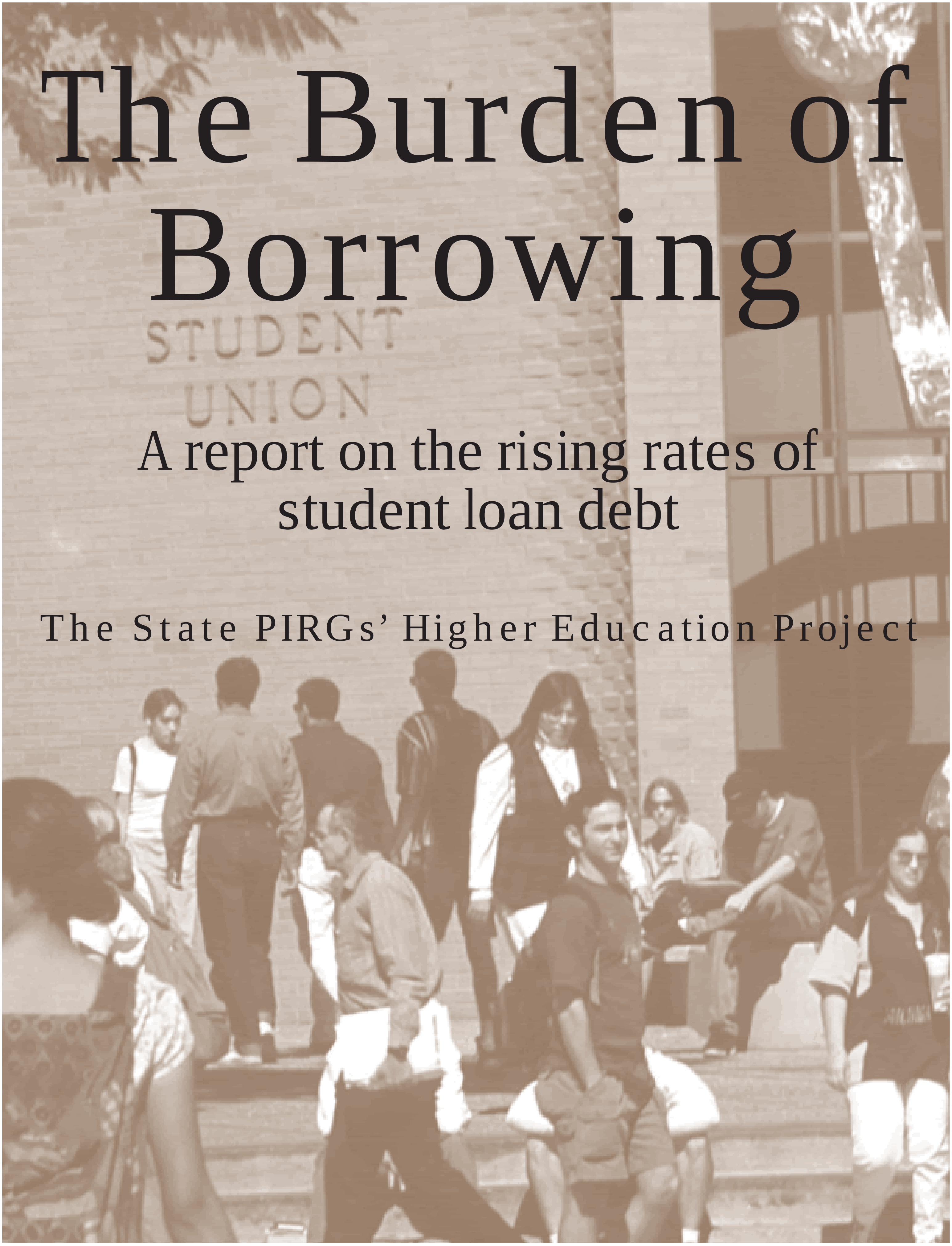
The Burden of Borrowing

A report on the rising rates of student loan debt

The State PIRGs' Higher Education Project



The Burden of Borrowing:

A Report on the Rising Rates of Student Loan Debt

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The State PIRGs are non-profit, non-partisan public interest advocacy groups. The Higher Education Project was established in 1994 to secure more aid for students, with a focus on additional grants, lowering the cost of borrowing, and better service to students in the federal financial aid system.

State PIRGs' Higher Education Project: http://www.pirg.org/highered
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Executive Summary

Higher education is critical to the future success of Americans. In addition to the inherent benefits of a higher education, a college degree is worth 75% more than a high school diploma or more than $1,000,000 over a lifetime in the workforce. However, as college costs continue to swell, students are increasingly shouldering high levels of debt to pay for a college education.

Thirty-nine percent (39%) of student borrowers now graduate with unmanageable levels of debt, meaning that their monthly payments are more than 8% of their monthly incomes. According to new data from the Department of Education's National Postsecondary Student Aid Study (NPSAS), not only are the majority of students turning to loans to finance college, but debt levels are also escalating. In 1999-2000, 64% of students graduated with student loan debt, and the average student loan debt has nearly doubled over the past eight years to $16,928.

Often the students who are most likely to graduate with debt are the same students who experience financial hardship after graduation. In 1999-2000, 71% of students from families with incomes less than $20,000 graduated with debt, compared to 44% of students from families with incomes more than $100,000. In all likelihood, students from low-income backgrounds receive limited financial assistance from and may have financial obligations to their families after graduation.

In addition, some groups of students are more likely to face unmanageable debt burden after graduation. Fifty-five percent (55%) of African-American student borrowers and 58% of Hispanic student borrowers graduated with unmanageable debt burden.

Data also suggest that Pell grant funding impacts borrowing trends among low-income students. Over the past decade, when Pell grant funding was cut, the percentage of low-income students who borrowed and the average debt among these students increased. In contrast, in recent years, when Congress increased Pell grant funding, the percentage of low-income students who borrowed stabilized, while growth in the average debt among these students slowed.

There are several possible explanations for increases in student borrowing. First, the strength of the Pell grant has declined from covering 84% of tuition at a four-year public institution in 1975-76 to 39% today.[1] While Congress has increased funding in recent years, the Pell grant maximum has not been able to keep up with inflation and rising tuition costs. As a result, low-income students are forced to borrow to cover that unmet need. Second, wealthy families may be shifting more of the cost of college from savings to student loans. Also, as tuition increases faster than inflation and median income, students overall are facing increasing levels of need.

We need to look for solutions that make college more affordable and protect students from unmanageable debt burden. Congress should increase grant aid funding, reduce the cost of student loans, and provide flexibility within the student loan program to help make college more affordable for all Americans.

The Burden of Borrowing

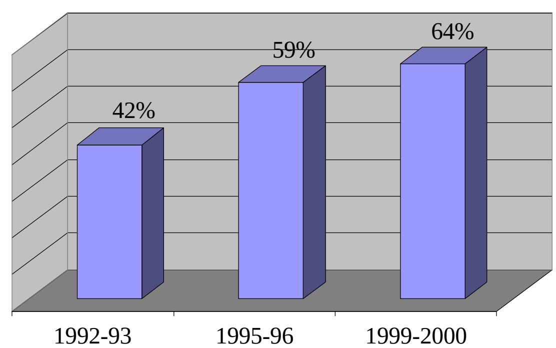
Student debt levels are skyrocketing, and as a result, many students find themselves saddled with unmanageable levels of federal student loan debt and experience difficulty repaying their loans. New data from the 1999-2000 National Postsecondary Student Aid Study (NPSAS), a survey conducted by the U.S. Department of Education's National Center for Education Statistics, shows that the average federal student loan debt has nearly doubled to $16,928 in the last eight years. Key findings:

- 39% of student borrowers graduate with unmanageable levels of federal student loan debt.
- Early in the decade, when Pell grant funding declined, the average debt among low-income students increased by 44%, and in recent years, when Congress was increasing Pell grant funding, average debt increased by only 24%.
- 71% of low-income students graduate with debt, compared to 44% of wealthy students.
- 55% of African-American and 58% of Hispanic student borrowers graduate with unmanageable levels of debt.

Student Loan Debt

The majority of students are graduating with student loan debt. In 1999-2000, 64% of students borrowed federal student loans, compared to 42% in 1992-93. In addition, the number of seniors who graduate with more than $20,000 in debt increased from 5% in 1992-93 to 33% in 1999-2000.

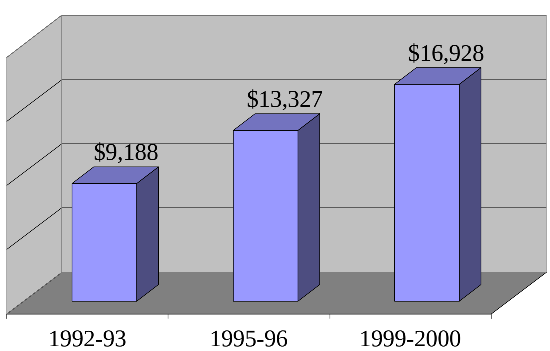
Percentage of Students Who Borrow Federal Student Loans, 1992-93, 1995-96, 1999-2000



The percentage of students who borrow has increased by more than 50% in the last eight years.

Not only are more students borrowing, debt levels are skyrocketing. Over the past eight years, the average cumulative federal student loan debt has almost doubled. In 1999-2000, the average student loan debt for a full-time student at a four-year institution was $16,928, up from $9,188 in 1992-93. The average loan debt at four-year public institutions was $16,243 and that at four-year private institutions was $17,613.

Average Cumulative Federal Student Loan Debt, 1992-93, 1995-96, 1999-2000



The average debt has nearly doubled in the last eight years.

Debt Burden

Debt burden can be defined as the level of difficulty a graduate experiences repaying his or her loans. Although many factors influence debt burden, one way to look at it is the monthly payment as a percentage of monthly income. The loan industry suggests that monthly student loan payments should not exceed 8% of monthly income before taxes. Although a current average income among recent graduates with student loan debt is not available, the closest approximation is the average earnings among 18 to 24 year olds with Bachelor's degrees working full-time and year-round. According to the Annual Demographic Survey of the Bureau of Labor Statistics and the Bureau of the Census, the average income of these recent graduates in 2000 was $32,101.

Based on this figure, an estimated 39% of all student borrowers graduate with unmanageable student loan debt; meaning, these students pay more than 8% of their monthly income on student loan payments.

This estimate may actually be higher as many students take out unsubsidized loans and face even higher monthly payments. The federal student loan program offers both subsidized and unsubsidized loans. Subsidized loans are need-based, and the federal government pays interest on the loan while the student is in college. Unsubsidized loans are available to all students, and interest capitalizes after graduation, making these loans substantially more expensive. Students who have unsubsidized loans pay higher monthly payments on the same debt amount, and more than half of student borrowers take out unsubsidized loans. Many students take out a combination of subsidized and unsubsidized loans, making it impossible to estimate the exact monthly payments that students face. This analysis assumes that all loans are subsidized; however, for at least half of student borrowers, actual monthly payments are likely higher, and even more students face high monthly payments as a percentage of their income.

Borrowing trends among student sub-populations

Family Income

Low-Income Students: Seventy-one percent (71%) of all dependent student borrowers from families with incomes less than $20,000 graduated with student loan debt, compared to 44% of students from families with incomes more than $100,000. Not only are low-income students more likely to take on debt, but they may often face more difficulty repaying their loans after graduation due to familial financial responsibilities.

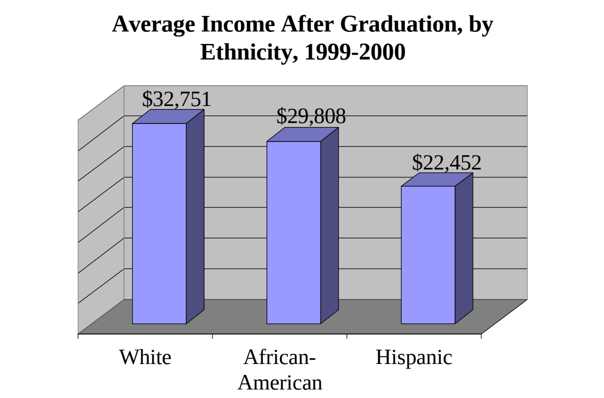
Independent Students: Low-income independent students borrow significantly more than students in any other income category. Seventy-seven percent (77%) of independent students with incomes less than $10,000 graduated with student loan debt, compared to 57% of independent students with incomes over $50,000. Independent students earning more than $50,000 borrowed an average of $17,583, while those with incomes less than $10,000 borrowed an average of $20,447.

Wealthy Students: Over the last eight years, there has been a rapid increase in the percentage of wealthier students who borrow. The percentage of dependent students with incomes of $100,000 or more who borrowed student loans quadrupled from 1992-93 to 1999-2000, and the percentage of those with incomes between $80,000 and $99,999 who borrowed more than doubled over the same time period.

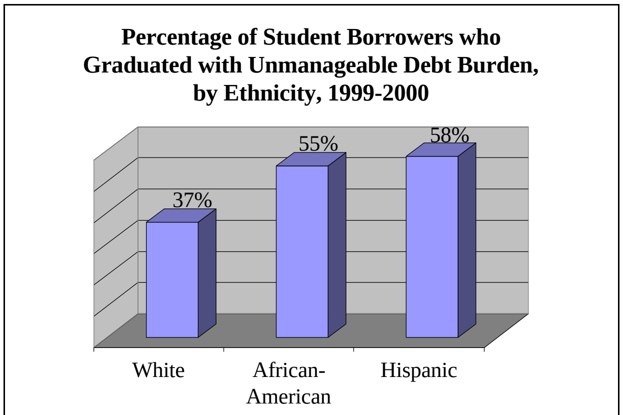
Ethnicity

African-American Students: In 1999-2000, 84% of all African-American students graduated with student loan debt and borrowed $2,000 more on average than the typical borrower. According to the U.S. Census, they also earned less after graduation,[2] and, as a result, 55% of African-American student borrowers graduated with unmanageable debt.

Hispanic Students: Although Hispanic students graduate with lower than average student loan debt levels, they earn nearly $10,000 less than their peers, based on U.S. Census data.[3] As a result, 58% percent of Hispanic borrowers graduated with debt burden that exceeds 8% of their monthly income.

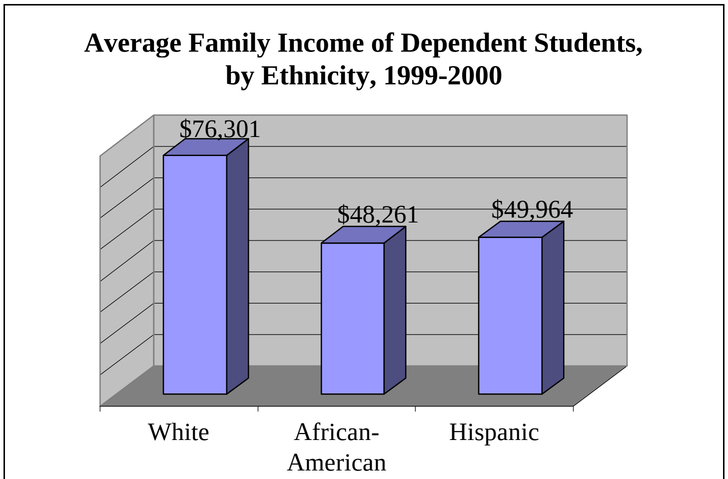


African-American and Hispanic students earn significantly less than average after graduation.



African-American and Hispanic students are more likely to graduate with unmanageable debt burden.

Many African-American and Hispanic student borrowers may also face additional burden, as they are more likely to come from low-income backgrounds. Twenty-two percent (22%) of African-American dependent students and 23% of Hispanic dependent students come from families with incomes less than $20,000. Nearly half of all students from each ethnic group are from families with incomes less than $40,000.



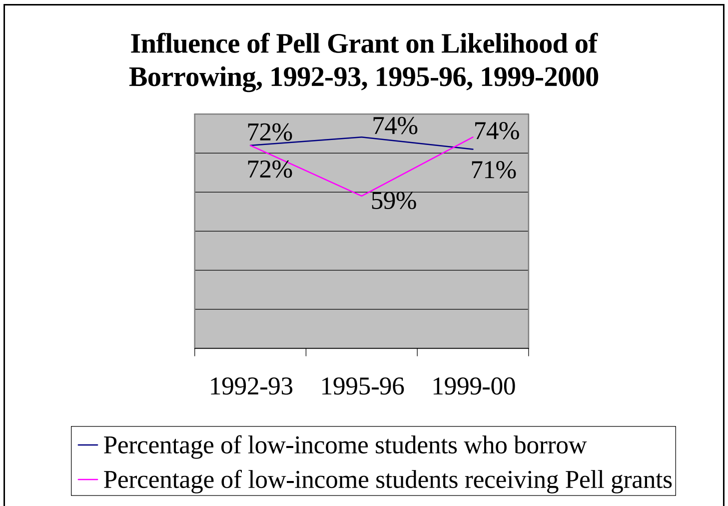
African-American and Hispanic students are more likely to come from low-income backgrounds.

Among students who borrow, African-American and Hispanic students are more likely to find their debt unmanageable after graduation. These students are also more likely to graduate with debt in the first place, with 84% of African-American and 66% of Hispanic students graduating with debt. As a result, African-American and Hispanic college students, including both borrowers and non-borrowers, are disproportionately likely to graduate with unmanageable debt burden. Nearly half of *all* African-American college students and more than one out of *every* three Hispanic college students graduates with unmanageable debt.

The expected influx of fifteen million students, many from low-income families, into America's colleges and universities over the next ten years will only exacerbate the debt burden problem.[4] Of these new students, 80% will be non-white, and 50% will be Hispanic. Among non-white students, 45% will be from families with the lowest expected family contribution.[5]

Other Types of Aid

Changes in Pell grant funding over the past decade may have influenced the borrowing patterns of low-income students. From 1992-93 to 1995-96, the maximum Pell grant decreased from $2,400 to $2,340, and the percentage of dependent graduating seniors from families with incomes less than $20,000 who received Pell grants dropped from 72% to 59%. At the same time, the percentage of low-income students who graduated with debt increased from 72% to 74%.



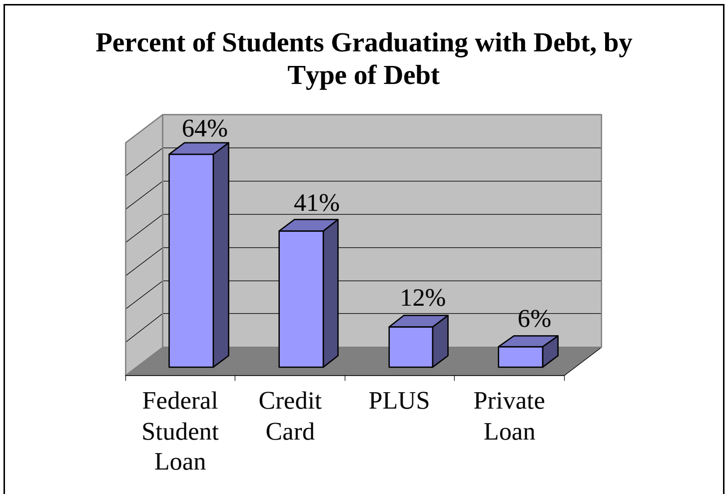
Increases in Pell grant funding may influence the percentage of low-income students who graduate with debt.

Over the second half of the decade, Congress made considerable strides in restoring the Pell grant to its original buying power. By 1999-2000, Congress had increased the maximum grant to $3,125, and the percentage of students in this income bracket receiving Pell grants went back up from 59% to 74%. Meanwhile, the percentage of low-income students who borrowed dropped from 74% to 71%.

The changes in Pell grant funding also may have influenced the levels of student loan debt with which low-income students graduate. Between 1992-93 and 1995-96, when Pell grant funding was cut, the average debt among low-income students increased by 44%, from $8,539 to $12,306. Between 1995-96 and 1999-2000, Congress increased Pell grant funding, and the rising debt levels among low-income students began to slow, with a 24% increase, from $12,306 to $15,287. While low-income students are more likely to graduate with debt, and with high levels of debt, recent increases in Pell grant funding may have kept some low-income students from borrowing and may have slowed growth in debt levels among those who did borrow.

Other Debt

Many students take on additional debt burden from other sources such as credit cards, Parent Loans for Undergraduate Students (PLUS), and private label loans. According to the 1999-2000 NPSAS data, 41% of the graduating seniors carried a credit card balance, with an average balance of $3,071. Student borrowers were even more likely to carry credit card debt, with 48% of borrowers carrying an average credit card balance of $3,176.



Many students graduate with other types of debt in addition to student loan debt.

The average student borrower who carries a credit card balance owes $20,104 to credit card companies and loan underwriters after graduation.

Many families also take out PLUS loans, federal low-interest loans that parents can take out to pay for their children's college education. The average family's PLUS debt was $15,836, and 12% of parents took out these loans. While these loans are intended for parents, it is possible that many students become responsible for repaying the loan after graduation.

Six percent (6%) of all students also borrow loans from private sources, such as independent banks. In 1999-2000, the average private label loan was $6,206. Although debt from these sources is not comparable to the magnitude of the federal student loan program, any debt in addition to the substantial debt from student loans augments the burden of debt after graduation.

Possible Explanations for Increases in Student Debt

Decline in the buying power of Pell grants

The Pell grant program is the foundation of federal financial aid for low-income students. Among dependent graduating seniors in 1999-2000, 88% of all Pell grants awarded went to students with family incomes of less than $40,000.

Despite recent increases in the maximum Pell grant award, the buying power of the grant has eroded over the past three decades. In 1976 the maximum award covered 84% of tuition costs at a four-year public institution, today the maximum award covers only 39% of these tuition costs.[6]

Shift from Savings to Student Loans

The percentage of wealthy students who borrow has been increasing at a rapid rate over the past eight years. In recent years, wealthy families may have contributed less than the Expected Family Contribution (EFC) and relied more on student loans. Financial aid offices use the EFC to determine how much a family should pay in order to calculate need-based financial assistance. These families may be saving less for college or spending less of their savings on college — depending on student loans to make up the difference.

It appears that while low-income students borrow to meet need in paying for college, wealthy students may be borrowing in excess of their need. A student budget is the cost of attending college after subtracting grant aid and EFC. While low-income students had an average student budget of $8,351, wealthy students had an average student budget of $2,520. At the same time, wealthy students borrowed $4,321, nearly $2,000 more than their need.

Tuition

Over the past ten years, after adjusting for inflation, the median family income increased by 12%, while the average tuition and fees at four-year public institutions increased by 40% and that at four-year private schools by 33%.[7] As family income in this country becomes more stratified, tuition as a percentage of family income will continue to increase, particularly for low-income students, amplifying the average student‘s debt burden.

Policy Recommendations

We need to make college more affordable and protect students from unmanageable debt burden. The number of students who take on unmanageable levels of debt will continue to escalate unless steps are taken to increase federal need-based aid and to lower the cost of borrowing to students.

Increase grant aid funding

Federal need-based grant aid provides low-income students with access to a higher education. Without this aid, many low-income students take on unmanageable levels of debt burden or forgo a college education altogether. Recent increases in Pell grant funding may have kept some low-income students from borrowing and slowed the growth of debt levels among those who did borrow. Congress should increase need-based grant funding and, specifically, fully fund the Pell Grant Program.

Lower the cost of borrowing to students

With the typical senior graduating with $16,928 in federal loan debt, Congress should take the following steps to reduce the cost of borrowing.

- Congress should maintain low interest rates on student loans.
- Congress should maintain a level playing field between the Direct Loan Program and the Guaranteed Loan Program to ensure that students receive the most benefits and the best service.
- Congress should pass the Affordable Student Loan Act (H.R. 1622), which would eliminate origination and insurance fees on student loans and save the typical student $677. These savings could be used to pay for tuition, books, and other living expenses.
- Congress should pass a tax credit of up to $1,500 for interest paid on student loans, which would help reduce the burden of debt after graduation.

Continue to provide flexible repayment options to borrowers

Congress should continue to provide flexibility within the student loan program to help make college more affordable for all Americans. Repayment options such as deferment, loan forgiveness, forbearance, and income-contingent repayment help students who are facing unmanageable debt repay their loans without going into default.

Maintain current loan limits

Congress should not increase loan limits without reducing the current cost of borrowing. Raising loan limits will not solve the access problem. Instead it will only make the situation worse with more and more students falling into burdensome debt after college. Congress should continue to work towards increasing access to higher education while protecting students from unmanageable levels of debt.

Methodology

This analysis is based on the National Postsecondary Student Aid Study, a nationwide survey conducted by the Department of Education's National Center for Education Statistics. The data is based on the borrowing patterns of the "typical" student, a full-time and full-year student at a four-year institution. The percentage of students with unmanageable debt burden was calculated by determining the percentage of student borrowers with debt where monthly payments would exceed 8% of monthly income. Monthly payments were calculated based in a standard 10-year repayment plan with a 7% interest rate[8] and assumed that all loans were subsidized. Income data for 2000, both general and ethnicity-specific data, is from the 2001 Annual Demographic Survey of the Bureau of Labor Statistics and the Bureau of the Census.

Endnotes

[1] Advisory Committee on Student Financial Assistance. 2001. *Access Denied: Restoring the Nation's Commitment to Equal Education Opportunity*. Washington D.C.
[2] The average income of 18 to 24-year-old African-Americans with Bachelor's degrees who worked full-time and year-round in 2000 was $29,808.
[3] The average income of 18 to 24-year-old Hispanics with Bachelor's degrees who worked full-time and year-round in 2000 was $22,452.
[4]http://www.studentaidalliance.org/facts/default.asp
[5] *Access Denied: Restoring the Nation's Commitment to Equal Educational Opportunity*.
[6] *Access Denied: Restoring the Nation's Commitment to Equal Educational Opportunity*.
[7] The College Board. 2001. *Trends in College Pricing.* Washington D.C.
[8] The 7% interest rate is the average of Congressional Budget Office projections from 2001 to 2005 and the recently passed fixed rate from 2006 to 2011.