankruptcy.

The other rationale that private loans would disappear—again, no evidence. And, in fact, if you actually look at the actual experience, the private student loan industry grew the most during a time before 2005 when bankruptcy was available for most private student loan borrowers. The industry has contracted significantly since 2005 when the loans were actually much harder to discharge. So the experience in many ways has been the opposite. Fluctuations are due to market forces, not to bankruptcy policy.

The rationale that the products would be worse if we restore bankruptcy relief to borrowers—again, no evidence. The terms have essentially been the same over time or fluctuated over time without regard to what the bankruptcy policy is. And, further, it is really hard to imagine a product much worse than some of those that some of the Attorneys General have mentioned, all of which have sprung up during a time when, in fact, bankruptcy—private student loans are difficult to discharge in bankruptcy.

The point that student loans are unique, which is what Professor Cole in particular focused on, is, in fact—on the private loan side is a little bit of an outdated view of what private student loans are. Almost all, nearly 80, 90 percent of private student loans now require co-signers. These are generally parents or older adults, and in that case, they are actually the private creditors assessing current ability to pay, not just speculating on future ability to pay.

There is no evidence that in any way bankruptcy policy has affected access to higher education. And, again, private student loans in any case are not financial aid. They are private credit products.

If we have time in the question-and-answer, I can answer more questions about the undue hardship issue and why that test has also not worked well. But I just want to say finally that we have a system that is set up to encourage access to education, and, fortunately, we have done that, but we slam those who fail based on

really speculation of what might happen as opposed to looking at the real experience. It is time to provide relief for student borrowers.

Thank you.

[The prepared statement of Ms. Loonin appears as a submission for the record.]

Senator DURBIN. Thank you, Ms. Loonin.

Let me ask a few questions of the panel. Ms. Jokela, I do not know if you are familiar with this, but as of November first last year, Career Education Corporation, which owned Harrington College of Design, was found to have falsely claimed that too many of its students were getting jobs after they graduated. Like you, many of them were not. Because of this fraudulence and falsification, they forced the CEO of Career Education Corporation to resign last November. The parting gift for this fraudulent misrepresentation to the Department of Education was a $4 million parachute that he was given as he left, an indication, I am afraid, at the time of some inherent problems within that industry, that you would be saddled with the debt, with a degree that has not led to the job you thought you would get, and he would be getting a parting gift of $4 million to leave.

I would like to ask the Attorneys General who are here, both of whom have been engaged, at least through their predecessors and perhaps personally, in multi-State efforts to deal with issues initially on tobacco—before your time probably—and then later on foreclosure. Is there any effort underway to convene Attorneys General in States across the Nation to discuss addressing this on a national basis? And let me add parenthetically, the reason this is being done by Attorneys General is because we do not have the political will to do it here. Please proceed.

Mr. CONWAY. Well, Senator Durbin, thank you for the question. First of all, thanks for your leadership on the issue. The answer to your question is yes, there is a move afoot. Each Attorney General typically has at his or her disposal a consumer protection act or an unfair trade practices act. In the Commonwealth of Kentucky, it empowers the Attorney General to go after false and misleading and deceptive representations and marketing. We are using that as a vehicle in our investigations of seven schools, two lawsuits that have been announced, and additional work that we are doing.

As I got into this issue, after Decker and after the American School of Law, I found out we have 141 of these institutions now in the Commonwealth of Kentucky. In talking to my colleagues like General Madigan, I found out a lot of—you know, Colorado and other States had investigations or actions ongoing.

So we have put together a multi-State effort. I am currently the Chair of it. It is bipartisan. There are 23 States that have signed on to the multi-State effort. We have executed information-sharing agreements that allow us to share law enforcement information amongst the States, particularly where we have common targets.

This effort is very distinct and different than tobacco or the recent mortgage settlement. In the recent mortgage settlement, we are looking at the five largest banks. In tobacco, we were looking

at the four largest producers who turned out to be the participating manufacturers.

Here we have such a diffuse group of schools, some operating only in particular States, others being large corporations that are traded on Wall Street or owned in part by hedge funds, for example. We are sharing information, but we are having some difficulty finding the common targets.

I can share with you that we in the leadership of the multi-State effort have been talking to the new CFPB and to Director Cordray——

Senator DURBIN. Consumer Financial Protection Bureau.

Mr. CONWAY. Right, Consumer Financial Protection Bureau and Director Cordray, because we are finding more of this institutional lending on the part of some of the for-profit schools. The 90/10 rule drives everything. So many of these schools are up against that 90-percent barrier that you see the extraordinary recruiting of veterans or current people in the military in order to get to the 10 percent to leverage to recruit another nine. We are also seeing these schools get into institutional lending, and it is essentially a loss leader. They are willing to write off in documents that they share with Wall Street that they are going to lose 50 percent of these loans just to get to that 10 percent.

Senator DURBIN. Thank you, Attorney General.

Mr. McCluskey, I understand the Cato Institute—and I understand you are not speaking for them but probably share their philosophy or you would not be working there. And I understand your notion about the role of the Federal Government and where you may see it excessive. You stated the Federal Government should get out of the student aid business and there are too many students going to college.

So let me ask you about another aspect of federal subsidy beyond student aid, and the Attorney General has just referred to it. We had to pass a law to say that these for-profit schools could receive no more than 90 percent of their revenue from the Federal Government. They found a way around it when it came to the GI bill. Now they are up to 95 percent. They are within 5 percent of being federal agencies, except for one thing: the federal pass-through of money to these schools results in these multimillion-dollar giveaways and profit taking by the owners.

So do you have the same level of outrage about the federal subsidy to for-profit schools as you do to federal student aid?

Mr. MCCLUSKEY. Yes, the important thing is that we put this all in context. The focus has been on for-profit schools, and, of course, there are for-profit schools making huge amounts of money through taxpayer funding. What we are missing in focusing on for-profit schools is that not-for-profit schools—both private not-for-profit and public schools—are also making tremendous amounts of money through federal student aid as well as, if we are talking about public colleges, through State subsidies. And so we have looked at how much profit, meaning how much more money are you bringing in than it costs to educate an undergraduate? How much profit are all schools making? And what our research has shown is that, depending on whether you include State subsidies on a per pupil basis, whether you include endowment funds on a per pupil basis, but

you will find the normal profit, depending on the type of school, for nonprofit schools runs between $2,000 and $12,000 per pupil.

So this is the point. Yes, for-profit schools are making a huge amount of money through federal aid, but so are other schools, and most importantly, this is what enables all colleges to raise their prices at rates far in excess of inflation. We are giving people money to pay for that.

Senator DURBIN. You may be surprised to know I agree with you, and I have said to those who run public universities as well as private universities that they are out of control. Georgetown Law School is now $50,000 a year, and to me that is just over the moon. And there are many that are very, very close in my home State of Illinois. The difference is this: I do not know that anyone at Georgetown is going to walk out with a $4 million parachute when it is all over, as they did at these for-profit schools.

So I would agree with you. I would say ratchet down to at least the level of private and public schools the federal subsidy to for-profit schools, and let us see if they can survive in that world as the private and public schools do.

My time is up at this point. You will get a chance, I am sure, again.

Senator Franken.

Senator FRANKEN. Thank you. There is really so much here to talk about. It is good to see you again, Attorney General Conway. You brought up the 90/10 rule, and, again, on these for-profit schools, they have to make sure that at least 10 percent of the loans fall into the non-federal loans. But our troops coming back who are benefiting from the GI bill are counted in the 10 percent, and you said you are working with Holly Petraeus at the CFPB. Can you tell about this recruitment even at hospitals? And did she tell you about the gentleman with TBI who was recruited?

Mr. CONWAY. No, she did not.

Senator FRANKEN. I am sorry. She testified about it, that there was these for-profit—one of these for-profit schools went to, I think it was San Antonio, where there was a unit for guys and women who had TBI, and they recruited there. And one of the students at one of these for-profit schools was asked, you know, "Do you go to school here?" And he said, "Yeah." "What are you majoring in?" He said, "I do not know."

Mr. CONWAY. To react to that, we have had instances of people with brain injuries signed up in the Commonwealth of Kentucky as part of our investigation. We have seen instances where people who do not have access to a computer have been signed up for online classes.

Ms. Petraeus wrote a piece for the *New York Times* recently about the for-profit colleges and targeting the military. She and I spent a day together with the Attorney General of Tennessee at Fort Campbell, which is a large military reservation in Tennessee and Kentucky. And the commanding general literally pulled us aside as we were talking about consumer protection issues and said, "I need to get my arms around this for-profit college recruitment issue because every Thursday night we have an on-post recruiting seminar where local vendors are able to come in and talk about services that they can provide to our military

servicemembers, and we are being overrun by for-profit college recruiters." And the No. 1 complaint we heard on post that day was from students who had been signed up, were not certain they got a good deal, and we heard quite a few horror studies. I did not hear the TBI story from Ms. Petraeus that day, but it does not surprise me.

Senator FRANKEN. Well, I think that maybe we should consider not including those veterans on the GI bill in the 10 but, rather, in the 90. I think that might be a good idea.

Ms. Loonin, or Professor Loonin, Dr. Loonin—Deanne. I am a little confused here. Did the interest rates for non-federal loans or private loans go down when they became non-dischargeable in 2005?

Ms. LOONIN. No. On average, we did not see any evidence of them——

Senator DURBIN. Turn your microphone on.

Senator FRANKEN. Put your microphone on.

Ms. LOONIN. I am sorry. We did not see any evidence that they went down, and, in fact, you know, there are some loan products now where the interest rates have gone down, so they fluctuated. But there is no pattern that we have seen that is connected to the bankruptcy——

Senator FRANKEN. So I do not know why both Professor Cole and Mr. McCluskey assumed they would go up if they became dischargeable. It does not seem backed up by empirical evidence. I know that Mr. McCluskey talked about the inflation at colleges being tied to the amount of aid that students got, but he does acknowledge in his written testimony that this creates a major endogeneity problem. And I think it really does. I think it is very hard to say that the loans are driving the costs of the school. I think very often the costs of the school are driving the loans. And I think that endogeneity problem includes more than even what Mr. McCluskey wrote in his testimony. I think it includes what people perceive, anyway, as the importance of college for future income and future progress.

I see my time has run out. I look forward to another round of questioning. Thank you.

Senator DURBIN. Thank you.

Senator Blumenthal.

Senator BLUMENTHAL. Thank you, Senator Durbin. And I want to thank Senator Durbin for having this hearing on a topic that I consider as important as any we are addressing in the Congress today. And I thank Attorneys General who are here for the excellent work they and their colleagues are doing on this issue.

Senator Durbin made reference to the tobacco initiative and to the lack of political will now to address this topic. In fact, the reason that the Attorneys General played a leading role in starting the tobacco investigation, as I can tell you from firsthand experience was, in fact, the lack of political will on the part of Washington, D.C., and the Department of Justice at the time, whom we requested and, indeed, implored to become involved. So thank you for the great work that you are doing in this area really leading the way to the Federal Government.

You know, Senator Durbin used the word "outrage," and I think the present system is an outrage not only because of its impact on individual students and consumers, but in the larger sense that Professor Cole described very well, its impact on human capital. And you described well, Professor Cole, how student loans are different insofar as the incentives of the lender are different and the assets of the borrower are different.

But it is also different from the standpoint of our Nation and society because we are investing in our human capital, our human infrastructure, our human resources for the future. And so that is a reason why I think this area is so critically important to our society and why we need to do better. And it is an outrage that we are failing to do better.

We have begun in the Health, Education, Labor, and Pensions Committee an investigation of the for-profit college marketing techniques to our veterans and our military service people. But that is just a part of the problem, and so I am going to ask you, since you offered to do so, what would be your remedies, suggested proposals, if we were not to use discharge in bankruptcy?

Mr. COLE . Well, thank you, Senator. There are various other ways of attacking the problem. If the problem is that we have got these for-profit entities that are essentially benefiting from what might be fraud, essentially selling a growth in human capital that is really not taking place, then there are other ways to address that other than simply having a blanket removal of the discharge.

So, for example, there is actually a practice in Europe with—there are not a lot of private colleges and universities in Europe, but there are some, and because they do not have a lot of foundations and charitable organizations to support them, they are supported largely by tuition. So I can give you an example of Bucerius Law School in Germany, which has a reputation of being the best law school in Germany. It is both an undergraduate and a graduate institution. And it is private, and it is very, very expensive.

So while students who could go to college for free decide that they want to go to Bucerius because they want the reputation and the better job prospects of going to Bucerius, what Bucerius does is they make a deal with their students. If you come here and you get a degree and go out in the world and perform, we will waive your tuition now in exchange for a portion of your income over the next 10 years. So, in other words, they basically place a bet on their graduates that they are going to get some percentage, 13, 18, 15 percent.

Senator BLUMENTHAL. And, presumably, they borrow to cover the cost of covering——

Mr. COLE. Yes. So they are essentially lending, but they are lending in a different way. They are not requiring the payment back of their tuition. They are saying, "We are going to lend you this tuition now in exchange for what we believe is going to be a higher income, a growth in human capital." So they really believe that they are producing growth in human capital.

Senator BLUMENTHAL. I just want to say, my time is going to expire shortly, but I would invite you and the other members of the panel to add to your response because I think that proposal and others may be very promising ways to go forward. But, you know,

I would just observe that the experience at Decker, where there was a questionable relationship between the school and SLX, the lender, and at Westwood, where there were outright deceptive and misleading practices, you know, "fraud" is the right word, and maybe it is that the penalties have to be increased. The penalties here have to be more than just a cost of doing business, and there is a significant enforcement problem that, Attorney General Conway, you described insofar as the targets are more diverse and numerous and very often the costs of pursuing them can be substantial.

So I would welcome any and all ideas that you may have, both on the penalty, the substantive prohibition, and the enforcement aspects of this problem.

Thank you.

Senator DURBIN. Senator Whitehouse.

Senator WHITEHOUSE. Thank you, Chairman Durbin. First of all, thank you for bringing attention to this issue. I know some of the witnesses have used— there was nearly $900 billion in student loan debt. I have seen figures that show that there were $1 trillion in student loan debt in this country. And when you compare that to other countries where a student can get a college degree, essentially on the government or at a very low cost, it builds a huge burden in for individuals. And when things do not work out, as they sometimes do not in life, usually what you can do is start over. And it is a tough process because bankruptcy is not easy, but you get a clean shot to kind of the American dream to rebuild again, and everybody understands that that is right. It has been something that witnesses have described to us as very important economically for people to be able to restart and, you know, find a way to create value in their lives and build a life for themselves rather than just be saddled with this debt forever with no way to get out of it, as Ms. Jokela's testimony showed.

First of all, we have got a bunch of former colleagues here. It is sort of Attorney General Day here in the Judiciary Committee— former Attorney General Blumenthal and myself, and both of you, Attorney General Conway and Attorney General Madigan. I had a consumer protection division in my office. Senator Blumenthal was very active with consumer protection in his office. I assume you have consumer protection divisions in your office. From a consumer protection standpoint, what are the issues that you are seeing in your offices related to student loans?

Ms. MADIGAN. Senator, at this point we are looking at student loans as really just the next predatory lending issue that we need to contend with. So it has been mortgage loans, auto loans, payday loans, and now student loans. Our lawsuit against Westwood goes through, really, from the beginning when students are recruited to attend all the way through the sign-up, and then the student aid meetings that they have and get signed up for these loans. It is fraudulent throughout the process. And when people are leaving Westwood's criminal justice program, they have on average $70,000 in debt, and because the college itself is not regionally accredited, these individuals are unable to become the police officers that the recruiters told them they could become. And so we find people working at Sam's Club. We have found people who have dropped

out of the job market because their degree is essentially worthless. And there are alternatives.

They could have, for instance, gone to a community college, spent a tenth of what they had to spend at Westwood, and actually gotten a degree that would have allowed them to become a member of the Illinois State Police, the Chicago Police Department, or a suburban police department. And so what we are seeing is a lot of the exact same fraudulent conduct.

When it specifically comes to the loans, it is the misrepresentations to the students about the fact that, you know, what is the interest rate. We have many students who tell us they never realized they had a loan at 18 percent. They were never given documentation. When they asked for documentation, they were told it would be sent to them. It was never sent to them. There was no real affordability test ever done. But they were constantly being told that this degree is accredited, you will be able to become a police officer, we have got good contacts with police departments, you know, do not worry, you will be fine. And the next thing people know, they graduate and they cannot get a job, and they are left with extraordinary amounts of debt. And so we are pursuing them through the consumer fraud act.

Senator WHITEHOUSE. And, Attorney General Conway, it seems as if there is room here for common schemes to develop between lenders and from for-profit higher education where you draw the victim in, you loan them enormous amounts of money. The institution gets paid through tuition and it makes its money. The lender has these people on the hook forever because there is no protection in bankruptcy for the individual. And at the end, somebody leaves, as Attorney General Madigan said, with very limited career options and an enormous amount of debt that they can never get out from under for the rest of their lives.

Have you seen that kind of—how frequent does it seem that there is a common scheme emerging between lenders and for-profit higher education institutions?

Mr. CONWAY. We have seen it. We certainly saw it in the instance of the for-profit law school in western Kentucky and their arrangement with SLX. We see it in one of two ways, Senator. We see it either in some sort of arrangement like that, some sort of preferred lender arrangement, or increasingly, we have seen a significant increase in institutional loans where the institution makes the loan itself, is willing to anticipate they are going to have a loss, just so that they meet the minimum criteria for non-federal revenue into their stream under the so-called 90/10 rule. So we are seeing it both ways.

To sort of follow up on what General Madigan said, we have 141 of these schools in Kentucky, and we have subpoenaed and are investigating seven. We let the data take us to where we thought we needed to be with those seven. We are looking at where we have the most complaints to our office or our council on postsecondary education. Where are we seeing—where do we have documents of the high-pressure sales tactics claiming 98 percent job placement or something like that? And then where do we cross-reference that with federal student loan default rates?

If you are seeing a school claiming 96 percent job placement and they have got a 40 percent federal student loan default rate, something is wrong. But we had a school like that in the Commonwealth of Kentucky. In one particular case, we had a school claiming 96 percent job placement, but then we found the information they sent to their accreditor—which was national accreditation, not regional—and they were claiming 60 percent in that. Now, that 60 percent may have been someone working in fast food who was still working in fast food after getting the so-called career education. But it is a simple consumer protection case to make out when you are claiming 96 percent job placement and what you are reporting to your accreditor does not even meet that.

So for the Federal Congress, we could use a lot of help. I know the gainful employment rule was a big right up here. But we need some help in understanding what for-profit schools need to report to accreditors regarding job placement, whether that is regional accreditation or national accreditation, because what we are seeing are high-pressure sales tactics, oftentimes going after single parents or people that have real problems making ends meet in this difficult economy. In fact, we have seen documents coming out of the Senate HELP Committee called "the pain funnel." Try to find the people that you can sign up today for these loans, and we have just seen some really remarkable practices.

One school in Kentucky in particular, they would not allow students access to their federal funds until they bought books at a premium, new from that very for-profit college's bookstore. That is the type of scams we are seeing and that we are fighting on a daily basis as AGs.

Senator WHITEHOUSE. Thank you very much, Chairman.

Senator DURBIN. Thank you, Senator Whitehouse.

Professor Cole, I am going to take exception to your theory about secured loans, unsecured loans, and student loans being sui generis. If this were so compelling and spot on that these were really different kinds of loans and needed to be treated differently, there might have been all of at least five minutes of testimony on the bankruptcy reform bill about this. No. This was slipped in. This was not even discussed, and no one knows. How did this get in there? How did we say that private loans are not dischargeable in bankruptcy?

And I might also say that I appreciated the refresher, I needed it, on the different kinds of loans. But if a person goes out and crosses North Capitol here and gets hit by a car and is taken to the local hospital and needs emergency surgery and ends up with a $200,000, $300,000 medical bill, I think that might qualify the same argument that you made for student loans. They did not operate on that person because of a security that they have in their body. They did not operate on them because they checked their net worth. They did their operation and then set out to collect it. You could make a similar argument to what you made that medical loans should not be discharged in bankruptcy on the same theory. It is based on getting well, right? Student loans are based on getting educated.

So I do not buy it. I do not buy the premise on what you are saying, and if it really was so compelling, it would not have been slipped in as it was in this circumstance here.

I do want to say, Ms. Jokela, would you be kind enough to tell us what the impact of all this debt has had on your ability to go back to school or borrow money or make plans for your own life?

Ms. JOKELA. Yes, absolutely. You know, ultimately I have a dream of operating my own design firm, but just, you know, thinking about the cost of starting your own business is just—you know, how could I even consider taking on any additional debt to try to do that? I certainly could never go back to school to even achieve an MBA or a master's degree because, you know, how would I pay for it? I definitely do not want to take out any more student debt.

So I am in this place right now where I just have to keep working and working and working and trying and trying to trying to pay this debt down and not really making any progress. And then sort of long term, even if I did not have these other aspirations, because of this student debt, I am not even in a place where I can have, you know, an emergency savings account or contribute to any kind of IRA for my long-term retirement. And, really, when I am facing retirement is the point that I am going to be done paying these student loans.

Senator DURBIN. How old are you now?

Ms. JOKELA. I am 32. So I have got 25 more years left, and then, you know, I will be a few years away from retirement, and that is not going to be enough time for me to really build the life that I want to have for myself in the future.

Senator DURBIN. Attorney General Madigan, I take the Kennedy Expressway out to O'Hare a lot, and I do not get on the plane with any trepidation, but usually with anger because I have just passed that building that has the big sign on it that says, "Westwood College." And every time I see it, I think of the worthless diplomas that they are peddling.

I had a situation in my office with a cleaning lady who was nearing retirement. Her daughter was accepted at Westwood, signed up. Her mom has to co-sign. After the Pell grant worth $5,000-plus, they signed up for $17,000 more in debt for the same worthless degree that you are now investigating. I wish these crime shows would get off television for a while so kids could start thinking about other things to do with their lives other than being a super chef or a forensic crime scene investigator.

But let me ask you, the incidents of parents co-signing and the impact that has had, you said you have had about 800 Westwood students who have contacted you. Have you found instances of the parents being brought into this kind of situation?

Ms. MADIGAN. We have. In terms of the APEX loans that I talked about, 40 percent of the Westwood College student end up taking out those APEX loans, whether they know it or not. And in many circumstances we have found—and I think as Ms. Loonin testified to—an increasing number of private loans requiring a co-signer. And so we are seeing that.

As I said, in the past few months, we have had over 1,000 people contact our office, and so they are now sending in paperwork and filling out questionnaires so that we are gathering more and more

information. But it is just clear from the beginning that people are being put into loans and, again, they have no idea—and it is not just being put into loans at the outset. It is that they are pressured while they are in school. We in our complaint have testimony from students saying that they were literally pulled out of class and told they had to sign up for another loan if they wanted to continue their enrollment in the school. And, again, they are kind of forced to because those credits cannot be transferred anywhere. I mean, it is just egregious, unconscionable situations.

Senator DURBIN. I might tell you, my cleaning lady's story has a happy ending. She had told me she was prepared to defer her retirement because her daughter was finally in college at Westwood. And when we found out the details, we called them and said, "There will be a press conference right outside your front door tomorrow morning with this lady and me if you do not tear up the paper." And they did. I wish I could do that for the thousands who have been exploited by this worthless Westwood College and so many like it. But I am glad you are pursuing this.

Are they being investigated by other States as well?

Ms. MADIGAN. Yes.

Senator DURBIN. Thank you.

Senator Franken.

Senator FRANKEN. Thank you, Mr. Chairman.

Let us follow up a little bit with Westwood, Attorney General Madigan. Your suit against them was for deceptive marketing practices, and I think that highlights a huge problem for the for-profit sector: the accreditation process, and the fact that many of these programs may not have the regional accreditation and, therefore, may not have their credits or degrees accepted by other local institutions or employers.

Ms. MADIGAN. Right.

Senator FRANKEN. What does the Federal Government need to do to strengthen and improve the accreditation process? And what can it do to make students more aware of the importance of the type of accreditation of their programs?

Ms. MADIGAN. Senator, it is a great question, and let me start by telling you something that one of the students told me from Westwood who was savvy enough to know to ask the question of the recruiter: "Are you accredited?" And they were told, "Yes, we are accredited." But that student would have had to know to ask more specifically, "Are you regionally accredited or nationally accredited?" Because most people have no understanding of the difference. And believe it or not, it is regional accreditation that is really the gold standard when it comes to accreditation and not national accreditation.

This is obviously work that can be done on the federal level to make sure that the accreditation process is something that is meaningful. You can do that, obviously, by looking at job placement rates. You do that by looking at default rates. And those are certain things that, when, for instance, Westwood was going through an accreditation process at one point, when they went on campus, interestingly enough—and this is just to add some more color to this story—administration actually told students that they were not allowed to complain or talk to the accreditation people who

were on campus and that they may be thrown out of school if they did talk to them.

So, obviously, there is a lot that can be done to ensure that, you know, there would be whistleblower provisions put in place, and that could be done both at the State level and at the federal level to protect students from ending up in programs where they end up with an enormous amount of debt and worthless degrees.

Senator FRANKEN. Ms. Jokela, thank you for your moving testimony. It reminds us all of how this impacts the lives of those who go through this and why it is so important to improve the student loan policy in this country.

Attorney General Madigan just talked about at Westwood that, I guess, 40 percent of the students got APEX loans, and a lot of them were not even aware that they did have APEX loans. I am very interested in working on ways to improve information that students receive before they decide how to pay for their college. Do you think that it would have helped in your case if you had been given a simple single sheet explaining your financial aid?

Ms. JOKELA. Well, I think it would have been somewhat helpful, but one of the staff members in Mr. Durbin's office had forwarded me a document that my school, Harrington, issues and the information that they are sort of saying as far as, you know, what students are taking out in private loans versus public loans and what the total overall debt is does not really reflect my situation nor the situation of many, many of the students that I graduated with.

I think what really would be helpful, what information needs to be presented up front, is how much is this particular loan, what is the interest rate on this particular loan; at this point, as they are going through your education, what is the total of your loans and sort of what you can reasonably expect to have to repay once you are done and graduated.

Senator FRANKEN. So a certain level of transparency might be required.

Ms. JOKELA. Yes, and not just putting it into a document that the student signs and takes home or gets filed away, but just really having a clear and concise discussion about it so that the students absolutely understand what it is that they are getting into before they make that decision and sign that paperwork.

Senator FRANKEN. Thank you.

Ms. Loonin, many commentators have equated the abuses in the private loan industry with the abuses that went on in the housing industry. I know that Attorney General Madigan said that this is really kind of an extension in her consumer bureau of what went on in the mortgage industry and the credit card industry.

The *Dodd-Frank Act* now requires institutions that securitize mortgages to retain some of the risk. Most institutions of higher education currently do not carry any risk associated with either federal or student loans. I think Professor Cole talked about this German institution that does. And that is, if students are unable to pay back their student loans, it does not really harm the institutions. Perhaps this should change so that institutions have more of a stake in what happens to their graduates.

How could the Federal Government require colleges to bear some of the risk students take on when they take out federal or private

student loans? In other words, can the Federal Government require institutions of higher learning to have some skin in the game?

Ms. LOONIN. Yes, thank you, and that is something that we are very interested in looking at some options.

First, the parallels really in the private student loan market and the subprime mortgage are very clear. A lot of the same things happened. But even on the federal loan side, here is an example, I think, of where you can incentivize schools by holding them more accountable when they commit fraud or other things. There are some limited relief options, discharge options, false certification, closed school, unpaid refund. This is on the federal student loan side, and the closed school is difficult. If the schools are closed, it is difficult to have them pay anything back. But the false certification is based on, you know, bad acts essentially that the schools did. The relief goes to the borrowers, which is great. We are able to get that for a lot of our clients. The Department of Education has the authority now to then seek reimbursement from the schools, and as far as we know, they have not been doing that even though the authority already exists. But something like that is an example where, if the school was actually held accountable, the borrower was made whole, the relief was paid out, and the taxpayer could be more whole also by seeking reimbursement.

Senator FRANKEN. I think most taxpayers would be for that.

Mr. Chairman, thank you.

Senator DURBIN. Senator Whitehouse. Senator Whitehouse defers to Senator Blumenthal.

Senator BLUMENTHAL. Thank you.

Since we are on the second round of questioning, I want to thank the Chairman again for having——

Senator DURBIN. Take all the time you need.

Senator BLUMENTHAL. Thank you.

[Laughter.]

Senator BLUMENTHAL. You know, I am struck by some of the discussion here because we are talking about the bankruptcy process for people about the age of the group that just entered this room. They are about the age of my four children who are in school, and they are at the start of their lives. And Senator Whitehouse rightly described the bankruptcy process as giving people a new start.

My goal here is really to enable people to avoid bankruptcy because it is a searingly painful and sometimes disabling process. As much as it may be a new start, it is also a public confession of financial failure that will follow people for the rest of their lives. And so the more we can do to avoid bankruptcy in the first place, in my view, that ought to be the objective here.

And so, you know, I am also struck by the experience, General Conway, at Decker. Decker failed. People went into bankruptcy because the school failed to deliver their education. They were unable to discharge themselves in bankruptcy from a debt they had because of the school's failure and its bankruptcy. What an anomaly in American life that the students were unable to get the same relief that the school did after it failed them, again, people not much older than college students in the case of law school, but also undergraduates at Decker.

You very rightly suggested two much more limited means of avoiding bankruptcy, for example, providing the opportunity for students to avoid repayment if they are unable to get the education that they took the loan to receive, which is provided under the federal loan program, and, again, also enabling people to avoid having to repay while they are still in school.

I want to ask you, and perhaps the other members of the panel, whether the protections under the federal student loan program should not be applied to the private loans, as you have suggested, General Conway, in two instances.

Mr. CONWAY. Well, I think going back, Senator Blumenthal, to the example of Decker, as I said, we approached the bankruptcy trustee in the Decker case because we had these students with these problems, and yet we had the trustee going after the students. And that is sort of—as you said, I think you called it an "anomaly," a situation like that.

We were able to get $4.6 million in very tangible debt relief for those students in the instance of Decker. And Decker is interesting because it was happening at about the time that Congress was going through bankruptcy reform and this mystery amendment that Senator Durbin has talked about was put in place. But the filing of bankruptcy happened after the changes, so this really was one of the cases of first impression how this was going to work out.

We were able to get that $4.6 million forgiven because they were institutional loans. What we basically said is, "Listen, you failed, and you cannot be going after these students." But what is still hanging out, and hanging out there to this day, is the roughly $13 million in private loans. We have had some success in saying, "Listen, okay, you did not have the right kind of lending relationship. We are going to advocate on behalf of the student." But we have not been successful in all those cases. And because the school failed and because federal protections—federal law has protections in the instance when a school fails, we have had some success in about $21 million worth of federal student loans that are involved in Decker. But we do still have this $13 million in private loans hanging out there, and I would argue, as you said in your remarks, that those people from Decker still facing those loans ought to have the same kind of protections that we were able to get either for the institutional loans or the federal loans.

Senator BLUMENTHAL. Professor Cole, what do you think about applying the federal protections to private loans?

Mr. COLE. Senator, I think that would be an appropriate thing to do. I think that it treats private loans, private student loans, as student loans, and in that sense it is an appropriate thing to do.

I do want to respond, if I may, to Senator Durbin's comment about—I almost feel as though I am being held responsible for the processes of Congress with the way the bill was—the Bankruptcy Code was amended. If I had been there, I would have made a comment similar to what I have made today. I do think that the rationale for exempting student loans is to be able to make students able to credibly commit. But I do think that there has to be a way to internalize the costs that some of these private for-profit colleges are imposing on people. And one of the ways to do that—the States can do that without bankruptcy, for example, by extending fraudu-

lent conveyance reach-back periods for college tuition only. If you are giving value and getting none in return, there ought to be a way in which individuals and their other creditors ought to be able to address that, and that can be done under State law without the stain of bankruptcy.

If you want to do it through the Bankruptcy Code, another way to do it is to allow for discharge for all but a percentage of future income, and that way the lenders are going to take more responsibility in investigating the colleges that are receiving these funds to make sure that they are giving an education, because no lender is going to want to lend against an education that is only going to generate a small amount of income in the future if they are worried that the rest of it is going to be discharged in bankruptcy.

So those are options that do not necessarily implicate the Bankruptcy Code or the bankruptcy process.

Senator BLUMENTHAL. Thank you.

Thank you, Mr. Chairman.

Senator DURBIN. Thanks.

Senator Whitehouse.

Senator WHITEHOUSE. Thank you, Mr. Chairman.

Let me ask Ms. Loonin: The National Consumer Law Center looks at this sort of from the 50,000-foot level as well as at the individual level. Have you made any determinations as to what the effect of the 2005 change in the law was on student loan interest rates? Is there a report of some kind that shows a categorical shift to the benefit of students as a result of the 2005 law?

Ms. LOONIN. Thank you. We have not done a report on that. The Project on Student Debt has done some analysis of that. We have done some—not an actual report. We have done some internal analysis as well as a report that we did in 2008 looking at private student loan products, and in all of those cases, we have not found, again, that the interest rates were—they fluctuated, but you cannot see any pattern that is tied to bankruptcy.

Senator WHITEHOUSE. Cannot attribute.

Ms. LOONIN. Right.

Senator WHITEHOUSE. Okay. Professor Cole, the history of this, as I understand it, was that, you know, the baseline is that debt is dischargeable in bankruptcy. Is that correct?

Mr. COLE. Yes, that is correct.

Senator WHITEHOUSE. And the baseline for student loans until 2005 was that they were dischargeable in bankruptcy?

Mr. COLE. For private student loans.

Senator WHITEHOUSE. Private student loans, correct?

Mr. COLE. That is right.

Senator WHITEHOUSE. And then the 2005 law, as our Chairman said, magically appeared without a lot of testimony to support it, but somehow it got into the law. And when it got in, it applied not just to loans that were originated after the change in the law. It applied to all student loans, did it not?

Mr. COLE. Yes, it did.

Senator WHITEHOUSE. So if you took out a loan in 1995 with the expectation that you would be able to discharge in a bankruptcy, you had that expectation disrupted by this law, correct?

Mr. COLE. Yes, that is correct. And if I can add, that is inappropriate. It is inappropriate for that to have been the case because you are changing the expectations in the middle of the game in the same way that this would change expectations——

Senator WHITEHOUSE. And the loaner never went back and said to that student who had the 1995 loan, "Hey, you know what? We are operating in a new environment in which you cannot get out from under this debt. I am going to be able to chase you to your deathbed and, therefore, I am eliminating a little bankruptcy risk to myself, and so I am going to reduce your interest rate." That student pre-2005 just plain lost something and got no value.

Mr. COLE. That is right. That is a windfall to the lenders.

Senator WHITEHOUSE. It is a windfall.

Mr. COLE. Yes, it is a complete windfall to the lenders.

Senator WHITEHOUSE. So in your testimony, where you express concern that to go back to the status quo ante of the 2005 bill, what existed beforehand, that would be a "change in the rules."

Mr. COLE. That is right, but——

Senator WHITEHOUSE. It would be just as bad to change the rules against the interests of the students.

Mr. COLE. Yes, Senator. But——

Senator WHITEHOUSE. As it is to change it against the interests of the loan companies, correct?

Mr. COLE. Yes, Senator. My response to that would be that two wrongs do not make a right. It is——

Senator WHITEHOUSE. Well, it does go back to the status quo ante, right?

Mr. COLE. It does. It does, but——

Senator WHITEHOUSE. So it puts everything back on the level playing field it was before.

Mr. COLE. But I also want to explain that you cannot really compare interest rates from before the change to after the change because interest rates, as I explained in my written testimony, are made up of at least three different components: There is a natural rate of interest; there is an industry rate; and then there is a borrower-specific rate of interest. And so just looking at the surface——

Senator WHITEHOUSE. I understand. You get into a huge attribution problem.

Mr. COLE. Right, exactly.

Senator WHITEHOUSE. But if your position is correct that this has a beneficial effect on the interest rate market, you have this exemption from bankruptcy to deny people the right to start again.

Mr. COLE. Yes.

Senator WHITEHOUSE. If it has that benefit, then clearly that is a benefit that was taken away from everybody pre-2005.

Mr. COLE. I agree completely.

Senator WHITEHOUSE. And so they got basically—I am not going to use the word in a Senate hearing, but you know what I mean. It was a plain consumer—they had something that they were entitled to, they had an expectation. It was taken away from them. It was taken away from them by something slipped into a bill in Congress. They lost as a result. And setting aside the market issues, it would be fair to at least put them back in the situation where

they were before some lobbyist snuck this into the bill and took away their rights, correct?

Mr. COLE. You could not have more agreement from anyone than I have with regard to that statement, although I would add——

Senator WHITEHOUSE. Thank you. I am way over my time.

Mr. COLE [continuing]. That this amendment does not do that.

Senator WHITEHOUSE. I appreciate you letting me go over my time. Thank you, Chairman.

Senator DURBIN. You are welcome, and thank you for being here. And the amendment is a work in progress, and some ideas have come up during the course of this hearing that I think should be brought into play.

Professor Cole, you gave a good written statement here, and I am glad you came a long way to be here to testify. I was stopped cold on the first page by two words when you described "innocent lenders."

Now that you have listened to what happened to Ms. Jokela, after you have heard the Attorneys General talk about the schools that are lending money, do you still consider them innocent?

Mr. COLE. No, Senator, I do not. But I want to say that the proposed amendment lumps in innocent lenders with guilty, fraudulent lenders. And what I am suggesting is that you can address those fraudulent lenders without undermining the student loan market.

Senator DURBIN. I do not quarrel with that premise.

I might also add for the record that the largest for-profit school in the United States of America makes no private loans. You will probably be able to guess which one that is, but I was surprised to learn that. This seems to be a little sidelight, kind of a juice loan deal, a little, you know, title loan company that goes with some for-profit schools. So I do not think there is a lot of innocence.

You know, one of the things that I think should be disclosed to the student is before you borrow private loans with three times the interest rate, you incidentally still are eligible to borrow more under the federal loan. Wouldn't that be a pretty reasonable thing to disclose?

Mr. COLE. I think it would be an absolutely appropriate disclosure.

Senator DURBIN. Ms. Loonin, one of the things you talk about here is the statute of limitations. Do you want to address that for a moment?

Ms. LOONIN. On the federal loan side, the fact that there is no——

Senator DURBIN. I do not think your microphone is on.

Ms. LOONIN. Oh, I am sorry. On the federal loan said, there is no statute of limitations. It was eliminated in 1991. So that is a major reason why I have clients who are in their 80s and 90s still being hounded on the federal loan side.

But one of the connections we have seen on the private loan side on the debt collection side, the debt collectors collecting private loans take advantage, frankly, of borrowers and of borrowers' confusion about what type of loan they have and will often say, you know, there is no time limit, we can come after you forever on the private loan side, even though that is not the case.

Senator DURBIN. I am going to bring this hearing to a close. It has been a good one and a great panel. I thank you all for coming because I know there was some personal sacrifice to your being here. It is an issue which has been taken up in the authorizing Committee by Senator Harkin with a number of hearings. We have had several hearings through the Judiciary Committee, and they will continue.

As I mentioned at the outset, come July there will be a moment of reckoning when we decide whether to address the interest rate to be charged on federal student loans. As I understand it, it doubles from 3.4 percent to 6.8 percent, a burden which I do not want to impose on students across this country. But it also creates an opportunity for us, if we are up to it, to have an honest discussion about what is happening to student debt in America. The student debt crisis in this country is largely ignored by Congress. We are not paying any attention. And, unfortunately, there are a lot of lives of individuals—Danielle Jokela is one—who are being changed dramatically by laws that we pass or fail to pass.

And going back to the point made by Senator Blumenthal, it is hard to imagine a young person who thinks they are doing the right thing—an education, for goodness' sake—borrowing money to get that degree which they have been told is the most important thing in life, making a decision before they are 25 or 26 years old that ends up haunting them for a lifetime. And that is literally what we are talking about here. When it is not dischargeable in bankruptcy, it is there to the grave, and that is why it is so important we continue to work on this.

Thanks again to the panel. Members may send you some written questions. It is rare, but occasionally they do. And if you receive one and could respond promptly, we would appreciate it. Thank you.

This meeting will stand adjourned.

[Whereupon, at 11:41 a.m., the Subcommittee was adjourned.]

APPENDIX

Additional Material Submitted for the Record

Witness List

Hearing before the
Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts

On

"The Looming Student Debt Crisis: Providing Fairness for Struggling Students"

Tuesday, March 20, 2012
Dirksen Senate Office Building, Room 226
10:00 a.m.

The Honorable Jack Conway
Attorney General for the Commonwealth of Kentucky
Frankfort, KY

The Honorable Lisa Madigan
Attorney General for the State of Illinois
Chicago, IL

G. Marcus Cole
Professor of Law
Stanford University
Stanford, CA

Danielle Jokela
Chicago, IL

Deanne Loonin
National Consumer Law Center
Boston, MA

Neal P. McCluskey
Associate Director, Center for Educational Freedom
Cato Institute
Washington, DC

PREPARED STATEMENT OF RANKING MEMBER CHUCK GRASSLEY

Statement of Senator Charles E. Grassley of Iowa
Senate Committee on the Judiciary,
Subcommittee on Administrative Oversight and the Courts,
Hearing on "The Looming Student Debt Crisis:
Providing Fairness for Struggling Students"
Tuesday, March 20, 2012

Today's hearing fails to address why college graduates are struggling to find jobs while faced with burdensome student loan debt due to ever increasing tuition rates. Instead we're examining how to "provid[e] fairness for struggling students." This title is misleading because all the bill being discussed today does is give some college graduates or even college dropouts a bailout at the expense of others. Nothing being considered today helps students, unless you think telling them to take out a loan and then file bankruptcy when you either graduate or tire of school is help. We're not seriously considering how to help out students just now preparing to enter college or a trade school, primarily because that subject isn't within this Committee's jurisdiction. Rather, we're examining whether Congress should reconsider the way it overwhelmingly voted to treat private student loans, a small subset of all student loans, in bankruptcy. It seems to me that what's on the table for discussion will not help students find jobs nor will it address the rising cost of college tuition. Unfortunately, allowing private student loans to be unconditionally dischargeable in bankruptcy will contribute to the rising cost of college tuition.

Regardless, today's hearing intends to examine the treatment of private student loans in bankruptcy. Specifically, Senator Durbin has introduced S. 1102, "The Fairness to Struggling Students Act of 2011," which amends 11 U.S.C. § 523(a)(8) so that private student loans are unconditionally dischargeable in bankruptcy. We're told that this change will serve as an incentive for lenders to work out flexible repayment plans with their borrowers. However, while this may be one consequence of the bill, there may be other consequences, such as encouraging people to file bankruptcy.

In considering why student loans are treated as conditionally dischargeable debt in bankruptcy, it's important to recognize the unique characteristics of student loans and why Congress treats them differently in bankruptcy. Unlike other unsecured loans, student loans are often long-term extensions of credit, with repayment options of up to 30 years. These are loans made to student borrowers with no assets and basically no way of demonstrating their creditworthiness, let alone demonstrating any ability to repay the loan. In how many other situations would a lender extend credit to someone in this kind of financial situation? Why do the lenders extend credit to these risky borrowers? Because student loans are essentially an investment in the student's education, which has the promise that the borrower will eventually achieve a higher earning capacity than he or she had at the time of the loan. For other unsecured consumer loans, lenders are willing to extend credit even if those debts can be discharged in bankruptcy because borrowers have other assets that can be used to satisfy the debt in the event of default. Thus, there is a legitimate reason the bankruptcy code treats student loans differently from other unsecured consumer loans.

Today's hearing will likely make a point that the Bankruptcy Code has not always treated private student loans as conditionally dischargeable. The Bankruptcy Abuse Prevention and Consumer

Protection Act of 2005 made private student loans subject to the same requirements as federally guaranteed student loans. This change was the result of efforts starting in the late 1990s to treat all student loans the same in bankruptcy. With the treatment of student loans as, essentially, non-dischargeable unless a debtor can show that payment would impose an undue hardship, Congress sought to limit instances where a borrower can obtain the benefit of higher education without ever having to pay for it. And individuals in the 1970s did strategically file bankruptcy just to get their student loans discharged before Congress changed the way student loans were treated in bankruptcy. Abuse was real, not just perceived as some may say. As a result of limiting discharge of student loans in bankruptcy, students can now obtain student loans at more affordable rates than ever before.

As mentioned at the outset, the proposed bill fails to provide any help to students facing high tuition costs when enrolling in college. We should be discussing how to treat the real problem, which is the outrageous cost of tuition. Congress should be considering other, substantial reforms to the market for financial aid that could provide true relief, and fairness, to student loan debtors.

One possible reform I would like to highlight is that lenders could do a better job of educating borrowers as they prepare for higher education. There are studies that show borrowers of private student loans often fail to exhaust their eligibility for federal student loans. This could be due to several reasons, but borrowers must be educated as to the consequences of these decisions. Perhaps borrowers of private student loans are not always well-informed of their repayment responsibilities, and improved disclosure requirements or educational tools could prevent students from taking out more private loans than they need.

On this point, I note an initiative by Iowa Student Loan back in my home state. Iowa Student Loan is a private, nonprofit corporation, with a mission to help Iowa students and families obtain the resources necessary to succeed in postsecondary education. Currently, Iowa Student Loan helps more than 220,000 students pay for college. As part of its work in educating borrowers before they take on student loan debt, Iowa Student Loan has in place an online counseling program that requires all borrowers of private student loans to complete. The program requires borrowers to input their college major and other data, and it shows them how much they are likely to earn after graduation and estimates how much of their income will go towards their loan payments. Iowa Student Loan has found that by going through this counseling program, students actually reduce the amount of private student loans they take out. We must address the issue on the front end, when students take on the loans, rather than years down the road through the bankruptcy code.

Incentivizing individuals to file bankruptcy in order to discharge student loan debt is a short sighted option for young debtors. This is not the purpose of the Bankruptcy Code. Moreover, when an individual files for bankruptcy protection there will be a host of consequences flowing from that decision. If Congress really wants to help provide fairness to students, then let's do so with a comprehensive review of federal higher education policy that looks at how well our current programs address the rising costs of tuition and provide value for the taxpayers' money in terms of graduates with greater employment prospects.

Prepared Statement of Jack Conway, Attorney General for the Commonwealth of Kentucky, Frankfort, Kentucky

Kentucky Attorney General Jack Conway

Testimony for the Senate Judiciary Committee/Subcommittee on Administrative Oversight and the Courts

March 20, 2012 - 10 a.m. EDT

"The Looming Student Debt Crisis: Providing Fairness for Struggling Students"

Senator Durbin, Ranking Member Sessions, thank you for inviting me to testify before this subcommittee today. I appreciate your attention to this issue.

As Attorney General of the Commonwealth of Kentucky, the issue of students being unable to discharge private educational loans in bankruptcy is linked to my investigation into for-profit career colleges.

I first became aware of the tremendous debt burden carried by students at some proprietary colleges through the investigation into possible consumer protection violations by Decker College and subsequently my investigation into the closing of the for-profit American Justice School of Law in Paducah.

Eventually, Decker College closed and was forced into bankruptcy in 2005 following a loss of accreditation and its eligibility to receive Title IV funds. The students were left in a terrible situation. They had incurred thousands of dollars

in debt to pay for certifications as heating and air conditioning technicians, electricians, and plumbers. This was an education promised to secure them a higher paying job, but the school closed before the training was complete. And, to add insult to injury, the credits they had earned and paid for did not transfer to another school.

The American Justice School of Law and its successor, Barkley School of Law, failed to obtain accreditation from the American Bar Association, closed and also filed for bankruptcy. Most students had not completed their education when the school closed.

As you are aware, students with federal student loans who are unable to complete their degree because a school closes are entitled to have those federal loans discharged. However, the same protection is not available for private institutional loans or loans from other private lenders. Both Decker and Barkley students had millions of dollars in these institutional and private student loans that were not dischargeable in bankruptcy under the closed school discharge rule.

The Trustees in the Decker and Barkley bankruptcies began efforts to collect on the private loans the schools had extended to students. But, ironically, the students who were living on

the financial edge, saddled with tens of thousands of dollars in student loans, likely would not be able to discharge their student loans in personal bankruptcy.

In both instances, my office was able to successfully work with the Trustees to discharge loans owed directly to the schools. In the case of Decker College, the settlement negotiated by my office released the loans of 2,200 students that totaled $4.5 million dollars. Likewise, in the Barkley bankruptcy, after being contacted by my office, the Trustee released the student debts to the school.

With respect to other students at the law school, we were also able to secure a settlement with the private lender. We found that the school had a questionable relationship with a company called SLX. Further, notwithstanding the representations to students, these private loans didn't include the same consumer protections as federal student loans. Those protections include the ability to defer payment on the debt while still in school. We found evidence that the loan holder began requiring some students to repay their loans while they were still in school. Deferment for the entire time needed to complete a degree wasn't available under the terms of the loan.

So, students were forced into forbearance and into accruing significant amounts of capitalized interest.

My office was able to secure $3.6 million in debt reduction in the loan obligations for students who attended the law school. Students' loans were reduced by an amount equal to the amount of tuition paid for credits that did not transfer to another law school. The average loan reduction per student was $25,000.

We received calls, emails and letters from students thanking my office for its work. The reduction in these loans changed their lives. They were able to make a fresh start.

But, students at these schools had loans with other lenders. Decker College closed its doors in 2005, and my office still receives calls every week from students struggling to pay their school loans. One former student called because his tax refund had been taken to pay a student loan, but he needed this money to make a car repair. Another student needed the money to move her family into a safe apartment. Do we understand — really understand — how close to the line some of these borrowers are living? That working car means the difference between being able to get to work and keeping a job or losing

that job. That apartment means safety and security for a family.

Indeed, there are material differences between private loans and federal loans. The federal loans have important provisions protecting students. For example, as I mentioned earlier, the "closed school" discharge rule provides relief for students faced with a circumstance like Decker College. Some Decker students were able to get a "closed school discharge" for their federal loans. That remedy was not available for the students' private or institutional loans. Federal loans have other protections for borrowers too, including a fixed interest rate that is capped, an income based repayment plan, and the ability to defer repayment. Private lenders, on the other hand, are not required to offer any of these protections to borrowers.

After studying the cases of Decker College and the law school, in December 2010, I launched an investigation into seven other for-profit colleges operating in Kentucky. The students enrolled in most of these career schools are some of our most financially vulnerable citizens – they are Pell Grant recipients, they rely heavily on student loans to pay for their educations, and very often they are the first in their families to attend a college of any sort. According to most recent data

available from the Project on Student Debt, an estimated 96% of graduates from four-year proprietary schools have loans. Of great concern is that 42% of these students have private loans-- without the protections of federal loans-- in contrast to the 14% of students at public four-year institutions and just 4% at public two-year institutions who have private loans.

An even more troubling statistic from the Senate HELP Committee is that while students at the for-profit schools are only 10% of the higher education body, they account for 47% of all defaults on federal loans. For the 2009-2010 year, according to the Institute for College Access & Success, students at these career colleges received approximately 25% of all Title IV Aid. Unfortunately, no comprehensive data on private loan defaults is available.

These schools receive a large portion of the funds intended for our veterans as well. A recent article in the Army Times reports that for-profit schools have received approximately 37% of the $17.2 billion cost for the GI Bill, and "almost 50% of the $563 million spent last year by the Defense Department on tuition assistance for active-duty troops went to for-profit schools."

My office has received hundreds of complaints since we commenced our investigation in 2010 ranging in topics from misrepresentations about financial aid, non-transferability of credits, and inability to get a job. Many of these students who took a chance on education are stuck with thousands of dollars in debt and no way to repay that debt.

In 2011, I filed suit against two colleges alleging they made false and misleading statements to consumers on matters including the rate of job placement, transferability of credits, and the students' financial aid. We are continuing our investigation into other schools.

I am now chairing a multistate working group looking into this issue with 23 other state attorneys general. In addition to the two suits my office has filed, Attorney General Madigan's Office has filed suit against Westwood College, the Colorado Attorney General has just reached a $4.5 million consumer protection settlement with Westwood College and other Attorneys General have active investigations.

The great tragedy is that students at some of these career schools, like Decker College, obtain these loans to go to school and change their lives--to get a higher paying job and improve their standard of living. Unfortunately, for many of these

borrowers, they are unable to complete their education or the school closes and they are left with no job and a mountain of debt that bankruptcy experts tell us is almost impossible to discharge.

The more we learn about the private student loan market, the more concerns we have. We have seen borrowers manipulated both by lenders and unscrupulous institutions that are in a fiduciary relationship with these borrowers.

Because of this dynamic, I must ask, why should we provide these students with no less than the same consumer protections that are available to federal student loan borrowers? Instead, current law provides private borrowers with none of the protections we've mentioned, and according to many experts, the law has made it almost impossible to get out of debt and get beyond the financial hardship that these private loans have caused.

With such harsh consequences for failure, these students are trapped in a cycle of dodging bill collectors, wage garnishment, and no meaningful path to financial recovery. This must not be the legacy of our efforts to provide an opportunity for education.

PREPARED STATEMENT OF LISA MADIGAN, ATTORNEY GENERAL FOR THE STATE OF ILLINOIS, CHICAGO, ILLINOIS

Testimony of

Illinois Attorney General Lisa Madigan

Testimony before the

Subcommittee on Administrative Oversight and the Courts
Senate Committee on the Judiciary

Tuesday, March 20, 2012
Dirksen Center Office Building
Constitution Avenue and 1st Street, NE
Room 226
Washington, D.C. 20510
10:00 A.M.

Hearing on

"THE LOOMING STUDENT DEBT CRISIS: PROVIDING FAIRNESS FOR STRUGGLING STUDENTS"

Protecting Consumers from Predatory Student Loan Practices:
The Perspective of Illinois Attorney General Lisa Madigan

Introduction

Senator Durbin and members of the subcommittee, thank you for inviting me to testify today about a growing problem that that could result in our nation's next great economic crisis if left unchecked.

The costs of obtaining an advanced education in this country are rapidly exceeding the financial means of most families. Millions of college students and graduates are carrying debt loads of crippling proportions. An abundance of statistics substantiates borrowers' daily struggles to manage their student loan debt. To highlight just a few:

A recent report by the National Association of Consumer Bankruptcy Attorneys estimates that college seniors who graduated in 2010 owed an average of $25,250.00, up 5 % from 2009.[1] Student loan debt is increasing at a rate of about $2,853.88 per second. The delinquency rates for these loans are equally alarming. According to a report released this month by the Federal Reserve Bank of New York, as many as 27 % of our nation's 37 million student loan borrowers are 30 days or more past-due on their balances. Collectively, American consumers now owe about $870 billon in student loan debt, surpassing the amount of our nation's household credit card debt. This financial burden is not borne exclusively by young adults. Nationally, 5.3 % of consumers carrying student loan debt are age 60 or over, and another 11 % are age 50 to 59. These numbers indicate that parents are increasingly taking out loans to pay for their children's advanced education, and are carrying the debt into their retirement years.

A growing percentage of this loan debt comes from private student loans, which often carry higher interest rates and fewer consumer protections than government loans. According to the Department of Education, between 2003-04 and 2007-08, the percentage of undergraduates obtaining private student loans rose from 5 % to 14 %, and the percentage of graduate students obtaining private student loans increased from 7 % to 11%. In 2007-08, the Department of Education estimated that lenders provided about $22 billion in private loans.

Prior to the economic crisis of 2008, many proprietary schools partnered with third party lenders to provide private student loans to their students outside the federal student loan program. These loans were usually more expensive than federal student loans and were made with little or no underwriting, similar to what occurred in the mortgage lending market. When these loans began to fail, lenders left the market. Students, however, are still saddled with these expensive and often unaffordable loans, which cannot be discharged in bankruptcy.

My Office has been aggressively pursuing the faulty underwriting practices of mortgage lenders for years, and we are taking an equally aggressive approach to reviewing the lending practices of proprietary schools. In our recent investigations we have seen the rise of expensive private loans that are self-financed by the schools themselves or by others through school loan guarantees.

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[1] "The Student Loan 'Debt Bomb': America's Next Mortgage-Style Economic Crisis?" The American Association of Consumer Bankruptcy Attorneys, February 2012.

Schools continue to use private lending in spite of the fact that default rates for proprietary schools loans are extremely high. According to a 2011 report from the National Consumer Law Center, institutional loans to students at for-profit colleges have surged. For example, Corinthian Colleges reports that a significant number of its students have institutional loans as well as federal loans, and the company plans to double its institutional loan volume to $240 million per year, even though it is writing off 55% of these loans. Other large for-profit college companies, such as ITT Educational Services and Career Education Corporation, are also lending to students, despite anticipating write-offs in excess of 40% of these loans.

One reason proprietary schools continue to offer expensive private loans is to satisfy the federal "90-10" rule, which requires that at least 10% of the school's lending come from non-Title IV funding. These private loans carry high interest rates. In Illinois, Westwood College offers a private loan with an APR of 18%. Some schools such as Westwood require students to make payments on institutional loans while they are still enrolled. This policy differs from federal loans, which can be deferred during school. Students tell my Office they are confused about where these payments are going and have difficulty making the payments while still enrolled.

The Illinois Experience

At the state level we see first-hand the damage done to the lives of students burdened with enormous debt loads from proprietary schools. These students wanted nothing more than to go to school and better their lives. But too many of them end up struggling to pay for an expensive education that did not give them the skills necessary to obtain meaningful employment.

On January 18, 2012, I filed a lawsuit against the for-profit college Westwood for engaging in deceptive practices that saddled Illinois students with up to $80,000.00 in debt for degrees that failed to qualify them for careers in criminal justice.

The lawsuit alleges that in marketing its criminal justice program, Westwood falsely represented to prospective students that they could pursue a law enforcement career with agencies such as the Chicago Police Department, Illinois State Police and suburban police departments, even though virtually all of those employers do not recognize a Westwood degree due to its lack of regional accreditation.

When enrolling prospective students, Westwood promised to help them get part-time jobs to assist with paying for their degrees. Westwood, however, failed to follow through with that commitment in any meaningful way. Westwood compounded these misrepresentations by downplaying the financial burden associated with obtaining a Westwood degree.
Many students learned only after graduation—and after racking up thousands of dollars in student loan debt—that their degrees would not land them the law enforcement jobs they originally sought. Additionally, because Westwood isn't recognized by regionally accredited colleges, students found they couldn't transfer their coursework to alternative programs to complete a degree. In short, many Westwood students are now burdened with debt loads as high as $80,000 and stuck with a degree that is neither marketable nor transferrable. Since we filed our lawsuit, more than 800 former and current students have come forward to complain about their experience at Westwood College.

Our lawsuit alleges that Westwood made misrepresentations regarding its regional accreditation status. Westwood is only nationally accredited. It is not—and never has been—regionally accredited. Because Westwood is only nationally accredited, coursework offered through Westwood's programs is not recognized by many regionally accredited institutions. Further, because of its lack of regional accreditation, degrees offered by Westwood are not recognized by many employers, particularly employers in the criminal justice field.

As alleged in my lawsuit, Westwood employees made verbal representations that Westwood is a regionally accredited institution to potential, current, and former Westwood students. Further, in spite of the lack of professional recognition of degrees that are not regionally accredited, Westwood made verbal representations to potential, current, and former students that students would be able to transfer their credits to other institutions that accept credits only from regionally accredited schools.

Westwood made verbal representations to potential, current, and former students that students would be able to obtain specific jobs in the criminal justice field. In fact, many of those employers do not recognize Westwood degrees because Westwood is not regionally accredited. Approximately 3,367 students have enrolled in Westwood's Criminal Justice Program from 2001 to 2011.

Additionally, Westwood made misleading verbal representations to potential, current, and former students with criminal records that they would be eligible for employment in the criminal justice field. Numerous students have reported that Westwood's faculty and staff told them that Westwood could expunge or seal students' criminal records; connect students with top employers who would disregard their criminal records; and that students would be able to secure jobs within the criminal justice field (such as being a police officer) despite their criminal records.

Westwood regularly promoted their Criminal Justice Programs through television and online ads promoting exciting criminal justice career opportunities with high paying salaries. The advertisements contained dramatic and repeated images of police officers investigating crime scenes and apprehending criminals. Further, Westwood engaged in deceptive Internet advertising that created the false impression that Westwood was regionally accredited and that Westwood's degrees were recognized by employers such as the Chicago Police Department and the Illinois State Police. As stated earlier, Westwood was in fact only nationally accredited and the Chicago Police Department and the Illinois State Police did not recognize Westwood' criminal justice degrees.

Not only were Westwood students generally unable to use their degrees to obtain employment in the field for which they trained, but Westwood is a very expensive education option as well. A three-year Bachelor's of Applied Science degree in criminal justice costs over $70,000 – and that is just the cost of tuition, not for room and board. Our investigation revealed that most students must take out student loans to finance their Westwood education. Every student we interviewed used student loans to pay their Westwood tuition. The average debt level of the students we interviewed is $55,000. Approximately 70% of those students had taken out private student

loans, and 40% had financed part of their tuition with a Westwood APEX loan, which is Westwood's institutional loan that carries an 18% interest rate.

When prospective Westwood students met with financial aid officers, the students were generally presented with four different types of payment options: grants; federal loans; private loans; and APEX loans. Many students were simply told to sign the paperwork and that Westwood would take care of everything else. At least one student was told that she was approved for federal aid that would cover the entire cost of her degree, which Westwood told her would be approximately $56,000.00. But there are limits on the amount of federal aid a student can borrow for any given year based on various circumstances, and students have to reapply for financial aid annually. In other words, the student was not and could not have been approved for a single federal loan that covered the entire cost of her degree.

The same student was then advised to take a separate $10,000.00 private loan to cover additional unexpected expenses "just in case." Throughout her time at Westwood, the student was advised to take out two additional $10,000.00 "just in case" loans. The student was led to believe that these loans would be returned to the lender if not needed, which was simply untrue.

When the student graduated, she learned that she had not taken one $56,000.00 federal loan to cover the cost of her degree plus three additional loans that could be returned, as Westwood had led her to believe. Instead, she learned that she had taken multiple different loans with interest rates ranging from 2.9% to 11.9%, none of which could be returned. Her total debt at the time of graduating was $77,000.00, which would require her to pay $598.00 per month for the next 25 years.

My lawsuit also alleges that Westwood offered a private lending program called APEX. APEX was purportedly designed to finance the portion of a student's education not covered by grants, federal aid, or private loans. To enroll, a student must sign a contract and agree to pay some monthly amount – typically $150 – toward the balance while still in school. While the student is enrolled, the amount financed does not accrue any interest. But 90 days after the student graduates, interest begins to accrue on the unpaid amount at rates as high as 18%. Many students were confused about the purpose of these expensive loans. Some thought the loans were paying off other loans, such as their Sallie Mae loans. Others didn't even realize they had taken out the loans until after graduation.

Summary

Student debt poses a large and growing threat to the stability of our economy. Just as the housing crisis has trapped millions of borrowers in mortgages that are underwater, student debt could very well prevent millions of Americans from fully participating in the economy or ever achieving financial security. My Office will take the following actions to address some of the problems driving this impending crisis:

- The Illinois Attorney General's Office has aggressively pursued predatory mortgage lending and will continue its investigation of student lending practices at proprietary schools.

- We support permitting students to discharge private school debt in bankruptcy. Private loans carry none of the protections afforded to students who take out federal loans. Federal protections include: interest rate caps, loan limits, income-based repayment, deferment programs and cancellation rights. It is of particular concern that the private student loans originated prior to 2008 may have been written with little or no examination of the prospective student's ability to re-pay the loan.

- Staff from the Illinois Attorney General's Office is participating in the Department of Education (DOE) Negotiated Rulemaking Committee. The Committee is addressing issues including income-based repayment plans and circumstances surrounding rehabilitation of student loans in default.

Conclusion

Thank you for the opportunity to testify before the subcommittee today. As the chief consumer advocate for the state of Illinois, I am committed to working with my partners on the state and federal levels to implement real solutions to the student loan debt crisis. Moreover, I will continue to investigate and prosecute abuses in the proprietary school industry, for it is my belief that reforming the practices of proprietary schools is a necessary component of any effective solution.

Prepared Statement of G. Marcus Cole, Professor of Law, Stanford University, Stanford, California

Statement of
Prof. G. Marcus Cole
The Wm. Benjamin Scott & Luna M. Scott Professor of Law
Stanford University

Before the
United States Senate
Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts

March 20, 2012

Mr. Chairman, Senators, Ladies and Gentlemen.

My name is Marcus Cole, and I am the William Benjamin Scott and Luna M. Scott Professor of Law at Stanford University, where I teach courses in commercial and financial law and regulation. My areas of research include bankruptcy, venture capital, and banking regulation, with a focus on the law and economics of regulatory structures and institutions. I have been invited to comment upon the proposed amendment to the Bankruptcy Code that would eliminate the exemption from discharge currently enjoyed by private, for-profit student loan obligations. While I am, like most Americans, sympathetic to the plight of consumer debtors, I hope to raise, for your consideration, what I think are the likely and undesirable consequences of the removal of the exemption.

In short, I think that the removal of the exemption from discharge of privately placed student loans will result in a dramatic increase in the cost of student loans for all student borrowers, ultimately "drying up" the availability of such loans for those who need them most. If the goal is to relieve the debt burden upon student borrowers who have taken on student debt that did not result in higher productivity and earnings potential, removal of the exemption is a blunt instrument that is unlikely to address the root source of the problem, accomplishing instead a one-time, unjust transfer from innocent lenders who did nothing more than give money to people in the hopes of being repaid someday. This would be a one-time wealth transfer because, if it were to occur, the likely effect would be to chill or discourage student lending entirely, resulting in a "drying up" of student loan markets. If it is not your goal to limit access to higher education, then perhaps you might want to consider alternatives to achieve your goal. I mention some of the alternatives near the end of my statement.

To explain why removal of the exemption would have the effect of drying up the availability of student loans, I would like to break the analysis into three parts:

First, I would like to explain the three different types of lending that are available to borrowers in our economy, and how they differ from each other. Most importantly, I want to explain how student loans are fundamentally different in nature from either secured loans or other types of unsecured loans.

Prof. G. Marcus Cole
Stanford Law School

Second, I would like to describe the basic components of interest rates, how they are associated with various risks, and why interests rates might be higher or lower for different borrowers. Because interest rates necessarily must reflect the risk that the lender will not be repaid, the removal of the discharge exemption from privately funded student loans will necessarily increase the risk that student loan lenders will not be repaid, and this risk will, necessarily, be reflected in the risk premium component of interest rates borne by all student loan borrowers.

Finally, I would like to explore alternative ways to get at the problem I think you are trying to address, namely, the level of student debt that does not result in higher graduate incomes, but instead imposes a seemingly insurmountable debt burden on those students whose aspirations of a higher income and a better life never materialized. In particular, there are two alternatives that would be more narrowly tailored toward achieving what I think is your goal, without the harmful unintended consequences that are likely to result from a removal of the exemption for privately funded student loans.

I. The Three (Not Two) Types of Credit in Our Economy

Everyone, I think, is familiar with the two most basic forms of credit in our economy, namely, secured and unsecured credit. Most debt obligations incurred in our society are unsecured, meaning that when one person owes another person money, the person to whom the debt is owed looks to the general ability of the person owing the debt to repay it. An unsecured creditor does not have special rights associated with any one particular asset of the debtor, but has to take his or her chances that the debtor will repay either out of the debtor's current assets, or from the debtor's income. And when it comes to getting repaid, an unsecured creditor must take his or her chances alongside other unsecured creditors, hoping and expecting there is enough income or assets to pay all of them in full.

Secured creditors are different. They don't want to take their chances with respect to whether they will get repaid. They take measures to reduce the risk that they won't get paid. Instead of looking to the debtor's assets in general, a secured creditor insists upon "collateral" before extending the loan. By taking a security interest in a particular asset, a secured creditor has all the same rights of an unsecured creditor, but also acquires two rights that unsecured creditors do not enjoy.

First, in most states, a secured creditor has the right of "self-help." When a lender on a car note repossesses a car parked on the street in the middle of the night because the borrower failed to repay, the car note lender is exercising self-help. Self-help is an important right to be sure, but it is by no means the most important right of a secured creditor. That honor falls upon the secured creditor's right of priority with respect to the particular asset, or "collateral," in which the secured creditor has a security interest. This second right of secured creditors is what makes secured credit less risky for the lender, and in turn, less expensive for the borrower.

Prof. G. Marcus Cole
Stanford Law School

The key difference between unsecured credit and secured credit is that one type (unsecured) looks to the debtor's assets generally for repayment, while the other (secured) looks to a particular asset of the debtor to ensure repayment of the obligation. But the one thing these two types of credit have in common is that they *both look to the debtor's present ability to repay as the basis for pricing and extending the loan in the first place.*

Student loans are fundamentally different from either secured or unsecured credit. While on the surface they look indistinguishable from other forms of unsecured loans, they are extended on a completely different basis. While most other forms of unsecured credit are extended on the basis of a debtor's present ability to repay, *student loans are unique in that they are based upon the debtor's projected future ability to repay.*

The purpose of a student loan is to increase the borrower's *human* capital, and a resultant increase in the borrower's productivity and earning potential. The only asset most student borrowers can pledge to a lender in order to provide an assurance of repayment is their *future* earnings potential. A student approaching a lender in a world where there is no exemption from discharge for student loans has a problem: "How do I get a lender to believe me when I say I will repay my student loan, given that I have no other assets to pledge other than my future income?" A lender approached by this student has very little incentive to lend to the student except at an astronomically high interest rate, to reflect the risk of not being repaid. A student without means, then, faces the prospect of either not being able to access higher educational at all, or accessing it at astronomically high costs.

Fortunately, Congress rescued millions of students like this (and like me, once) by making it difficult to discharge student loans in bankruptcy. Because student loans are difficult to discharge, a student borrower can credibly commit to repay the student loan. Furthermore, the lender, confronting a lowered risk of default, can charge a drastically lower rate of interest for the loan. This lower interest rate, in turn, makes the loan, and the education for which it pays, much more affordable for the student borrower.

II. The Increased Interest Rate Resulting From Removal of the Discharge Exemption for Private Student Loans

The next question may be "why does the dischargeability of a loan affect the interest rate associated with it?" The answer stems from the fact that money is fungible. If we put two twenty-dollar bills next to each other, no one would be able to tell which was mine and which belonged to you. In fact, money is the most fungible commodity in the world. Like all fungible commodities, the buyers and sellers all exist in a competitive market. Money from one supplier is just as good as money from any other supplier. And any borrower who needs that money is just as happy, if the terms are equivalent, to get that money from one supplier as from any other.

The question that follows is "but if it is true that money (credit) markets are competitive markets, then why do different borrowers face different terms from

lenders?" The answer is that while there is a competitive "market" price for money, there is also an "insurance premium" that must cover the risks that a lender will not be repaid. In fact, there are essentially two risks associated with any one borrower's willingness and ability to repay a loan, namely, "industry risk" and "borrower-specific risk."

Industry risk is the risk associated with the type of business, trade, or industry in which a particular borrower earns his or her income. A smart-phone manufacturer, for example, has a different industry risk profile than a manufacturer of VHS video recorder machines. Both companies may be "creditworthy," in that they always pay their bills on time, and that they do not borrow more than they can feasibly repay. Nevertheless, a lender approached by these two manufacturers would charge a higher interest rate to the VHS machine manufacturer to reflect the risk that there may be no VHS industry a year from now.

Borrower-specific risk is the risk that *this particular borrower* brings to the credit relationship. You may have two borrowers with identical job titles or in the same industry, but one has a history of paying his or her bills on time, while the other does not. For this reason, the more creditworthy borrower will be confronted with lower borrowing costs than the less creditworthy borrower.

The interest rate associated with any loan, then, can be said to consist of at least three simple components, namely, (1) the "natural" interest rate (the market price for or time value of money); (2) the industry specific risk associated with this particular borrower; and (3) the borrower-specific risk associated with this particular borrower. There is virtually nothing a lender or borrower can do to reduce or eliminate the "natural" interest rate component of the interest associated with their loan. But there are some things that can be done to lower or eliminate industry risk, and even more that can be done to lower borrower-specific risk.

To lower industry risk, the economic uncertainties associated with particular *types* of borrowers in a particular industry must be addressed somehow. This is *precisely* what Congress did to lower student loan interest rates when it exempted them from discharge in bankruptcy. This meant that any student seeking a student loan, without regard to his or her own, personal creditworthiness, could credibly commit to a lender that he or she would repay the loan. Since the loan could not be discharged in bankruptcy (without great difficulty and uncertainty), the risk of loss to the lender is dramatically lowered, and the lender, like all competing lenders, would be able to reduce the risk premium and resultant interest rate associated with all student loans.

The next question must be, "Does this mean that repealing the exemption from discharge from student loans will cause their interest rates to rise?" All else being held equal, the answer is, emphatically, "yes." Without the assurance of repayment afforded by the exemption from discharge, there is little a student can use to assure a lender of repayment. Removal of the exemption removes every student's ability to make a *credible* commitment regarding their willingness and ability to repay from their future earnings. The resultant increase in the risk premium could make student loan interest rates usurious. In other words, interest

rates on student loans can go so high that no lender could legally offer student loans, even if there existed rational lenders willing to take on the new risks.

But repeal of the exemption from discharge would do far more than just increase interest rates and dry up the availability of student loans. It would also change the rules in the middle of the game for lenders who lent with the expectation that they would get repaid without fear of discharge in bankruptcy. The effect of a repeal upon these lenders would be an instantaneous transfer of wealth from the lenders to the borrowers, without the lenders having done anything wrong to be deprived of their right to repayment.

Even if Congress was to attempt to reverse the repeal after witnessing the inevitable effects upon student loan markets, the damage will have been done to the confidence of potential lenders. Any potential lender considering lending to students will price into their loan a risk premium associated with the behavior of Congress. The knowledge that Congress changed the rules of the game before "half-time" bears the risk that it might do so again, and again.

III. Possible Alternative Approaches to Address Underproductive Student Loan Debt

The final question might be, "if Congress does not remove the exemption for private, for-profit student loans from discharge in bankruptcy, then how can overburdened student borrowers find relief from their debt burdens?" The answer to this depends upon whether we are concerned with past or future borrowers.

For borrowers who have already taken on student debt for which they find themselves unable to repay, there exists a "hardship" test that will allow, in exceptional cases, the discharge of student loan debt in bankruptcy. The test for hardship is not spelled out with clarity in the bankruptcy code, and as a result, varies from district to district across the country.[1] Whether Congress wishes to make this test uniform is not a matter about which I have a strong opinion. From my discussion above, regarding the need for student borrowers to have the ability to make credible commitments, it stands to reason that the hardship test should not be made easier to satisfy.

A more just solution than simply punishing lenders for giving money to people would be to place the burdens of student borrowers upon all taxpayers.

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[1] Different courts use different tests to determine whether a particular student loan borrower has shown an undue hardship. One frequently-used standard is the *Brunner* test, which requires a debtor to show that 1) the debtor is unable to maintain, with current income and expenses, a "minimal" standard of living for the debtor and the debtor's dependents if forced to repay the student loans; 2) additional circumstances exist indicating that this state of affairs is likely to persist for much if not all of the repayment period remaining on the student loans; and 3) the debtor has made a good faith effort to repay the student loans. (*Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987).

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Whether the lenders, who did nothing wrong, or the taxpayers, who did nothing wrong, shoulder this burden, the goal of relieving debtors from the burden of student loan debt would be achieved, but without the economic consequences of discouraging lenders from lending in the future.

A more targeted approach to the problem of student borrowers with more debt than acquired human capital would be to look at *why* their borrowing did not result in increased human capital sufficient to repay the loan. Did their institutions of higher learning, trade schools or other educational institutions defraud them, making false promises of a better future? Or did they find their studies too difficult, or change their minds about their goals and aspirations? An inquiry like this might be more fine-tuned to the problem to be addressed than the blunt instrument of a sweeping amendment to the bankruptcy code.

In addition to the aforementioned approaches, there are two other, more novel approaches that might be entertained by Congress. The first would be to internalize the cost of "bad" educational lending upon the lenders themselves by forcing them to do what all lenders do in the contexts of secured and unsecured lending alike. All mortgage lenders, for example, insist upon a home appraisal before making a home loan. Similarly, all car note lenders insist upon a valuation of the car securing the note. Even unsecured lenders will seek information about assets and income before lending on an unsecured basis.

In the context of student loans, Congress may wish to require private student lenders to assess the earnings potential of any student borrower associated with any particular educational institution. If the student loan is to be used to pay for an education that has proven in the past to be of little value in the market place, then perhaps the lenders themselves ought to bear the cost of helping such institutions remain open. Toward this end, a hardship test that revolved around the quality of the educational institution and its track record might target the problem of fraudulent schools.

A different, more creative approach can be borrowed from Europe. Although there are very few private universities in Europe, there are some, and many of these have helped students finance their education in ways we might find quite novel. For example, Bucerius Law School in Hamburg, Germany, is the first and only private law school in Germany. Since performance on the German state examination is public record, the reputation of Bucerius has been catapulted to the very top of the German legal academy due to the performance of Bucerius graduates on these examinations. And since there are few charitable foundations in Germany supporting Bucerius and its mission, much of Bucerius' operations are financed through tuition.

But not all Bucerius students can afford the steep annual cost of tuition at the school. For those who cannot, Bucerius makes a deal: instead of paying annual tuition now, agree to pay a fixed percentage of your future income over a capped period of time after graduation. The more money a Bucerius graduate earns, the more money the school receives from its graduates. The reverse is also true. If a Bucerius graduate struggles financially after graduation, Bucerius will receive that same fixed percentage of the graduate's income, however low it might be.

The one thing that makes the Bucerius "future income arrangement" work, of course, is that the obligation to repay the school is not dischargeable in bankruptcy. Universities and colleges in the United States, including the chancellors of the University of California, are reportedly exploring similar arrangements. One hurdle they will confront, however, is the question of whether such arrangements are dischargeable in bankruptcy. To the extent that they are, there is little chance that these creative solutions to the problem of investing in human capital will ever take root.

In summary, I am very sympathetic with the plight of debtors overburdened by student loans that did not do what the loans were supposed to do, namely, to make the students lives better and more productive. I myself grew up in the Terrace Village Housing Projects of Pittsburgh, Pennsylvania, and I could not have imagined going to college without the help of student loans. But I would never have had access to student loans, or the college education they made possible, if my lenders did not have the assurance that they would be repaid from my future income. Although I was completely unaware of it at the time, Congress gave me the power to make a credible commitment to my student loan originators, and I would not be here before you today if it were not for the education my country made possible for me through student loans.

Thank you very much for this opportunity to testify before you.

Prepared Statement of Danielle Jokela, Chicago, Illinois

United States Senate Judiciary Committee
Hearing before the Subcommittee on Administrative Oversight and the Courts
"The Looming Student Debt Crisis: Providing Fairness for Struggling Students"
March 20, 2012

Testimony of Danielle Jokela

First, I would like to thank Senator Durbin for inviting me to speak today, and also thank the members of the Committee for your time and patience while I tell you my story. It's my hope that through coming here today, I can serve as a voice for the countless students that find themselves in a situation similar to my own.

Both of my parents were high school drop-outs. Of the five children that I grew up with, I am the only one who graduated from high school on a somewhat traditional path. I say somewhat, because although I did graduate from a traditional public high school, when I was a junior, my mom told me that she could not afford to support me and I was out on my own. I finished my last year of high school living on my own, working a fast food job that paid my rent and virtually nothing else. The odds were against me, but because of the personal value I have for education and my strong work ethic, I pushed through and managed to graduate in the top ⅓ of my class.

In 2004, I relocated from Minnesota to Chicago to attend Harrington College of Design, a Career Education Corporation school. With my background, I could not rely on my family for financial support, or guidance. As a result, I fully trusted the staff at Harrington to give me the guidance I needed, and to work in my best interests. They helped fill out the financial aid paperwork for my loans, made phone calls on my behalf, and worked diligently to ensure I had the funds I needed to pay for school. There was no discussion about what my interest rates were or what my actual debt load looked like. We never talked about what my monthly payments would be once I graduated. Compound interest was a concept I had never heard of, and of course it was never explained to me. I had no clue what sort of salary I could expect to earn upon graduation, and while my school claimed a very high job placement rate, nobody told me what percentage of graduates actually were working in their chosen field, or what their starting wages were.

In 2007, I graduated with highest honors, and received my BFA in interior design. I could not have been more proud of my achievements. My pride soon became dismay when I struggled to find work as a designer, and accepted a position doing admin work for a flooring contractor. Six months after graduation, all pride was gone when I began repayment on my student loans. I realized then that I had graduated with $37,625 in federal loans and $40,925 in private loans for a combined total of nearly $79,000 that had ballooned to more than $100,000 after interest and fees. My minimum monthly payment was more than half of my income. I took a six month forbearance, and stretched the pay back period from 15 to 30 years to make the payments more manageable.

After the forbearance, I resumed paying my loans until 2009, when I found myself looking for work. When I did find work, it was only as an independent contractor, again doing admin work, making far less than my previous salary. At that time, I took a second six month forbearance until I could get things stabilized. When I resumed payments, all progress I had made in the two

years prior had been erased. Fees were assessed and added to my balance so that I could take the forbearance, and compound interest kept accumulating, despite my financial hardship. This pushed my balance back up to $100,000.

Today, five years after graduation, I have still not found work as a designer, and I still owe more than $98,000 in student loans. I have 16 separate private and federal loans with Sallie Mae. Sallie Mae will not allow me to consolidate my private loans. I make one combined payment each month of approximately $830. Nearly 28% of my current income goes towards student loan debt. Almost all of my loans have variable interest rates. The low interest on my federal loans makes them manageable, but my private student loans have interest rates ranging from 8% to 11%. If interest rates rise, so does my monthly payment, and the total amount that I will have paid back over the lifetime of the loans. 25 years from now, if interest rates hold, when I am finally done paying for my student loans, I will have paid nearly $56,000 for my federal loans and nearly $155,000 for my private loans - approximately $211,000 towards a $79,000 debt. That's a staggering 264%.

I'm out of options. I can't file bankruptcy because the vast majority of my debt is student loan and mortgage debt. I can't negotiate a settlement with Sallie Mae, and I can't stop paying my student loans. I don't want to destroy my credit. I don't want to have my wages garnished. Even more, I don't want to add on more fees, interest, and other costs to a debt that is already a burden I cannot bear. My only option is to give up my home. I am literally losing my home so that I can continue to pay my student loans and other monthly bills. It's the only option I have.

I'm here today to advocate on behalf of myself and the rest of the students who are trapped in the same situation, carrying an unreasonable debt load for the opportunity to try to improve our lives. I'm asking you to create legislation that will empower us to overcome this burden, and prevent future students from falling into the same trap. I ask that private student loans once again be dischargeable in bankruptcy, and that all schools be required to provide clear and full disclosure to students regarding the amount of their loans, interest rates and expected payments.

Education is the key to success for the American people, and every American should have the opportunity to pursue a quality education without the fear of excessive debt. Thank you again for your time, for the work you do, and thank you for listening to my story.

PREPARED STATEMENT OF DEANNE LOONIN, NATIONAL CONSUMER LAW CENTER, BOSTON, MASSACHUSETTS

Testimony before the

U.S. Senate Judiciary Subcommittee on Administrative Oversight and the Courts

"The Looming Student Debt Crisis: Providing Fairness for Struggling Students"

March 20, 2012

Testimony submitted by:

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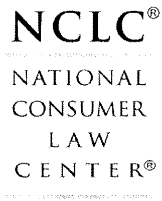

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Testimony of Deanne Loonin for the

U.S. Senate Judiciary Subcommittee on Administrative Oversight and the Courts

"The Looming Student Debt Crisis: Providing Fairness for Struggling Students"

March 20, 2012

The National Consumer Law Center (NCLC) thanks the Committee for holding this hearing and inviting us to submit this testimony on behalf of our low-income clients. The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations that represent low-income and older individuals on consumer issues.[1] NCLC's Student Loan Borrower Assistance Project provides information about student loan rights and responsibilities for borrowers and advocates. We also seek to increase public understanding of student lending issues and to identify policy solutions to promote access to education, lessen student debt burdens and make loan repayment more manageable.[2]

In my work as the Director of NCLC's Student Loan Borrower Assistance Project, I provide training and technical assistance to attorneys and advocates across the country representing low-income student loan borrowers. I have written numerous reports on student loan issues as well as NCLC's *Student Loan Law* publication. I also provide direct representation to low-income borrowers through Massachusetts-based legal services and work force development organizations. Many of these borrowers seek assistance because they are trying to rebuild their lives after escaping domestic violence or homelessness. The non-profit work force development organizations help them get G.E.Ds if necessary and hopefully move on to higher education. However, many cannot take this next step because of prior student loan debt. I also have daily contact with a wide range of borrowers through our student loan web site. Because of my extensive experience representing student loan borrowers and working on student loan matters, I have served as the legal aid representative at a number of Department of Education negotiated rulemaking meetings, including the current "Loans team" session. My testimony is based on this work and previous work representing low-income consumers at Bet Tzedek Legal Services in Los Angeles.

Introduction

Investment in education can be one of the best financial decisions consumers make. Unfortunately, it can also be the beginning of a lifetime of burdensome debt. As college costs

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[1] In addition, NCLC publishes and annually supplements practice treatises which describe the law currently applicable to all types of consumer transactions, including *Student Loan Law* (4th ed. 2010 and Supp.).

[2] *See* the Project's web site at http://www.studentloanborrowerassistance.org.

rise in a tight economy, a growing number of student borrowers end up with staggering debt burdens that they can never escape.

Students go to college to improve their lives. Unfortunately, not everyone succeeds, especially not financially. Far too many never graduate. Many who do graduate are unable to find work to repay burdensome debt loads.

It is increasingly difficult for students to figure out how to pay for college. Tuition keeps growing while scholarship and grant aid shrinks. A growing number of students must rely on loans to finance their educations. The increased borrowing is not only from federal loans. The borrowing limits in the federal loan programs, the skyrocketing cost of higher education and aggressive lender marketing have fueled the growth of private student loans, which are almost always more expensive than federal loans.

Despite the growing perils of trying to pay for college, Congress has consistently weakened the safety net, including bankruptcy, for those who try, but end up unable to repay their education debts. Our experience working with low-income borrowers is that bankruptcy is almost never their first choice. Most express a desire to avoid bankruptcy because it feels like a failure. They also fear the stigma and the resulting difficulties of finding employment and housing. However, for many, bankruptcy is the only way to get a fresh start in life.

Bankruptcy is not and should not be the entire safety net, but it is the most organized and effective system we have to offer relief to those who need it. It is never an easy decision for a consumer to choose bankruptcy. This choice comes with many costs and consequences, including damaged credit that lasts for years. However, it was a choice that was available to private student loan borrowers before 2005 and is still fully available to nearly all other unsecured debtors. For student loan debtors, however, bankruptcy relief is now available only through the random, unfair, and costly "undue hardship" system. Effectively, it has become no choice at all for those who most need it.

The New York Federal Reserve Board reported in March 2012 that outstanding student loan debt stands at about $870 billion, higher than total credit card balances ($693 billion) and total auto loan balances ($730 billion).[3] The Board noted that student loan balances are expected to continue this upward trend.

It is not just the amount of outstanding debt that causes concern, but the growing delinquency and default rates. Our testimony focuses on the social, economic and human toll of these staggering debt burdens and defaults. Just as college costs are increasing and grant aid has declined, policymakers have chosen over time to punch major holes in the safety net for borrowers. Congress has eviscerated bankruptcy rights for federal and private student loan borrowers. On the federal loan side, Congress and various Administrations have instituted tax refund intercepts (including EITC seizures), eliminated the statute of limitations, initiated administrative wage garnishment and Social Security offsets, and expanded use of private collection agencies. This conscious destruction of the safety net has occurred just as enrollment in higher education continues to skyrocket, college costs are rising exponentially and the income gap in this country continues to grow.

[3] Federal Reserve Bank of New York, "Grading Student Loans" (March 5, 2012).

We see and hear the human toll of the eviscerated student loan safety net every day from the low-income borrowers we represent. Some are so traumatized by collection calls and skyrocketing debt loads that they vow never to try education again. These choices not only impact these individuals and their families, but society as well. Beyond the benefits for individuals, there are a broad range of social gains from a more educated population. The College Board publishes research on the benefits of higher education, including not just higher earnings for individuals, but also less reliance on public benefits among those with more education, better health, and higher voting and volunteering rates.[4]

As evidenced by the Obama Administration's higher education goals, it is in our national interest for more people to get post-secondary education or training. If public policies only encouraged safe choices, few would borrow to go to college. Few would start businesses either. Most businesses fail, even those started by those who have previously run successful businesses. Yet we have decided as a society that we want people to start businesses even if this means writing off some bad debt. The same principle should apply to education.

Student Loan Defaults and Delinquencies Harm Borrowers, Society and the Economy

Private Student Loans

There are limits on how much students can borrow through most of the federal student loan programs. However, some students and their families borrow more by taking out private student loans. Some take out private loans because they are not aware of the federal student loan programs or incorrectly believe they are not eligible for federal loans or that the private loans are better deals. This often occurs because of aggressive private student loan marketing or borrower confusion about loans. The Project on Student Debt found that the majority (52%) of private loan borrowers in 2007-08 borrowed less than they could have in Stafford loans.[5]

The College Board reports that after peaking at 25% of total education loan volume in 2006-07, nonfederal loans declined to 8% of the total in 2009-10 and 7% in 2010-11.[6] More recently, however, lenders have reported a return to growth and increased competition.

Unfortunately, many private student loans are high cost loans that borrowers cannot repay or are in amounts far in excess of the student's ability to repay with anticipated income. Many of the most expensive private student loans are made to for-profit school students. These loans default at staggering levels.

A high percentage (about 70 -75%) of the clients we represent through NCLC's Student Loan Borrower Assistance Project attend for-profit schools. These schools have had the largest proportion of students taking out private loans and the largest increase in private loan borrowing. Forty-two percent of all for-profit school students had private loans in 2007-08, up from 12% in 2003-04.[7] In contrast, 25% of students at private non-profit four year schools, 14% of students at public four year schools and 4% of students at public two year schools had private student

[4] College Board, "Education Pays 2010" (2010).
[5] The Project on Student Debt, "Private Loans: Facts and Trends" (July 2011).
[6] CollegeBoard, "Trends in Student Aid 2011" (2011).
[7] The Project on Student Debt, "Private Loans: Facts and Trends" (July 2011).

loans in 2007-08.[8] In 2007-08, for-profit school students comprised about 9% of all undergraduates, but 27% of those with private loans.[9]

The private student loan industry generated huge profits for lenders and investors for many years. The private loan market was profitable largely because originators sold the loans with the intention of packaging them for investors. Prior to the credit crisis, private student lenders engaged in many of the same predatory practices as occurred in the subprime mortgage market. Not surprisingly, the industry began to crash once it could no longer rely on passing off dubious loans through the securitization process. Defaults and delinquencies ballooned during this time and continue to be a major problem.

Moody's acknowledged in early 2010 that the high default rates for private loan securitizations reflected weak underwriting, referring in this case to the 2006-07 period.[10] "Non-traditional" students or those attending "non-traditional" schools had a large portion of the defaulted loans, but many students graduating from traditional colleges and universities have also struggled under unsustainable loan burdens.

Fitch Ratings reported in July 2011 that losses for private student loans continue to increase. [11] According to Moody's, the private student loan default rate in the most recent quarter was about 5.1%, double what it was before the recession.[12]

To compound the pain for borrowers, as the subprime student loan market contracted, many for-profit schools began to develop their own products. As documented in NCLC's January 2011 report, the default rates on these school loan products are shockingly high.[13] Corinthian Colleges, for example, has told investors that it expects its students will not be able to repay 56-58% of its institutional private loans.[14] Despite the dismal performance of these loans, Corinthian executives told investors in summer 2011 that they planned to double the volume of private loans made through the institutional loan program to $240 million.[15]

As has occurred with the failed mortgage lending market, high student loan write-off and default rates block economic recovery. This is a particularly critical time for policymakers to provide relief for student borrowers and ensure that the private student loan market that emerges from the credit crisis is fair and efficient.

Federal Student Loans

There has also been a steady increase in federal student loan default rates in recent years. Even using the limited official cohort default rate, which only tracks borrowers for a few years,

[8] Id.
[9] Id.
[10] Student Lending Analytics Blog, "Moody's Outlook for Student Loan Securities: Expect Negative Credit Trends for Private Loans in 2010" (Jan. 29, 2010).
[11] Fitch Ratings, "The Student Loan Report Card "(July 2011).
[12] Don Lee, "Report on College Loan Delinquency Rate Raises Alarms," Los Angeles Times (March 5, 2012).
[13] National Consumer Law Center, "Piling It On: The Growth of Proprietary School Loans and the Consequences for Students," (January 31, 2011).
[14] Id.
[15] Id.

default rates are growing. According to the most recent data, 8.8% of federal student loan borrowers who entered repayment in 2009 had defaulted by the end of 2010, up from 7% for those entering repayment in 2008. For-profit colleges continue to have the highest two-year default rates, with a 15% cohort default rate for borrowers entering repayment in 2009. [16]

These rates only show loans that went into default. The full scope of student loan problems is more accurately portrayed by examining delinquency rates as well. In a 2011 report, the Institute for Higher Education Policy found that more than one-fourth of the borrowers in their study who entered repayment in 2005 became delinquent on their loans at some point, even though they did not default. [17]

The consequences of federal loan default are particularly severe. The government has extraordinary powers to collect student loans, far beyond those of most unsecured creditors. The government can garnish a borrower's wages without a judgment, seize his tax refund, even an earned income tax credit, seize portions of federal benefits such as Social Security, and deny him eligibility for new education grants or loans. Even in bankruptcy, most student loans must be paid. Unlike any other type of debt, there is no statute of limitations.

Borrowers who are current on their loans suffer from high debt burdens as well. Flexible repayment programs such as income-based repayment allow federal loan borrowers with limited incomes to make very low payments. This is extraordinarily helpful in preventing the worst consequences of default, but many of these borrowers are not making much if any progress toward paying off their loans. In some cases, payments do not even cover the interest that accrues monthly. Among other problems, this can impede asset building since creditors avoid lending to consumers with high debt-to-income ratios. Those in default face even graver credit reporting consequences.

The Diverse Student Borrower Population

The debate about student loan debt generally spotlights the struggles of young college graduates. There is no question that the problems faced by these "traditional" students are critical and should be addressed in policy reform. However, focusing exclusively on this population ignores the fact that the majority of students are "non-traditional," meaning that they are working adults over 25 or otherwise financially independent.

Despite the term "non-traditional," these students greatly outnumber traditional students. Low-income students are even more likely to fit the non-traditional profile and more likely to rely on student loans than their high or middle income traditional student peers. [18]

[16] The Project on Student Debt, "Sharp Uptick in Federal Student Loan Default Rates" (Sept. 12, 2011).
[17] Alisa F. Cunningham, Gregory S. Keinzl, Institute for Higher Education Policy, "Delinquency: The Untold Story of Student Loan Borrowing" (March 2011).
[18] U.S. Dep't of Educ., Nat'l Center for Educ. Stat., "Characteristics of Undergraduate Borrowers: 1999–2000" at 13-14 (Jan. 2003).

The population of student loan borrowers is diverse. Our low-income clients, for example, include very young individuals who are often in financial trouble because they were unable to complete school or completed a program that did not prepare them for employment. We also represent single parents in their 30's and 40's as well as borrowers in their 80's or 90's. Many come to us for assistance because they want to go back to school and improve their employment prospects. Some of our clients are severely disabled or otherwise cannot work. The government is still hounding these borrowers, in many cases taking away portions of their Social Security lifelines.

Non-traditional borrowers are at high risk of default for a variety of reasons, including lower completion rates.[19] Many individuals delayed enrolling in school and worked to save money to finance education. Others worked during school to defray costs. These well-intended decisions unfortunately are correlated with higher withdrawal rates. In addition, students who attend for-profit or two year community colleges are more likely to default as well as those who do not have high school diplomas. Older students are also more likely to default as well as some borrowers of color. Low parental educational attainment is another risk factor. Most of these risk factors closely track the defining characteristics of non-traditional students.

We must reset our policy priorities so that these borrowers are given the opportunity for a fresh start, to finish school, and hopefully climb the economic ladder.

Restore Bankruptcy Rights for Student Loan Borrowers

Current bankruptcy law treats students who face financial distress the same severe way as people who are trying to discharge child support debts, alimony, overdue taxes and criminal fines. The current undue hardship system is arbitrary and unfair and denies relief to the most vulnerable student loan borrowers.

This harsh treatment of students in the bankruptcy system was built on the false premise that students were more likely to "abuse" the bankruptcy system. Yet there is no evidence and has never been any evidence to support this assumption.

When first considering this policy, Congress commissioned a Government Accountability Office (GAO) study on the topic which found that only a fraction of 1 percent of all matured student loans had been discharged in bankruptcy. The House report summarized the GAO's findings:

> First, the general default rate on educational loans is approximately 18%. Of that 18%, approximately 3-4% of the amounts involved are discharged in bankruptcy cases. Thus, approximately ½ to ¾ of 1% of all matured educational loans are discharged in

[19] See generally Mary Nguyen, "Degreeless in Debt: What Happens to Borrowers Who Drop Out", The Education Sector (February 23, 2012).

bankruptcy. This compares favorably with the consumer finance industry. [20]

Congress acknowledged the pressure from the anecdotal reports of abuse. For example, a 1977 House Report on this issue stated that:

> The sentiment for an exception to discharge for educational loans does not derive solely from the increase in the number of bankruptcies. Instead, a few serious abuses of the bankruptcy laws by debtors with large amounts of educational loans, few other debts, and well-paying jobs, who have filed bankruptcy shortly after leaving school and before any loans became due, have generated the movement for an exception to discharge. In addition, a high default rate has been confused with a high bankruptcy rate, and has mistakenly led to calls for changes in the bankruptcy laws. [21]

Despite the shaky foundation, Congress ignored the study and instead chose to make it more and more difficult for student loan borrowers to get a fresh start through bankruptcy. As Representative O'Hara noted in fighting student loan nondischargeability in the 1970's, "No other legitimately contracted consumer loan, applied to a legitimate undertaking is subjected to the assumption of criminality which this provision applies to every educational loan."[22]

After a series of changes which eliminated borrower rights, the final blow to students came in 2005 when Congress included private student loans in the non-dischargeability category. Congress made this change even though private student loans are not part of the federal financial aid system, which was created to promote equal access to higher education.

Even those who insist without evidence that students are more likely to file bankruptcy should be able to agree that the general changes made to the bankruptcy laws in 2005 address this issue. Congress added a number of new elements to the personal bankruptcy system in 2005, such as a means test and counseling requirements that make it more difficult for all consumers to file bankruptcy, especially those who have assets to pay their debts. In any case, the Bankruptcy Code has always included safeguards to prevent discharge in cases where a debt is obtained through false pretenses or fraud.

People who borrow to pay for education are trying to improve their financial situations, not ruin them. There is simply no evidence that less restrictive bankruptcy policies will lead to borrowers "irresponsibly" taking out loans that they know they cannot repay. Default is not something that anyone seeks out. Financial distress is also not something that anyone seeks out, but it happens. In this difficult economy, we know that people are struggling, including many who had been entrenched in middle class jobs. Bankruptcy may be the only option for many of these individuals.

In addition, bankruptcy provides the most complete relief for financially distressed borrowers. For example, borrowers who discharge debt in bankruptcy are not liable to pay any

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[20] H.R. Rep. 95-595, 1st Sess. 1977, 1978, 1978 U.S.C.C.A.N. 5963, 6094, 1977 WL 9628.
[21] Id.
[22] H.R. Rep. No. 94-1232 (1976) and H.R. Rep. No. 95-595 at 149 (1977), quoted in John A.E. Pottow, "The Nondischargeabilty of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory" (March 2007).

taxes for the amounts written off. This is in sharp contrast to many of the federal student loan discharge programs, including the disability discharge, which come with potential tax consequences. The income-based repayment program for federal loans is a very useful program, but unlike bankruptcy, there are potential tax consequences and under current law, borrowers do not obtain discharges until 25 years have passed. During this time, borrowers face numerous operational barriers that may prevent them, in some cases through no fault of their own, from staying on these relief programs. These barriers arise, among other reasons, because the government delegates dispute resolution authority to private collection agencies.

"Undue Hardship" and Lack of Relief

The current "undue hardship" system is random, arbitrary and unfair. Under current law, most federal and private student loans can only be discharged if the debtor can show that payment will impose an undue hardship on the debtor and the debtor's dependents. The student must seek the hardship determination in court through a separate proceeding.

The system is strikingly arbitrary. Judges are granted extraordinary discretion to make these decisions, especially since the Code provides no definition of "undue hardship." Professors Pardo and Lacey have studied this issue and found a high degree of randomness in the application of the undue hardship test.[23] They also found that students seeking bankruptcy relief were in fact suffering financial distress, concluding that judicial discretion has come to undermine the integrity of the undue hardship system.[24]

At this point, nine circuits use the so-called *Brunner* test to evaluate hardship.[25] This test requires a showing that 1) the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for the debtor and the debtor's dependents if forced to repay the student loans; 2) additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and 3) the debtor has made good faith efforts to repay the loans.

In recent years, many judges have recognized the random and unfair application of this "test." According to the Tenth Circuit, many courts have "...constrained the three *Brunner* requirements to deny discharge under even the most dire circumstances."[26] The court further noted that this overly restrictive application fails to further the Bankruptcy Code's goal of providing a "fresh start" for the honest but unfortunate debtor.[27] In criticizing the test, another judge noted that *Brunner* was "...made up out of whole cloth anyway."[28] Among other nearly

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[23] See Rafael I. Pardo & Michelle R. Lacey, "Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt," 74 U. Cin. L. Rev. 405 (2005); Rafael I. Pardo, Michelle R. Lacey, "The Real Student-Loan Scandal: Undue Hardship Discharge Litigation," 83 Am. Bankr. L.J. 179 (Winter 2009).
[24] Id.
[25] *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987).
[26] *ECMC v. Polleys*, 356 F. 3d 1302 (10th Cir. 2004).
[27] Id.
[28] *In Re Cummings*, 2007 WL 3445912 (Bankr. N.D. Cal. Nov. 13, 2007).

impossible barriers, the test forces borrowers to prove a negative—they must somehow prove that their future is as hopeless as their present.

Other courts have taken the *Brunner* test to the extreme of requiring that a borrower show a "certainty of hopelessness." In rejecting this analysis, some courts have blamed its widespread use on an erroneous reading of *Brunner*.[29]

The current system is stacked against the most financially distressed borrowers. These borrowers have few, if any, resources to pay for legal assistance to prove to judges that they suffer from undue hardship. Yet competent legal assistance is one of the key factors in determining whether a borrower will successfully get a discharge.[30]

Most bankruptcy courts are even unmoved by borrowers who went to fraudulent schools. Judges have struggled to fit the concept of "educational benefit" into the undue hardship analysis even in cases where the school closed while the borrower was in attendance or was otherwise a sham school.[31]

The Business Impact of Student Loan Bankruptcy Policy

Many creditors argue that treating student loans the same as other debts in bankruptcy would create greater risk for them. This is far from obvious. If most borrowers who file for bankruptcy cannot afford to repay their debts, a more restrictive bankruptcy policy is not going to make them more able to pay.

It is certainly true that private student loans, made without government guarantees, can be risky for both creditors and borrowers. Many students are young, with little or no credit history. Their earning power is mostly speculative. Yet responsible underwriting of student loans is not impossible. Recent trends in the industry show that creditors know how to sell less risky products and still generate profits.

The fact is that the private student loan industry grew rapidly during the pre-2005 period when these loans were fully dischargeable in bankruptcy. This should not be so surprising. During the past decades of irresponsible lending, creditors threw credit around like candy even where the credit was dischargeable in bankruptcy (such as credit cards) and those where it was harder to write off debts in bankruptcy.

The private student loan industry has contracted in recent years even with a restrictive bankruptcy policy. The more restrictive credit market has helped eliminate loans that never should have been made. This has forced schools and lenders to think twice before pushing these high priced products, a welcome market correction.

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[29] *In re King*, 368 B.R. 358 (Bankr. D. Vt. 2007).

[30] Rafael I. Pardo, Michelle R. Lacey, "The Real Student-Loan Scandal: Undue Hardship Discharge Litigation," 83 Am. Bankr. L.J. 179 (Winter 2009).

[31] *See, e.g., In re Gregory* 387 B.R. 182 (N.D. Ohio 2008) (relief on the basis of fraud can be had only against those who are shown to be parties to the fraud).

There is simply no good evidence that bankruptcy policy has much impact on creditor behavior. Interest rates, for example, were largely the same before and after the 2005 bankruptcy law which made private student loans more difficult to discharge in bankruptcy.

The business of private lending has expanded and contracted based on market opportunities, not based on bankruptcy policy. Some lenders continue to make high rate, risky loans even during the current economic climate. While some of the larger lenders have at least temporarily tightened criteria, other, less selective lenders have stepped into the market. In some cases, for-profit schools are making private loans knowing that the majority of their students will not be able to repay. Corinthian Colleges, for example, has told investors that it expects its students will not be able to repay 56-58% of its institutional private loans.[32] Yet it keeps making these loans, even with a restrictive bankruptcy policy, presumably because the loans lure students to its schools and gives it access to federal student aid dollars.

Further, there is no evidence that restoring bankruptcy rights will negatively impact college enrollment by limiting access to funds. In fact, enrollment is at record highs even though the private student loan industry has contracted after the credit crisis.

Lack of Non-Bankruptcy Alternatives: Private Student Loans

The current bankruptcy policy might not be so harsh if borrowers had ample non-bankruptcy alternatives to address student loan problems. Given their role in creating the recent economic crash, it is reasonable to expect lenders to do everything possible to help borrowers with unaffordable loans. Distressingly, this has not occurred. In NCLC's experience representing borrowers through the Student Loan Borrower Assistance Project, we have found private lenders to be inflexible in granting long-term repayment relief for borrowers. Lenders that had no problem saying "yes" to risky loans are having no problem saying "no" when these borrowers need help. [33] These lenders rarely cancel loans or offer reasonable settlements. We found that the lenders require very large lump sums to settle debts even from borrowers with very low incomes.

Fundamentally, lenders who make private student loans are not obligated to offer repayment modification or relief under any circumstances, leaving borrowers truly at the mercy of their lenders. We have found that even when lenders do offer some flexibility, these are usually short-term interest-only payments plans that do not extend loan terms.

The options are particularly limited for borrowers in default. We are told again and again that once a loan has been written off, there is nothing the lenders can do. We have not encountered any private student lender with a rehabilitation program or any other program to allow borrowers to get out of default and back into repayment.

[32] Consumer Law Center, "Piling It On: The Growth of Proprietary School Loans and the Consequences for Students," (January 31, 2011).
[33] National Consumer Law Center, "Too Small to Help: The Plight of Financially Distressed Private Student Loan Borrowers" (April 2009), aavailable on-line at: http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/TooSmalltoHelp.pdf.

Yet these are generally the borrowers most desperate for assistance. This is also in sharp contrast to the federal student loan programs where borrowers in default have various ways to select affordable repayment plans and get out of default.

Private student loan creditors may offer flexible payment arrangements to borrowers not yet in default, but they are not required to do so. None of the loan notes we surveyed in s 2008 report specifically provided for income-based repayment.[34] A few stated that borrowers would be able to choose alternative repayment plans in certain circumstances. However, the specific criteria and circumstances were not spelled out in the agreements.

For example, we recently had a client with six private student loans from National Collegiate Trust (serviced by AES). He has private student loans from other lenders as well. Our client had already exhausted available hardship forbearances. His modified repayment plan option required a payment of $823.46/month. Earning a salary of about $10/hour and facing payments on other private student loans, even the supposed flexible plan payment of over $800/month was far beyond his budget.

These are just a few e-mails we have received through our web site helping to illustrate the human toll of the "no relief" policy:

> **Borrower in Ohio**: "I have a private loan with Sallie Mae that allowed me to defer due to economic hardship. All of a sudden it would not allow me to do so and my loan went into default... They have told me to stop paying other bills and to do what I have to do to get the money. They have also told me to take other loans or sell my belongings to get the money. I have nothing except too much debt to income at this time to be able to do so. They tell me to make an offer, but what I can do at this time never works for them…it's their way or no way and it doesn't matter if I'm put out on the street or left to starve."
>
> **Borrower in Turner Falls, MA**: "I'm writing to support: H.R. 2028: Private Student Loan Bankruptcy Fairness Act of 2011.
>
> "I graduated with a Bachelors degree in 2008. After graduation I could not find a job because of the poor economy. I searched for jobs daily; I had sent out hundreds of resumes to no avail. I ended up having to pay Sallie Mae $150.00 (that I didn't have) every 3 months for them to grant me a forbearance! That money did NOT go to the principal balance of the loan, it was theirs to keep as well as interest that was accruing due to my involuntary hardship…
>
> "I've tried numerous times to work things out with Sallie Mae; they will not work with me on this issue. Needless to say, the phone calls from Sallie Mae are endless and harassing. I have been yelled at, degraded, and verbally abused by their debt collectors, but I see no end to this downward spiral of college debt. (I'm not even working in my field of study).

[34] See National Consumer Law Center, "Paying the Price" The High Cost of Private Student Loans and the Dangers for Student Borrowers" (March 2008), available at: http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/Report_PrivateLoans.pdf.

"I want to live the "American Dream." I want a small house with a picket fence; a golden retriever; a decent job. I do not see the "American Dream" in my future at all."

A lender's failure to have a loan modification program and other practices to help distressed borrowers is an element or sign of unfair origination and underwriting practices. Speculative projections of future income made as part of determining ability to pay also require a plan for contingencies if the student's income is not – either temporarily or permanently – as projected. Loan modifications that enable a student to make payments on a loan rather than completely defaulting are in both the students' and the lenders' best interests, but as we have seen in the mortgage market, sometimes industry needs the push of a regulator or Congress to come up with a win-win solution.

The recent private student loan complaint system established by the Consumer Financial Protection Bureau (CFPB) is a promising development. [35] This system, among other benefits, will help policymakers track the most common types of complaints and borrower responses. The CFPB has committed to reporting to Congress about the complaints it receives and to provide recommendations to improve relief for borrowers.

Appendix A, attached to our testimony includes recommendations we recently submitted to the CFPB in response to a request for comments. The recommendations focus on protecting borrowers and ensuring fair lending in the private student loan market.[36]

Lack of Non-Bankruptcy Alternatives: Federal Student Loans

The good news for federal student loan borrowers is that there are numerous options available if they are having trouble repaying student loans, including limited cancellation rights. The bad news is that these programs are underutilized and not well publicized. There are many operational barriers to access. For example, in the case of defaulted borrowers, collection agencies often provide inaccurate information about borrower rights.

Improving relief requires additional legislation as well as improved operations at the Department of Education. The Department of Education can go a long way toward providing greater relief by making sure that existing programs such as income-based repayment are implemented fairly and efficiently. The Department must make similar changes to improve rehabilitation and consolidation, the two main ways for borrowers to get out of default through repayment. Both programs are flawed in design and in execution.[37]

It is also critical to strengthen the various federal student loan cancellation/discharge programs and enact targeted legislative change as needed. The three cancellations (or "discharges") intended mainly to address fraud are closed school, false certification, and unpaid refunds. It is important to emphasize that not one of these programs provides general remedies

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[35] Rohit Chopra, Consumer Financial Protection Bureau, "Our Student Loan Complaint System is Open for Business" (March 5, 2012).
[36] See also National Consumer Law Center, "Comments to the Consumer Financial Protection Bureau on Request for Information Regarding Private Education Loans and Private Educational Lenders" (Jan. 17, 2012).
[37] See, e.g, Kelly Field, "Department's New Debt Management System Leaves Some Students Stuck in Default," The Chronicle of Higher Education (Dec. 9, 2011).

for borrowers who attended a fraudulent school. For example, a school may routinely pay admissions officers by commission in violation of incentive compensation rules, fail to provide educational materials or qualified teachers, and admit unqualified students on a regular basis. None of these violations is a ground for cancellation. Instead, each cancellation offers relief for a narrow set of circumstances. We recommend that Congress and the Department consider new loan cancellation criteria that will afford relief to all borrowers who attend schools that violate key Higher Education Act (HEA) regulations and for borrowers who have secured judgments against schools based on HEA violations but are unable to collect from the schools or other sources. We also urge creation of a fair and equitable disability discharge process. [38]

Restore an Adequate Safety Net for Student Loan Borrowers

Some former students will never recover financially, often due to disability or related health problems. There comes a point of no return where the government's ceaseless efforts to collect make no sense, monetarily or otherwise.

S. 1102, the "Fairness for Struggling Students Act of 2011" is a critical first step in restoring bankruptcy rights which will help students get back on their feet. The legislation would allow private student loan borrowers the same relief afforded to other unsecured debtors.

In addition to restoring bankruptcy rights, we urge the following reforms:

- Re-impose a reasonable statute of limitations on federal student loan collections. The elimination of the statute of limitations for student loans in 1991 placed borrowers in unenviable, rarified company with murderers, traitors, and only a few violators of civil laws. Even rapists are not in this category since there is a statute of limitations for rape prosecutions, at least in federal law and in most states.

- Eliminate Social Security and federal benefit offsets. At a minimum, increase the $9,000 annual exemption amount. This "floor" has not been amended since the mid 1990's.

- Eliminate offset of earned income tax credits.

Reining in collection abuses is a key component of a viable safety net. Unfortunately, there are serious collection abuses in both the federal and private student loan industries. In the private student loan industry, many violations occur due to collectors' inaccurate claims about their collection powers. It is particularly common for collectors of private student loans to claim that they can use collection tools unique to federal loans, such as Social Security offsets. These types of deceptive or false claims can be the basis of state or federal debt collection or other legal violations.

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[38] See generally National Consumer Law Center, "Written Testimony of Deanne Loonin in Response to the May 5, 2011 U.S. Department of Education Notice of Establishment of Negotiated Rulemaking Committees and Notice of Public Hearings" (May 20, 2011), available at: http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/2007/03/neg-rulemaking-may2011.pdf.

With respect to federal loan collection, the Department of Education has turned over almost all student loans it holds to private collection agencies. In a 2009 report, the Treasury Department stated that the Department of Education uses private collection agencies heavily to collect defaulted student loans and refers every eligible debt to these agencies as quickly as possible.[39]

Student loan debt collection contacts, both by private collectors and guarantors, involve a remarkable amount of deceptive, unfair, and illegal conduct. There are several reasons for the extent of these abusive collection actions, including:

- Remedies available to collect on student loans are often both unique and misunderstood (for example, federal tax refund offsets, federal benefits offsets, and non-judicial garnishments), and collectors often misrepresent the exact nature of these remedies when they send collection letters.
- Private collection agencies are delegated the responsibility for determining the size of a reasonable and affordable payment plan for rehabilitation. In addition, these collection agencies help determine if students have defenses to wage garnishments, tax refund offsets and other collection actions, even though the collection agencies' financial incentive is not to offer reasonable and affordable plans or to acknowledge defenses.

We urge the Department of Education to eliminate the use of private collection agencies.[40] In the meantime, there are ways to improve the system so that private collection agencies follow the law and better serve borrowers, including:

- Developing a rigorous, public training process for collection agencies that includes information about all student loan rights as well as fair debt collection rights,
- Improving all aspects of enforcement and oversight of private collection agencies, and
- Only charging collection fees that are bona fide and reasonable and actually incurred in collecting against individuals.

Conclusion

Restricting relief for student loan borrowers gives lenders some additional peace of mind and potentially more profits. These goals reflect industry interests, not the key policy goals of improving access to education and making college more affordable for students and their families.

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[39] U.S. Dep't of the Treasury, "U.S. Government Receivables and Debt Collection Activities of Federal Agencies: Fiscal Year 2008 Report to the Congress" at 14 (July 2009).

[40] See Deanne Loonin, New America Higher Ed Watch, "Get Rid of Student Loan Collection Agencies" (Jan. 6, 2010), available at: http://higheredwatch.newamerica.net/node/25940.

There are many ways to close the education achievement gap, but at a minimum, we must ensure that those who do not succeed the first time can try again if they are ready and able. A first attempt at higher education should not be the final attempt. We must also create an adequate safety net for financially distressed borrowers.

Appendix A

Recommendations to Protect Private Student Loan Borrowers and Ensure Fair Lending

Origination of Private Student Loans

- Develop and enforce sound underwriting standards ensuring ability to pay.
- Define and act against unfair, deceptive and abusive marketing practices.
- Improve and broaden scope of Truth in Lending Disclosures (TILA) and enforce TILA requirements.
- Require school certification of loans, including notifying borrowers of any untapped federal student loan eligibility.

Servicing

- Encourage and, where appropriate, require loan modification standards for distressed borrowers and discharges in case of death or disability.
- Extend Fair Credit Billing Act rights to private student loan borrowers.

Collection

- Enforce fair debt collection laws for the entire student loan collection market, both federal and private student loans.
- Prohibit deceptive, unfair and abusive default triggers, such as universal default clauses.
- Ban collection actions in inconvenient forums.

Additional Relief for Borrowers and Measures to Promote Responsible Lending

- Enforce the FTC Holder rule giving borrowers defenses against lenders with close relationships with unscrupulous schools.
- Ban mandatory arbitration clauses.
- Promptly create an effective private loan ombudsman office.
- Push restoration of bankruptcy rights for student loan borrowers.

Data Collection and Research

- Collect data on private student lending, including loan defaults, lender responses to borrower distress as well as campus-level loan volume and pricing.
- Work with the Department of Education and other lenders to make this information available to borrowers and advocates as well as policymakers.

Prepared Statement of Neal McCluskey, Associate Director, Center for Educational Freedom, Cato Institute, Washington, DC

Reducing Federal Aid, Not Changing Bankruptcy Laws, Key to College Affordability

By Neal McCluskey

Associate Director, Center for Educational Freedom, Cato Institute

Senate Judiciary Committee

Subcommittee on Administrative Oversight and the Courts

"The Looming Student Debt Crisis: Providing Fairness for Struggling Students"

March 20, 2012

Chairman Durbin, members of the committee, thank you for inviting me to speak with you today. My name is Neal McCluskey and I am the associate director of the Center for Educational Freedom at the Cato Institute, a nonprofit, non-partisan public policy research organization. My comments are my own, and do not represent any position of the institute.

As a result of decades of college price increases that have eclipsed normal inflation and growth of household income, the nation has rightly begun to focus on the extraordinary cost of postsecondary education. And the federal government, as the primary supplier of aid to students, has a critical role to play in restoring sanity to college pricing: it must greatly reduce student aid. Unfortunately, what this committee is contemplating – changing bankruptcy law concerning private student loans – will do almost nothing to address the root cause of rampant tuition inflation.

The logic behind seeing federal aid as a primary cause of inflation is straightforward. First, subsidies drive increased demand, which increases prices. Second, and more important, colleges raise their prices if they know students will be able to pay them, and federal aid ensures that they can. You might know this as the "Bennett Hypothesis," put forth by U.S. Secretary of Education William Bennett in 1987. It is perhaps best captured, however, by former Harvard University President Derek Bok, who wrote that "universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires."[1]

The basic facts clearly support the Bennett Hypothesis. According to data from the College Board, between the 1981-82 and 2010-11 school years, inflation-adjusted aid per full-time equivalent student – the bulk of which came through the federal government – rose from $4,418 to $13,914, a 215 percent increase.[2] Meanwhile, real tuition and fee costs at four-year colleges grew roughly apace. At four-year public institutions prices expanded from $2,242 in 1981-82 to $8,244 in 2011-12, a 268 percent ballooning. At four-year, nonprofit private institutions prices rose from $10,144 to $28,500, a 181 percent leap.[3]

It is, of course, difficult to conclude definitively from simple aid and price comparisons that aid fuels price increases. But a growing body of research controlling for variables outside of aid supports the hypothesis that aid has an appreciable inflationary effect, though study results vary by type of aid and institution.[4] And there is a limit to what empirical research can reveal because aid automatically increases with higher prices, creating a major endogeneity problem.

Perhaps, though, price increases are not fueled by aid, but necessitated by state and local funding cuts to public colleges and universities. This is a frequently offered argument, and there is no question that state and local governments have faced tough economic times over the last few years. This is, however, an inadequate explanation for rampant tuition inflation.

For one thing, private colleges would not fall under this as they receive only a tiny fraction of their funding from state and local governments. Nonetheless, their prices have ballooned at almost the same rate as public schools.

More directly, state and local taxpayers have not become increasingly tightfisted with colleges. According to data from the State Higher Education Executive Officers, inflation-adjusted state and local outlays to colleges for general operations rose from $57.7 billion in 1986 to $74.2 billion in 2011, a 29 percent increase.[5]

Where it appears that state and local taxpayers have become less generous is expenditures on a per-pupil basis. Again using SHEEO numbers, real appropriations per full-time equivalent student declined from $8,025 in 1986 to $6,290 in 2011, a 22 percent drop. But this has to be taken with a sizable grain of salt. First, state and local appropriations tend to rise and fall with the business cycle, and the overall trend is pretty flat. More importantly, fitting trend lines to appropriations per-pupil and net tuition revenue per-pupil shows that for the past quarter century public schools have raised tuition revenue by about two dollars for every dollar lost in cuts. The appropriations trend line drops about $43 per year, while tuition revenue increases $83 per annum.

The "cheap states" theory doesn't wash: It doesn't explain private colleges' inflation at all; real state and local appropriations have not fallen; and on a per-pupil basis, public institutions have been raising revenue through tuition much faster than they've been losing it in appropriations.

Which brings us to the biggest problem: Based on students' demonstrated ability to complete college work; the limited amount of learning signified by a college degree; and workplace realities, it appears far too many people are enrolled in college. As much as Congress wants to help all people by giving them money to go to college, it is in fact doing few people any real favors. That is, other than the colleges and their employees, which are profiting mightily whether they are for-profit or putatively not-for-profit institutions.[6]

Start with completion rates. According to the latest data from the federal *Digest of Education of Education Statistics*, only 55 percent of first-time, full-time bachelor's degree seekers at public institutions finish their degree within six years – 150 percent of the expected time. At private, nonprofit four-year institutions the rate is just a little bit better: 64 percent. At for-profit four-year

schools the rate is much worse: 22 percent. And that is not the absolute rock-bottom rate: At public, two-year institutions the three-year completion rate is a puny 21 percent.[7]

If you factor in transfers and part-time students these numbers likely get a little better, but the ultimate story is clear: We are paying billions for a whole lot of people to undertake education they will never complete.

What about those who do finish? Isn't it clear that a degree confers major new earning ability?

That is the case on average, though how much additional earning potential is a matter of serious dispute, with estimates ranging from $1 million over a lifetime to just about $100,000.[8] And those are averages: Many graduates will likely not gain even that $100,000 premium, depending on their major.

So the college earnings premium almost certainly does not reach the $1 million we so often hear about. In addition, there is significant evidence that the value of a bachelor's degree is shrinking. Essentially, degrees are becoming more widespread and easier to obtain, and signify less and less that the possessor has valuable skills and knowledge.

According to Bureau of Labor Statistics' data, the weekly earnings for people whose maximum educational attainment is a BA have dropped over the last decade, by about 4 percent. Only people possessing advanced degrees saw an increase, something missed when, as is often the case, people with bachelor's degrees and advanced degrees are all lumped into one category.[9]

Is this drop a function of credential inflation, or the economy increasingly demanding advanced skills?

It is hard to tell definitively because we have no comprehensive measure of what students are learning in college. One longitudinal assessment, however, suggests that the problem is credential inflation. The National Assessment of Adult Literacy was conducted in 1992 and 2003, and revealed a shocking decrease in literacy among college graduates. For instance, the percentage of bachelor's holders proficient in prose literacy dropped from 40 to 31 percent between 1992 and 2003, and in document literacy from 37 to 25 percent. Among adults with at least some graduate education, there were proficiency drops from 51 to 41 percent in prose, and from 45 to 31 percent in reading documents.[10] In other words, a college degree appears to represent significantly decreased abilities.

Recent research illustrates why this might be: students simply aren't learning much in college, at least as measured by the Collegiate Learning Assessment. According to research by Richard Arum and Josipa Roksa, 45 percent of students in their sample, drawn from a variety of school types, demonstrated no significant learning in their first two years of college, and 36 percent demonstrated no learning in four years.[11]

Finally, it is assumed that almost everyone will need some sort of postsecondary training to get a job in the new economy. And perhaps they will – but not necessarily from colleges or universities. According to BLS projections, the large majority of the 30 occupations expected to

see the largest employment growth this decade will require no more than a high school diploma and involve on-the-job training.[12] By pushing everyone into outside-the-job, postsecondary education, we are setting them up for expensive failure. Indeed, currently about one-third of people with bachelor's degrees are in jobs that do not require them.[13]

The solution to these problems is clear: Reduce student aid, which encourages millions of people to pursue studies they are not prepared to complete, and decreases their sensitivity to prices.

Some of this could be relatively painless, such as phasing out tax benefit programs that are biased toward those wealthy enough to hire accountants or financial advisors to help them minimize their tax liability. Similarly, federal loan programs that have no income cap could be eliminated.

Such changes would begin to restore sanity to college pricing by better focusing eligibility on truly lower-income students. But that will not be sufficient: It is clear that many students of all income levels simply aren't prepared or inclined to do college work, yet they can easily get federal student aid to attend school. It is a waste of their time and money, as well as taxpayers' dollars.

To deal with this Washington could peg aid to strong evidence of an ability to benefit from college; perhaps some combination of high standardized test scores and grade point averages. But these are imperfect measures, and would no doubt weed out some students who could handle college work while allowing others in who could not.

To avoid this problem – and the rightful objection many will have that if they pay taxes, they should be eligible for aid – the best solution is for the federal government to get out of the student aid business entirely. If you look at the numbers there is no logical reason to remain in it, nor is there authority to be involved if you examine the specific, enumerated powers given to the federal government in Article I, Section 8 of the Constitution. Quite simply, the aid self-defeatingly spurs price inflation as colleges capture the money while likely encouraging many people to spend time and treasure on an education for which they are either unprepared or under-motivated.

Critically, students would be able to afford college were aid phased out: Prices would have to come back to Earth as students were required to pay with their own money or with funds voluntarily received from others. Meanwhile, even the lowest-income student would be able to attain a loan if she had a strong, demonstrated ability to do college-level work and attain a well-paying job as a result. Both lender and borrower would benefit as the degree would translate into substantial earnings.

Unfortunately, what this committee is considering – making private student loans dischargeable in bankruptcy – ignores the gigantic root problem underlying college pricing insanity and would at best nibble around the edges. At worst, it would encourage students to over-consume even more.

A little perspective. According to College Board data, in 2010-11 around $6 billion was originated in private student loans. In that same year, total federal loans equaled almost $104 billion, or an amount roughly seventeen times larger. Throw in grants, tax benefits, and work study, and federal aid exceeded $169 billion.[14] $6 billion is just the proverbial drop in the bucket.

What would changing bankruptcy laws for private loans do for college affordability? It is difficult to predict: If lenders know that borrowers can escape repayment through bankruptcy they would likely raise interest rates to account for that risk and lend to fewer people, discouraging use of such loans. However, students might be more apt to take such loans – and pay still higher college prices – if they think that they will be able to unload their debt without repaying it.

Both possible outcomes have concerning aspects, but the change would still have a negligible effect on affordability because private loans are such a small piece of the pie. Ultimately there is simply too much aid, and most of it comes from Washington.

Thank you, and I look forward to your comments and questions.

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[1] Derek Bok, *Universities in the Marketplace: The Commercialization of Higher Education* (Princeton, NJ: Princeton University Press, 2003), p. 9.

[2] College Board, Trends in Student Aid 2011, Table 3, http://trends.collegeboard.org/student_aid/report_findings/indicator/Aid_Per_Student_All_Students, accessed March 15, 2012.

[3] College Board, Trends in College Pricing 2011, Table 4, http://trends.collegeboard.org/college_pricing/report_findings/indicator/Tuition_Fees_Over_Time, accessed March 15, 2012.

[4] See, for instance, Stephanie R. Cellini and Claudia Goldin, "Does Federal Student Aid Raise Tuition? New Evidence on For-profit Colleges," National Bureau of Economic Research Working Paper 17827, February 2012; Bradley A. Curs and Luciana Dar, "Do Institutions Respond Asymmetrically to Changes in State Need- and Merit-Based Aid?" Working Paper, November 1, 2010; John D. Singell, Jr., and Joe A. Stone, "For Whom the Pell Tolls: The Response of University Tuition to Federal Grants-in-Aid," *Economics of Education Review* 26, no. 3 (2006): 285-95; Bridget Terry Long, "How Do Financial Aid Policies Affect Colleges? The Institutional Impact of Georgia Hope Scholarships," *Journal of Human Resources* 30, no. 4 (2004): 1045-66; Michael Rizzo and Ronald G. Ehrenberg, "Resident and Nonresident Tuition and Enrollment at Flagship State Universities," in *College Choices: The Economics of Where to Go, When to Go, and How to Pay for It*, edited by Caroline M. Hoxby, (Chicago, IL: University of Chicago Press, 2004); Rebecca J. Acosta, "How Do Colleges Respond to Changes in Federal Student Aid," Working Paper no. 808, Department of Economics, University of California, Los Angeles, October 2001.

[5] State Higher Education Executive Officers, Supplemental SHEF Data Tables and Figures, "1986-2011 All States and National" Excel file, http://www.sheeo.org/finance/shef/shef_data11.htm, accessed March 16, 2012.

[6] Vance Fried estimates that the average private research university makes between $5,515 and $12,807 in profit, depending on whether donation revenue is included, on the average undergraduate. Public research universities make between $2,000 and $11,000, depending on whether state subsidies are included. These profit margins exceed even those of the for-profit Apollo Group. See Vance H. Fried, "Federal Higher Education Policy and the Profitable Nonprofitables," *Cato Policy Analysis* no. 678, http://www.cato.org/pubs/pas/PA678.pdf, June 15, 2011.

[7] U.S. Department of Education, National Center for Education Statistics, *Digest of Education Statistics*, Table 341, http://nces.ed.gov/programs/digest/d10/tables/dt10_341.asp, accessed March 15, 2012.

[8] The $1 million figure has appeared in many places, and most recently can be calculated using earnings data from Tiffany Julian and Robert Kominski, "Education and Synthetic Work-Life Earnings Estimates," U.S. Census Bureau, http://www.census.gov/prod/2011pubs/acs-14.pdf, September 2011. In contrast, the Association of Public and Land-grant Universities estimates that the average graduate of a public research university will realize just a $120,000 earnings increase after including the cost of her education. See Peter McPherson and David Shulenburger, "University Tuition, Consumer Choice and College Affordability: Strategies for Assessing a Higher Education Affordability Challenge," http://www.aplu.org/document.doc?id=1296, November 2008.

[9] Calculated using median weekly earnings data from Current Population Survey, U.S. Bureau of Labor Statistics, http://www.bls.gov/webapps/legacy/cpswktab5.htm.

[10] National Assessment of Adult Literacy, "A First Look at the Literacy of American Adults in the 21st Century," 2006, p. 15, http://nces.ed.gov/NAAL/PDF/2006470.PDF.

[11] Richard Arum and Josipa Roksa, "Are Undergraduates Actually Learning Anything?" *The Chronicle of Higher Education*, http://chronicle.com/article/Are-Undergraduates-Actually/125979/, January 18, 2011,

[12] U.S. Department of Labor, Bureau of Labor Statistics, "Table 6. The 30 occupations with the largest projected employment growth, 2010-20," http://www.bls.gov/news.release/ecopro.t06.htm, accessed March 15, 2012.

[13] Anthony P. Carnevale and Stephen J. Rose, "The Undereducated American," Georgetown University Center on Education and the Workforce, http://www9.georgetown.edu/grad/gppi/hpi/cew/pdfs/undereducatedamerican.pdf, June 27, 2011.

[14] College Board, *Trends in Student Aid 2011*, Table 1, http://trends.collegeboard.org/student_aid/report_findings/indicator/Total_Aid_Adjusted_for_Inflation, accessed March 15, 2012.

QUESTIONS SUBMITTED BY SENATOR DICK DURBIN FOR PROFESSOR G. MARCUS COLE

Hearing on "The Looming Student Debt Crisis: Providing Fairness for Struggling Students
Questions for the Record
Senator Dick Durbin

Questions for Professor Marcus Cole

1. You discussed in your testimony how you were fortunate to be able to take out loans to pay for your college education because Congress made certain that your creditors would be repaid for your student loans. Both federal student loans and private loans are currently nondischargeable in bankruptcy, but federal loans are significantly safer and lower-cost. Do you support steps to encourage borrowers to exhaust their federal student loan eligibility before pursuing higher-cost private loans that lack the consumer protections and repayment options that federal loans offer?

2. During the hearing I described as a mystery amendment the provision in the 2005 bankruptcy reform law that made private student loans nondischargeable. I have since been informed, and I want to clarify for the record, that this provision was originally authored by then-Representative Lindsey Graham in 1999 who offered the language as a modification to an amendment on the House Floor, and that it was subsequently included in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. In your view, did the enactment of this provision disrupt the settled expectations of student borrowers who took out private loans prior to 2005 with the understanding that the loans would be dischargeable in bankruptcy?

3. In your testimony you describe returning to the pre-2005 treatment of private student loans in bankruptcy as a "blunt instrument." Would you support a more surgical provision that restores dischargeability for private student loans in egregious cases? For example, if a for-profit college defrauded a potential student into enrolling by making material false promises, should the student's private loans be made dischargeable in that context?

QUESTIONS SUBMITTED BY SENATOR DICK DURBIN FOR DEANNE LOONIN

Hearing on "The Looming Student Debt Crisis: Providing Fairness for Struggling Students
Questions for the Record
Senator Dick Durbin

Questions for Deanne Loonin

1. As you know, under current law student loans can be discharged in bankruptcy if the debtor can establish "undue hardship." This term has been interpreted by the courts very restrictively and few bankruptcy debtors can afford to litigate the issue before the bankruptcy court and on appeal.

   a. In your experience, does the "undue hardship" exception provide most student debtors with a realistic path for relief from loans they cannot afford to repay?
   b. Do you see any problems with the case-by-case analysis approach under the current "undue hardship" system?

2. In your experience, have private student lenders been willing to work with struggling borrowers to craft reasonable repayment plans? Would making private student loans dischargeable again increase the incentive for lenders to negotiate with distressed borrowers before calling in the collection agency?

3. Typically whenever bankruptcy reforms are proposed that would assist debtors, creditors claim that such reform will hurt consumers by raising the cost and reducing the availability of credit. Back before private students loans were made nondischargeable in 2005, was there a healthy private student loan market?

4. During the hearing I described as a mystery amendment the provision in the 2005 bankruptcy reform law making private student loans nondischargeable. I have since been informed, and I want to clarify for the record, that this provision was originally authored by then-Representative Lindsey Graham in 1999 who offered this language as a modification to an amendment on the House Floor, and that it was subsequently included in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. However, it is still my understanding that this provision was not the subject of significant Congressional discussion or analysis between 2000 and 2005. Are you aware of any such discussion or analysis?

5. Do you have suggestions of ways that relief can be provided outside of bankruptcy to overwhelmed student loan borrowers:
   a. For federal loans?
   b. For private loans?

Questions submitted by Senator Jeff Sessions for Professor G. Marcus Cole

Senator Jeff Sessions
Questions for the Record
Marcus Cole
Professor of Law, Stanford University

1. Do you believe that federal and state governments are capable of protecting student loan borrowers from unfair, deceptive, and predatory lending practices without affecting the dischargeability of student loans in bankruptcy?

2. If private student loans were made dischargeable in bankruptcy, you testified that the market for private student loans would likely dry up. The federal government, which already originates or guarantees the vast majority of student loans, would then be the sole provider of loans for higher education. What do you think would be the effect on the federal deficit if that were to occur?

3. Would it be preferable to clearly define what constitutes an "undue hardship" so that the test may be uniformly applied rather than to risk the unintended consequences of making all private student loans dischargeable in bankruptcy?

4. What do you think would be the effect of returning to a system where student loans, both private loans and federally guaranteed loans, are dischargeable after seven years?

5. What is the public policy rationale for treating private lenders differently from federally-guaranteed lenders in bankruptcy?

QUESTIONS SUBMITTED BY SENATOR JEFF SESSIONS FOR NEAL MCCLUSKEY

Senator Jeff Sessions
Questions for the Record
Neal McCluskey
Associate Director, Center for Educational Freedom, Cato Institute

1. In your testimony, you argued that the best solution to ever-increasing costs of tuition and the inflation of the student loan bubble may be for the government to get out of the student financial aid business altogether. But if private loans were made dischargeable in bankruptcy, the result could be that the government is the sole provider of student financial aid. What do you think will be the effect on the student loan bubble if the government becomes the sole provider of financial aid?

RESPONSES OF DEANNE LOONIN TO QUESTIONS SUBMITTED BY SENATOR DURBIN

1

Hearing on "The Looming Student Debt Crisis: Providing Fairness for Struggling Students
Questions for the Record
Senator Dick Durbin

Questions for Deanne Loonin

1. As you know, under current law student loans can be discharged in bankruptcy if the debtor can establish "undue hardship." This term has been interpreted by the courts very restrictively and few bankruptcy debtors can afford to litigate the issue before the bankruptcy court and on appeal.

   a. In your experience, does the "undue hardship" exception provide most student debtors with a realistic path for relief from loans they cannot afford to repay?
   b. Do you see any problems with the case-by-case analysis approach under the current "undue hardship" system?

   Response from Deanne Loonin

   1.a. In my experience representing low-income borrowers, consulting with other lawyers across the country, and analyzing case law, I have found that the "undue hardship" exception system is random, arbitrary and unfair. Few borrowers obtain relief from student loan debt through this system.

   1.b. The case by case analysis sets a very high procedural bar for debtors. They must file a separate adversary proceeding in bankruptcy court and be prepared to litigate. Most financially distressed borrowers do not have the knowledge or resources to follow through or even start this difficult and expensive process.

   Bankruptcy courts consider a debtor's individual financial circumstances through the means test and other "point of entry" requirements. The undue hardship system is an unnecessary and unfair additional test applied only to student loan debtors. It conflicts with the primary purpose of bankruptcy, which is to give a fresh start to financially distressed debtors.

2. In your experience, have private student lenders been willing to work with struggling borrowers to craft reasonable repayment plans? Would making private student loans dischargeable again increase the incentive for lenders to negotiate with distressed borrowers before calling in the collection agency?

   Response from Deanne Loonin

   In NCLC's experience representing borrowers through the Student Loan Borrower Assistance Project, we have found private lenders to be inflexible in granting relief for borrowers. We also find that many private student loan collectors use the lack of bankruptcy alternatives as a way to place unrealistic and in some cases improper or illegal pressure on borrowers. It seems likely that taking away this bankruptcy break for

lenders would encourage them to offer a wider range of options for financially distressed borrowers.

3. Typically whenever bankruptcy reforms are proposed that would assist debtors, creditors claim that such reform will hurt consumers by raising the cost and reducing the availability of credit. Back before private students loans were made nondischargeable in 2005, was there a healthy private student loan market?

Response from Deanne Loonin

The private student loan industry grew rapidly during the pre-2005 period when these loans were fully dischargeable in bankruptcy. The private student loan industry has contracted in recent years even with a restrictive bankruptcy policy. The more restrictive credit market has helped eliminate loans that never should have been made. There is simply no evidence that changes in the market, positive or negative, are caused by changes in bankruptcy policy.

4. During the hearing I described as a mystery amendment the provision in the 2005 bankruptcy reform law making private student loans nondischargeable. I have since been informed, and I want to clarify for the record, that this provision was originally authored by then-Representative Lindsey Graham in 1999 who offered this language as a modification to an amendment on the House Floor, and that it was subsequently included in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. However, it is still my understanding that this provision was not the subject of significant Congressional discussion or analysis between 2000 and 2005. Are you aware of any such discussion or analysis?

Response from Deanne Loonin

The National Association of Consumer Bankruptcy Attorneys (NACBA) analyzed this issue after the March 20 hearing. After conducting a review of the bills introduced in the 105th, 106th, 107th, 108th, and 109th Congresses, as well as hearing records, committee reports, floor debate and advocacy materials, NACBA found one piece of testimony and three minutes of floor debate on this issue. This is an insignificant amount of time given that the debates over changes to the bankruptcy code spanned eight years and five congresses, nearly 20 hearings, and countless days of debate. A copy of NACBA's analysis is attached.

5. Do you have suggestions of ways that relief can be provided outside of bankruptcy to overwhelmed student loan borrowers:
   a. For federal loans?

   b. For private loans?

Response from Deanne Loonin

5.a. Federal Loans

At a minimum, Congress and the Department of Education should strengthen the existing Higher Education Act cancellation/discharge programs, particularly those intended to provide relief to borrowers harmed by abusive school practices. Relief may be extended in some cases through regulatory action. In other cases, Congressional action is necessary.

Among other changes, we urge broadening relief available through the false certification discharge to all cases where the school falsifies the requirements for loan eligibility or otherwise improperly certifies loan eligibility. In addition, the false certification/identity theft cancellation adopted in 2006 remains mostly an illusory right as long as borrowers are required to prove that a crime was committed in order to obtain relief.

Providing much-needed relief for vulnerable borrowers will not necessarily require significant government funding as long as the Department of Education is encouraged to use its existing authority to pursue reimbursement from schools. We do not believe the Department is currently using this authority to seek reimbursement from schools AFTER granting discharges to qualified borrowers. We describe additional proposals to expand relief for financially distressed borrowers in comments submitted to the Department of Education in May 2011.[1]

5 b. Private Loans

The right to assert defenses to repayment of the loan and bring school-related claims against lenders is especially important when private lenders have close ties to for-profit schools that promote, package or help the lender market their private loan products. In these cases, borrowers are often limited in the relief directly available from schools, many of which are out of business or insolvent by the time borrowers seek redress. Even borrowers who successfully obtain damages from an unscrupulous school are often left with significant loan debt.

A key to lender liability in many cases is the FTC holder rule. The holder rule puts lenders on the hook when they have "referring relationships" with schools that defraud students or shut down unexpectedly.[2] The holder rule gives lenders an incentive to scrutinize the schools with which they have close relationships and to originate loans only with upstanding schools.

Because the FTC does not have jurisdiction over banks, the holder rule only applies to schools, not depository lenders. That is the FTC rule obligates only the schools, not the lenders, to include the holder notice in the contract. In general, the school must insert the notice in consumer credit agreements, whenever the school is the originating lender and must arrange for the lender to insert the notice in the lender's credit agreement whenever the school refers the consumer to the lender or otherwise has a business arrangement with the lender. The remedy is to require all lenders that have close relationships with a school to include the holder rule in the loan contracts and to prohibit measures to undercut the rule.

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[1] The comments are available in this section of our web site: http://www.studentloanborrowerassistance.org/legal-policy/.
[2] 16 C.F.R. §433.2.

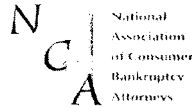
Other key reforms include:

- Encourage and, where appropriate, require loan modification standards for distressed borrowers and discharges in case of death or disability.
- Extend Fair Credit Billing Act rights to private student loan borrowers.

5

Attachment

NACBA Memo



Via e-mail

April 9, 2012

TO: Deanne Loonin, National Consumer Law Center

FROM: Maureen Thompson, Legislative Adviser,
National Association of Consumer Bankruptcy Attorneys

RE: Clarification of legislative history of private student loan discharge in bankruptcy

In the February 2012 report of the National Association of Consumer Bankruptcy Attorneys (NACBA), *"The Student Loan 'Debt Bomb': America's Next Mortgage-Style Economic Crisis,"* it was asserted that "an unidentified lawmaker" slipped a provision into the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act that made private student loans non-dischargeable in bankruptcy. It further was asserted that there were "no hearings or public discussion of such a fundamental change in policy on private student loans during the several years the bankruptcy bill was under discussion."

Those statements, while believed to be true by those from the consumer community who were most actively involved in the nearly eight year debate leading up to the 2005 Bankruptcy Act, are not entirely accurate.[1] After conducting a review of the bills introduced in the 105th, 106th, 107th, 108th and 109th Congresses, as well as hearing records, committee reports, floor debate and advocacy materials, this memo is intended to correct the record with respect to the origin of the private student loan provision in the 2005 Act.

As you know, a version of what became the 2005 Bankruptcy Act was first introduced in the 105th Congress in 1998 (H.R. 3150 and S. 1301). There was no provision related to private student loans in the first bills as introduced. Over the course of 1997 and 1998, the Senate Judiciary Subcommittee on Administrative Oversight and the Courts held three hearings on consumer bankruptcy issues and heard from 25 witnesses. No witness raised the private student loan discharge issue. During the Subcommittee mark up, eight amendments were considered. None dealt with the private student loan issue. When the full Judiciary Committee considered the bill, 13 amendments were offered. None dealt with the private student loan issue.

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[1] Indeed, Stephen Burd, who covered this issue for the Chronicle of Higher Education, said in an April 2007 interview with Robert Siegel on NPR's "All Things Considered" program: "The interesting thing I'd point out about the private loan part of this is that although the bankruptcy bill was before Congress for almost a decade, I believe, there was very little to no discussion about this provision. In fact, there were no hearings on this. It didn't get a lot of attention because private loans as opposed to federal loans used to really only go to graduate and professional students." ("2005 Law Made Student Loans More Lucrative, April 24, 2007). Likewise, Ranking Member of the Judiciary Committee, Rep. John Conyers, said in a September 23, 2009 hearing: 'As I recall, this particular amendment was never the subject of any formal Congressional hearing."

During that same time period (1997 and 1998), the House Judiciary Committee and its Subcommittee on Administrative and Commercial Law held seven hearings on the operation of the bankruptcy system, including four hearings devoted to the legislation, H.R. 3150. More than 60 witnesses offered testimony at the hearings. Just one witness, Jill Sturtevant with the American Bankers Association, raised the issue of dischargeability of private student loans in bankruptcy. In her testimony, Ms. Sturtevant recommended "technical" amendments to the proposed legislation, one of which was that private student loans be made non-dischargeable in bankruptcy. Ms. Sturtevant devoted four short paragraphs of her testimony to this recommendation.

During the Judiciary Committee mark up of the legislation, a dozen amendments were considered; none dealt with private student loans. The issue was not raised during floor debate nor was it raised during the House-Senate Conference Committee.

Legislation to overhaul the bankruptcy system was introduced again in the 106th Congress. The private student loan provision was not in the bills as introduced, nor was the provision added during Committee deliberation. Instead, then-Representative Lindsey Graham on May 5, 1999, offered an amendment during the House floor debate on H.R. 833 to extend the non-dischargeability of student loans to private loans. A total of three minutes of floor time was devoted to the debate. After Rep. Graham agreed to narrow the scope of the amendment, it was agreed to by a voice vote. The provision was in every subsequent bankruptcy bill.

This one piece of testimony and three minutes on the floor in 1999 appears to be the sum total of congressional debate on the issue of the treatment of private student loans in bankruptcy. The debate over changes to the bankruptcy code spanned eight years and five congresses, and included 18 hearings in the House Judiciary Committee and six hearings before the Senate Judiciary Committee and countless days of floor debate in both chambers.

Given this history, it is a fair characterization to say the provision was "slipped into the bill," though it is not technically correct. We stand corrected on not knowing the identity of the lawmakers who sponsored the provision. A closer inspection of the record identifies then Rep. Lindsey Graham as the sponsor.

RESPONSES OF NEAL MCCLUSKEY TO QUESTIONS SUBMITTED BY SENATOR SESSIONS

Senator Jeff Sessions
Questions for the Record
Neal McCluskey
Associate Director, Center for Educational Freedom, Cato Institute

1. In your testimony, you argued that the best solution to ever-increasing costs of tuition and the inflation of the student loan bubble may be for the government to get out of the student financial aid business altogether. But if private loans were made dischargeable in bankruptcy, the result could be that the government is the sole provider of student financial aid. What do you think will be the effect on the student loan bubble if the government becomes the sole provider of financial aid?

Were the federal government to become the sole loan provider it would have little effect on the expanding loan bubble because the federal government is already very close to that monopoly position. As I noted in my written testimony, in the 2010-11 school year only $6 billion was originated in private loans, versus $104 billion in federal loans. Add federal grants, tax benefits, and work study, and federal aid leaps to $169 billion, dwarfing private lending.

By far the biggest threat to what remains of private student lending is not changing bankruptcy law, but the willingness of the federal government to spend seemingly without limit on student aid. Recent history bears this out: Private lending reached a peak in 2007-08, hitting $22,080 according to the College Board, and then dropped precipitously. Why? In part it was likely a result of the economic downturn tightening credit markets, but much more important was a huge increase in federal aid. As a result of several aid-increasing laws passed during or after 2007 (as well, notably, as increasing enrollment) federal loans rose from $72 billion in 2007-08 to $104 billion in 2010-11, a 44 percent jump. Federal grants, largely due to student-aid legislation attached to the sweeping 2010 health care act, more than doubled, from $22 billion to $49 billion. Basically, Washington crowded out private lenders.

By far the biggest threat to make Washington the monopoly student lender isn't changing bankruptcy law, but the federal government's willingness to endlessly expand student aid. And it is not clear that making private loans dischargeable in bankruptcy would itself push private lenders out. While the risk incurred in lending would rise, entering into bankruptcy is not something one can easily do, rendering unclear how many borrowers would pursue that option. Perhaps as important, if potential borrowers were to *believe* that they could easily escape private loans in bankruptcy – even if that were not the case – they might be more inclined to pursue private loans than federal loans, which are not dischargeable. That could *increase* private lending, though likely not much relative to total federal aid.

There is a very real and present danger that the federal government will become the sole provider of student financial aid, and will continue to fuel rampant college price inflation with continued, ballooning aid. But that danger does not stem from proposals to change private loan bankruptcy laws. It comes from a federal government that seems utterly unwilling to face the inflationary reality of aid, and instead insists on shoveling evermore taxpayer money to evermore people in the name of college affordability.

NOTE: At the time of printing, after several attempts to obtain responses to the written questions, the Committee had not received any communication from G. Marcus Cole.

AMERICAN ASSOCIATION OF UNIVERSITY WOMEN (AAUW), MARCH 19, 2012, LETTER

AAUW

Support the Fairness for Struggling Students Act of 2011

March 19, 2012

Dear Senate Judiciary Committee:

On behalf of the 100,000 bipartisan members and donors of the American Association of University Women (AAUW), I urge you to support the *Fairness for Struggling Students Act of 2011*. AAUW has long supported congressional actions that help remove the burden and risk that private loans place on student borrowers. This legislation will ensure that private student loans are no longer treated more harshly than similar types of debt. Since its founding in 1881, the American Association of University Women (AAUW) has been committed to making the dream of higher education a reality for women. AAUW's 2011-2013 Public Policy Program affirms our commitment to "a strong system of public education that promotes gender fairness, equity, and diversity....and advocates increased support for, and access to, higher education for women and other disadvantaged populations."[i]

At current rates, the U.S. will add over 16 million jobs by the year 2018 that require at least some postsecondary education.[ii] Moreover, the number of jobs requiring a graduate degree is estimated to grow by 2.5 million by that same year.[iii] Since many students cannot pay for their degrees out-of-pocket, student loans become an important resource. Yet private student loans lack many of the protections federal student loans offer to help borrowers with any financial stress they may face as they repay their loans. This shortage of options leaves borrowers vulnerable to lenders. The *Fairness for Struggling Students Act of 2011* would give private student loan borrowers the ability to discharge private student loans, as is done with comparable types of debt.

Many graduates struggle to repay their loans. Loan repayment is an even more significant burden for women, who earn less on average over the course of their lives than their male counterparts. In 2009, the average woman who worked full time earned just over 77 cents for each dollar earned by her male counterpart.[iv] AAUW's *Behind the Pay Gap* report found that college-educated women earn five percent less than men one year out of college and 12 percent less than men 10 years out of college, even when they have the same major and occupation as their male counterparts and when controlling for factors known to affect earnings such as education and training, parenthood and hours worked.[v] These findings suggest that sex discrimination not only continues to be a problem in the workplace, but that it affects the incomes of even the most educated women starting immediately out of college. Since women are more likely to borrow than men and will make less on average after graduation, female graduates are more likely to struggle with their loan debt.[vi]

AAUW shares the goal of the *Fairness for Struggling Students Act of 2011* to restore fairness in student lending by treating private loans the same as other types of private debt in bankruptcy proceedings. If you have any questions or need additional information, feel free to contact me at 202/785-7720, or Erin Prangley, associate director of government relations, at 202/785-7730.
Sincerely,

Lisa M. Maatz
Director, Public Policy and Government Relations

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[i] American Association of University Women. (June 2011). *2011-13 AAUW Public Policy Program.* Retrieved August 11, 2011, from www.aauw.org/act/issue_advocacy/principles_priorities.cfm.
[ii] U.S. Department of Labor. Bureau of Labor Statistics. (December 11, 2009). *Economic News Release. Employment and Total Job Openings by Postsecondary Education or Training Category, 2008-18.* Retrieved February 22, 2011, from www.bls.gov/news.release/ecopro.t09.htm.
[iii] Ibid.
[iv] U.S. Census Bureau. (September 2010). *Income, Poverty, and Health Insurance Coverage in the United States:* 2009. Retrieved February 23, 2011, from www.census.gov/prod/2010pubs/p60-238.pdf.
[v] AAUW. (2007). *Behind the Pay Gap.* Retrieved August 11, 2011, from www.aauw.org/learn/research/behindPayGap.cfm.
[vi] Price, Derek V. (2004). *Borrowing Inequality: Race, Class, and Student Loans.* Boulder, CO.

Consumer Bankers Association, Washington, DC

March 20, 2012

The Honorable Tom Coburn
United States Senate
Washington, DC 20510

Dear Senator Coburn:

The undersigned organizations are writing to express our opposition to S. 1102. This legislation would revise the federal bankruptcy law to make it easier for borrowers to discharge some educational loans.

S. 1102 is unnecessary because under current law, any borrower may discharge student loans if repayment would constitute an undue hardship. In enacting this into law, Congress intended to create a necessary and well-balanced safety valve for borrowers.
S. 1102 undermines this balance and is unfair to lenders who have relied on current law when extending credit to students with little or no credit history. It is also unfair to students because it will have the effect of restricting the availability of student loans and raising the cost of loans when they are available. For these and other reasons, S. 1102 should not be reported by the Committee or passed by the Senate.

There is no question that the ever increasing cost of education is making it harder for students to afford college. Between 1986 and 2011, inflation increased by 115% but college tuition increased by over 498% - outpacing inflation by more than 4 times the rate. Although federal Pell Grant assistance has increased significantly during this period, reliance on student loans—in particular federal student loans—has increased dramatically. The Department of Education projects that over 25 million Federal Direct Student Loans will be made this year totaling over $124 billion. In addition to these Direct Loans to students and parents, private sector lenders will make approximately $8 billion in loans—or about 6 percent of the overall total.

Rising education costs are the reason students and families continue to take out student loans over and above the direct lending programs provided by the Federal government. Yet, nothing in this bill attempts to address the root problem of rising education costs. Instead, it seeks to amend the Bankruptcy Code in a way that encourages defaults and that ensures that student loans will become even harder to obtain for deserving students. Moreover, the changes made by the bill do not apply to federal or student loans made by other governmental entities, which are the vast majority of student loans, and thus S. 1102 would not even help most borrowers.

For the small subset of loans that are covered, the bill changes the Bankruptcy Code in a way that will add uncertainty and additional risk to student lending. This will further restrict the availability of credit at a time when students are already finding it harder to find loans due to the credit crunch.

Current law allows student loans to be discharged in bankruptcy if "undue hardship" to the borrower or their dependents can be shown. This policy protects truly unfortunate borrowers while at the same time preserving the integrity of the bankruptcy system. This balanced federal policy is designed to ensure that a sufficient volume of loans are available to meet the financial needs of students across the country, and it has worked.

The proposed legislation would undermine this policy by allowing private sector student loans to be discharged without a showing of "undue hardship." Under the bill, federally funded loans and

loans made or guaranteed by governmental entities could still be discharged only upon a showing of undue hardship. In contrast, students taking out other private loans could run up thousands of dollars in private loans, carry them without having to pay interest while in school and then walk away without making a single payment even if the student in the future should be able to repay the loans in full. Moreover, it is retroactive and will apply to existing as well as future student loans. As a result, the bankruptcy system would be opened to abuse.

Enactment of S. 1102 will discourage lenders from making private student loans or force them to find some way to offset the increased risk. These risk management effects could mean raising interest rates and fees, or reducing the term of the loan (perhaps to 5 years) which would increase monthly payments, further increasing monthly debt service costs. None of these effects would benefit students.

We strongly urge the Committee to reject the S. 1102.

American Bankers Association
American Financial Services Association
Consumer Bankers Association
The Financial Services Roundtable

cc: Members of the Judiciary Committee

Statement for the Record

Consumer Bankers Association

U.S. Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts

March 20, 2012

Hearing Entitled

"The Looming Student Debt Crisis: Providing Fairness for Struggling Students"

The Consumer Bankers Association (CBA[1]) appreciates the opportunity to submit this statement for the record for the Senate Judiciary Subcommittee on Administrative Oversight and the Courts hearing entitled "The Looming Student Debit Crisis: Providing Fairness For Struggling Students."

Members of the CBA Education Funding Committee have been engaged in private education lending for more than three decades. Our committee membership includes seven of the top eight private education lenders. Currently, our members make more than $4 billion in education loans. Our testimony today is based on this collective experience in helping students and their families meet the rising cost of higher education.

The private education loan market exists because college is expensive, costs continue to rise and borrowers need additional financing to meet their educational needs. Between 1986 and 2011, inflation increased by 115% but college tuition increased by over 498% - outpacing inflation by more than 4 times the rate. Although federal Pell Grant assistance has increased significantly during this period, reliance on student loans—in particular federal student loans—has increased dramatically. The Department of Education projects that over 25 million Direct Student Loans will be made this year totaling over $124

[1] The Consumer Bankers Association (CBA) is the only national financial trade group focused exclusively on retail banking and personal financial services - banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and supercommunity banks that collectively hold two-thirds of the total assets of depository institutions.

billion. In addition to these Direct Student Loans, private sector lenders will make approximately $8 billion in loans—just about 6 percent of the overall total market.

The private student loan market of today is often misunderstood and mischaracterized. Instead of being viewed as part of the solution in helping finance the rising costs to attend college, private student lenders are often painted by a single brush and cast as the problem. Private student loans are often portrayed as "risky," "dangerous," and "predatory." Borrowers, we are told, do not understand the private student loan notes they are signing. Schools, we are told, "lure" students into signing up for private loans when lower cost federal student loans are available.

Lenders take the problem of student debt seriously—no federally chartered financial institution wants to see loans go into delinquency or default. We recognize that some of the issues being raised about the quality of higher education merit a healthy policy discussion. But we believe discussions of changing the bankruptcy code, as it applies to private student loans, should take place with an accurate, fair, and complete picture of the student loan market, the different market players and most importantly, the reasons behind the increase in student loan debt.

The student loan industry of today is dramatically different than that of a decade or even five years ago. Most notably, in 2010 the federal government assumed full responsibility for about 94% of the student loan market when it ended the Federal Family Education

Loan program. Less well known is the fact that today the private student loan market is about a third—actually less than a third—of the size it was as recently as 2007.

As we all know, the financial crisis dramatically changed the financing of all consumer assets. Before the financial crisis, increasing volumes of student loans were being financed through asset backed securities. The financial crisis effectively ended that. And with the end of securitization for private student loans, underwriting standards for legacy ABS issuers became more restrictive. The result is that private student loans made today are more likely to be made to borrowers (and their co-signers) with stronger credit histories and with better indicators of probability of repayment than five years ago.

A second major change in the private student loan market came when Congress passed legislation that modified the Truth-in-Lending Act to require three comprehensive sets of borrower disclosures to be given in association with private educational loans: One at the time of solicitation, one at the time of acceptance, and one at the time of consummation. The breadth and detail of information concerning loan terms and impact to repayment provide important consumer protections available only with private student loans.

CBA believes that that these disclosures have resulted in better informed borrowers and that, while there is always room for improvement in borrower counseling, the private student loan borrower of today is much better informed than the borrower of a decade ago.

Today, there is a heightened awareness of the importance of both lenders and schools in counseling borrowers. These services include advising the borrower to explore federal student loans before committing to use non-federal student loans; supplementing that counseling is better access to servicers. Today's student loan borrower has 24/7 access to their private loan account information and a much easier ability to ask questions and seek assistance on their loan than was the case 10 years ago.

Today's borrower also has access to the new private student loan ombudsman at the Consumer Financial Protection Bureau (CFPB or Bureau). CBA supported the creation of this function within the CFPB and is hopeful that the office will function as an additional means of resolving issues between lenders and borrowers. CBA has been active in working with the CFPB on its student lending efforts and will continue to work with the Bureau.

While we applaud this subcommittee for raising awareness on student debt issues, Congress must look at the root causes of debt for students – the cost of higher education. As costs continue to rise, students will be required to take on additional loan debt. Congress, colleges and universities, consumer groups and the financial community must work together to find policy solutions to help address these issues.

The legislation being discussed, S. 1102, does nothing to address the problem of college costs or discourage borrowers from taking on excessive debt. In fact, the federal

government now originates over 90% of student loans, and S. 1102 would provide no relief to those students.

If the goal is to treat all student loan borrowers fairly, then all new borrowers of student loans (federal and private) should benefit from any change made to the bankruptcy code, not just those who borrowed from the private non-governmental sector. The bill would arguably provide meaningful relief to less than 10 percent of all outstanding borrowers, even including borrowers who under current law would be able to secure discharge of private education loans. If the goal of S. 1102 is to help struggling borrowers struggle less, it must be noted that the vast majority of borrowers of private student loans also have federal student loans. Is the goal of this legislation to encourage the discharge of private loans so the federal government can recoup its student loans? That makes little sense.

Presumably because the cost of providing relief to borrowers of federal student loans would cost the federal government billions of dollars, these loans are excluded from the proposed change in the Code. Borrowers of loans made by state-owned lenders are also excluded. Thus, S. 1102 would leave many borrowers still facing large student loan debt, even if they were able to discharge their private student loans. We doubt whether the borrowers involved would find this fair.

Members of the CBA believe that it is appropriate for this subcommittee to look at changes in the Code that are a response to the problem of rapidly increasing levels of

student loan debt. We have closely examined S. 1102 and the similar bill introduced by Congressman Cohen in the House, H.R. 2028. Unfortunately, neither of these bills addresses the underlying problems. We encourage members of this subcommittee to work with their colleagues to address the fundamental issue behind the increase in student debt – the rising costs of college. Changing the bankruptcy code for some private student loans, which are only 6 percent of the market, will not address this problem.

It is also very important to keep in mind that the current Code permits discharge of loans in bankruptcy for borrowers where non-discharge would result in undue hardship to the debtor or their dependents. Thus, in cases where there is such hardship, relief is available under current law. CBA fully supports judges granting discharge in cases where undue hardship is evidenced.

Allowing for the immediate discharge of student loans without a showing of undue hardship, as this legislation would permit, would create a loophole that could result in abuse and much larger loss exposure than assumed by private market lenders. Nobody knows for sure whether such a loophole would invite abuse, but the option may affect credit availability in the private student loan market. We would submit changing the Code to create such a loophole is not an appropriate means of finding out.

We also suggest that the subcommittee take a close look at all student loans—federal, other governmental, and non-federal. The private loan products of today themselves are among the most consumer friendly loans in the market place: the loan may be paid over a

period of 10 – 30 years, fixed and variable-rate options are available, borrowers have a right to rescind (not available in the federal program) and most do not require any payments until a student separates from school – often many years after the loan was first made. In addition, there are no prepayment penalties for borrowers who wish to pay ahead of schedule, and there are opportunities for borrowers to stop making payments for a period of time even after the repayment period commences.

The terms and conditions inherent in student loans today provide avenues of relief for many borrowers, including an increasing number of lenders providing loan forgiveness for the death or disability of the student. Those not finding relief continue to have the opportunity for discharge if there is evidence of undue hardship.

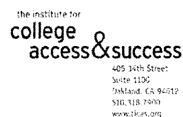
A third consideration for the Subcommittee is the question of what impact a change in the Code might have on the availability of new private education loans. Some have suggested that the enactment of the proposed change in the Code would not impact loan availability or pricing. We question this projection. Where is the data to support this?

Logic suggests that if lenders face significantly increased loss risk, they will attempt to compensate for that risk by either revising loan availability or by increasing the cost of loans to consumers, or leaving the market entirely. While some in the higher education community have suggested that tighter availability of private education loans would somehow "benefit students," effectively denying a student access to the financing she

might need to attend the college best suited to her abilities and aspirations is not helping students.

CBA hopes the subcommittee continues its work on this important issue and considers our concerns around the root cause of student debt – rising costs. CBA would welcome the opportunity to work with Congress to examine the realities of the student loan market, the rising costs of college, and both the federal, state and private student loans roles in meeting the financial needs of borrowers.

INSTITUTE FOR COLLEGE ACCESS & SUCCESS, MARCH 19, 2012, LETTER



March 19, 2012

The Honorable Dick Durbin
United States Senate
711 Hart Senate Building
Washington, DC 20510

Dear Senator Durbin:

On behalf of the Institute for College Access & Success and the 35 student, consumer, civil rights, education and public policy organizations that signed the enclosed letter endorsing the Fairness for Struggling Students Act of 2011 (S.1102), thank you for your leadership in introducing this legislation and for scheduling tomorrow's Senate Judiciary Committee hearing on it.

Private student loans are no more a form of financial aid than a credit card used to pay tuition. Like credit cards, they typically have variable interest rates that are highest for those who can least afford them. But private student loans are treated much more harshly in bankruptcy than credit cards and other comparable types of debt.

Private student loan borrowers also lack access to the important deferment, income-based repayment and loan forgiveness options that come with federal student loans. This leaves most private loan borrowers at the mercy of their lender if they face financial distress due to unemployment, disability, illness or military deployment, or when a school shuts down before they can finish their certificate or degree.

By treating private student loans like comparable forms of debt in bankruptcy, the Fairness for Struggling Students Act would help restore fairness for struggling Americans who pursued the American dream by going to college, only to find themselves in financial distress.

Signed,

Pauline Abernathy
Vice President
The Institute for College Access & Success

Enclosure

LETTER TO SENATOR DURBIN FROM 35 ORGANIZATIONS EXPRESSING SUPPORT FOR THE *Fairness for Struggling Students Act of 2011*

May 25, 2011

The Honorable Dick Durbin
United States Senate
711 Hart Senate Building
Washington, DC 20510

Dear Senator Durbin:

On behalf of the undersigned organizations, we are writing to express our strong support for the *Fairness for Struggling Students Act of 2011*.

Private student loans are one of the riskiest, most expensive ways to pay for college. Like credit cards, they typically have variable interest rates that are higher for those who can least afford them. However, private student loans are treated much more harshly in bankruptcy than credit cards and other comparable types of debt.

Private student loan borrowers also lack access to the important deferment, income-based repayment, or loan forgiveness options that come with federal student loans. This leaves most private loan borrowers at the mercy of the lender if they face financial distress due to unemployment, disability, illness or military deployment, or when a school shuts down before they can finish their certificate or degree.

With recent reports that student loan debt has outpaced credit card debt, the *Fairness for Struggling Students Act of 2011* is needed now more than ever. It is inappropriate and unfair to distressed borrowers to treat private student loans more harshly than comparable types of debt. Your bill would indeed restore fairness for struggling Americans who pursued the American dream by going to college, only to find themselves in financial distress. Our broad coalition of groups representing students, consumers, higher education institutions, faculty and staff, as well as civil rights and public policy organizations thanks you for your leadership on this important issue.

Signed,

American Association of Collegiate Registrars and Admissions Officers
American Association of Community Colleges
American Association of State Colleges and Universities
American Association of University Women
American Council on Education
American Federation of Teachers
Americans for Financial Reform
Association of Public and Land-grant Universities
Campus Progress Action
Consumer Action
Consumer Federation of America
Consumer Federation of California
Consumer Watchdog
Consumers Union
Dēmos: A Network for Ideas & Action
The Education Trust
Empire Justice Center
The Greenlining Institute
The Institute for College Access & Success and its Project on Student Debt

National Association for College Admission Counseling
National Association for Equal Opportunity in Higher Education
National Association of Consumer Advocates
National Association of Consumer Bankruptcy Attorneys
National Association of Student Financial Aid Administrators
National Center for Public Policy and Higher Education
National Community Reinvestment Coalition
National Consumer Law Center (on behalf of its low income clients)
National Consumers League
National Council of La Raza
National Education Association
Public Citizen
UNCF
U.S. PIRG
United States Student Association
Young Invincibles

CONSUMER ACTION, WASHINGTON, DC, MARCH 16, 2012, LETTER

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San Francisco, CA 94105
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213-624-4631

Richard J. Durbin
U.S. Senate
711 Hart Senate Office Building
Washington DC 20510

March 16, 2012

Dear Senator Durbin,

Thank you for scheduling a hearing on the "The Looming Student Debt Crisis: Providing Fairness For Struggling Students." While we take exception with the word "looming" as there is we believe already a student debt crisis, we are grateful for the excellent line up of witnesses that you have agreed to hear from on this issue.

There has been a big increase in private loan borrowing by undergraduates and private loan volume grew substantially in recent years. These loans are nearly impossible to discharge in bankruptcy and are not eligible for the deferment, income based repayment and loan forgiveness benefits of federal student loans.

Consumer Action supports Senate Bill 1102 — the Fairness for Struggling Students Act. This legislation could restore fairness for Americans who pursued the American dream by going to college, only to find that their dreams of financial success don't always pan out and find themselves in financial distress. These Americans deserve the same rights as credit card and other debtors have to the financial safety net of personal bankruptcy court.

Sincerely,

Linda Sherry

Linda Sherry
Director, National Priorities
DC Office

AMERICAN BANKERS ASSOCIATION, AMERICAN FINANCIAL SERVICES ASSOCIATION, CONSUMER BANKERS ASSOCIATION, THE FINANCIAL SERVICES ROUNDTABLE, MARCH 20, 2012, JOINT LETTER

March 20, 2012

The Honorable Tom Coburn
United States Senate
Washington, DC 20510

Dear Senator Coburn:

The undersigned organizations are writing to express our opposition to S. 1102. This legislation would revise the federal bankruptcy law to make it easier for borrowers to discharge some educational loans.

S. 1102 is unnecessary because under current law, any borrower may discharge student loans if repayment would constitute an undue hardship. In enacting this into law, Congress intended to create a necessary and well-balanced safety valve for borrowers.
S. 1102 undermines this balance and is unfair to lenders who have relied on current law when extending credit to students with little or no credit history. It is also unfair to students because it will have the effect of restricting the availability of student loans and raising the cost of loans when they are available. For these and other reasons, S. 1102 should not be reported by the Committee or passed by the Senate.

There is no question that the ever increasing cost of education is making it harder for students to afford college. Between 1986 and 2011, inflation increased by 115% but college tuition increased by over 498% - outpacing inflation by more than 4 times the rate. Although federal Pell Grant assistance has increased significantly during this period, reliance on student loans—in particular federal student loans—has increased dramatically. The Department of Education projects that over 25 million Federal Direct Student Loans will be made this year totaling over $124 billion. In addition to these Direct Loans to students and parents, private sector lenders will make approximately $8 billion in loans—or about 6 percent of the overall total.

Rising education costs are the reason students and families continue to take out student loans over and above the direct lending programs provided by the Federal government. Yet, nothing in this bill attempts to address the root problem of rising education costs. Instead, it seeks to amend the Bankruptcy Code in a way that encourages defaults and that ensures that student loans will become even harder to obtain for deserving students. Moreover, the changes made by the bill do not apply to federal or student loans made by other governmental entities, which are the vast majority of student loans, and thus S. 1102 would not even help most borrowers.

For the small subset of loans that are covered, the bill changes the Bankruptcy Code in a way that will add uncertainty and additional risk to student lending. This will further restrict the availability of credit at a time when students are already finding it harder to find loans due to the credit crunch.

Current law allows student loans to be discharged in bankruptcy if "undue hardship" to the borrower or their dependents can be shown. This policy protects truly unfortunate borrowers while at the same time preserving the integrity of the bankruptcy system. This balanced federal policy is designed to ensure that a sufficient volume of loans are available to meet the financial needs of students across the country, and it has worked.

The proposed legislation would undermine this policy by allowing private sector student loans to be discharged without a showing of "undue hardship." Under the bill, federally funded loans and

loans made or guaranteed by governmental entities could still be discharged only upon a showing of undue hardship. In contrast, students taking out other private loans could run up thousands of dollars in private loans, carry them without having to pay interest while in school and then walk away without making a single payment even if the student in the future should be able to repay the loans in full. Moreover, it is retroactive and will apply to existing as well as future student loans. As a result, the bankruptcy system would be opened to abuse.

Enactment of S. 1102 will discourage lenders from making private student loans or force them to find some way to offset the increased risk. These risk management effects could mean raising interest rates and fees, or reducing the term of the loan (perhaps to 5 years) which would increase monthly payments, further increasing monthly debt service costs. None of these effects would benefit students.

We strongly urge the Committee to reject the S. 1102.

American Bankers Association
American Financial Services Association
Consumer Bankers Association
The Financial Services Roundtable

cc: Members of the Judiciary Committee

NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS, WASHINGTON, DC, STATEMENT

STATEMENT OF

Justin Draeger
President
National Association of Student Financial Aid Administrators

TO THE SUBCOMMITTEE ON ADMINITRATIVE OVERSIGHT,
AND THE COURTS,
COMMITTEE ON THE JUDICIARY,
UNITED STATES SENATE

RE: S.1102, Fairness for Struggling Students Act of 2011

Submitted on behalf of:

The National Association of Student Financial Aid Administrators

March, 19, 2012

PHONE: 202.785.0453 FAX: 202.785.1487 WEB: www.nasfaa.org
1101 CONNECTICUT AVE NW, SUITE 1100, WASHINGTON, DC 20036-4303

NASFAA March 19, 2012

Chairman Durbin, Ranking Member Cornyn, and members of the Subcommittee,

We appreciate the opportunity to offer a statement of support for S.1102, the *Fairness for Struggling Students Act of 2011*. The National Association of Student Financial Aid Administrators (NASFAA) represents more than 18,000 financial aid professionals who serve 16 million students each year at nearly 3,000 colleges and universities throughout the country, and supports the aptly-named legislation to restore fairness and protection to student loan borrowers in the bankruptcy code.

According to a report from the National Consumer Bankruptcy Attorneys (NACBA), annual student loan borrowing reached a record of over $100 billion in 2010, and the aggregate outstanding loan amount reached $1 trillion—surpassing the amount Americans own on credit cards. While these numbers represent both Federal and private student loans, over the past decade private student loans have grown at a rapid pace, and as a result a greater proportion of borrowers are finding themselves with at least some private student loan debt.

Prior to the enactment of the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, private student loans were unconditionally dischargeable in bankruptcy. However, the 2005 law gave private loans the same treatment as Federal student loans, meaning that they would generally no longer be dischargeable in bankruptcy. NASFAA finds it troublesome that current bankruptcy code treats private education loan debt differently than other consumer debt such as mortgage and credit card debt.

As currently stipulated by bankruptcy law, borrowers that demonstrate an undue hardship may have their loans discharged in bankruptcy. However, NASFAA does not find the "undue hardship" clause to be sufficient protection for private education loan borrowers. The phrase "undue hardship" is not defined in law, making it subject to judicial review, tests, and precedent.

Courts almost always apply a very strict interpretation of this provision, and the NACBA report finds that "most bankruptcy attorneys (95 percent) report that few student loan debtors are seen as having any chance of obtaining a discharge as a result of undue hardship."

Opponents of this bill argue that the ability to discharge private education loans in bankruptcy leads to frequent and capricious filings and, perhaps from a more philosophical standpoint, reduces personal fiscal responsibility. To the first argument, we refer to a 1977 GAO study, which took place during a time when loans *could* be discharged, and found that less than 1 percent of student loans were discharged in bankruptcy. To the second argument, NASFAA has always encouraged responsible borrowing, and is not adverse to exploring options that would require a few years of good-faith efforts at repayment prior to a bankruptcy discharge. Requiring additional steps prior to bankruptcy discharge may also be justified for education loans that are funded by public dollars at the state level, but considered to be private loans.

However, at no time should we put in place the same bankruptcy restrictions for private education loans that we do for federal student loans. While both are used to pay for education, private education loans lack the income-based repayment plans and generous loan forgiveness provisions after many years of economic hardship found in the federal loan programs. Federal student loans also offer other valuable consumer protections including fixed interest rates, multiple repayment options, and deferment and forbearance provisions that can forestall delinquency or default.

Allowing the discharge of private student loan debt in bankruptcy is critical to ensuring fairness for American consumers and to provide a way for some struggling private student loan borrowers to establish financial stability. It is for these reasons that we support efforts to allow private education loans to be discharged in bankruptcy as outlined in the Fairness for Struggling Students Act of 2011, and we urge Congress to support this essential bill.

References:

National Association of Consumer Bankruptcy Attorneys (2012). *Student Loan "Debt Bomb": America's Next Mortgage-Style Economic Crisis.*

U.S. Government Accountability Office (1977). *1978 U.S.C.C.A.N. 5787*

National Council of Higher Education Loan Programs, Inc., Washington, DC, statement

1100 Connecticut Avenue, NW, 12th Floor, Washington, DC 20036-4110 • Tel: 200-822-2106 • Fax: 202-822-2142 • Web site: www.nchelp.org

To: Members of the Senate Committee on the Judiciary

Re: March 20, 2012 Hearing on Fairness for Struggling Students Act of 2011
Statement for the Record

This statement is being submitted to the Committee on the Judiciary by the National Council of Higher Education Loan Programs (NCHELP) in connection with the March 20, 2012 hearing held by the Subcommittee on Administrative Oversight and the Courts on "The Looming Student Debt Crisis: Providing Fairness for Struggling Students". We request that it be included in the official record of the hearing.

NCHELP is a trade association that represents a nationwide network of guaranty agencies, secondary markets, lenders, loan servicers, private collection agencies, schools and others that administer education loan programs that make loan assistance available to students and parents to pay for the costs of postsecondary education, including both federal and private loan programs.

There has been much in the news about the "student debt bubble" and the fact that students who borrow to attend postsecondary school on average graduate with around $24,000 in student loans. Individual circumstances of course vary and some, including many who have gone on to post-baccalaureate study, have borrowed significantly higher amounts. This should not be a surprise, as the cost of education continues to rise at a faster clip than both the inflation rate and the rate of increase in income. We submit that greater attention needs to be given by policymakers to dealing with the rising cost of postsecondary education.

Stories about the burden of high debt have caused some to seek to repeal of the current exclusion of private education loans from general discharge in bankruptcy (though it should be understood that all education loans are dischargeable if the debtor meets the hardship test in the Bankruptcy Code). In fact, this is what the Fairness for Struggling Students Act of 2011 (S. 1102) would provide. While private education loans are the subject of the bill, the vast majority of outstanding education loans were made under the federal education loan programs (either the Direct Loan Program or the Federal Family Education Loan Program), and well over 90 percent of new education lending is made directly by the Federal government through the Direct Loan Program. S.1102, by protecting the government, the creditor with the deepest pocket, would not provide relief to federal loan borrowers. This despite the fact that today private loan programs oftentimes offer attractive terms, particularly when compared to federal PLUS loans to parents and graduate students.

We are sympathetic to the concerns raised by many of those whose long term prospects, despite best efforts, indicate they will have insufficient income to repay their loans. However, we believe that any relief being considered should be available for all education debt, not just private education loans. It should be noted in this regard that federal education loans,

unlike private education loans, are not subject to statutory limitation of action periods. Federal loan borrowers can be subject to collection action for their entire lives.

Also, whatever relief is considered should take into consideration the special nature of education borrowing. With the average student carrying $24 thousand in education debt at graduation, many would meet the Bankruptcy Code's insolvency test immediately upon leaving school. A former student's true financial outlook typically does not become clear for many years after they leave school. For example, the recent recession certainly has delayed the employment of some recent graduates into positions for which they qualify. We believe the public would find it untenable for students to attend college using borrowed funds and be able to walk away from their financial obligations by filing for bankruptcy once they leave school.

It also should be recognized that S. 1102, or other legislation that would allow private education loan borrowers to seek bankruptcy relief after leaving school, would result in substantially higher charges on private education loans. These additional costs, which would fall on all private student loan borrowers, need to be understood and taken into consideration by policymakers. It also must be understood that, since rating agencies and investors would assume elevated loan losses , any such change to the Bankruptcy Code would make it more difficult and costly to finance private education loans. A retroactive change would also have a negative impact on the ratings of existing financings, and thus hurt investors.

Please do not hesitate to contact me if you have any questions.

Shelly Repp
President

"HOW MUCH IVORY DOES THIS TOWER NEED?" OCTOBER 27, 2011, REPORT BY NEAL MCCLUSKEY

Policy Analysis

No. 686 October 27, 2011

How Much Ivory Does This Tower Need?

What We Spend on, and Get from, Higher Education

by Neal McCluskey

Executive Summary

It is commonly asserted, especially by people within higher education, that the American Ivory Tower is strapped for cash and tightfisted taxpayers are to blame. Taxpayer support for postsecondary education has long been in decline, this narrative goes, and has forced schools to continually raise tuition to make up for the losses.

Tallying taxpayer-backed expenditures on higher education over the last quarter-century, and separately tallying 15 years of taxpayer burdens after accounting for student loans being paid back, reveals that this narrative is inaccurate. No matter how you slice it, the burden of funding the Ivory Tower has grown ever heavier on the backs of taxpaying citizens. Whether one examines taxpayer dollars in total, per enrollee, per degree, or per tax-paying citizen, real spending has gone up.

Unfortunately, financial costs are only part of the story. While the evidence is not conclusive, it appears that the additional spending and the additional students and degrees it has helped to fund do not ultimately constitute a net societal gain. Instead, all the coerced, third-party support has likely produced several damaging, unintended consequences: credential inflation, sky-high noncompletion rates, and rampant tuition inflation. In other words, the money taken from taxpayers, in total and on an individual basis, to "invest" in higher education has been on the rise, and it appears to be hurting both taxpayers individually and society as a whole. We have taken money from people who would have used it more efficiently than has the system to which it was given.

Neal McCluskey is associate director of the Cato Institute's Center for Educational Freedom and author of the book Feds in the Classroom: How Big Government Corrupts, Cripples, and Compromises American Education *(Lanham, MD: Rowman and Littlefield, 2007).*

CATO INSTITUTE

It is quite possible that taking money from taxpayers will produce a worse aggregate outcome than allowing taxpayers to keep their money.

Introduction

If you follow higher education—or just live near a college or university—you've probably heard the complaint: government keeps axing higher education funding. Often the evidence offered to substantiate the claim is a proposed funding cut for the upcoming fiscal year, or reductions over a few years, or state appropriations to schools decreasing as a percentage of overall school revenues. Rarely is the change in the burden borne by taxpaying citizens in total, as well as individual taxpayers—the most direct and important measures of taxpayer support—furnished.

So has government been getting increasingly tightfisted with colleges? That is what this analysis endeavors to determine. And while it lays out changes in funding per student and per degree awarded, most importantly it examines funding overall from taxpayers and the burden borne by the *average* taxpayer. These latter two measures are critical because taxpayers are real people bearing real costs—they are half of the higher education funding equation—but they are typically ignored in anecdote-driven media stories that focus on financially struggling students.

This is hardly just a human interest concern. It is quite possible that taking money from taxpayers—who know their individual needs and desires better than government—will produce a worse aggregate outcome than allowing taxpayers to keep their money. Forced third-party funding could be encouraging aid recipients to consume education they may not need or be able to handle, it might be enabling schools to spend wastefully because they receive funding involuntarily, and it could be taking money from people who would have used it more efficiently had they been able to keep it.

To determine if these negative outcomes might, in fact, be occurring, the final goal of this report is to gauge—as best can be done with limited performance measures—whether taxpayer funding has contributed to net positive or net negative outcomes.

How Spending Is Calculated

"Over several decades there has been a material and progressive disinvestment by states in higher education."[1] That statement, in a 2009 op-ed by University of California, Berkeley, chancellor Robert J. Birgeneau and vice chancellor Frank D. Yeary, is something most people have likely heard in some form in the last few years. But is it true? Have states been in a long process of disinvesting from colleges and universities? How is that determined? These are critical questions, but they are all too often left unasked in the public discourse on the state of the nation's Ivory Tower.

To measure taxpayer investment, analysts will often use state and local government funding as a share of overall school revenues, then argue that state and local funding has been decreasing.[2] Other times they will look at changes in appropriations at the peak and trough of a business cycle, when state funds naturally fluctuate, rather than providing long-term trends that include multiple waves.[3]

Knowing how investment is being measured can make the difference between thinking that taxpayers are increasingly cheap or increasingly generous. By looking at total state and local taxpayer spending on higher education—not breaking it down per pupil—the State Higher Education Executive Officers (SHEEO) reached a conclusion completely contrary to that of Birgeneau and Yeary. "Some observers have suggested that states are abandoning their historical commitment to public higher education," SHEEO wrote. "National data and more careful attention to variable state conditions strongly suggest that such a broad observation is not justified by the available data."[4]

To answer the question of how much taxpayer support colleges and universities

receive and how it has changed over the last several years, this report provides information on taxpayer support through myriad streams: state and local funding directly to schools; state support to students in the form of financial aid; federal direct support to schools; federal financial aid; state and federal funding of university-based research; and combinations thereof. Most important, the report shows changes in spending not just from the perspectives of greatest interest to schools— i.e., funding per student and per degree—but from the perspective important to taxpayers and society as a whole: the overall taxpayer-funded burden and the total burden falling on the average taxpayer.

Accounting Problems

As you read this, keep in mind that the numbers are estimates. Though one might think accounting for what taxpayers spend on higher education would be straightforward, it is not. The following are major obstacles that stand in the way of pinpointing expenditures.

Data Sources

There is no one, consistent, comprehensive source of data on taxpayer expenditures for higher education. That is largely a good thing, reflecting that there is no one, especially governmental, entity controlling all schools. Overall, that decentralization is key to the greater success of American higher education than its elementary and secondary system; it fosters competition, innovation, and specialization. It does, though, complicate data collection.

As recently as 1996 the federal government collected comparable data for all "degree-granting" institutions—public and private—that included federal, state, and local government revenues. However, in 1997 public and private colleges went onto different accounting standards, making it problematic, at best, to combine their numbers.[5] As a result, no compilation similar to what the federal government published until 1996 appears to be available now.

The main sources for this study are federal *Digest of Education Statistics, 2010*; the College Board's *Trends in Student Aid, 2010*; SHEEO's *State Higher Education Finance: FY 2010*; and the National Science Foundation's *Academic Research and Development Expenditures: Fiscal Year 2009*.[6] The *Digest* is primarily the source for longitudinal data on federal postsecondary expenditures; the *Trends* report for longitudinal state and federal student aid totals; SHEEO for total state and local expenditures on public colleges and universities; and the National Science Foundation for state and local research expenditures.

In addition to the problem of having no single, consistent data source, there are a few smaller problems that have likely led to some inaccuracies in the data analysis. First, the figures presented for 2010 are, in fact, a mix of 2009 and 2010 data. Numbers from 2009 were used in some cases where 2010 data were not available, with the expectation that they would likely be closer to actual 2010 numbers than would a projection based on, for instance, average changes in funding over some number of previous years. In addition, numbers from the *Digest*, SHEEO, and the College Board were adjusted for inflation using different "market baskets." The College Board uses the Consumer Price Index for all urban consumers (CPI-U) for its inflation adjustments, while the *Digest* employs the "federal funds composite deflator," a measure based on changing costs of goods and services consumed by the federal government.[7] Finally, SHEEO uses the Higher Education Cost Adjustment index, which is based 75 percent on changing compensation costs for white-collar workers and 25 percent on general inflation in the U.S. economy.[8]

Accounting for Loans and "Tax Expenditures"

The federal government provides data for "on-budget" expenditures—generally, funds tied to appropriations—for postsecondary

Overall, decentralization is key to the greater success of American higher education than of elementary and secondary schooling.

Net present value-based accounting is essentially an educated guess at what taxpayers will ultimately pay for loans.

education, but for federal loan programs the on-budget expenditures before 1992 are not comparable to those after. Until 1992 the federal government accounted for loan expenditures on a cash basis, meaning that for federal guaranteed loans—in which Washington backed loans originated by private lending companies—the federal subsidies net of borrower fees for that year were the on-budget costs. For direct loans—in which the federal government lends directly from the treasury—the full loan volume net of fees was reported. That changed effective 1992 as a result of the Federal Credit Reform Act of 1990, which switched accounting to a net present value basis. Basically, the net costs to the government over the life of a loan originated in a given year, adjusted for the changing value of money over time, is the on-budget cost for that year.

It is important to note that net present value-based accounting is essentially an educated guess at what taxpayers will ultimately pay for loans, a guess that cannot easily anticipate such factors as changing default risks or future increases in federal loan forgiveness programs. In addition, there are significant fluctuations in reported on-budget loan costs from year to year, which according to the U.S. Department of Education largely reflect changes in loan volumes and interest rates.[9]

To cope with these problems, the first set of calculations—called "taxpayer-based funding"—includes the total volume of loans. That number will most likely be much higher than the ultimate cost to taxpayers as loans are repaid, but it covers basically everything for which taxpayers are liable and allows consistent comparisons back to 1985. In the second set of calculations—called "taxpayer cost"—only the estimated ultimate cost to taxpayers is factored in. Those calculations look only at numbers between 1995 and 2010, which in addition to ensuring that the on-budget data are consistent, ensures that both the guaranteed lending program—which stopped originating loans in 2011 as part of the 2010 health care reform bill—and the direct lending program, which started in 1994, are included in the period examined.

The bottom line on loans is that calculations that include total loan volume provide reliable and consistent annual totals, but much of that money will eventually be returned to the government. How much will be returned, however, is something we'll only be certain of in the future, which renders present-value subsidy costs only rough estimates.

In addition to trying to properly account for federal loans, one has to decide how to deal with federal "tax expenditures": tax deductions and credits that the federal government uses to incentivize people to purchase higher education. The first problem with dealing with this category of aid is wildly inconsistent accounting. The College Board doesn't even begin to account for such incentives until the 1998-99 school year, while the *Digest* stops accounting for them in 2002. The second problem is that there is a great deal of dispute over whether such expenditures should be considered government aid or simply allowing taxpayers to keep what is theirs (albeit for specific, government-favored purposes). Given the first problem, and feeling that money taxpayers are allowed to keep should not be considered taxpayer-funded aid, tax expenditures are not included in this report's calculations. However, they should be kept in mind, and in light of them it should be understood that estimates using just government expenditures and loans underestimates, perhaps significantly, government influence on college enrollment and prices.

What's Student Aid? What's Not?

Some federal programs have student aid components wrapped up with other higher education spending. For instance, outlays for the Senior Reserve Officer Training Corps, as reported in the *Digest*, include both scholarship costs and the costs of paying staff, running training exercises, and so on. Where the titles of programs in the *Digest* indicate that the programs might contain

both aid and direct spending components, those programs were researched in more depth and, where possible, the student aid components separated so they wouldn't be double counted when student aid and other higher education outlays were combined. Thankfully, this was only necessary for a few programs, and few had price tags even close to the size of Department of Education–run loan and grant programs.

One of the biggest debates in higher education is whether funding for research should be counted as aid to schools or government payment for a service. Many in higher education argue research is vital for keeping professors up-to-date in their fields, enabling them to be the best teachers of their subjects, while others assert that research largely aggrandizes researchers and has at best limited positive spillovers into instruction. To deal with the ambiguous educational effects of research, this report provides breakdowns including and excluding research funding.

The Findings

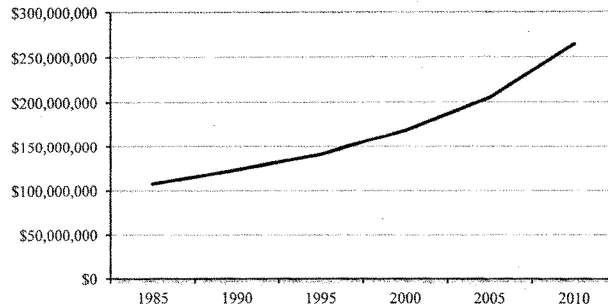
The natural place to begin to determine how much money taxpayers supply to higher education is to ascertain the total taxpayer-based funding that goes to schools and students. For this report's purposes, "total taxpayer-based funding" is every dollar generated by taxpayer-funded programs, including total student loan volume and research. This is the most inclusive compilation possible (save one that includes "tax expenditures") and will maximize the appearance of taxpayer generosity.

Figure 1 shows the inflation-adjusted growth in total taxpayer funding of higher education, which rose from roughly $108 billion (measured in 2010 dollars) in 1985 to $264 billion in 2010, a 144 percent increase.

What are the constituent parts of the total, and how did they change over time? The trend lines for all components are laid out in Figure 2. They are as follows:

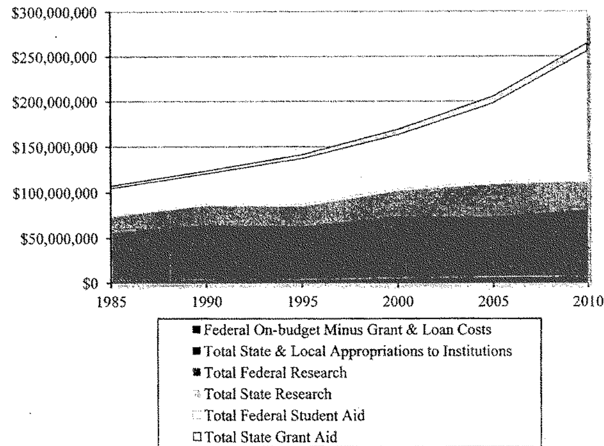
The natural place to begin to determine how much money taxpayers supply to higher education is to ascertain the total taxpayer-based funding that goes to schools and students.

Figure 1
Total Taxpayer-Based Funding (in thousands of 2010 dollars)



Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list, April 2011; The College Board, "Trends in Student Aid 2010," trends.collegeboard.org/student_aid; State Higher Education Executive Officers, State Higher Education Finance, www.sheeo.org/finance/shef-home.htm; and National Science Foundation, "Academic Research and Development Expenditures: Fiscal Year 2009," Table 1, http://www.nsf.gov/statistics/nsf11313/.

Figure 2
Total Taxpayer-Based Funding by Source (in thousands of 2010 dollars)



Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list, April 2011; The College Board, "Trends in Student Aid 2010," trends.collegeboard.org/student_aid; State Higher Education Executive Officers, State Higher Education Finance, www.sheeo.org/finance/shef-home.htm; and National Science Foundation, "Academic Research and Development Expenditures: Fiscal Year 2009," Table 1, http://www.nsf.gov/statistics/nsf11313/.

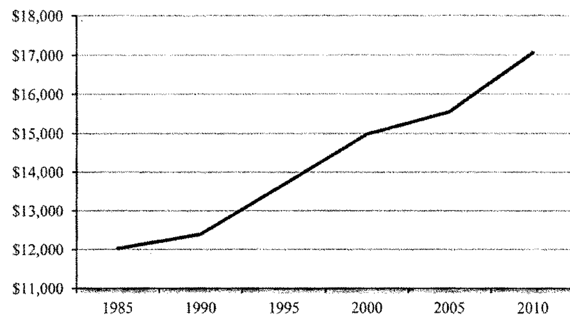
- federal on-budget expenditures, minus grant and loan costs,
- state and local appropriations to schools,
- federal funding for research conducted at educational institutions,
- state and local funding for research conducted at educational institutions,
- total federal student aid, and
- total state grant aid to students.

Over the last 25 years, all of these components have increased, but clearly the largest growth has been in federal student aid. It ballooned from $29.6 billion in 1985 to $139.7 billion in 2010, a 372 percent leap. No other segment came close to that growth rate, with the next-biggest contributor—state and local appropriations to schools—rising 38 percent, going from $54.1 billion to $74.9 billion. Notable also is the relatively tiny contribution of the federal government through on-budget funds. That consists mainly of relatively small pools of money going directly to schools, including several programs specifically for minority-serving institutions, as well as expenditures to maintain service academies such as the United States Naval and Military Academies. Numerous departments also run a variety of small programs that contribute to that total. On-budget federal funds rose 135 percent, but from just $2.7 billion to $6.4 billion.

Over the last 25 years, all of these components have increased, but clearly the largest growth has been in federal student aid.

Clearly, total taxpayer-based funding for

Figure 3
Total Taxpayer-Based Funding per Full-Time Equivalent Student (in 2010 dollars)



Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list, April 2011; The College Board, "Trends in Student Aid 2010," trends.collegeboard.org/student_aid; State Higher Education Executive Officers, State Higher Education Finance, www.sheeo.org/finance/shef-home.htm; and National Science Foundation, "Academic Research and Development Expenditures: Fiscal Year 2009," Table 1, http://www.nsf.gov/statistics/nsf11313/. Enrollment data from U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 226, nces.ed.gov/programs/digest/d10/Figures/dt10_226.asp?referrer=list.

higher education has not dropped in the last 25 years. But that is just one way to measure public funding of higher education. It leaves open the question of whether funding has increased because more people attended college, more degrees were being conferred, or simply because there were more people contributing to the local, state, and federal coffers. To supply this context, what follows is total taxpayer-based funding broken down by students served, degrees attained, and individual taxpayers.

Figure 3 shows the change in total taxpayer-funded expenditures divided by the number of full-time equivalent (FTE) students each year.

On a per pupil basis, taxpayer-based funding has risen, though not nearly as fast as the overall pool of money, climbing only 42 percent (versus 144 percent). This is the result of major increases in college enrollment, which went from 8.9 million FTE students in 1985 to 15.5 million in 2010.

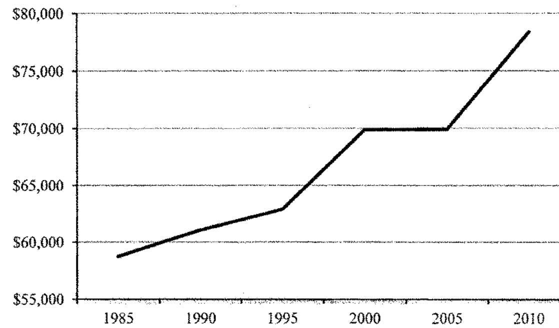
What is the cost per degree awarded? A simple way to calculate this is to divide total spending in a given year by the number of degrees awarded that year. This is not a perfect measure; a degree, of course, typically takes more than one year to complete, so the outlays for a given year did not, obviously, fully fund the degrees awarded that year. However, the results of this analysis, in Figure 4, are insightful.

The story remains the same: There were substantial increases, in this case a rise of 33 percent as taxpayer-funded outlays per degree rose from $58,755 in 1985 to $78,347 in 2010. But it was smaller by far than the increase in total taxpayer-based funding, and somewhat smaller than taxpayer-based funding per student

Finally, what's been the change in taxpayer-based funding per individual taxpayer? In other words, what's been the changing impact on the people supplying the funds? Unfortunately, it is not possible to calculate

There were substantial increases as taxpayer-funded outlays per degree rose from $58,755 in 1985 to $78,347 in 2010.

Figure 4
Total Taxpayer-Based Funding Per Degree (in 2010 dollars)



Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list, April 2011; The College Board, "Trends in Student Aid 2010," trends.collegeboard.org/student_aid; State Higher Education Executive Officers, State Higher Education Finance, www.sheeo.org/finance/shef-home.htm; and National Science Foundation, "Academic Research and Development Expenditures: Fiscal Year 2009," Table 1, http://www.nsf.gov/statistics/nsf11313/. Degree data from U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 279, nces.ed.gov/programs/digest/d10/Figures/dt10_279.asp?referrer=list.

this simply by dividing total expenditures by total taxpayers, because when state and federal funds are included it is necessary to account for not just income taxes, but sales taxes, property taxes, and other revenue sources. As a result, the following estimate divides total expenditures by the number of Americans age 15 or older, roughly the age at which many people begin to work and buy things.

Taxpayers have not sloughed off the burden of financing higher education, and that burden has grown substantially for every individual who pays taxes.

Once again, as Figure 5 illustrates, expenditures have gone up considerably over the past 25 years, rising from $577 to $1,068. This cements the conclusion: When examining what they are ultimately required to pay, taxpayers have not sloughed off the burden of financing higher education, and that burden has grown substantially for every individual who pays taxes.

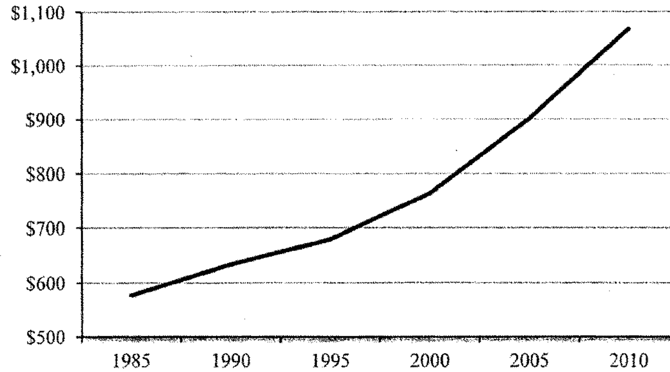
Total Taxpayer Cost

As mentioned, the numbers discussed so far include both research expenditures and total student loan volume—the most liberal estimate of taxpayer burden. The figures that follow, in contrast, offer a more conservative estimate, excluding research expenditures and including only federal on-budget costs. This is labeled "taxpayer costs" to indicate that it is the cost for higher education actually borne by taxpayers, with the understanding that it includes estimates of the likely final cost of student loans. And recall that these data only go back to the mid-90s because data after 1992 are not consistent with data before.

Figure 6 shows the increase in total costs. Again it is steep, as were total taxpayer-based expenditures. Here the increase is from $88.5 billion to $131.6 billion, a nearly 50 percent jump in just 15 years.

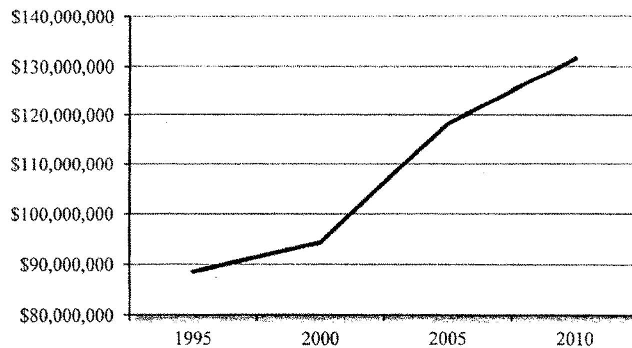
How about costs on a per pupil basis? Figure 7 furnishes that information. Note that a trend line with the formula for its slope accompanies the line chart. Whereas previous charts featured fairly steady chang-

Figure 5
Total Taxpayer-Based Funding per Taxpayer (in 2010 dollars)



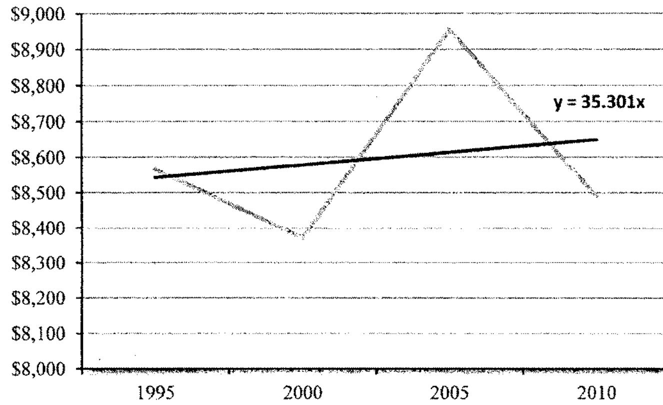
Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list, April 2011; The College Board, "Trends in Student Aid 2010," trends.collegeboard.org/student_aid; State Higher Education Executive Officers, State Higher Education Finance, www.sheeo.org/finance/shef-home.htm; and National Science Foundation, "Academic Research and Development Expenditures: Fiscal Year 2009," Table 1, http://www.nsf.gov/statistics/nsf11313/. Total count of taxpayers for 1985 to 2000 from U.S. Census Bureau, "No. HS-3. Population by Age: 1900 to 2002," www.census.gov/statab/hist/HS-03.pdf; for 2005, from "American Fact Finder: General Demographic Characteristics, 2005," factfinder.census.gov/servlet/ADPFigure?_bm=y&-qr_name=ACS_2005_EST_G00_DP1&-geo_id=01000US&-gc_url=null&-ds_name=ACS_2005_EST_G00_&-_lang=en; and for 2010, from "Age and Sex Composition: 2010," *2010 Census Briefs*, Table 2," www.census.gov/prod/cen2010/briefs/c2010br-03.pdf.

Figure 6
Total Taxpayer Cost (in thousands of 2010 dollars)



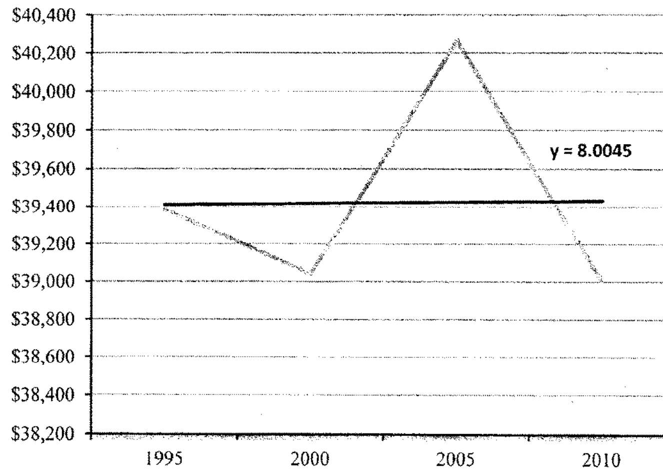
Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list; and State Higher Education Executive Officers, State Higher Education Finance, http://www.sheeo.org/finance/shef-home.htm.

Figure 7
Taxpayer Cost per Full-Time Equivalent Student (in 2010 dollars)



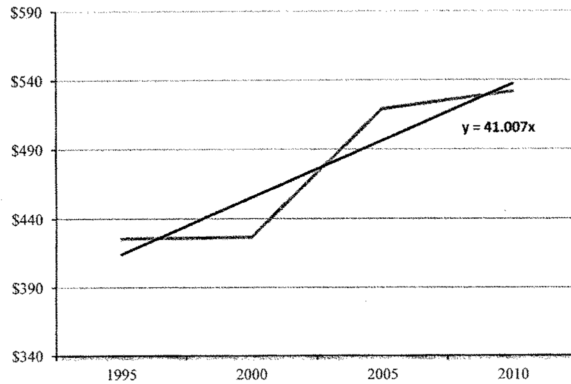
Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list; and State Higher Education Executive Officers, State Higher Education Finance, http://www.sheeo.org/finance/shef-home.htm. Enrollment data from U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 226, nces.ed.gov/programs/digest/d10/Figures/dt10_226.asp?referrer=list.

Figure 8
Taxpayer Cost per Degree (in 2010 dollars)



Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list; and State Higher Education Executive Officers, State Higher Education Finance, http://www.sheeo.org/finance/shef-home.htm. Degree data from U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 279, nces.ed.gov/programs/digest/d10/Figures/dt10_279.asp?referrer=list.

Figure 9
Taxpayer Cost per Taxpayer (in 2010 dollars)



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es, allowing the general trend to be easily discerned, this and subsequent figures rise and fall over the 15-year period, rendering the overall trend harder to determine. The trend line is intended to give a better sense for the overall pace and direction of change.

Once again, there is an increasing trend, though a very modest one, of $35 per five-year increment, and 2010 ends below 1995. Note the spikes, which make the trend hard to see. They are likely a result of a well-known phenomenon in higher education: when economic times are bad many more people enroll in school. Meanwhile, state and local governments have less money to spend, decreasing funding going to schools on a per-pupil basis. When economic conditions improve, the situation reverses.

What is the cost per degree? For all intents and purposes the overall trend is one of no change; a mere $8 increase per five-year increment from a starting point of almost $39,400. And as Figure 8 shows, there were once again up and down spikes, and the end-year cost was slightly lower than the first-year cost.

Lastly, Figure 9 furnishes the cost to a given taxpayer. Here again, we see increasing expenditures, making clear that even absent research funding and total loan volume, the burden on the individual taxpayer for higher education has gone up. And the inflation-adjusted increase has been significant, rising from $426 in 1995 to $532 in 2010, a 25-percent expansion. That's $532 the taxpayer can't spend on food, housing,

Even absent research funding and total loan volume, the burden on the individual taxpayer for higher education has gone up, rising from $426 in 1995 to $532 in 2010, a 25-percent expansion.

The difference between earnings for people with a bachelor's degree and those with only a high school education are large not because one attains valuable skills pursuing a degree, but because degrees are so commonplace.

investing, or other uses—all of which might be more important than funding higher education—and it refutes any notion that there has been declining taxpayer support for higher education.

The Benefits . . . or Lack Thereof

What has the nation gotten for its "investment" in higher education? This is not as easy a question to answer as it seems it should be at first blush. Clearly we have seen greatly increasing numbers of people enrolled in college, and degrees awarded, but this is insufficient evidence to demonstrate whether the attendant spending was truly beneficial. For that, it is necessary to know if the quickly rising enrollment and degree-attainment numbers translated into a much greater pool of skills and abilities, and if that outweighed the opportunity costs of taking money from taxpayers. In other words, it is important to know if human capital has expanded and, if so, if that produced greater public benefit than would have resulted if taxpayers had kept their dollars.

Making such an assessment more difficult is that, unlike in elementary and secondary education, in postsecondary schooling we do not have a single, representative, consistent assessment of learning such as the long-term National Assessment of Educational Progress (NAEP). This is not necessarily a bad thing on net—NAEP is at best an incomplete yardstick to measure what children are learning—but absent something like NAEP, various fragmented, incomplete measures must be cobbled together to assess learning gains, and then cautiously interpreted to get a sense of what's been achieved with taxpayer spending.

Increased Enrollment and Degrees

Without question, enrollment and the number of degrees awarded increased significantly over the last 25 years, with FTE enrollment rising 73 percent and degrees awarded rising 84 percent. It is certainly reasonable to conclude that at least part of those increases was spurred by expanding taxpayer support, though it is impossible to know what the changes would have been in the absence of such spending. Indeed, we might very well have seen growing numbers regardless of spending, and college enrollment was expanding significantly prior to the advent of large federal aid programs. Between 1969—the closest year to the 1965 Higher Education Act available in the 2010 *Digest of Education Statistics*—and 2008, enrollment rose 139 percent, but between 1929 and 1969 it increased by 627 percent.[10]

How about human capital? Again, the intuitive answer is that of course it expanded as attainment grew. And labor markets would seem to agree. As economists Anthony Carnevale and Stephen Rose point out, the current wage premium for bachelor's degree holders is 74 percent, meaning employers are willing to pay someone with a four-year degree 74 percent more than someone without one; degrees, on average, appear to have a sizable payoff.[11] In addition, citing data from economists Claudia Goldin and Lawrence Katz, Carnevale and Rose note that the bachelor's degree premium rose markedly between 1980 and 2005, from 48 percent to 81 percent.[12] That would seem to indicate that college education is becoming more valuable in the labor market.

There are numerous problems, however, with simply concluding that because enrollment, degree attainment, and the college wage premium all rose along with spending, spending increases were good investments. The first is that in looking at averages one can miss a lot of data, and many people with college degrees might not get much economic value from them. The second is that we might be fueling credential inflation, in which the difference between earnings for people with a bachelor's degree and those with only a high school education are large not because one attains valuable skills pursuing a degree, but because degrees are so commonplace—and perhaps signal some basic threshold level of intelligence and work habits—that employers reflexively screen out job seekers without degrees. Finally, there

are very large percentages of people who enroll in college, perhaps lured by the promise of government aid to pay for it, who do not end up getting degrees. Their payoff is often small or negative.

There's a Lot That Is Not Average

One powerful sign that a significant proportion of degree holders are not benefiting from their degrees—or, at least, that taxpayer funding of their degrees is wasteful—is that about 33 percent of bachelor's degree holders are in jobs that do not require a degree.[13] This rate has been rising, from about 11 percent of graduates underemployed in 1967.[14]

Carnevale and Rose assert that this underemployment is not necessarily a sign that college education is economically wasted. They note that in nondegree occupations people with degrees tend to make significantly more than those without. What they discount is the strong possibility that having a degree doesn't *cause* someone to be, say, a better dishwasher,[15] but that someone who possesses the punctuality, discipline, and so forth, that make him a superior employee would also make him more likely to complete college. In that case, the correlation between holding a degree and higher pay does not mean that having the degree—or skills one might have attained in pursuit of it—causes the higher earnings.

On the flip side of this is that many people without college degrees outearn those with them. Famous examples are such billionaire college dropouts as Microsoft founder Bill Gates and Virgin Group founder Sir Richard Branson. Looking more systematically—and despite their strong support for college as a key to economic growth—Carnevale, Rose, and Cheah report that 14 percent of workers with no more than a high school diploma earn at least as much as the median bachelor's holder, and 1.3 percent of people with less than a high school education earn at least as much as the median possessor of a professional degree, such as a doctor or lawyer.[16] And critically, one's field makes a big difference in potential earnings. Degrees in several types of engineering tend to lead to very high earnings, while degrees in the arts or social work tend to lead to very low earnings.[17]

Credential Inflation

How about the credential inflation possibility? There is good reason to believe that credential inflation is happening; that a bachelor's degree is increasingly easy to get, pushing a need to obtain yet higher credentials—even without gaining additional skills—to obtain employment that previously required no such degree. University of Pennsylvania sociologist Randall Collins argues that that this is exactly what's been occurring for decades:

> In the 1960s and '70s, as competition for managerial positions grew among those who held bachelor's degrees, M.B.A.'s became increasingly popular and eventually the new standard for access to corporate jobs. Holders of such degrees have attempted to justify the credential by introducing new techniques of management—often faddish, yet distinct enough to give a technical veneer to their activities. Similarly, credentialed workers in other occupations have redefined their positions and eliminated noncredentialed jobs around them. Thus, the spiral of competition for education and the rising credential requirements for jobs have tended to be irreversible.[18]

Economist Richard Vedder has begun to put numbers on the credential inflation problem. He notes, for instance, that in 1970 the unemployment rate for holders of four-year degrees was about a quarter of that of the general population. By 2010 the unemployment rate for four-year degree holders was about half of the general population's—a sizable increase in relative unemployment for people with college degrees. He also notes that in the major economic downturn

The correlation between holding a degree and higher pay does not mean that having the degree causes the higher earnings.

of 1982-83, overall unemployment was a bit higher than it was 2010—the midst of the current malaise—but unemployment for people with at least a bachelor's degree was appreciably *lower* than it was in 2010.[19]

Further evidence supporting the credential inflation theory is that over the last decade weekly wages have fallen for all groups except those with *advanced* degrees. Bureau of Labor Statistics data show that inflation-adjusted wages fell 6 percent from 2001 to 2010 for both workers without a high school diploma and workers with some college education who did not achieve a four-year degree.[20] Workers with only a high school diploma saw roughly a 5 percent drop, and those with only a bachelor's degree lost about 4 percent. Only advanced degree holders saw an increase—about 2 percent.

In addition to this, among bachelor's and higher degrees awarded, the percentage that were master's, first-professional, or doctoral degrees rose between the 1969-70 and 2008-09 academic years. In 1969-70, 26 percent of bachelor's-and-above degrees were advanced; in 1979-80, it was 30 percent; in 1999-00, 32 percent; and in 2008-09, 34 percent.[21] This trend, along with increasing real wages only for advanced-degree holders over the last decade, suggests that advanced degrees are significantly fueling college wage premiums, especially when the premiums are reported using bachelor's *or higher* as a single category.[22]

Further evidence supporting the credential inflation theory is that over the last decade weekly wages have fallen for all groups except those with *advanced* degrees.

Of course it is possible that we aren't seeing credential inflation, but that greater skills and knowledge are truly needed as the economy evolves, and advanced degrees actually require that one learn these things. This is the standard argument for why higher degrees are in increasing demand: they indicate higher levels of needed skill.

The evidence on these rationales, however, is mixed at best. First, it is difficult to establish that higher-level skills are increasingly required to get necessary work done, and that these skills could only be obtained in college degree programs (as opposed to on-the-job training or specific skills-development programs). We also lack a set measure of higher education learning outcomes in order to test whether more degrees do, in fact, mean greater learning. The balance of the evidence we do have, however, tilts more toward the credential-inflation hypothesis than greater-human-capital hypothesis.

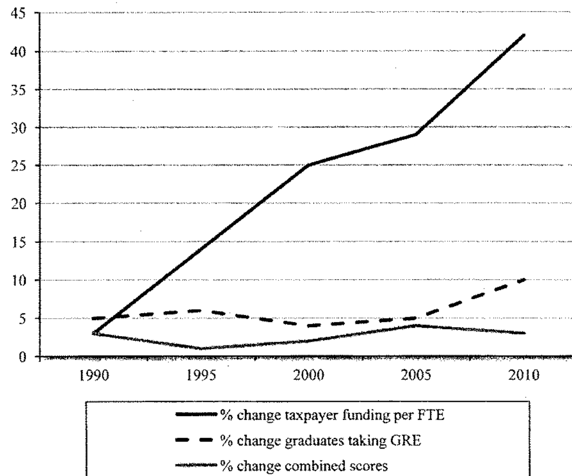
One test for which we have many years of data to help gauge learning is the Graduate Record Exam (GRE), which individuals with an undergraduate degree (or working on one) typically take if they plan to pursue nonprofessional graduate studies. Already, we can see the limit of the test: it is only taken by students hoping to pursue graduate-level studies, and not by students who are content with a bachelor's degree or who seek professional degrees. That means it is almost certainly not representative of the knowledge of the "average" college graduate. With that in mind, what do the GRE scores show us?

Figure 10 plots percentage changes in combined verbal and quantitative GRE scores against percentage changes in total taxpayer-funded aid per FTE. It also plots the change in the percentage of bachelor's degree holders taking the GRE since 1985.

What the chart shows is that both the percentage of students taking the GRE and average scores had slight upward trends since 1985. Spending per FTE, however, also trended upward, and at a far faster pace. The fact that rising scores have accompanied increasing participation rates suggests that degree holders might be learning more, bolstering the argument that more degrees has meant rising human capital. But that's during a time of large spending increases. And remember the big caveat: GRE test takers are almost certainly not representative of all undergraduate students. It is also difficult to know how the test might have changed—overtly or subtly—over time.

Similarly suggestive, but revealing in the other direction, are findings in *Academically Adrift: Limited Learning on College Campuses*, by Richard Arum and Josipa Roksa.[23] According to their research, which looked at

Figure 10
Changes in GRE Scores, Percentage Taking GRE, and Taxpayer Funding per FTE



Sources: U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 344, nces.ed.gov/programs/digest/d10/tables/dt10_344.asp?referrer=list. : U.S. Department of Education, *Digest of Education Statistics, 2010*, Table 380, nces.ed.gov/programs/digest/d10/Figures/dt10_380.asp?referrer=list, and Table 382, nces.ed.gov/programs/digest/d10/Figures/dt10_382.asp?referrer=list, April 2011; The College Board, "Trends in Student Aid 2010," trends.collegeboard.org/student_aid; State Higher Education Executive Officers, State Higher Education Finance, www.sheeo.org/finance/shef-home.htm; and National Science Foundation, "Academic Research and Development Expenditures: Fiscal Year 2009," Table 1, http://www.nsf.gov/statistics/nsf11313/.

Collegiate Learning Assessment scores for 2,322 students at a mix of four-year schools, 45 percent of students demonstrated no significant learning in their first two years of college and 36 percent demonstrated no learning in four years.[24] Those are very large percentages of students apparently getting little or no new knowledge from higher education.

This is worrisome, but it must be qualified. The Collegiate Learning Assessment is aimed at "critical thinking," which is a notoriously difficult outcome to measure. In addition, the sample of students wasn't randomly selected and consists only of students in four-year institutions. Finally, the study is not longitudinal, so one cannot see if learning has been growing or declining over time.

The only representative assessment we have of the abilities of college grads comes from the National Assessment of Adult Literacy, "a nationally representative assessment of English literacy among American adults age 16 and older."[25] The problem is that the assessment has only been conducted twice—in 1992 and 2003—so we have only a short, two-point trend line to consider. Moreover, the test is only one measure of

Forty-five percent of students demonstrated no significant learning in their first two years of college and 36 percent demonstrated no learning in four years.

Literacy among college grads dropped at roughly the same rate that enrollment grew, and taxpayer funding per student was markedly increasing.

learning, and no doubt fails to capture many specific skills people acquire in college.

That said, what that trend shows is not good. In almost all types of literacy—prose, document, and quantitative—the percentage of people with at least "some college" demonstrating proficiency decreased markedly between 1992 and 2003. More disturbing, the percentages also plummeted for people with bachelor's degrees and graduate degrees. For instance, the percentage of bachelor's holders proficient in prose literacy dropped from 40 to 31 percent, and in document literacy from 37 to 25 percent. Among adults with at least some graduate education, there were proficiency drops from 51 to 41 percent in prose, and from 45 to 31 percent in reading documents.[26] To put that in context, between 1990 and 2000 the number of FTE college enrollees rose 13 percent and total taxpayer funding per FTE increased 21 percent. So literacy among college grads dropped at roughly the same rate that enrollment grew, and taxpayer funding per student was markedly increasing. It's a finding that suggests serious credential inflation and little overall bolstering of human capital.

Noncompleters

In addition to major underemployment among college grads and strong evidence of credential inflation, it is necessary to explore the possibility that taxpayer subsidies for higher education fuel noncompletion of studies. It is possible that some students might enter college because aid makes it less expensive than it otherwise would be but do not finish because they lack the necessary ability or drive to do so. In other words, aid could have the unintended effect of encouraging people to tackle something that they might not be prepared to handle.

Once again, this is not easy to determine. For one thing, we do not know whether people who entered college and did not complete it would have done so in the absence of aid. In addition, we do not have much long-term data to draw on to correlate greater taxpayer funding and completion rates. Moreover, what little longitudinal data we do have is only for first-time, full-time post-secondary students. Yet again, the data are only suggestive, not conclusive.

To the extent the information we have tells us anything of value, it is overall very discouraging, although it may be improving slightly. According to the *Digest of Education Statistics*, the percentage of bachelor's degree seekers who complete their degrees within four years is very low. The trend starts with students who began their studies in 1996 and remains low through the cohort that started in 2002. Only 33.7 percent of the 1996 cohort completed their degrees within four years, rising to only 36.4 percent for the 2002 group. There are similar trends for six-year grad rates: only 55.4 percent of 1996 starters had finished within six years, as had only 57.3 percent of 2001 starters. The absolute graduation rates were very poor, though at least the trajectory was slightly upward.[27]

Things are worse for two-year programs, with slightly downward trends. Only 29.3 percent of students who started two-year programs in 1999 had finished within three years. Among 2005 starters, only 27.5 percent had finished within three years.

What does this tell us? In an absolute sense, very small percentages of first-time, full-time students are completing their programs, even well beyond the time it is supposed to take them. The long-term trends are more mixed, but still disturbing, with four-year completion rates rising slightly while two-year rates dipped. At best, then, the trends are a wash—improving a bit for four-year programs, worsening for two-year—and the absolute performance is dismal.

Of course, whether or not this massive noncompletion problem is attributable to student aid is impossible to prove. But it does show that, with almost two-thirds of college students receiving some sort of aid, lots of students are getting taxpayer dollars and not completing their studies. Many people who are, apparently, not prepared for college are entering it and are paying for the

experience at least partially with taxpayer funds.

The Big, Clear Problem: Price Inflation

The presumption behind many of the taxpayer-funded programs for colleges and, especially, students, is that the money will make higher education more affordable and, hence, boost enrollment and human capital. But underlying this is the assumption that colleges will not raise their prices and capture student aid, use direct subsidies to buy items of questionable educational value such as new recreation centers, or hire more administrators, instead of using the funds to keep prices down. That assumption is demonstrably incorrect.

There is significant debate about whether student aid drives college price increases, though as we'll see, arguments against the possibility are weak. There is no question, however, that colleges and universities have been raising their prices at a very brisk pace in recent decades, and that those increases have largely nullified aid increases. A 2003 report from the U.S. House Subcommittee on 21st Century Competitiveness captured the problem nicely:

> There is no question that the federal contribution to student aid programs has been significant, and has increased much more quickly than the rate of inflation in order to keep pace with college costs. However, college costs have risen dramatically over the past three decades, and even the immense federal contribution has struggled to keep pace with skyrocketing tuition increases.[28]

Some basic numbers tell the tale. According to the College Board, real average tuition and fees at public four-year colleges rose by about $5,500 between 1980 and 2010, and by about $17,800 at private four-year schools. Meanwhile, total aid per student, which comes primarily through government, rose by $8,165, likely roughly equaling the average tuition increase when weighted by enrollment in public and private schools.[29] Indeed, adjusting aid for enrollment and average prices in three higher education sectors between the 1986-87 and 2006-07 school years reveals that "sticker prices" rose roughly 68 percent, but after-aid prices inflated only about 29 percent.[30] And note that aid is higher for students at the most expensive colleges and universities because, while prices a student faces vary from institution to institution, the student's "expected family contribution"--basically, what the federal government determines a student is able to pay—stays fixed, which means that government-provided aid makes up more of the difference at the higher-priced schools.

Clearly price increases swallow a lot of aid. But does aid fuel those increases? Unfortunately, many of the studies on this question are plagued by the use of short timeframes that might only capture one trough of a business cycle, or difficulties accounting for the fact that a student's aid eligibility automatically rises anytime prices increase.[31] But ultimately those problems, coupled with the reality that human beings will typically strive to maximize benefits for themselves, makes it almost impossible not to conclude that increasing aid enables colleges to raise prices, which schools do because they always believe they have need for even greater revenue. College presidents attest to this reality. Former Harvard president Derek Bok summed up the problem: "Universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires."[32] It's a more colorful way, essentially, of framing "Bowen's Law," named after economist and multiple-college president Howard Bowen, which essentially states that "colleges raise all the money they can, and spend all the money they can raise."[33] There is also, critically, research that does indeed find that increasing aid fuels rising prices, but the findings are fragmented by type of aid program, school, and so forth.[34]

Admittedly, there is no incontrovertible

Former Harvard president Derek Bok summed up the problem: "Universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires."

proof that taxpayer-funded aid drives rampant college price inflation. Given the major obstacles in the way of obtaining such proof, it is unlikely it can ever be attained. However, the logical and corroborated expectation that colleges will grab ever-increasing funds, and the strong empirical evidence that some types of colleges do indeed raise prices to capture at least some types of aid, strongly suggest that schools raise prices because government aid makes more money available to them.

A Net Loss

What does all this tell us about the effect of taxpayer funding on higher education? At the very least, it suggests that massive increases in total funding coming through taxpayer-based programs have had considerable negative consequences. On balance the indicators we have suggest that, while the huge funding boosts might have produced more students and degrees, the average degree holder is likely becoming less well educated. Moreover, it is very difficult not to conclude that increasing aid has in large part enabled schools to raise their prices rather make college more affordable. Finally, existing evidence suggests that credential inflation is at work, with many bachelor's degrees representing little by way of new, necessary skills or knowledge attained in college, and that advanced degrees are now alone in accompanying rising wages. In light of all this, it seems likely that taxpayer funding of higher education has been a net loss and should be greatly decreased, if not completely phased out.

Taking money from taxpayers and giving it to students and schools extracts money from more efficient users—people who know their needs best and earned the money—and delivers it to less efficient users for whom the money is unearned.

Withdrawing federal intervention is, first of all, a legal issue. There is no constitutional justification for a continued federal presence outside of programs such as ROTC, which serves the legitimate function of supplying officers for the armed forces. Otherwise, Washington has no constitutional authority to be involved in higher education: such authority is not among the federal government's specifically enumerated—and only—powers. Even if federal college programs worked, the Constitution would have to be amended to allow them to continue.

But government intervention in higher education does not appear to work at any level, for all the reasons cited above. The reality seems to be that on net, government funding—federal, state, and local—of higher education is counterproductive. Indeed, at the state level researchers have found that greater state expenditures on higher education lead to lower rates of economic growth, other things being equal.[35] The likely reason? Taking money from taxpayers and giving it to students and schools extracts money from more efficient users—people who know their needs best and earned the money—and delivers it to less efficient users for whom the money is unearned.

Given this—and with the critical understanding that federal involvement is unconstitutional and should thus be completely eliminated—from an economic standpoint Congress at a minimum should eliminate loans for anyone other than truly low-income students—a designation perhaps pegged at the poverty rate—and should turn federal grant programs into loans. The goal of higher education, generally, is to increase one's earning potential, so there is no justification for giving away money from taxpayers—many of whom did not go to college—in order for someone else to get a degree and become wealthier. Moreover, ensuring that aid recipients ultimately bear the costs of their education would be a considerable deterrent against unprepared or unmotivated individuals enrolling in college. And, of course, private entities—both for-profit and charitable—could and would provide assistance to promising students as they already do, despite the huge crowding-out presence of taxpayer funds.

At the state level, subsidies to schools should be phased out, requiring institutions to survive and thrive by satisfying customers. At a minimum, state subsidies should be greatly reduced and "voucherized," connecting money to students, not schools. Schools should have to provide what paying custom-

ers want, not what educators can lobby for.

Does this mean public colleges would be defunded? No.

For one thing, colleges already get tens of billions of dollars annually in philanthropic support. There is every reason to believe that that funding would greatly increase if government were to stop footing much of the bill. Moreover, public colleges—especially large research universities—have big competitive advantages over most private schools because the research universities have very large campuses and extremely diverse and expensive facilities. That would make them natural first choices for people wanting to finance all sorts of research. And all levels of government could continue to fund university-based research, but it should be research that (1) serves legitimate government purposes, which for the federal government is only research enabling it to better execute its specific, enumerated powers, (2) cannot be done more effectively and efficiently by the private sector, and (3) does not substantially detract from schools' teaching missions.

The ultimate goal should not be to tear down the Ivory Tower. It should be to make higher education much more efficient and effective, and do so without creating net harm to society. Eliminating massive, forced, third-party funding of higher education is the key to doing that. Unfortunately, the tendency in public policy is to look simplistically at the loss of public funding rather than consider the potentially huge gains from changing the current system: college would have to become cheaper and more efficient as subsidies were eliminated; potential students would have to be more discerning when deciding whether and where to go to college; credentials would have their value restored; and, most importantly, taxpayers would find hundreds of additional dollars in their pockets each year to apply to the priorities in their lives, whether that's food, housing, education, or investing for the future. And, ultimately, doing that would produce a much more efficient outcome for society as a whole.

Conclusion

Taxpayer funding for higher education has ballooned over the last quarter century, but there is little evidence it has done net good. It has probably helped to produce more college enrollees, but it has almost certainly also underwritten poor academic results, rampant price inflation, and considerable college inefficiencies, and has taken increasing amounts of money from individual taxpayers that they would have applied to more important and effective endeavors. That makes the ultimate conclusion pretty clear: taxpayers have been paying far too much for higher education over the last, roughly quarter century, and getting far too little for it.

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The ultimate goal should be to make higher education much more efficient and effective, and do so without creating net harm to society.

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"UNBEARABLE BURDEN? LIVING AND PAYING STUDENT LOANS AS A FIRST-YEAR TEACHER," DECEMBER 15, 2008, REPORT BY NEAL MCCLUSKEY

Policy Analysis

No. 629 December 15, 2008

Unbearable Burden?

Living and Paying Student Loans as a First-Year Teacher

by Neal McCluskey

Executive Summary

It is widely believed that starting public school teacher salaries are too low, and student loan burdens are too high. If true, we could be facing a situation in which recent college graduates cannot afford to go into teaching because they will be unable to repay their college debts. Public policies are already being formulated on the basis of that conclusion.

Unfortunately, the only major analysis of teacher salaries and student debt published to date is based largely on borrowers' subjective feelings about debt manageability. Likewise, more traditional methods of determining how much debt is too much offer little help because they are based primarily on general risks of default predicted by debt-to-income ratios rather than the ability of specific borrowers to handle their debts and other expenses.

To provide legislators with a more objective basis for policymaking, this paper assesses first-year teachers' ability to pay back college loans given their actual salaries and expenses. This method eliminates both the subjectivity of determining debt burdens on the basis of debtors' feelings, and the imprecision of using correlations between debt-to-income ratios and overall default rates.

The findings presented here reveal that first-year teachers in even the least affordable of the 16 districts examined can easily afford to pay back their debts. Indeed, with just some basic economizing, a first-year teacher could not only pay back average debt, but could handle debt levels nearly three times the national average. This does not mean that current teacher salaries or student debt burdens are "right"—only markets can determine that—but it does mean that there is no need for policymakers to intervene in either teacher pay or student aid to assure that college graduates can afford to become public school teachers.

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Teaching: a prescription for a life of sacrifice, penury, and ramen noodles?

Introduction

There is a widespread belief that public school teachers are underpaid. Many people also feel that college debt loads are becoming unbearable. Put these assumptions together, and they make a career in teaching seem like fiscal suicide—a prescription for a life of sacrifice, penury, and ramen noodles.

Fear of this scenario becoming reality—as well as new graduates finding it difficult to enter other public service fields—has prompted significant policy rhetoric and political action in recent years. The State Public Interest Research Groups, an organization that in higher education advocates for increased student aid, called attention to the potential problem in 2006 with its report *Paying Back, Not Giving Back: Student Debt's Negative Impact on Public Service Career Opportunities*, which examines the impact of debt on prospective teachers and social workers.[1] In 2007, Congress enacted the College Cost Reduction and Access Act, which among other things forgives Federal Direct Loans to people in "public service jobs"—including public school teachers—after 10 years of continual public service and unmissed payments.[2] In May 2008, Rep. Joe Baca (D-CA) introduced the Teacher Education Assistance Creating Hope for our Future Act, which would forgive up to $25,000 in federal student loans to any teacher who completes five years of service.[3] The newly reauthorized Higher Education Act directs the U.S. Secretary of Education and the Office of Management and Budget to study the impact of student loan debt on graduates entering public-service careers, and includes loan forgiveness for some teachers and others employed in areas of "national need."[4] Finally, President-elect Barack Obama has proposed creating "Teacher Service Scholarships" for educators working in "high-need" fields or schools.

This paper tests assertions about unmanageable teacher debt by examining whether a first-year teacher with only a bachelor's degree and no prior teaching experience would have serious difficulty living on his salary while making average college loan payments.

Almost as important as what this paper does, it should be noted, is what it does not do: identify how much a first-year teacher *should* get paid or how much debt a college student *should* graduate with. These are among the biggest and most contentious debates in both K-12 and higher education, but what constitutes a "fair" debt burden or salary are inherently subjective questions that empirical testing cannot answer.

This does not mean that the findings presented here are unrelated to fairness. In most sectors of American life the market determines fair wages and loan terms by balancing the desires and preferences of employers and lenders with the desires and abilities of employees and borrowers. Through millions of individual, voluntary agreements, lenders, borrowers, employers and employees arrive at borrowing and wage levels acceptable to all parties. These are truly fair terms because they are imposed on no one against their will.

In contrast to this, current student loan levels and terms, as well as teachers' salaries, are generally determined by political forces, not voluntary agreements, and revolve around what one party can impose on the other through government. This is why arriving at the truth about teacher salaries and loan burdens is so important: in the absence of markets, it is often the most compelling *political* case that carries the day, and all parties spin reality to their advantage. When it comes to salaries and college debt, teachers and students have an interest in convincing policymakers that they are struggling, and that only more government assistance can help them. In contrast, budget-conscious policymakers and taxpayers have an incentive to portray students and teachers as flush with cash in order keep spending down. We have to get past this spin. To make the political process work as well as possible, we have to use real debt and expense numbers to determine whether teacher salaries are too low and student debt burdens too high for first-year teachers to make ends meet.

Teacher Pay in Brief

In order to put the question of student loan affordability in context and assess the degree to which teachers can supplement their public school income, it is necessary to understand how they are paid. For the most part, public school teachers' salaries are fixed on ladders set at the district level, usually, but not always, through collective bargaining between the school board and district's school-employee union. Steps on the salary ladder are ordinarily based on a teacher's experience and education level; a teacher who has taught for 10 years and has a master's degree will earn more than a teacher with two years of experience and a bachelor's degree. There are exceptions to this—some states and districts are looking to differential pay to attract teachers in shortage areas like mathematics, science, and special education, or to pay teachers on the basis of "merit"—but the norm is still the salary ladder.

Still more contentious than the structure of teacher remuneration is the actual amount that teachers get paid, especially relative to other professions. Quantifying teacher pay sounds like it should be straightforward, but a lot depends on how the money and time are divvied up. Perhaps as a result of this, the public appears to have a deflated sense of teachers' salaries. According to a recent survey, respondents underestimated the average public school teacher salary in their state by about 30 percent, or $14,370.[5]

Using the most basic measure of payment—annual wages—teacher pay is above the national average. According to the Bureau of Labor Statistics' Occupational Employment Statistics survey, in May 2007 the mean annual wage for all nonfarming occupations was $40,690. Elementary and secondary school teachers, in contrast, had mean wages over $50,000.[6]

Of course, it is most informative to compare teachers to people in lines of work with similar requirements, and when looking strictly at salaries, teachers do tend to earn less than other professionals. An analysis in *Education Week*'s 2008 *Quality Counts* compendium, which used two years of data from the U.S. Census Bureau's American Community Survey, revealed that on average public school teachers earned 88 cents for every dollar earned by workers in sixteen "comparable" occupations, including accountants, computer programmers, and occupational therapists. The authors report that, using their methodology, public school teachers earned a median salary of $44,690 while members of the other professions earned a median salary of $50,784.[7]

Though overall salary data are useful, especially for understanding teachers' basic pay, many researchers argue that it is not a full portrayal of teachers' monetary compensation, in large part because it fails to account for actual time worked. With school calendars featuring many built-in breaks—including roughly two-and-a-half months in the summer—and school days averaging around only 6.5 hours in length, it is reasonable to suspect that teachers work fewer hours for their salaries than other professionals.

Recent analyses of Bureau of Labor Statistics data taken from the National Compensation Survey confirm this suspicion. Looking at 2001 data, economist Richard Vedder compared teachers' *hourly* earnings to those of numerous other professionals and found that teachers out-earned architects, mechanical engineers, biological and life scientists, and several other professionals. In 2000, the average hourly wage for a job defined as a "professional specialty" by the BLS was $27.49, reports Vedder, while the average wage for elementary school teachers was $28.79, secondary school teachers $29.14, and special education teachers $29.97.[8] Using 2005 NCS data, the Manhattan Institute's Jay Greene and Marcus Winters examined hourly teacher pay and arrived at similar findings. They discovered that the average public school teacher made $34.06 per-hour in 2005, 11 percent more than the average professional specialty and technical worker.[9]

These analyses, while making more of an apples-to-apples comparison than simply comparing annual salaries, are still not wholly

The average public school teacher made $34.06 per hour, 11 percent more than the average professional specialty and technical worker.

satisfactory, primarily because they may undercount time worked by teachers and overcount time worked by other professionals. Sean P. Corcoran and Lawrence Mishel of the Economic Policy Institute note, for instance, that NCS data count paid time off such as paid vacations and holidays as hours worked for most professionals but not teachers, who are typically paid for roughly a 180-day year that does not include holidays and paid vacations. Greene and Winters did not adjust for this according to Corcoran and Mishel, inflating nonteachers' wages for hours *actually worked*. A more accurate measure, they argue, would calculate nonteachers' hourly pay using only days actually worked and excluding paid vacation and holidays.[10]

Doing what Corcoran and Mishel suggest still demonstrates much greater comparability between teacher and other professional pay than is indicated by annual salaries alone. Using OES data from May 2007, a comparison of average teacher salaries—including *private* school teachers, who get paid nearly 40 percent less than public school teachers[11]—and a few other professions included in the *Quality Counts* data bear this out. The lowest average hourly earnings for non-special education, nonvocational, elementary, middle, and secondary school teachers accrue to elementary school teachers at $35.49, a figure derived using 188 days (183 instructional and 5 in-service), 7.5 hours per day, and a mean annual wage reported by the OES of $50,040. In comparison, accountants and auditors, registered nurses, insurance underwriters, and computer programmers earn hourly wages of $32.91, $32.54, $31.31, and $37.51, respectively, figures determined by dividing the mean annual wage for each job as reported by the OES by actual hours worked, or 240 days a year (52 weeks a year, five days a week, minus ten days of paid vacation and ten paid holidays) for eight hours a day.[12] Only computer programmers made more per-hour than the lowest-paid subset of teachers.

Even during months when they are teaching, educators work less time than other professionals.

One last objection to hourly-earning comparisons is that teachers work many more hours than are reflected in official time spent at school. They grade papers, plan lessons, call parents, often after school and on weekends. "Six or seven hours is the 'contracted' workday, but unlike in other professions, the expectation for teachers is that much required work will take place at home, at night and on weekends," explains a "Myths and Facts" page on the website of the National Education Association. "For teachers, the day isn't over when the dismissal bell rings."[13]

It is true that teachers often work at home, but a recent BLS study suggests that even during months when they are teaching, educators work less time than other professionals. According to the study, in which participants logged how much work they did each day and where they did it, teachers worked on average 18 fewer minutes per day than other professionals. And that included only days when the subjects worked—summer and other vacation days were not included in the average.[14]

The longest period during which teachers are not working for their salary, of course, is during the summer, when they often pursue additional employment. Critically, *no potential income from summer employment is included in this analysis of first-year teacher compensation*, but many teachers do earn income by tutoring, managing pools, working at summer camps, house painting, freelance writing, and a variety of other jobs. According to the National Education Association, 45 percent of public school teachers worked during the summer of 2000.[15] Moreover, according to the BLS, roughly half of all teachers do not work past 4:00 p.m. on any given day, providing additional time that could be used for a second job. And there is evidence that teachers do use time this way: the BLS reports that while 12 percent of other professionals had second jobs while working in their primary occupation, 17 percent of teachers had second jobs during periods *when they were teaching*.

Debates over teacher compensation will certainly continue, but two important things are clear for our purposes. The first is that teachers get paid roughly on par with other comparable professionals on an hourly basis and have much more time in a year to earn money

beyond their salaries. This makes it politically difficult to justify higher pay for teachers even if their annual compensation is too low to afford average student debt because, on an hourly basis, they would have to be paid in excess of comparable professionals. The second reality, however, militates against this first concern by making it clear that teachers have plenty of time to significantly supplement their income. This last point is especially important to keep in mind when considering the analysis presented later in this report, which, because it does not include any potential income beyond a teacher's basic salary, *almost certainly underestimates a first-year teacher's total annual income.*

Student Loans in Brief

There is no question that the "sticker price" of higher education–the published cost of tuition, fees, room and board–has gone up markedly over the last couple of decades. According to data from the College Board, the average inflation-adjusted cost of tuition, fees, and room and board at four-year private colleges grew 70 percent between 1987–88 and 2007–08, from $19,000 to $32,307. Over the same period, the cost at a four-year public institution rose 78 percent, from $7,631 to $13,589.[16]

So, how have students been able to afford these significant price increases? A good bit of the answer is financial aid, much of which comes through student loans. College Board data show that between 1986–87 and 2006–07, the average inflation-adjusted aid per full-time-equivalent student (which includes undergraduate and graduate students) rose 139 percent, from $3,967 to $9,499. This was split almost equally between grant aid (which students don't have to pay back) and federal loans (which they do), though tax benefits started to creep into the equation in 1998–99. Between 1986–87 and 2006–07, inflation-adjusted grant aid per full-time-equivalent student rose 131 percent, from $2,014 to $4,648, and federal loan aid rose 138 percent, from $1,826 to $4,337.[17]

In addition to these aid sources, students have increasingly taken out private loans which are not backed with taxpayer dollars and often don't carry the generous interest rates and repayment terms that federal backing makes possible. The College Board doesn't provide a per-pupil breakdown of private borrowing, but reports that in the 2006-07 academic year $17.1 billion was borrowed from private lenders.[18] On the flip side, many students don't borrow any money to attend college; about one-third of four-year college students graduate debt-free.[19]

The concern among students, parents, politicians, and student advocacy groups is that loan amounts are becoming increasingly unbearable. According to the Project on Student Debt, between 1993 and 2004 the average amount owed by seniors who graduated with debt rose 58 percent after adjusting for inflation, going from $12,152 to $19,200, an appreciable rate of increase that many people fear will only grow if tuition continues to skyrocket.[20] This concern is especially acute for students intending to go into what many consider low-paying careers, and it's what prompted the State PIRGs to publish *Paying Back, Not Giving Back: Student Debt's Negative Impact on Public Service Career Opportunities,* a report examining the impact of debt on students planning to go into teaching or social work.

Paying Back, Not Giving Back asserts that given "high debt levels, the congressional fixed 6.8 percent interest rate for federal loans, and low starting salaries . . . 23 percent of public four-year college students graduate with too much debt to manageably repay their loans as a starting teacher," as do 38 percent of private-school graduates.[21] The solutions provided in the report are a bit vague, but can essentially be summarized as: (1) increase need-based grant aid; (2) put caps on the amount of debt that students have to pay back and the length of time they can be saddled with debt; (3) regulate private loans more strictly, including their interest rates and terms; and (4) provide financial incentives (presumably federal) for state governments and colleges to keep tuition costs low.[22]

Adjusted for inflation, college aid has risen 139 percent over the past 20 years.

The more aid students get from taxpayers, the less sensitive they are to price increases, and the more colleges can charge.

While these measures may sound reasonable, they are likely to do more harm than good. Expanding aid either by increasing grants, making it easier to discharge debts, or both, will continue to drive the third-party-payer problem that has been inflating tuition prices. Essentially, the more money obtained through taxpayers (the third parties in the student-school transaction) that students and their families can use to pay for college, the less sensitive students are to price increases, the more they demand, and the more schools charge without imposing any additional "pain" on students.

The College Board data cited earlier suggest that this is happening: while real, enrollment-weighted, tuition, fee, and room-and-board costs for private and public four-year schools have risen around 75 percent over the last two decades, aid per student has grown almost 140 percent. Applying average aid per full-time equivalent student to public and private four-year college costs and adjusting to make aid amounts proportionate to the difference between public and private school costs (aid data are currently available only as an average for all students, but aid generally rises as costs rise), one can approximate the degree to which aid makes students less sensitive to increasing prices.

While the real "sticker price" rose 70 percent over the last two decades for private colleges, going from $19,000 to $32,307, the after-aid costs rose only 42 percent, moving from $12,335 to $17,489. At public schools, a 78 percent sticker price increase—$7,631 to $13,589—felt more like a 48 percent boost from $4,933 to $7,320.[23] Of course, students are sensitive to loans even when they are heavily subsidized, so not all aid makes students completely numb to real price increases. On the other hand, lower-than-market interest rates make them less sensitive than market rates, and with federally subsidized Stafford loans, the government pays the interest while students are in school and for six months after they graduate.

What would be the likely effects of requiring private lenders to offer lower interest rates and/or more generous repayment terms? Both options are dangerous due to the phenomenon already discussed: the cheaper the funding, the less the constraint on students' ability and willingness to pay, and the more schools can charge. In this regard private loans perform more of a public service than federal loans because they give a greater impetus to keep prices down. There is also a serious question of fairness when government puts its thumb on the lending scale. True balance is struck when borrower and lender find terms that are mutually agreeable, not when government privileges one party over the other.

Finally, proposals to have Washington offer schools incentives to keep tuition down are not as simple as they sound. One possible approach would involve revoking aid to students at institutions that raise tuition faster than a pre-approved rate, but this would require expensive, in-depth monitoring, and would prevent many schools from raising tuition when necessary to expand or improve their product. The other approach, which appears in a mild form in the most recent Higher Education Act reauthorization, would penalize states by withholding access to some federal money if they did not hold funding to public universities at or above average levels for previous years. Such a move ties the hands of state legislators who are attempting to balance budgets, and it hurts state taxpayers who may have other priorities than higher education.

Difficult tradeoffs confront any effort to deal with increasing student loan burdens, whether the tack is to increase access to aid or coax schools to curb prices. With these potentially painful tradeoffs in mind, it is important to know for certain whether student debt is truly so burdensome that it seriously threatens graduates' ability to go into fields like teaching.

Prevailing "Unmanageable Burden" Calculations

With teachers' remuneration appearing low relative to comparable professionals—that

is, if one doesn't account for the additional time teachers have available for other employment—and with college graduates' debt burden growing, some people believe that many new teachers will find their student debts unmanageable. But does reality bear this out? To answer the question, we need first to know what is meant when debt is called "unmanageable."

In general, guidelines for how much debt is too much vary widely and depend a great deal on individual financial circumstances and tolerances for risk. A general rule of thumb according to many financial advisors is to never let one's debt-to-income ratio exceed 36 percent.[24] Just for student loans, the general rule is to not let debt exceed between around 8 and 15 percent of one's income.[25] The rationale is that higher debt-to-income ratios significantly increase the risk that borrowers will default on their loans.

In determining how many teachers face overly burdensome debt, the State PIRGs used an index created by economists Sandy Baum and Saul Schwartz intended to identify unmanageable debt as perceived by borrowers, *not* what lenders identify as debt levels that dangerously increase the chance of default. In the currently available version of Baum and Schwartz's paper, they use 20 percent of income beyond 150 percent of the poverty line as their ceiling for annual payments.[26] So, for instance, Baum and Schwartz note that 150 percent of the poverty line for a single person was $14,700 at the time they were writing. If a new teacher were to make $20,000, using Baum and Schwartz's index her "manageable" annual debt payment would be $1,060, or 20 percent of the difference between her total income and 150-percent of poverty. The State PIRGs, it should be noted, report having used a version of Baum and Schwartz's index that used 20 percent of income beyond half of the median pre-tax income for a single American—not 150 percent of the poverty line—rendering their results a bit different from what would have been yielded using the currently available version of Baum and Schwartz's paper.[27] Half of median pre-tax income was $18,771.

In keeping with their goal of assessing debt burden from the borrower's perspective, Baum and Schwartz's determination of the debt maximum is informed by—but not systematically based on—several considerations. Among them are the improved earnings generated by having a bachelor's degree rather than just a high school diploma; financial-need analyses that place college costs in context with other financial demands; and analyses showing that borrowers' perceptions of how burdensome their loans are increase as their ratios of loan payments to pre-tax income rise.[28]

The State PIRGs used Baum and Schwartz's index to calculate percentages of new graduates of public and private four-year colleges in each state who would have had unmanageable debt had they taken teaching jobs in the state. First, they adjusted the $18,771 half-of-median pre-tax income baseline up or down according to state-by-state median income differences. Next, they subtracted those adjusted baselines from average starting teacher salaries in each state and multiplied the remainders by 20 percent, yielding "manageable" annual loan repayment maximums. They then divided those annual maximums by 12 to get monthly maximum payments and calculated the debt level that would generate such payments for a 10-year loan with a 6.8 percent interest rate, the standard rate for subsidized Stafford loans. (The standard subsidized Stafford interest rate has since dropped and will continue to do so each year before resetting to 6.8 percent for the 2012–13 school year.) Finally, the State PIRGs calculated what percentage of new graduates from public and private four-year institutions in each state had debt levels that generated monthly payments beyond the maximum, and identified those as the percentage of new graduates whose debt was too high to manage on a first-year teacher's salary. For public school graduates, New Hampshire had the highest debt problem, with 54 percent of recent grads facing debt levels too large to handle on an average first-year teacher's salary, while Georgia was lowest at 12 percent.

The State PIRGs' analysis offers a bleak picture for first-year teachers, but it suffers

People believe that many new teachers will find their student debts unmanageable. Does reality bear this out?

Whether or not teachers say they feel burdened is of secondary concern to whether or not they can actually pay their debts.

serious problems and policymakers should not base decisions on it.

First, Baum and Schwartz's burden index—on which the State PIRGs based their calculations—is highly subjective, based in part on borrowers' self-reported feelings. Baum and Schwartz acknowledge this problem in their paper, noting that "deriving one set of benchmarks from the data reported here clearly requires a subjective judgment."[29] Second, the State PIRGs use the median debt level for *all* new college graduates—not just prospective teachers—to calculate how manageable debt would be on a first-year teacher's salary. But many students no doubt consider costs and expected earnings when choosing colleges, and pick less expensive schools when their expected earnings are lower. Education majors' average debt level supports this: according to a 2005 U.S. Department of Education report, among students who borrowed for college and received their bachelors degrees in the 1999-2000 school year (the latest with available data), education majors borrowed $1,300 less than the overall average.[30]

The final and most important problem with the State PIRGs' methodology—and the underlying Baum and Schwartz analysis—is that it dances around reality, estimating burdens based on borrowers reported perceptions, not the *actual expenses first-year teachers are likely to face*. It is important to know how teachers feel about their debt burdens, especially if they pass those feelings on to potential teachers and discourage them from entering the profession. But what teachers report may be exaggerated, and whether or not they say they feel burdened is at best of secondary concern to whether or not they can actually pay their debts while maintaining a reasonable quality of life. Answering that primary question is the goal of our analysis.

Assessing Loan Manageability by Assessing Teacher Costs

Given average student debt, actual salaries, and expenses they are likely to face, can first-year teachers afford to pay back their loans? To answer that question, this paper examines a geographic and demographic cross-section of districts around the country. It uses the following 16 districts, about which more information is available in Appendix A:

- Allendale County Schools, South Carolina
- Baldwin Community Schools, Michigan
- Battle Creek-Ida Grove Community School District, Iowa
- Calipatria Unified School District, California
- Clay County Public Schools, Kentucky
- Coahoma County School District, Mississippi
- Dallas Independent School District, Texas
- Denver Public Schools, Colorado
- Duval County Public Schools, Florida
- Madison School District #321, Idaho
- Memphis City Schools, Tennessee
- New York City Public Schools, New York
- Pembroke School District, New Hampshire
- Phoenix Union High School District, Arizona
- Santa Maria Independent School District, Texas
- Seattle Public Schools, Washington

Overall, the districts range in physical location from the west to east coasts, are in areas with median household incomes ranging from $20,364 to $54,297 and include rural and urban districts. It is not a randomly selected sample, but rather one specifically chosen to maximize the diversity of the settings examined. For each of these districts, this paper reports 2007-08 salary information for a first-year teacher with a bachelor's degree and no previous experience, and estimates the costs of both necessary expenses such as debt repayment and rent, and discretionary expenses such as a cable television subscriptions and clothing purchases.

When examining the findings of this analysis, there are several important points to keep in mind:

1. **The teacher's income used here is only her base teaching salary.** As mentioned earlier, teachers have a great deal of time away from teaching during which they can, and often do, work other jobs that provide supplemental income. In addition, teachers often assume extra duties in their districts for which they get paid beyond their base salary, such as coaching teams, advising student groups, or helping to write curricula. Since no additional income is incorporated in this analysis, it almost certainly *underestimates, perhaps significantly*, the average first-year teacher's actual income.
2. **No efforts were made to economize on expenses.** The costs used for numerous goods and services are based on readily available offers and prices, and no special effort to find "deals" was made. In addition, housing is calculated for a single renter in an average-cost apartment, whereas recent graduates, regardless of profession, often have roommates in below-average apartments. This means it is very likely that a thrifty teacher could get the items used here for significantly less than the cost given.
3. **No special deductions or affordability programs were considered.** Some perks teachers get include housing assistance from their districts and educator-specific discounts from companies such as Barnes and Noble, Apple Computers, Ann Taylor, and others.[31] In addition, teachers and other taxpayers are often eligible for a variety of credits and deductions on their taxes. None of these or other potential savings were used in this analysis to calculate teachers' likely expenses.
4. **This is not a nationally representative sample.** While a serious effort was made to analyze a diverse set of districts, the sample was small and not randomly selected. Resources did not permit collection of a large, nationally representative sample, but it would be valuable to collect such a sample to verify the conclusions of this study on a truly national scale.

What were the specific conditions under which the calculations in this paper were made? More fine-grained details concerning the districts used and expenses tallied can be found in the appendices—and even more explicit data than that are available upon request—but it is important to understand a few major details up front.

The salary information is based on a 12-month breakdown—even if a teacher could opt to get paid on, say, a 10-month schedule—of annual salaries as reported by districts for a first-year teacher with a bachelor's degree and no experience. The monthly loan payment is based on a total loan of $20,011. It is derived from the most recent estimate of average loan burden for new college graduates as calculated by the Project on Student Debt adjusted for inflation, and the smaller average debt burden borne by education majors.[32] Finally, expenses include

- average inflation-adjusted rents for the district and surrounding areas;
- food consumption adhering to the U.S. Department of Agriculture's "liberal" food plan plus $32 monthly for eating out, the total of which was then adjusted for regional cost differences;
- medical and dental insurance costs borne by teachers;
- union dues, where applicable;
- costs to fill a 2000 Toyota Corolla with gasoline on a weekly basis;
- auto insurance costs for the Corolla;
- a car loan payment at a 7.43 percent interest rate and 60-month term;
- clothing purchases and laundry costs;
- miscellaneous costs that could include start-up furniture, housewares, and other new housing needs;
- telephone, internet, and television costs;
- federal and state (where applicable) taxes.

Teachers have a great deal of time away from teaching during which they can work other jobs.

New college graduates who become public school teachers can easily manage average college debt.

Appendix B presents the primary results for this income-expense analysis, and makes clear that while there was certainly variation in affordability, in none of the districts would a first-year teacher with average student debt be unable to live comfortably. Not only could a first-year teacher afford all of his staples like housing, food, and monthly student loan payments, he could afford to purchase numerous miscellaneous items, some of which he would likely already have, including dinnerware and furniture. Indeed, with the exception of Pembroke, New Hampshire, pro-rated over 12 months he could afford all those things with over $100 remaining at the end of each month. In Dallas, he would have $900 remaining at the end of each month.

In addition to overall affordability, the average debt-to-income ratio for the sample was 8 percent, with a high of 11 percent in Ida Grove, Iowa, and a low of 6 percent in Dallas and New York City. These results are well within the safe range of the debt estimates commonly accepted as manageable.

Clearly, first-year teachers in these districts could afford to live with security and relative comfort while making the monthly payments on average student debt. Another important question to answer, however, is what the *maximum* amount of debt is that a first-year teacher could afford. Knowing this would indicate how much students could spend on college and still manageably become public school teachers.

If we cut a bit of the most accessible "fat" from the consumption estimated in the primary analysis—those things that are nice to have but are not necessary for survival—we can get an idea. We calculate this not on a district-by-district basis, but based on the case of Pembroke, New Hampshire, the *least* affordable of the districts examined.

Splitting rent with a roommate on a still median-rent apartment in Merrimack County, New Hampshire, would immediately save $344 a month.[33] Dropping down from what the USDA considers a "liberal" expenditure on food to one that's "moderate"—but still keeping $32 a month for restaurants—would save an additional $61. Finally, getting rid of the teacher's landline telephone service, which would not be a big inconvenience as long as she keeps her cellular phone, as is increasingly common, saves $36 a month. Just making those changes would give the teacher an additional $441 to spend servicing her debt each month, which, added to the current monthly debt payment of $230, could cover monthly payments on a total debt of more than $58,000, an amount that approaches triple the national, inflation-adjusted debt average of $21,450 based on Project on Student Debt estimates.

An itemized estimation of both basic, teaching-salary-only income and likely expenses reveals that a first-year public school teacher could easily manage average student debt. The debt-to-income ratios are typically considered manageable by standard estimates, and teachers can afford numerous necessities and amenities almost always with $100 or more per month left over. In addition, when the maximum debt one could handle after making a few, fairly painless cuts is calculated, it is clear that no public policies need to be implemented either to raise teacher salaries or make college cheaper in order for teachers to be able to afford both their profession and student loans. This does not mean that teacher pay or college costs are currently "right" or "fair"—those are things only free markets can determine—but it does indicate that new college graduates who become public school teachers can easily manage average college debt.

Conclusion

Whether teachers are underpaid or overpaid, and whether student debt burdens are too great, are subjective questions that cannot be answered through empirical analysis. What can be determined empirically, however, is whether teachers with varying student-debt levels can afford to service their debt and pay for the necessities of life on a first-year public-school teacher's salary. Based on detailed analysis of the costs first-year teach-

ers are likely to face in demographically and economically diverse school districts around the country, the answer appears to be that they can afford average college debt, and well beyond average debt if they are willing to do some moderate economizing. Performing this same analysis on a larger, random sample of districts would be necessary to ensure nationally representative results, but compared to the subjective estimates typically used to identify "unmanageable" debt, the present analysis allows one to draw a more reliable conclusion: for a new graduate with no previous teaching experience, average student debt can be safely managed on a public school teacher's salary in widely varying districts around the country.

Appendix A: District Profiles

Note that for all categories, the most recent available U.S. Census figures were used. Population figures come from U.S. Census Bureau, "Population Finder." Household income figures and poverty rates were taken from U.S. Census Bureau, "State and County Quick Facts." Income figures were adjusted to 2007 dollars using the Gross Domestic Product Deflation Calculator at http://cost.jsc.nasa.gov/inflate GDP.html. This was done in order to make income figures coincide with the year for which teacher salaries and affordability were calculated. Also, for noncounty and nonurban districts the median household income for the county, rather than the district, was used because the prices and other economic conditions teachers would face would be more affected by the median income for the entire county.

Allendale County Schools
Location: Allendale County, South Carolina
Area Served: Entire County
Classification: Rural
Population Served, 2007: 10,475
Median Household Income, 2004: $21,527
Adjusted to 2007: $22,491
Percent Below Poverty Line, 2004: 32.1

Baldwin Community Schools
Location: Baldwin Village, Michigan
Area Served: Baldwin Village and surrounding communities
Classification: Rural
Population Served, 2007: 1,182[34]
Median Household Income, Lake County, 2004: $27,868
Adjusted to 2007: $29,116
Percent Below Poverty Line, Lake County, 2004: 19.7

Battle Creek–Ida Grove Community School District
Location: Battle Creek and Ida Grove, Iowa
Area Served: Battle Creek and Ida Grove
Classification: Rural
Population Served, 2007: 2,740
Median Household Income, Ida County, 2004: $40,421
Adjusted to 2007: $42,232
Percent Below Poverty Line, Ida County, 2004: 9.4

Calipatria Unified School District
Location: City of Calipatria, California
Area Served: City of Calipatria
Classification: Rural
Population Served, 2007: 7,638
Median Household Income, Imperial County, 2004: $33,674
Adjusted to 2007: $35,183
Percent Below Poverty Line, Imperial County, 2004: 18.5

Clay County Public Schools
Location: Clay County, Kentucky
Area Served: Entire County
Classification: Rural
Population Served, 2007: 23,730
Median Household Income, 2004: $19,491
Adjusted to 2007: $20,364
Percent Below Poverty Line, 2004: 34.3

Coahoma County School District
Location: Coahoma County, Mississippi
Area Served: Entire County
Classification: Rural
Population Served, 2007: 27,543

Median Household Income, 2004: $23,560
Adjusted to 2007: $24,615
Percent Below Poverty Line, 2004: 30.6

Dallas Independent School District
Location: Dallas, Texas
Area Served: City of Dallas and surrounding communities
Classification: Urban
Population Served, 2007: 1,240,499[35]
Median Household Income, 2004: $41,645
Adjusted to 2007: $43,511
Percent Below Poverty Line, 2004: 16.2

Denver Public Schools
Location: Denver, Colorado
Area Served: City and County of Denver
Classification: Urban
Population Served, 2007: 588,349
Median Household Income, 2004: $41,767
Adjusted to 2007: $43,638
Percent Below Poverty Line, 2004: 15.2

Duval County Public Schools
Location: Duval County, Florida
Area Served: Entire County
Classification: Urban
Population Served, 2007: 849,159
Median Household Income, 2004: $41,736
Adjusted to 2007: $43,606
Percent Below Poverty Line, 2004: 11.7

Madison School District #321
Location: Madison County, Idaho
Area Served: Entire County
Classification: Rural
Population Served, 2007: 36,647
Median Household Income, 2004: $32,569
Adjusted to 2007: $34,028
Percent Below Poverty Line, 2004: 15.6

Memphis City Schools
Location: Memphis, Tennessee
Area Served: City of Memphis
Classification: Urban
Population Served, 2007: 674,028
Median Household Income, 1999: $32,285
Adjusted to 2007: $36,902
Percent Below Poverty Line, 1999: 20.6

New York City Public Schools
Location: New York, New York
Area Served: New York City
Classification: Urban
Population Served, 2007: 8,724,527
Median Household Income, 1999: $38,293
Adjusted to 2007: $43,769
Percent Below Poverty Line, 1999: 21.2

Pembroke School District
Location: Pembroke, New Hampshire
Area Served: Pembroke, but the high school also serves three other towns
Classification: Rural
Population Served (Pembroke only), 2007: 7,353
Median Household Income, Merrimack County, 2004: $51,969
Adjusted to 2007: $54,297
Percent Below Poverty Line, 2004: 6.3

Phoenix Union High School District
Location: Phoenix, Arizona
Area Served: City of Phoenix
Classification: Urban
Population Served, 2007: 1,552,259
Median Household Income, 1999: $41,207
Adjusted to 2007: $47,100
Percent Below Poverty Line, 1999: 15.8

Santa Maria Independent School District
Location: Santa Maria, Texas
Area Served: Santa Maria and Bluetown-Iglesia Antigua
Classification: Rural
Population Served, 2000: 1,538
Median Household Income, Cameron County, 2004: $26,719
Adjusted to 2007: $27,916
Percent Below Poverty Line, 2004: 29.4

Seattle Public Schools
Location: Seattle, Washington
Area Served: City of Seattle
Classification: Urban
Population Served, 2007: 594,210
Median Household Income, 1999: $45,736
Adjusted to 2007: $52,276
Percent Below Poverty Line, 1999: 11.8

Appendix B: Data and Sources

Table B1
Teacher Income and Expenses, by District

	Allendale	Baldwin	BC-IG	Calipatria	Clay	Coahoma	Dallas	Denver
Income								
Monthly Salary	$2,422	$2,534	$2,177	$3,003	$2,808	$2,658	$3,625	$2,964
Expenses								
Loan Payment	$230	$230	$230	$230	$230	$230	$230	$230
Rent	$342	$434	$379	$565	$327	$403	$725	$707
Food	$354	$329	$329	$347	$354	$354	$354	$347
Medical	$93	$26	$6	$102	$0	$18	$24	$0
Dental	$0	$0	$8	$102	$21	$30	$13	$0
Union Dues	N/A	$83	N/A	$90	N/A	N/A	N/A	$14
Transportation	$166	$176	$171	$192	$169	$168	$169	$170
Auto Insurance	$155	$144	$88	$143	$249	$219	$174	$166
Car Loan Payment	$94	$94	$94	$94	$94	$94	$94	$94
Clothing/Laundry	$100	$100	$100	$100	$100	$100	$100	$100
Telephone (landline)	$13	$40	$25	$40	$33	$33	$33	$31
Telephone (cell)	$40	$40	$40	$40	$40	$40	$40	$40
Internet	$42	$30	$22	$30	$33	$33	$33	$31
Cable	$42	$38	$35	$38	$33	$33	$33	$31
Start-up/Miscellaneous	$80	$80	$80	$80	$80	$80	$80	$80
Taxes (State)	$132	$102	$96	$79	$138	$86	N/A	$137
Taxes (Federal)	$331	$348	$294	$453	$404	$366	$608	$443
Total Expenses	$2,214	$2,294	$1,997	$2,725	$2,305	$2,287	$2,710	$2,621
Income Remaining	$208	$240	$180	$278	$503	$371	$915	$343
% Income Remaining	9%	9%	8%	9%	18%	14%	25%	12%
Debt as % of Income	9%	9%	11%	8%	8%	9%	6%	8%

Continued next page

Table B1
Teacher Income and Expenses, by District—*Continued*

	Duval	Madison	Memphis	New York	Pembroke	Phoenix	Santa Maria	Seattle	Avg.
Income									
Monthly Salary	$3,083	$2,500	$3,224	$3,614	$2,542	$3,079	$2,833	$2,720	$2,862
Expenses									
Loan Payment	$230	$230	$230	$230	$230	$230	$230	$230	$230
Rent	$670	$334	$614	$790	$687	$697	$463	$808	$559
Food	$354	$347	$354	$378	$378	$347	$354	$347	$352
Medical	$0	$0	$44	$0	$123	$0	$0	$0	$27
Dental	$95	$0	$0	$0	$8	$7	$15	$0	$19
Union Dues	N/A	N/A	N/A	$90	$57	N/A	N/A	$70	$25
Transportation	$176	$174	$167	$180	$166	$172	$169	$183	$173
Auto Insurance	$152	$117	$213	$308	$96	$262	$162	$188	$177
Car Loan Payment	$94	$94	$94	$94	$94	$94	$94	$94	$94
Clothing/Laundry	$100	$100	$100	$100	$100	$100	$100	$100	$100
Telephone (landline)	$33	$31	$33	$31	$36	$29	$42	$31	$32
Telephone (cell)	$40	$40	$40	$40	$40	$40	$40	$40	$40
Internet	$33	$31	$33	$31	$36	$29	$42	$31	$33
Cable	$33	$31	$33	$31	$36	$29	$42	$31	$34
Start-up/Miscellaneous	$80	$80	$80	$80	$80	$80	$80	$80	$80
Taxes (State)	N/A	$113	N/A	$272	N/A	$71	N/A	N/A	$77
Taxes (Federal)	$473	$342	$508	$605	$349	$472	$410	$382	$424
Total Expenses	$2,563	$2,064	$2,543	$3,260	$2,516	$2,659	$2,243	$2,615	$2,476
Income Remaining	$520	$436	$681	$354	$26	$420	$590	$105	$386
% Income Remaining	17%	17%	21%	10%	1%	14%	21%	4%	13%
Debt as % of Income	7%	9%	7%	6%	9%	7%	8%	8%	8%

Sources

This section lists all data sources except for the specific bundles of goods used to estimate clothing, start-up/misc., and telephone (landline)/internet/television costs. That information is available upon request.

Monthly Salary. The annual salary for a first-year teacher with a bachelor's degree and no prior experience as reported by the district either on its website or in response to a direct query, divided by 12. The figures are for the 2007–08 school year. The following are the links for salary ladders available on the Web. For districts without websites listed here, salary data were obtained by calling district offices.

Allendale County Schools: The 2007-08 salary schedule is unavailable on the district's website and was obtained through the business and finances department. The 2008–09 salary schedule is available at www.acs.k12.sc.us/downloads/737F0EB386D349E082F8EA54C5551A45/Certified%20Salary%20Schedule%2008-09.pdf.

Baldwin Community Schools: The 2007-08 salary schedule is unavailable on the district's website and was obtained through the central business office. The 2005-06 salary schedule and criteria for increases can be found in Appendix A-1 of the Master Agreement between the Baldwin Community Schools and Baldwin Education Association, available at www.baldwin.k12.mi.us/filesection/275/BEA_MasterAgreement_2005-2008_Final.pdf.

Battle Creek-Ida Grove Community School District: The 2007-08 salary schedule is unavailable on the district's website and was obtained through the business manager.

Calipatria Unified School District: The 2007-08 salary schedule is unavailable on the district's website and was obtained through the business manager.

Clay County Public Schools: The 2007-08 salary schedule is unavailable on the district's website and was obtained through the finance officer.

Coahoma County School District: The 2007-08 salary schedule is unavailable on the district's website and was obtained from the payroll clerk.

Dallas Independent School District: The 2007-08 salary schedule is no longer available on the district's website, from which it was obtained. The 2008-09 schedule is available in the district's "Salary Handbook" at www.dallasisd.org/employment/nas/SalaryHandbook.pdf.

Denver Public Schools: The 2007-08 salary schedule was found in the "Addendum to the DPS/DCTA Agreement: September 1, 2007" available at hr.dpsk12.org/pay/pdf/2007%20Salary%20Schedule%20Changes.pdf.

Duval County Public Schools: The 2007-08 salary schedule is no longer available on the district's website, from which it was obtained. The 2008-09 schedule is available at www.duvalschools.org/static/wearedcps/employeeinfo/teacher_salary_schedule.asp.

Madison School District #321: The 2007-08 salary schedule is no longer available on the district's website, from which it was obtained. The 2008-09 schedule is available at d321.k12.id.us/main/. After reaching the main site click on the "District" tab and then "Certified Salary Schedule."

Memphis City Schools: The 2007–08 salary schedule is no longer available on the district's website, from which it was obtained. The 2008–09 schedule is available at www.mc sk12.net /forms/10%20MONTH%20TEACHER%20SALARY%20SCHEDULE%20(24%20PAY).pdf.

New York City Public Schools: The 2007–08 salary schedule is no longer available on the district's website, from which it was obtained . The 2008–09 schedule is available at schools.nyc.gov/NR/rdonlyres/72DE1FF1-EDFC-40D7-9D61-831014B39D1E/0/7TeacherSalarySchedule.pdf.

Pembroke School District: The 2007–08 salary schedule is unavailable on the district's website and was obtained from the human resources coordinator.

Phoenix Union High School District: The 2007–8 salary schedule is no longer available on the district's website, from which it was obtained . The 2008–09 schedule is available at www.phxhs.k12.az.us/education/sctemp/a225b445549665bd3e9c3b8b5999e426/122046 4151/Teacher_salary_schedule_08-09.pdf.

Santa Maria Independent School District: The 2007–08 salary schedule is unavailable on the district's website and was obtained through the business office.

Seattle Public Schools: The 2007–08 salary schedule is no longer available on the district's website, from which it was obtained . The 2008–09 schedule was not posted at the time this paper went to press but is scheduled to be available at http://www.seattleschools.org /area/hr/sal.xml.

Loan Payment. The monthly loan payment is derived from the most recent estimate of the average loan burden for new college graduates of four-year institutions as estimated by the Project on Student Debt, *Student Debt and the Class of 2006*.[36] That figure, \$21,100, was then adjusted for inflation to 2007, bringing it to \$21,450, which was adjusted again to reflect the smaller average debt burden borne by education majors. This was calculated using the 1999–2000 data in the U.S. Department of Education's *Debt Burden: A Comparison of 1992–93 and 1999–2000 Bachelor's Degree Recipients a Year After Graduating*, and yielded a debt level of \$20,011.[37] Finally, the monthly payment was derived using FinAid.org's loan calculator by using a 6.8 percent interest rate and 10-year term.

Rent. For noncounty and nonurban districts this report uses median gross rents for the county in which the district is located, rather than the district alone, because the housing stock from which teachers would choose would likely extend beyond district boundaries. Rents used were reported by the U.S. Census Bureau for 2000 and adjusted to 2007 dollars. "Gross rent" is defined by the Census Bureau as "the amount of the contract rent plus the estimated average monthly cost of utilities (electricity, gas, and water and sewer) and fuels (oil, coal, kerosene, wood, etc.) if these are paid for by the renter (or paid for the renter by someone else)."[38]

Food. The February 2008 monthly cost of the U.S. Department of Agriculture's Liberal Food Plan for a male 19–50 years of age was used. The liberal plan is "a national standard for a nutritious diet" that can be purchased at an expenditure level "in the top quartile of food spending."[39] In addition, \$32 was added to the monthly cost of \$318 for the purchase of prepared foods, and the resulting \$350 allotment was adjusted for regional differences in food prices as reported by the USDA.[40] Note that because only costs for males were used, this figure *overstates* actual costs, because the female costs for the Liberal Food Plan are 9 percent lower than the costs for males.

Medical/Dental. The monthly cost borne by the teacher for medical and dental coverage as reported by the district either on its website or in response to a direct query. Where multiple plans are offered the least expensive one for the teacher was selected.

Allendale County Schools: 2007-08 medical and dental benefit information was obtained through the business and finances department.

Baldwin Community Schools: 2007-08 medical and dental benefit information was obtained through the central business office. The 2005-06 MESSA PAK-A plan information and criteria for monthly charge increases can be found on page 29 of the Master Agreement between the Baldwin Community Schools and Baldwin Education Association, available at www.baldwin.k12.mi.us/filesection/275/BEA_MasterAgreement_2005-2008_Final.pdf.

Battle Creek-Ida Grove Community School District: 2007-08 medical and dental benefit information was obtained through the business manager.

Calipatria Unified School District: 2007-08 medical and dental benefit information was obtained through the business manager. Medical and dental benefit costs to the teacher were quoted as a single number, and were split in half for calculation purposes only.

Clay County Public Schools: 2007-08 medical and dental benefit information was obtained through the finance officer.

Coahoma County School District: 2007-08 medical and dental benefit information was obtained through the payroll clerk.

Dallas Independent School District: 2007-08 medical and dental benefit information is no longer available on the district's website, from which it was obtained. 2008-09 information is available at www.disdatyourservice.org/SiteNavTemplateBaCost5.aspx. TRS ActiveCare 1 was used for medical and Dental HMO for dental.

Denver Public Schools: 2007-08 medical and dental benefit information is no longer available on the district's website, from which it was obtained. 2008-09 is available at hr.dpsk12.org/benefits/insurance/rates.shtml. Note that teachers can get medical and dental coverage at no cost to themselves using the DPS Flex Plan, which is itemized at hr.dpsk12.org/benefits/insurance/district_contribution.shtml.

Duval County Public Schools:. 2007-08 medical and dental benefit information is no longer available on the district's website, from which it was obtained. Information for 2008-09 is available at www.duvalschools.org/static/wearedcps/employeeinfo/employee benefits/downloads/08-09%20Medical%20Plan%20C%20Communication.pdf. Dental costs were obtained from the benefits department.

Madison School District #321: 2007-08 medical and dental benefit information was obtained through the payroll and benefits department.

Memphis City Schools: 2007-08 medical and dental benefit information is no longer available on the district's website, from which it was obtained.. 2008-09 is available at secure.ben

ergy.com/ASPX/EE/ReviewPlanCosts.aspx. Dental costs are covered under the medical premium, and monthly charges were converted to 24 pay periods to reflect 12-month costs.

New York City Public Schools: 2007-08 medical and dental benefit information is unavailable. Medical information for 2008-09 is available at www.nyc.gov/html/olr/down loads/pdf/healthb/emp_rates.pdf. Public school employees have the same insurance options as all city employees, including several that require no payroll deduction. Dental costs for United Federation of Teachers members are covered under the UFT/SIDS Participating Dentist Program.

Pembroke School District: 2007-08 medical and dental benefit information was obtained through the human resources coordinator.

Phoenix Union High School District: 2007-08 medical and dental benefit information is unavailable. Medical and dental information for 2008-09 is available on page 6 of the "Phoenix Union High School District Benefits Enrollment Guide" at www.google.com/search?hl=en&q=%22Phoenix+Union+High+School+District%22+%22Benefits+Enrollment+Guide%22. The "Middle Option" medical and "Pre Paid Option- Total Dental Administrators" plans were used.

Santa Maria Independent School District: 2007-08 medical and dental benefit information was obtained through the business office.

Seattle Public Schools: 2007-08 medical and dental benefit costs are available through the www.seattleschools.org/area/hr/groupbenefits.xml website. Both medical and dental coverage cost an individual teacher nothing after including the district's monthly benefit contribution. The 2007-08 district monthly contribution rate is unavailable on the district's website, but the 2008-09 rate can be obtained via the website just cited.

Union Dues. The monthly dues borne by the teacher where it is necessary to be represented by a union. Agency fees, which are lesser charges nonunion members must pay to cover the costs of collective bargaining in states where districts are required to negotiate with unions, were not used. The figure includes local, state, and national affiliate dues where the teacher is required to join all affiliates, as reported by districts in response to direct queries.

Allendale County Schools: no membership requirement.

Baldwin Community Schools: Baldwin Community Schools did not report union dues, so the highest of all the districts—New York City's—was used in its place in order to estimate the highest likely costs to the teacher. The reported figure of $83 is *not* the reported dues.

Battle Creek-Ida Grove Community School District: no membership requirement.

Calipatria Unified School District: 2007-08 union dues were obtained through the business manager.

Clay County Public Schools: no membership requirement.

Coahoma County School District: no membership requirement.

Dallas Independent School District: no membership requirement.

Denver Public Schools: dues were calculated according to Article 1, Section 8, of the Denver Classroom Teachers Association Bylaws, available at www.denverclassroom.org/By_Laws.html#ARTICLEI. For the 2007-08 school year, the step 8, BA salary was $39,820.

Duval County Public Schools: no membership requirement.

Madison School District #321: no membership requirement.

Memphis City Schools: no membership requirement.

New York City Public Schools: dues were calculated using "11/07-12/07" rates at www.uft.org/member/money/tax/uft_dues/.

Pembroke School District: 2007-08 union dues were obtained through the human resources coordinator.

Phoenix Union High School District: no membership requirement.

Santa Maria Independent School District: no membership requirement.

Seattle Public Schools: dues data were received from the Seattle Education Association by e-mail.

Transportation. The monthly cost to fill a 13.2-gallon Toyota Corolla fuel tank once a week with regular unleaded gasoline. The price used is from April 1, 2008, as reported for each state by the American Automobile Association.[41] Where public transportation is available the money could be used for that instead of driving.

Automobile Insurance. Estimated monthly cost for "recommended" insurance, paid in full, for a 22-year-old male with no previous accidents driving a 2000 Toyota Corolla as estimated for each state on Progressive.com.

Car Loan Payment. Estimated monthly cost to pay off a 2000 Toyota Corolla CE in good condition, valued at $5,335 by the Kelley Blue Book, with a $1,000 down payment and a 60-month loan at 7.43 percent interest.

Clothing/Laundry. Estimated using packages of men's and women's wear that would provide a full business wardrobe for the teacher with a final cost pro-rated over twelve months. The higher of the two packages—the men's—came out to $831, or $69 per month, and was then applied across the board. Added to this was a monthly approximation of laundry costs for two wash loads and one hour of drying per week, plus $3.00 per month for detergent. The final laundry cost was $31, which added to the pro-rated clothing costs totaled $100 per-month. No costs for possible dry cleaning were included. Detailed lists of clothing in the packages and their prices are available upon request.

Telephone (Landline)/Internet/Television. In most cases these services were purchased in a "bundle" and the prices were either split three ways or according to the prices for specific bundle components as indicated by the provider. In two cases, complete bundles were not available and the services would have to be purchased separately. These were in Allendale, South Carolina, in which cable and internet access could be purchased as a bundle but landline telephone service had to be purchased separately, and Battle Creek-Ida Grove, Iowa, in which tele-

phone and satellite television access could be purchased as a bundle but internet access had to be purchased separately. The specifics of each plan are available upon request.

Telephone (Cell). The Verizon Wireless "Nationwide Basic" plan was used.

Start-Up/Miscellaneous. Costs were estimated using a package of home furnishings, kitchenware, and consumer electronics that a former student newly on his own might need, though most recent graduates would be expected to already have some of the items included. The total cost was $845, which pro-rated over 12 months equaled roughly $70 per month, a figure that was increased to $80 to cover items possibly not accounted for in the sample package. Detailed lists of items in the package and their prices are available upon request.

State Taxes. All state taxes, where applicable, were estimated on 2007 state income tax forms using the teacher's full salary as federal taxable income and without taking any non-standard credits or deductions. This was done for New York, but for New York City the local income tax was also included.

Federal Taxes. All federal taxes were estimated using the Internal Revenue Service's "2007 Federal Tax Rate Schedules."[42]

Notes

1. Luke Swarthout, "Paying Back, Not Giving Back: Student Debt's Negative Impact on Public Service Career Opportunities," The State PIRGs' Higher Education Project, April 2006.

2. Public Law 110-84, 110th Cong., 2d sess. (October 1, 2007).

3. HR 6144 IH, 110th Cong., 2d sess. (May 22, 2008).

4. Public Law 110-315, 110th Cong., 2d sess. (August 14, 2008).

5. William G. Howell and Martin R. West, "Is the Price Right?" *Education Next*, Summer, 2008, pp. 37–41.

6. U.S. Department of Labor, Bureau of Labor Statistics, "Occupational Employment and Wages, May 2007," www.bls.gov/oes/current/oes_stru.htm#00-0000. The figure is for all teachers identified as elementary, middle school, and secondary (not including special and vocational education).

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33. Unfortunately, the Census calculation of median rent does not break units down by number of bedrooms. Presumably, though, units with different numbers of bedrooms are in the range of the median rent.

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35. Includes only the city of Dallas.

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"FEDERAL HIGHER EDUCATION POLICY AND THE PROFITABLE NONPROFITS," JUNE 15, 2011, REPORT BY VANCE H. FRIED

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Federal Higher Education Policy and the Profitable Nonprofits

by Vance H. Fried

Executive Summary

Undergraduate education is a highly profitable business for nonprofit colleges and universities. They do not show profits on their books, but instead take their profits in the form of spending on some combination of research, graduate education, low-demand majors, low faculty teaching loads, excess compensation, and featherbedding. The industry's high profits come at the expense of students and taxpayer.

To lower the cost of education, federal government policies should encourage competition. Regulations should not favor nonprofits over for-profits. Further, the accreditation process should be reformed so that any qualified institution can easily enter the industry. The financial-aid process should be redesigned to remove the bargaining advantage that colleges currently hold over prospective students.

The higher-education industry is heavily subsidized by the federal government. These subsidies play a significant role in the high profitability of the industry and represent a massive transfer of wealth from the taxpayer to the industry. This should change. All tax credits and deductions should be eliminated immediately, as should all direct subsidies. The federal loan program should be restructured to eliminate the government subsidy and ensure that any deserving student can graduate from college without excessive debt, and eligibility for Pell grants should be tightened significantly. The net result of these changes would be greater efficiency and annual savings of $50 to $60 billion. To the extent that the federal government continues to play any role in higher education, its goal should be to ensure that all deserving students have access to higher education, not to maintain high industry profits.

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Comparing the costs of educating undergraduate students to per-pupil revenue, nonprofit schools have higher "profit" margins than for-profits.

Introduction

As a result of rapid increases in the amount of federal financial aid and other federal student assistance programs going to for-profit schools, Tom Harkin has launched a broad-based oversight effort to better understand how well for-profit schools, many of which are highly profitable publicly traded corporations, are serving the students attending the schools and the taxpayers who commit approximately $24 billion to the schools each year.[1]

So reads the website of Sen. Tom Harkin (D-IA), chairman of the Senate Health, Education, Labor, and Pensions Committee. The senator's interest in oversight of federal student-assistance programs is laudable, but should not be limited to for-profit colleges. Federal aid to nonprofit colleges should also be a matter of great concern. Indeed, taxpayers' annual commitment to nonprofit schools is much higher than it is to for-profit institutions.

So why are nonprofit institutions not getting the same scrutiny as for-profit schools? The inattention is perhaps unsurprising, given that many of the for-profits are not just profitable, they are *highly* profitable. For example, Apollo Group, owners of the University of Phoenix, reported a 30 percent operating profit margin in the first quarter of 2011.[2] However, comparing the actual cost of educating undergraduate students to per-pupil revenue, it appears that the "profit" margins of nonprofit schools are in fact higher than for-profit colleges.

Identifying Nonprofit Profits

How can a nonprofit have profits? Simply put, it happens when the revenue the nonprofit derives from providing a service exceeds the cost of providing that service. This might seem obvious, but it is often assumed that putatively "nonprofit" schools, by virtue of their designation, never make a profit from providing a particular service. In addition, such schools never report that they have realized profits, even when the profits happen to be large. Why? Because profits are reported as expenses. Nonprofit schools take their profits from undergraduate education (which is typically the main focus of policymakers who are seeking greater affordability, access, etc.) in the form of spending on some combination of research, graduate education, low-demand majors, low faculty teaching loads, excess compensation, and featherbedding.

Profits from undergraduate education are of two types: economic rents and subsidies for other missions. Economic rents are payments made to college insiders that do not increase college outputs. Excess compensation (e.g., a small-college president making over $1 million) and featherbedding (e.g., a 10:1 student faculty ratio) are economic rents. Subsidy for other missions is the spending on missions that are unrelated to undergraduate education but are funded partially by revenue generated through undergrads, such as graduate education and research. Unlike economic rents, this spending does increase the colleges' outputs, and applying the term profits to it is not making a value judgment as to whether it is good for society and/or appropriate for the school. Rather, the point is that it is spending beyond what is necessary to provide an undergraduate student with a high-quality education. It is spending coming, in part, from undergraduates' tuition payments that provides no benefits to undergraduate students. From a public policy standpoint the high profits earned by nonprofit colleges do not justify punitive regulation of the industry any more than do the high profits earned by for-profit colleges. Rather, as will be discussed in depth, the federal public-policy problem is that various government actions benefit the higher education industry at the expense of the undergraduate student and the taxpayer.

The profligacy of nonprofit colleges is well known. As long-time Harvard president Derek Bok once quipped, "universities share one characteristic with compulsive gamblers and exiled royalty: there is never enough money to satisfy their desires."[3]

Why do nonprofit colleges behave this way? Thirty years ago, Howard R. Bowen, an economist and president of three different colleges, proposed what is known in education circles as Bowen's Law.[4] It can be summarized as "colleges raise all the money they can, and spend all the money they can raise." Bowen's Law is well-accepted by scholars of higher education economics.[5]

But don't colleges try their best to keep costs low in order to keep tuition down? No! As Bowen points out:

> The question of what *ought* higher education to cost—what is the minimal amount needed to provide services of acceptable quality—does not enter the process except as it is imposed from the outside. The higher educational system itself provides no guidance of a kind that weighs costs and benefits in terms of the public interest. The duty of setting limits thus falls, by default, upon those who provide the money, mostly legislators and students and their families.[6]

This isn't to say that most college insiders necessarily realize they are spending excessively. Rather, spending for just about anything is justifiable to them in the name of reputation and the pursuit of knowledge.[7] Further, the culture of academia tends to see practical financial concerns as anathema to the scholarly ideal.

Robert E. Martin, an economics professor with substantial experience as a faculty member at both a large state research university and a small liberal arts college, recently expanded on Bowen's Law. He concluded:

> . . . as the Bowen hypothesis suggests, higher education finance is a black hole that cannot be filled. The relationship between revenues and subsequent costs has a dynamic feedback effect. Higher education responds to higher costs by raising tuition and fees or initiating fundraising campaigns. But because costs in higher education are capped only by total revenues, there is no incentive to minimize costs. The costs go up in tandem with revenues. The next year, the cycle begins again because the higher costs mean that the new programs must be financed by additional revenues. There is thus a never-ending spiral effect between revenues and cost.
>
> As revenues increase, faculty, administrators, and board members extract more surplus from the cash flows in the form of higher costs and then use those higher costs as justification for more revenue. *Imagine the consumer's response if for-profit firms argued they had to raise prices because the surplus that they extracted during the last period (i.e., profit) increased* [italics added].[8]

But why wouldn't for-profit schools also just do more—regardless of its value—as revenues increased? Largely because their goal is to maximize the return to investors, which requires doing as efficiently as possible those things that customers want and are willing to pay for.

Higher education finance is a black hole that cannot be filled.

High Industry Profits

The profits of nonprofit colleges are not readily visible from publicly reported financial data. Colleges directly report their revenues, but not their real costs, so the profits are invisible from a financial accounting standpoint. To know profits, one needs to know real costs.

There are two viable approaches to identifying real costs. One is to use a build-up method to determine costs at a college that utilized best practices to provide an under-

The average private undergraduate school makes $12,800 in profits per student, based on tuition, donations, and endowments.

graduate education. This approach eliminates both economic rents and other mission subsidies. The problem is that it is based on a hypothetical college.

One published study by this author has used the build-up method for a hypothetical college.[9] It created a business model for a hypothetical College of Entrepreneurship and Leadership in Society (CELS) and then determined its cost by developing a detailed pro forma statement of operating costs. The basic design premise was simple: maximize value to the student. Determine what package of benefits (primarily learning) and price is attractive to them. If an activity has a high cost but provides a substantial benefit, do it, but do it as efficiently as possible. If an activity adds significant cost but only minor benefits, don't do it. CELS was designed as a high-quality residential college. It didn't cut any corners on spending, but it did not spend profits.

The CELS pro forma statement takes a detailed look at the cost side of providing education. In 21 pages it presents individual cost items down to the number of clerical staff needed in the registrar's office and photocopying costs for class handouts. The biggest cost item, faculty salaries, was determined by first creating a curriculum for general education and nine broad majors, including business and engineering science; second, by determining the number of courses to be offered in a year, given the curriculum and enrollment; and third, by determining the size and makeup of faculty staffing necessary to teach those courses. Faculty salaries were at the national average for small doctorate-granting institutions. Minimal use was made of adjunct faculty. Depreciation assumed a new campus in the Dallas, Texas area with per-foot construction costs 20 percent higher than the regional average.

The College of Entrepreneurship and Leadership in Society's operating costs were $6,705 per pupil for a college with 3,200 students. Because of some loss due to economies of scale, costs went up to $9,200 per student for a small college with 1,200 students. On the other hand, a commuter college could realize about $1,700 in savings by eliminating student life activities, such as athletics, concerts, and student organizations.

The second approach to identifying real costs is to use actual cost data from real colleges. Publicly available data on college costs do a poor job of allocating costs to various missions. Costs for graduate instruction are lumped in with undergraduate instruction, and many research costs are allocated to instruction, not research. However, some states perform internal studies that more accurately allocate spending by mission for their state-owned colleges, producing data that do not lump costs of other missions in with undergraduate instruction.

Florida, Illinois, and Ohio make their actual cost data available in this manner in a report published by the State Higher Education Executive Officers (SHEEO).[10] Actual costs for undergraduate education were $7,080 in Florida, $11,040 in Ohio, and $7,980 in Illinois. The drawback of the SHEEO study is that it does not eliminate economic rents tied to undergraduate education.

Based upon the CELS and SHEEO studies, the real cost of undergraduate education could vary from $5,000 to $9,000 per year, depending on institutional characteristics.[11] For simplicity of presentation, assume $8,000 is the real cost of providing a quality undergraduate college in a residential setting.

As itemized in Table 1, the average private undergraduate college has net tuition revenues—sticker-price tuition and academic fees minus tuition discounts (often called institutional scholarships)—of $13,515 per student per year, plus $7,292 per student per year in donations and endowment income.[12] Based on tuition revenues alone, the average private undergraduate school makes about $5,500 per student. When donations and endowment income are added, profits jump to $12,800 per student. That's more than a 60 percent net profit margin per student—double the margin of for-profit Phoenix—and that's just the average. Many private scolleges are much more profitable from tuition alone.

Table 1
Private Bachelor's Colleges, Average Annual Revenue per Student

	Without donations ($)	With donations ($)
Net Tuition	13,515	13,515
Donations/Endowments	0	7,292
Revenues	13,515	20,807
Costs	8,000	8,000
Profits	5,515	12,807

Source: The Delta Project on Postsecondary Education Costs, Productivity, and Accountability. Figures are for a private bachelor's college in 2008.

Table 2
Public Research Universities, Average Annual Revenue per Student

	Without subsidy ($)	With subsidy ($)
Net Tuition	10,000	10,000
State Subsidy	0	9,000
Revenues	10,000	19,000
Costs	8,000	8,000
Profits	2,000	11,000

Public colleges are also highly profitable, as illustrated in Table 2. Take a typical public research university that charges in-state tuition of $10,000 per student (see Table 3 for a list of such schools and their prices) and receives a state subsidy of $12,000 per student. The difference between out-of-state and in-state tuition is a good proxy for the subsidy for in-state students.[13] Assume that $3,000 of the subsidy is earmarked for research and public service, leaving $9,000 to subsidize undergraduate education. The university has a 20 percent margin simply from in-state tuition. Margins jump to 58 percent when the state subsidy for undergraduate education is included.

Undergraduate Education as a Commercial Enterprise

Nonprofit colleges, whether private or government owned, were originally designed to provide an education to students funded by a mix of commercial and donated funding. The commercial funding came in the form of tuition paid by students for their education. The donations came in the form of charitable giving and state subsidies. These donations were used to reduce the need for commercial funding. In other words, the donation benefited the student by reducing tuition. This is how most nonprofits were funded until the 1980s.

Over the last 30 years the amount of non-tuition funding has increased substantially. In 1980, states were the primary donors to higher education through the subsidy they provided to state-owned colleges. States have continued to generously fund higher education. While in some years there have been cuts because of downturns in state tax revenues, historically the subsidy has gone back up as

Until the 1980s, nonprofit colleges used their donations to benefit the students by reducing tuition.

Table 3
In-State Tuition and Fees, Public Research Universities, 1980 and 2010

University	2010 ($)	1980 (in 2010 $)
Pennsylvania State University	17,344	4,272
University of Illinois–Urbana-Champaign	15,144	2,561
University of Michigan–Ann Arbor	14,168	3,822
University of California–Berkeley	12,461	1,994
University of Colorado at Boulder	11,960	2,590
University of Kansas	11,780	2,007
University of Virginia–Main Campus	10,906	2,712
University of Connecticut	10,416	2,780
University of Kentucky	9,813	1,775
Texas A & M University	9,606	1,273
University of Iowa	9,220	2,160
The University of Texas at Austin	8,930	1,176
Ohio State University–Main Campus	8,679	2,890
Indiana University–Bloomington	8,613	2,637
University of Wisconsin–Madison	8,310	2,619
University of California–Los Angeles	8,266	1,976
University of Maryland–College Park	8,053	2,301
University of Alabama	7,900	1,991
University of North Carolina–Chapel Hill	6,666	1,556
University of Florida	5,381	1,931

Sources: Tuition and fees for 1980 were taken from the Integrated Postsecondary Education Data System (http://nces.ed.gov/ipeds/datacenter) and converted to 2010 dollars using the Consumer Price Index. Tuition and fees for 2010 were taken from the universities' own websites. Many colleges vary their tuition and fees based upon the number of credit hours taken, course level, and subject matter. The figures shown assume that a student is taking 32 hours (16 per semester) of upper-division business courses.

Given the large inflow of government funds, what have colleges done with their prices? Aggressively raised them.

the state's financial position improved. In fact, between 1987 and 2009, per capita state spending on higher education increased by 31 percent in real terms.[14]

At the same time, the federal government radically increased funding for higher education. From 2000 to 2010, annual student lending went from $42 billion to $96 billion and Pell grants increased from $9 billion to $28 billion.[15] Congress also created federal tax deductions and credits.[16] For example, in 2010, a married couple with an income under $160,000 could receive a $2,500 credit for their child's college tuition. Total federal tax benefits for higher education in 2009 totaled $18.2 billion.[17]

Given this large flow of government funds, what have colleges done with their prices? They have aggressively raised them. For example, see the following table showing inflation-adjusted, in-state tuition at several large state-owned research universities.

The funding model for higher education has changed at both public and private colleges. Today, tuition not only covers the full cost of providing an undergraduate education, it generates profits. Even at state-subsidized colleges, most undergraduate

students now pay the full cost of their education, with state subsidies going toward profits—particularly subsidies of other missions such as graduate education and research. Undergraduate education is clearly a profit-generating commercial activity at nonprofit colleges. A major driver of this appears to be the federal government, which by greatly increasing subsidies has allowed schools to earn increasingly larger profits.

Federal Policy Implications

The federal government has done nothing to restrain price increases, but rather has played a significant role in increased tuition prices, higher overall school profits, and significant transfers of wealth from students, parents, and taxpayers to colleges.[18] It has also helped the industry gull naïve citizens into believing that college is always a good investment, that price doesn't matter when deciding which college to attend, and that high student debt won't cause long-term economic hardship. This is in the face of a staggering 35 percent underemployment rate for college graduates and high student-loan default rates.[19] The net impact of federal policy is that college is less affordable for everyone, including lower-income students.

In light of this, one can seriously question why the federal government should be involved in higher education at all. Even if one ignores the constitutional argument against a federal role,[20] the results of federal involvement are not supportive of the wisdom of using top-down decisionmaking in higher education. Rather than trying to correct federal policy, it might be best to simply eliminate the federal role.[21] However, if there is to be a federal role, there are several areas for improvement.

Don't Discriminate against For-Profits

As suggested by Senator Harkin's recent hearings, many people within the government want federal programs to favor nonprofit colleges over for-profit colleges, perhaps in part because for-profit schools are forthright about wanting to make money from their services to undergraduate students. Yet nonprofit schools often extract more profits from students and society than do for-profit schools. If it is to be concerned about anything in higher education, the federal government should be concerned about a college's instructional quality and cost, not its form of ownership.

Decrease Funding to the Industry

Rather than putting more money into the industry, the federal government should put in less and get the same output. Less federal money would force higher college productivity and, of course, lower government spending. And, as the following discussion of federal higher-education subsidies will illustrate, ensuring that all qualified students, regardless of their economic status, can get a college education requires little in the way of federal funding.

Direct Payments. Last year individual colleges received over $2.3 billion in direct payments from the federal government. By far, the biggest recipient was Howard University. Howard is a private university that has historically received 50 percent of its revenues directly through the Department of Education budget. This amounted to $206 million for general support in 2010.[22] While Howard University receives more than $19,000 per student directly from the government, it still charges students $17,000 a year for tuition.[23]

Direct payments to most colleges are not in the department budget. Instead, they come through earmarks.[24] With an average grant of $500,000, most colleges receive much less than Howard through regular appropriations. However, many more colleges receive earmarks, which in total amounted to almost $2 billion in 2010. Many of these earmarks were for research, but some were for education.

The Republican caucuses in both the House and Senate have recently adopted rules eliminating earmarking. Education-related earmarks can be easily eliminated, as well as other direct payments to colleges. The only

Rather than putting more money into the higher education industry, the federal government should put in less.

adverse impact will be on the profit margins of colleges. Colleges justify many of their earmarks on the grounds that they are necessary to provide an education.[25] However, colleges already have revenues far in excess of educational costs. Colleges use these earmarks to pay costs, but they do not reduce tuition accordingly. In effect, earmarks increase profits. They aren't justifiable, even if there were no federal deficit.

Loans. The current federal loan programs are not only costly to taxpayers, they can be very harmful to borrowers. Take the case of Kelli Space, a first-generation college student from New Jersey who graduated from Northeastern University with a BA in sociology and almost $200,000 of student loans.[26] The student-loan programs encourage students like Space to spend excessively on college without paying serious attention to its costs and benefits. Further, excessive borrowing can put a student in a very poor financial situation after graduation. A student can struggle all his life to pay off a loan for an overpriced college degree, and unlike most consumer debt, student loans are non-dischargeable in bankruptcy.

The current federal loan programs are not only costly to the taxpayer, they can be very harmful to borrowers.

In the long run students would benefit from reducing the amount of money they can borrow from the government and capping the amount of student debt that is non-dischargeable in bankruptcy. The goal should not be to do away with a student's ability to borrow for reasonable college costs, but rather to avoid excessive debt and costs. Given this goal, how high should the cap be? Let's look at the question in two ways. First, let's consider what amount is repayable, and second, what amount is needed.

The rule of thumb among financial counselors is that the total student debt should not exceed the first year's earnings.[27] At that level, the graduate can live comfortably and still repay debt. Some argue this is overly conservative, since it assumes that the debtor's income will not rise beyond entry level. Of course, earnings vary significantly by individual and major—young engineering graduates get paid a lot more than young sociology graduates. So, let's assume the maximum loan is set at $40,000. Would this be enough money to finance a student's college education?

Take the extreme case of a student with no savings and no family support. At a minimum-wage job, the student needs to work about 30 hours per week to live a modest but comfortable student lifestyle (e.g., low-end shared dorm room, old car, basic cell phone, no spring-break trips to Vail or Cancun). With this amount of work, most students should be able to graduate in four years if they take a reduced per-semester load but go to school year round. So, students do not need to borrow money for living expenses. Particularly frugal students (e.g., the ramen noodle diet and inexpensive student housing), those with above-minimum-wage jobs, or those living at home could actually have excess from their earnings that could be used to pay for tuition. But if the student only made enough money to cover living costs with none left over, she would need to finance her tuition through a student loan.

In most states you can get a degree from the public flagship university for $40,000 or less in tuition. A student who instead combines two years at a community college with two years at a regional college might pay under $20,000 total. So, even at today's high tuition levels, a student could comfortably borrow enough to pay for college if there were a $40,000 cap. In fact, students at lower-cost institutions could afford to borrow all their tuition plus about $5,000 a year for their living expenses.

Students in a few states, such as Pennsylvania and Illinois, whose public colleges operate with well-above-average prices, will have some trouble fully financing tuition with a $40,000 cap. That problem could be resolved by those colleges reducing their prices to the already high average price. However, even at the extremely high prices these colleges currently charge, staying under a $40,000 cap is still possible if the student works full-time and uses her earnings to pay both living expenses and part of her tuition. For most

students, working full time means going to school part time. As a result, the time to graduation might go up to 6 years for a low-income student in states with particularly high-priced state colleges.

Private colleges will complain about a lower cap because it will make it harder for low-income students to attend their colleges instead of state schools. This is particularly a problem for for-profit colleges that heavily serve low-income students. State colleges are at a major advantage in competing for students because of state subsidies, which enable them to price tuition lower. Private colleges, both for-profit and nonprofit, correctly argue that this gives an unfair advantage to the state colleges. The existence of the subsidy means that public colleges, if they desire, can easily undercut a private college on price. As a result, private colleges avoid price competition with publics.

All students—not just low-income ones—would benefit from a system where a state provided its subsidy to students attending any in-state college, rather than requiring the student to attend a state-owned college.[28] This would increase competition between public and private schools, leading to lower prices. For instance, if a private nonprofit college priced its tuition at cost, it would only need to charge $8,000. If a state subsidy of $6,000 could be applied to private-college tuition, then tuition net of the state subsidy would be $2,000 a year. The public college would then lose students to the private college unless it lowered its own tuition to match. However, the allocation of state education funds is a state issue, not a federal issue.

No matter the state's policy on subsidies, a lower borrowing cap will be better for students because it will direct them to institutions they can afford and blunt the ability of schools to raise prices. It will also be highly beneficial for taxpayers. On federal loans, taxpayers are stuck with the bill for any defaults. According to the Congressional Budget Office, the federal direct-loan program costs taxpayers 12 percent of the amount lent.[29] With the 2009-2010 direct loans amounting to $97 billion, the cost to the taxpayer is close to $12 billion.

Lowering the cap will reduce the cost of the federal loan program since less money will be lent. It will also lower the cost by improving loan quality: low-balance loans have lower default rates than high-balance loans.

The cost of the loan program can also be reduced by increasing interest rates. For example, the National Commission on Fiscal Responsibility and Reform recently recommended eliminating the current subsidized interest rate, but not the deferral of interest payments, while a student is in college.[30] Going a step further, the CBO estimates that the federal loan program would break even if interest rates were increased by an average of 2 percent.[31] On a $40,000 loan, this means additional interest of $67 a month. An increase in payments of this limited magnitude wouldn't make college much less accessible to low-income students, but would save taxpayers $12 billion a year.

Pell Grants. In 1978, two million students received Pell grants. This number doubled by 1992, then remained flat until 2000. In 2000, it began to grow rapidly, reaching six million by 2008, and eight million in 2010.[32] This huge increase in the number of students receiving Pell grants is not justifiable. If our hypothetical student with no savings and no outside support can borrow enough money to pay for college, why does he need a Pell grant, which is money he never has to return to taxpayers? And if such a relatively strapped student does not need a grant, then who does? Perhaps those who cannot work much and go to school, such as the single parent without child support or the physically disabled may need grants, but the current eight million Pell recipients (or even the two million from 1978) certainly do not.

Tax credits/tax deductions. If most low-income students do not need a federal subsidy to attend college, upper-middle-class students certainly do not. In addition, these credits do not appear large enough to have much influence on the behavior of the people receiving the credit. They should be eliminated.

If most low-income students do not need a federal subsidy to attend college, upper-middle-class students certainly do not.

A used-car buyer is in a much better bargaining position than a potential student at many private colleges.

Lower the Barriers to Entry

The federal government has anointed various private accrediting groups as the gatekeepers for federal student aid. Since these accrediting groups are run by their constituent colleges, there is potential for the member colleges to engage in collusive behavior to maximize profits at the expense of their students. This can be seen in the current process a college must go through to gain initial accreditation.

The current process makes it very difficult for new colleges to enter the market, thus limiting competition. The most flagrant example of this behavior is accrediting agencies' refusal to approve colleges because they are organized as for-profits. The barriers for a new nonprofit are also high, if not absolute. Gaining accreditation is a slow process that has been known to take up to 10 years.[33]

This time frame is totally unreasonable. Basically, all the new college needs to show is that it has qualified faculty and management in place, written basic operating procedures and academic policies, and is adequately financed. A competent accrediting agency should be able to conduct an in-depth analysis of these issues for a new applicant in a matter of months, not years.

The current accreditation system has many other problems in addition to initial accreditation. Several solutions have been proposed, including eliminating mandatory accreditation altogether.[34] Whether or not any of these global solutions is adopted, the barrier-to-entry problem should be solved as soon as possible. Within the existing system this can be done by requiring that any federally recognized accrediting agency runs a clean, open, and timely process for initial accreditation.

Don't Take the Colleges' Side on Pricing

Many colleges, particularly private colleges, haggle with students over tuition. They set a high sticker price and then lower it through institutional "scholarships," which are actually individual price discounts. They are allowed to coordinate their pricing process with the federal student aid decision-making process.[35] In January of his senior year in high school, the potential college student seeking financial aid provides the Department of Education with extensive information about his family's finances. Based on this information, the department computes the student's Expected Family Contribution. The EFC is the amount that the department has determined that the student and his family are capable of paying for college. This information is used by the department to determine eligibility for federal financial aid.

In addition to assessing a student's eligibility for federal aid, the department sends a summary of the student's family information with the EFC to every college to which the student has applied. The result is a significant increase in the bargaining power of the college over the potential student. Many colleges try to limit the amount of discount to the college's sticker price less the applicant's EFC. In other words, they try to charge full sticker price if the student's EFC is higher than that amount. Students may be given the impression by colleges that the government has determined that this approach to pricing results in a fair price to the student. In effect, however, the government is giving its blessing to existing high prices. Even more shocking is that the government provides the college with confidential financial information about the student that the college can use to its benefit in price negotiations. A used-car buyer is in a much better bargaining position than a potential student at many private colleges.

The department should immediately cease sharing any student financial data with colleges. This doesn't just protect students who are middle-income and above with high EFCs. As the Center for College Affordability and Profitability argues:

> . . . by no longer giving the colleges students' financial information, one of the vilest practices in higher education will cease: "need-aware" admissions. This practice deliberately restricts the

number of needy students admitted by using the information provided by the SARs [student-aid reports] when deciding which applicants to accept. Poorer students who would be accepted on merit are rejected because they would require more aid. Many, including us, view it as "deceitful and wounding to reject a student without saying that the reason was financial rather than academic." For many schools, the alternative is "admit-deny," where students are admitted on a need-blind basis, but there is no guarantee that enough aid will be available to enable low-income students to attend. While this is also unfortunate, at least it is not deceitful, gives the student the final choice, and frames the decision in a familiar "can you afford to enroll here?" rather than the deceitful "you're not good enough to enroll here."[36]

Conclusion

The higher-education industry is highly profitable, and the nonprofit sector, both private and state-owned, has higher profit margins than the for-profit sector. The industry's high profits come at the expense of students, and federal policy has increased industry profits by driving up prices.

The higher-education industry receives massive federal subsidy payments, both directly from the government and indirectly through subsidies to students. These subsidies play a significant role in the high profitability of the industry and represent a massive transfer of wealth from the taxpayer to the industry. This should change. All tax credits and deductions should be eliminated immediately, as should all direct subsidies. The federal loan program should be restructured so as to eliminate the government subsidy and ensure that any deserving student can graduate from college without excessive debt. Eligibility for Pell grants should be tightened significantly. The net result of these changes would be greater efficiency, and annual savings of $50 to $60 billion.[37] To the extent that the federal government continues to play any role in higher education, its goal should be to ensure that all deserving students have access to higher education—not, as it has been doing, to maximize industry profits.

The federal government's goal should be to ensure that students have access to higher education, not to maximize industry profits.

Notes

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Stanley, "Four State Cost Study," State Higher Education Executive Officers, September 2010. Annual costs were calculated by multiplying undergraduate cost per student credit hour (Table 4) by 32 credit hours for a year. While data from New York is provided in the SHEEO report, it is excluded from this paper because unlike the other three states, New York did not charge institutional overhead to the various missions. If it had, New York's costs would likely be somewhat lower than those of Florida and Illinois.

11. Ohio costs were ignored since they are an outlier. It is not apparent from the SHEEO study why Ohio costs are substantially higher than those of the other three states.

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13. Commonly reported data showing subsidy per student includes both in-state and out-of-state students in the denominator even though the subsidy (numerator) is only for in-state students. As a result, the subsidy is understated in this data. The use of the in-state/out-of-state tuition differential may slightly overstate the state subsidy depending on the state system's specific techniques for allocating donated income and other non-subsidy items, as well as tuition discounts. It does not, however, include interest charges borne by the state to finance college buildings. Overall, the differential makes for a reasonable, readily available proxy for the subsidy. Indeed, some state college systems explicitly price by setting out-of-state tuition at actual cost and then deducting state subsidy to arrive at in-state tuition.

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EDUCATION FINANCE COUNCIL, WASHINGTON, DC, STATEMENT

Hearing on The Looming Student Debt Crisis: Providing Fairness For Struggling Students

Statement for the Record by the Education Finance Council

Senate Judiciary Committee
Subcommittee on Administrative Oversight and the Courts
March 20, 2012

The Education Finance Council (EFC) is the trade association representing nonprofit and state agency student lenders. For decades, these entities have provided access to higher education for thousands of students through the affordable option of a low interest rate supplemental student loan. While interest rates for nonprofit supplemental loan products vary, many are lower than the 7.9 percent rate charged under the federally guaranteed Parental Loan for Undergraduate Students (PLUS) loan program. By way of contrast, private loans offered by banks and other for-profit entities are currently carrying interest rates as high as 21 percent.

EFC does not support the Fairness for Struggling Students Act, which does little to fix the problems with increasing student debt. While we acknowledge these are challenging fiscal times for individuals, the myopic focus on changing one small part of the bankruptcy code to perhaps quell the short-term challenges of students with large loan balances and few job prospects will not prevent the excessive student debt problems from reoccurring.

Changing the status quo treatment of private student loans in bankruptcy, doesn't address the twin roots of excessive student debt: borrowing more than what is needed and the skyrocketing tuitions. Wondering how a student loan will be treated in bankruptcy should never drive decisions on how to finance higher education. The key to managing student debt is an effective understanding of how much to borrow, not eliminating responsibilities at the end of the process. For decades, nonprofit and state agency student lenders have operated programs with the goal of preventing over-borrowing. These programs, many of which are online portals that must be completed before a borrower completes the application process, give students and parents real-time information about how much is needed to borrow to meet the stated higher education objective and how the decision of the amount borrowed will affect their lifestyle after graduation.

Creating an easier pathway to discharging private student loans will frustrate the problem of over-borrowing. While there may be some debate about how many students will rush to have their private student loans discharged at the first sign of fiscal uncertainly, there is little argument that the ability to easily wipe away debt will lead to more accumulation of it from the outset. Relaxing the current dischargeability rules will fundamentally change the mindset of student borrowers and is directly in conflict with programs designed to prevent over-borrowing.

The second cause of the explosion in student debt is the exponential rise in higher education costs. According to the College Board, tuition rates are increasing at anywhere from 3.2 percent at for-profit schools to 8.3 percent at public four-year institutions. While the causes for these increases range from cuts to state aid to rising capital costs, they do not include having private student loans non-dischargable in bankruptcy except under a showing of undue hardship. Congress would serve the interests of students better by working collaboratively with the private sector to deal with

increases to college costs rather than taking a piecemeal approach to bankruptcy reform.

The Fairness for Struggling Students Act's targeting of privately originated student loans misses the mark by ignoring the source of most of the student debt. The student debt problem lies squarely with loans originated by the federal government through the William D. Ford Federal Direct Loan Program and PLUS. To understand the magnitude of the problem of only making some privately originated loans dischargeable, the Department of Education's Fiscal Year 2013 budget anticipates originating $121 billion in loans whereas the total amount of privately issued student loans is estimated to only be $7 billion for the same period.

The argument that federal government-issued loans should be exempt from the purview of the Act is specious. The "incentives," such as Income Based Repayment, used to push students into these higher interest rate government products do little to alleviate debt at the end of the day and actually exacerbate the problem.

Dischargeability will limit access to higher education by disrupting the market for lower cost supplemental loan programs. It is well known that eliminating non-dischargeability protection would force nonprofit and state agency lenders offering private loans to adjust their offerings by raising borrower rates, elevating underwriting standards, or both. This would reduce the higher education options available to many students.

Moreover, focusing on one facet of bankruptcy instead of engaging in a debate on full-scale reform is bad public policy. The non-dischargability of private student loans dates back to the enactment of the 1978 Bankruptcy Code, when loans made by nonprofit institutions of higher education were made non-dischargeable unless debtors could prove that the loans would impose an undue hardship on them and their dependents (see e.g, 11 U.S.C. 553(a)(8)). In 1984, the Bankruptcy Amendments and Federal Judgeship Act extended this non-dischargeability to all nonprofit lenders.
The proper focus of a hearing on student debt should not be the Fairness for Struggling Students Act; but rather a discussion on education about over-borrowing and ensuring students and parents have continued access to the best financing options.

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