Drowning in Debt: The Emerging Student Loan Crisis

by **Erin Dillon and Kevin Carey**

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Higher education has never been more expensive. The price of attending a public university doubled, after inflation, over the last two decades, and family income and student financial aid haven't kept pace.[1] As a result, students have no choice but to borrow, and more college students are borrowing more money than ever before.

But a new analysis of federal financial aid records reveals more than just surging debt levels. Students are taking on more of the riskiest debt: unregulated private student loans. Here, students have the least protection and pay the highest rates. For-profit colleges are leading the way in this trend, and minority college students appear to be borrowing a disproportionate share. If this continues, the consequences will be severe: reduced access to higher education, diminished life choices, and increasing rates of catastrophic loan default.

There are many culprits to this emerging student loan crisis: out-of-control tuition increases, lack of commitment to need-based financial aid, and states and universities increasingly spending scarce financial aid dollars on wealthy students. President Obama recently proposed reforming the federal student loan program by having all students borrow directly from the government. The money saved from this change would go to making Pell grants, which are targeted to the neediest students, an entitlement. The new plan would also tie annual increases in Pell grants to inflation. This is a good start to solving the problem of rapidly growing student debt, but much more needs to be done—from reforming state and institutional aid policies to creating better incentives for colleges to restrain prices.

Based on recently released data from the U.S. Department of Education's National Postsecondary Student Aid Survey (NPSAS) and an analysis of the past 15 years of NPSAS data, the following charts show just how much higher education debt is increasing, as well as identify several reasons for the surge and what steps policymakers can take to help students attend college without drowning in debt.

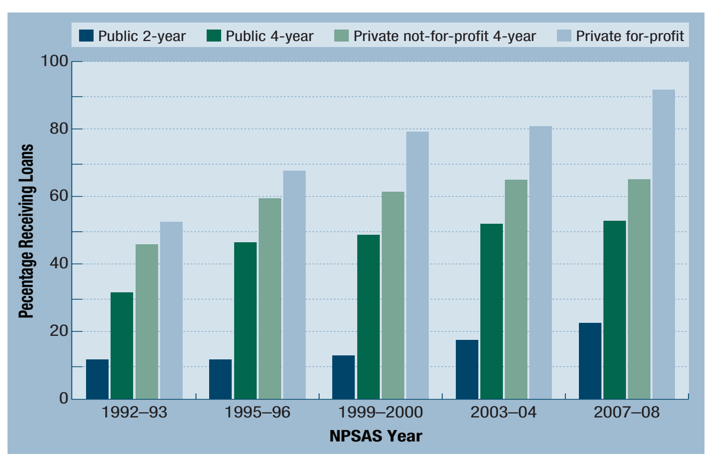
REACHING NEW HEIGHTS

Higher education debt has reached unprecedented heights. **Chart 1** shows the percentage of all full-time undergraduates who received student loans, broken down by the type of institution (public two-year, public four-year, private nonprofit four-year, and for-profit) in the five most recent academic years that the NPSAS was administered: 1992–93, 1995–96, 1999–2000, 2003–04, and 2007–08.

In 1993, overall, only 32 percent of undergraduates borrowed to attend college. Borrowing rates were lowest among students attending community colleges—unsurprising given that two-year public institutions are usually inexpensive. Roughly 32 percent of public four-year students borrowed, compared to 46 percent of students at private nonprofit institutions and 53 percent of those in for-profit colleges.

In every year since, nearly every one of those percentages has increased. As recently as the mid-1990s, borrowing was the exception. Now it's the rule. While community college students have remained relatively debt-free—only 23 percent borrowed in

Chart 1. Percentage of Full-Time, Full-Year Undergraduates Who Received Any Student Loans, by Institution Type



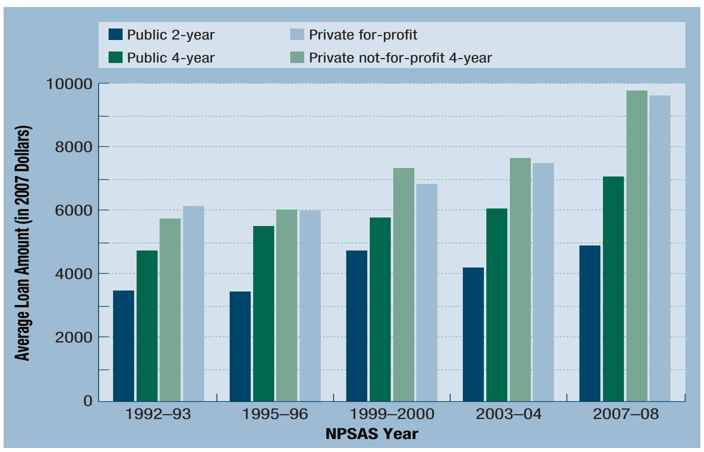
Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

2008—this is still nearly twice the percentage who borrowed in 1993. Even public four-year universities that receive large cash subsidies to keep tuition low have edged above the 50 percent borrowing threshold. But by far the biggest increase in the percentage of students borrowing is in for-profit education, which grew from 53 percent of students borrowing in 1993 to *92 percent* in 2008.

In addition to the percentage of students borrowing, the *amount* borrowed is increasing too.

Chart 2 shows the average yearly amount students borrowed, adjusted for inflation. From 1993 to 2008, the average yearly debt load increased by over 50 percent—even as the percentage of students who borrowed increased as well. Average annual debt for borrowers at four-year private universities increased by 70 percent. Average debt for students attending for-profit colleges increased by 57 percent, to $9,600 per year.

Chart 2. Among Full-Time, Full-Year Undergraduates Who Received Any Student Loans, Average Amount of Loans Received, by Institution Type



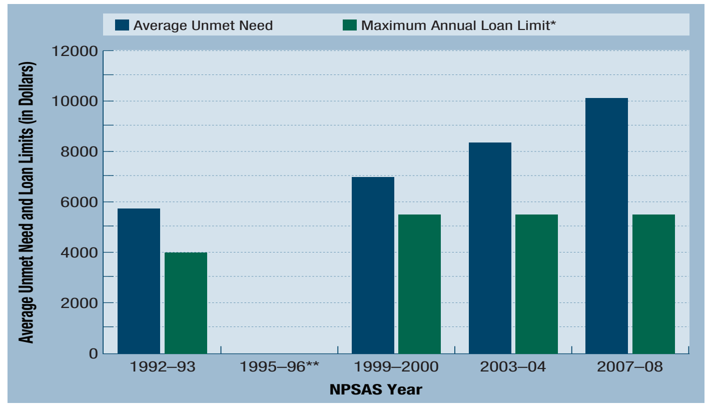
Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

RISE IN PRIVATE LENDING

The new data also show that private student loans are exploding. In 1993, such loans barely existed. The vast majority of all loans were issued through federal programs like the Stafford Loan Program and the Perkins Loan Program. Interest rates are subsidized and regulated in these programs, and borrowers are given specific protections like income-based repayment options and loan deferment if they return to school.

But there are limits to how much money students can borrow under federal loan programs. **Chart 3** shows the average amount of "unmet need" compared with the maximum federal loan limit on Stafford loans during that year. Unmet financial need is the difference between a student's total expenses for college and the sum of their expected family contribution (EFC) and the total amount of grant aid they receive.

Chart 3. Average Unmet Need Among Full-Time, Full-Year Dependent Undergraduates and Maximum Federal Loan Limit



*The maximum annual limit on Stafford loans for dependent undergraduates in their junior and senior years, including both subsidized and unsubsidized loans. Annual loan limits are lower for freshman and sophomore students. Historical data on federal loan limits can be found here: http://www.finaid.org/loans/historicallimits.phtml.

**The NPSAS 1995–96 dataset available through the Undergraduate Data Analysis System did not include a variable calculating total student budget minus expected family contribution and total grant aid.

Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

As Chart 3 shows, over the last 15 years, students' unmet financial need has increased much faster than the maximum amount of money they can borrow through subsidized federal loan programs.

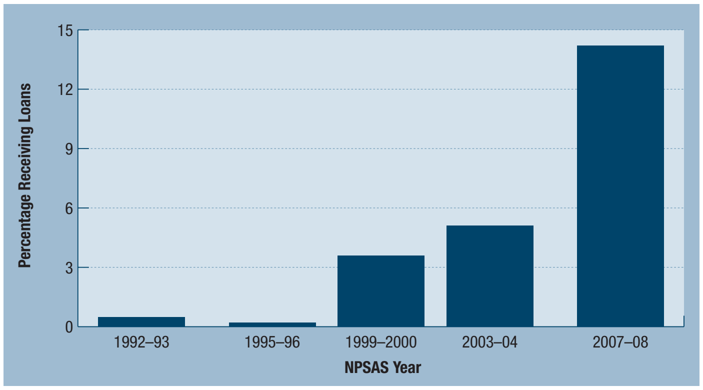
As a result, a multi-billion dollar private student loan market sprang into existence to fill the gap. Fueled by the simultaneous availability of cheap credit, firms with names like EduCap and Campus Door, along with well-known companies like Sallie Mae and Bank of America, began aggressively marketing private loans to hundreds of thousands of college students. Interest rates were often steep—as much as 19 percent in some cases. And unlike federal loans, it is much harder for students to delay payment on private loans if they go on to graduate school or become unemployed.[2]

The recent tightening of the credit markets has made it difficult for many private lenders to do business—Campus Door, for example, has stopped accepting new applications for loans. But as long as college prices increase faster than grant aid, family income, and available federal loans, students and families will have to borrow the difference from somewhere, and at market rates.

As **Chart 4** shows, 5 percent of undergraduates borrowed private loans during the previous NPSAS in 2003–04. But that proportion nearly tripled in the next four years, to 14 percent.

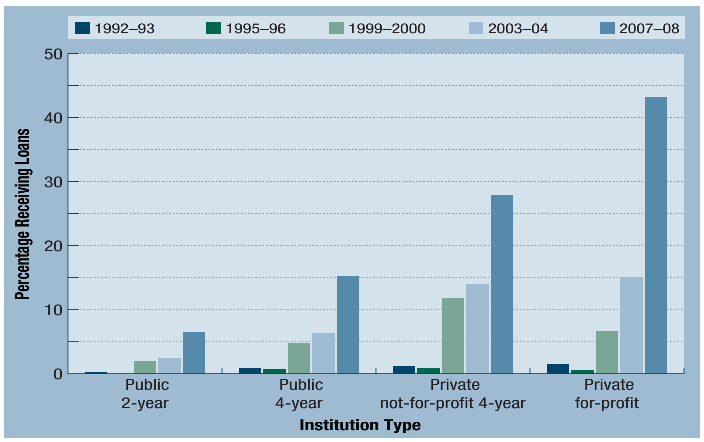
The increase wasn't evenly spread among students or institutions. As **Chart 5** shows, by far the biggest increase

Chart 4. Percentage of All Undergraduates Receiving Private Student Loans



Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

Chart 5. Percentage of Full-Time, Full-Year Undergraduates Receiving Private Student Loans, by Institution Type



Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

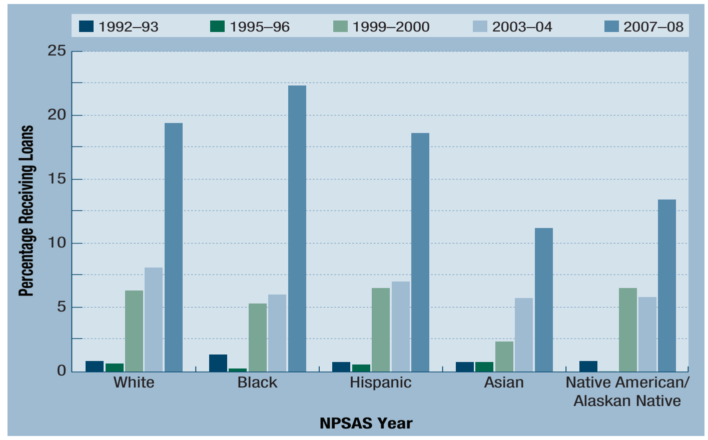
in private loans came among students attending private for-profit institutions—the same institutions that have shown the biggest increase in the percentage of students borrowing.

In 2004, 15 percent of full-time students attending for-profit institutions took out private loans In 2008, that proportion had nearly tripled, to 43 percent. Public and private nonprofit four-year institutions also had big upticks in private loan participation during the same time. But the for-profit sector stands out as becoming increasingly dependent on student loans, and with many of those loans outside the realm of public subsidy and regulation.

As **Chart 6** shows, private loan trends differ by students' race or ethnicity.

In 2004, a smaller percentage of black students took out private loans than did white or Hispanic students. Four years later, black students had the *highest* private student loan participation, with the percentage more than tripling over that time.

Chart 6. Percentage of Full-Time, Full-Year Undergraduates Receiving Private Student Loans, by Student's Race/Ethnicity

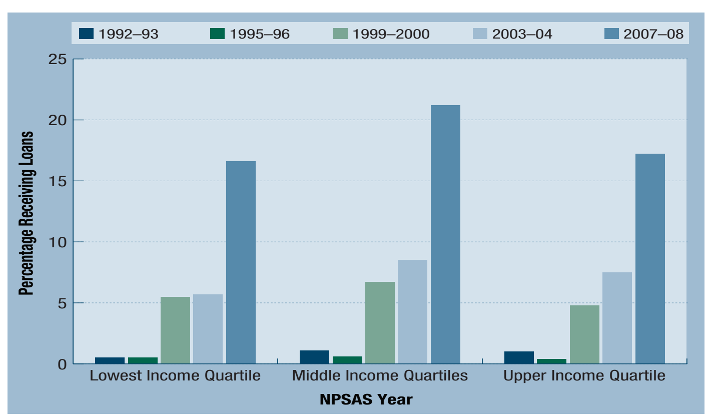


Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

Some might argue that private student loans make sense as a means of enabling well-off students to pay for an expensive, high-value education. But as **Chart 7** shows, almost as many students in the *lowest* income quartile take out private loans as do students in the highest income quartile.

This growth in private borrowing exposes more students to financial risk. Low-income students are less likely to have a financial safety net from parents if they have trouble repaying loans. And data from federal surveys indicates that minority students are more likely to default than others.[3] The default rate for black students who took out federal Stafford loans and earned a bachelor's degree in 1992–93 was nearly 40 percent after 10 years. The recent surge in risky private borrowing took place *after* the survey time period, suggesting that the default risk for low-income and minority borrowers may have grown even worse in recent years.

Chart 7. Percentage of Full-Time, Full-Year Undergraduates Receiving Private Student Loans, by Income



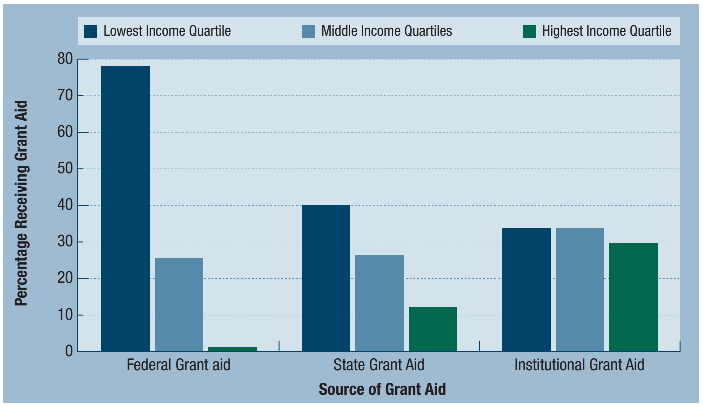
Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

SHIFTING PRIORITIES FOR GRANT AID

One way to reduce the need for risky student borrowing is to provide students with direct cash subsidies in the form of grants. Most grants come from three sources: the federal government (primarily through Pell grants), state governments, and colleges and universities themselves.[4]

But as **Chart 8** shows, these entities vary tremendously in who they give aid to. And institutional and state financial aid programs are increasingly less focused on helping low-income students afford college.

Chart 8. Percentage of Full-Time, Full-Year Undergraduates Receiving Grant Aid, by Aid Source and Income (2007–08)



Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Study (2007–08). Author analysis with Undergraduate Data Analysis System.

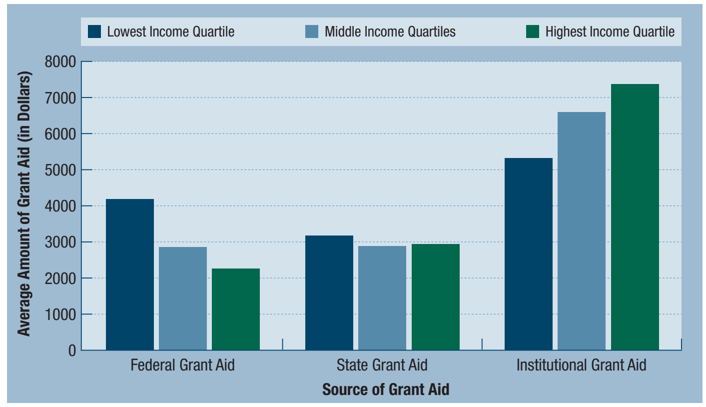
Federal grants and scholarships are highly targeted to low- and moderate income students. Nearly 80 percent of full-time students from households in the lowest income quartile receive federal grants. But participation falls off quickly from there—only 26 percent of those in the middle two income quartiles receive federal grants, and virtually no one earning more than that receives scholarships from Uncle Sam.

State aid programs are less targeted, but still vary inversely with income. Forty percent of those in the lowest income quartile receive state grants, compared to 12 percent of those in the top income quartile.

Institutional aid—grants paid directly to students in the form of scholarships or foregone tuition—is barely targeted at all. Thirty-four percent of the lowest-income students receive institutional aid—*only 0.2 percent more* than the percentage of those in the middle income quartiles, and barely more than the 30 percent of the wealthiest students who get grants from their college or university.

Also, as **Chart 9** shows, the patterns are even more pronounced for the amount of aid students receive. Lower-income students aren't just more likely to receive federal aid—they receive larger aid amounts. This is the logical outcome of programs designed to help students with fewer financial resources attend college.

Chart 9. Average Amount of Grant Aid Among Full-Time, Full-Year Undergraduates Receiving Grant Aid, by Source of Aid and Income (2007–08)

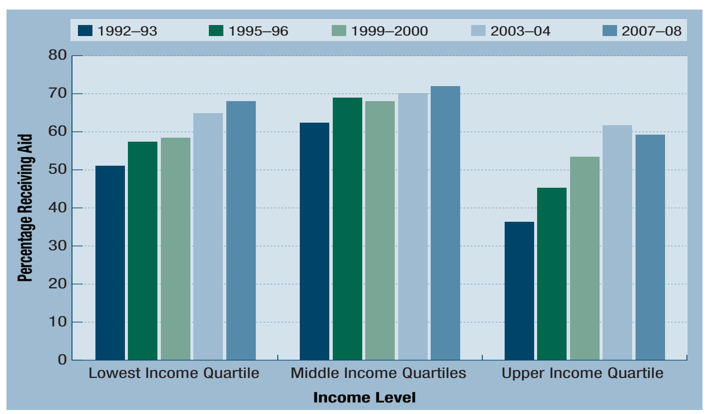


Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Study (2007–08). Author Analysis using Undergraduate Data Analysis System.

At the same time, state aid is only slightly concentrated among low-income families. But interestingly, the average amount of institutional aid steadily *increases* as students earn more money. To some extent this is because wealthy students are more likely to attend expensive colleges. A student getting a $10,000 discount at a $50,000 private liberal arts college receives a larger grant in absolute terms than a student receiving an $8,000 scholarship at a $12,000 public university. But it's also because institutions are, increasingly, using a significant amount of their student aid money to attract wealthy students.

It didn't used to be this way. As **Chart 10** shows, private, four-year institutions 15 years ago were more likely to spend their aid dollars on low-income students.

Chart 10. Percentage Receiving Institutional Aid Among Full-Time, Full-Year Undergraduates Attending Private, 4-Year Institutions, by Income

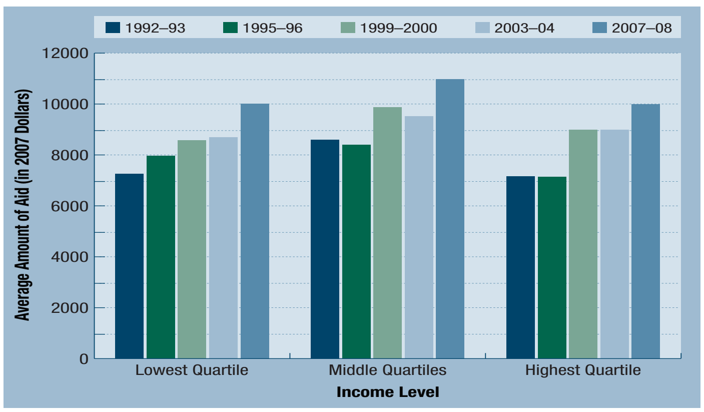


Source: Laura Horn and Katharin Peter, *What Colleges Contribute: Institutional Aid to Full-Time Undergraduates Attending 4-Year Colleges and Universities* (Washington, DC: National Center for Education Statistics, 2003). Tables 1a and 1b. Updated with author analysis of NPSAS 2007–08 data using the Undergraduate Data Analysis System.

In 1993, the majority of students from the lowest and two middle income quartiles received financial aid directly from their college or university, compared to only 36 percent of students from the top quartile. Over time, the percentage of all students receiving institutional aid has increased—reflecting, in part, more aggressive and sophisticated use of “tuition discounting” policies by colleges and universities. But the steepest increases came among the wealthiest students. The proportion of the wealthiest students getting institutional grants jumped to 59 percent.

Wealthy students are also keeping pace in the amount of institutional grants. As **Chart 11** shows, at private, four-year institutions in 2008, the wealthiest students received institutional grants of nearly identical size to those received by the lowest-income students.

Chart 11. Average Amount of Aid Among Full-Time, Full-Year Undergraduates Attending Private, 4-Year Institutions and Receiving Institutional Aid, by Income

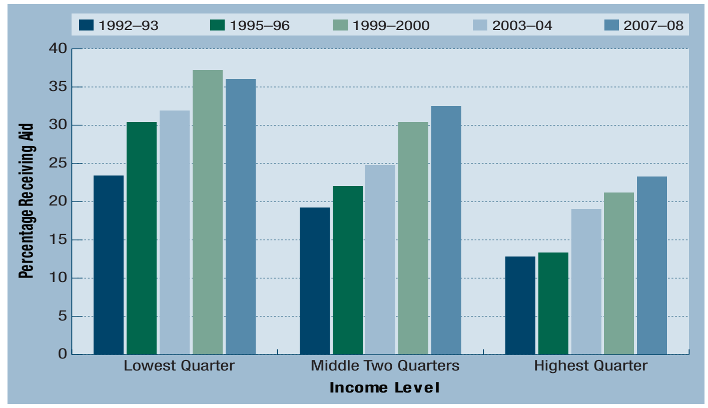


Source: Laura Horn and Katharin Peter, *What Colleges Contribute: Institutional Aid to Full-Time Undergraduates Attending 4-Year Colleges and Universities* (Washington, DC: National Center for Education Statistics, 2003). Tables 1a and 1b. Updated with author analysis of NPSAS 2007–08 data using the Undergraduate Data Analysis System.

Public four-year universities appear to have made similar choices. **Charts 12** and **13** show the percentage and amount of institutional aid given by public universities to students of different income groups. While public universities have increased institutional aid to students of all types, the percentage of wealthy students receiving aid has proportionally increased the most. Wealthy students who receive aid also get the highest average institutional grant awards—more money than students from middle- and lower-income backgrounds.

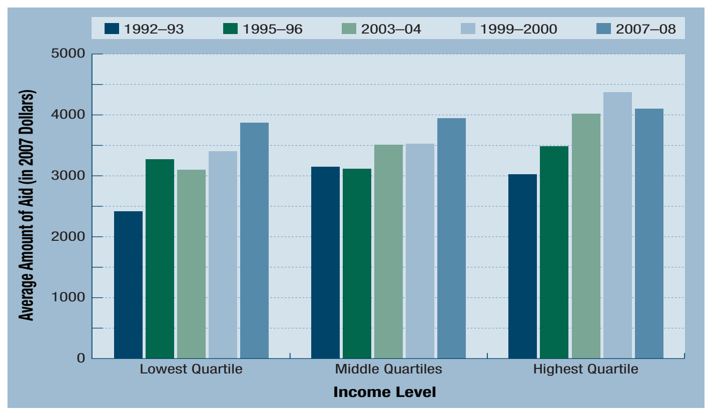
Overall, it’s clear that colleges and universities are spending an increasing percentage of their financial aid dollars on students who have the least financial need. This is partly a function of simple bottom-line concerns: A few thousand dollars spent to induce the child of wealthy parents to enroll can be money well spent if his or her parents write a check for the remainder and make a donation to the alumni fund in the bargain. Such aid is often misleadingly labeled

Chart 12. Percentage Receiving Institutional Aid Among Full-Time, Full-Year Undergraduates Attending Public, 4-Year Institutions, by Income



Source: Laura Horn and Katharin Peter, *What Colleges Contribute: Institutional Aid to Full-Time Undergraduates Attending 4-Year Colleges and Universities* (Washington, DC: National Center for Education Statistics, 2003). Tables 1a and 1b. Updated with author analysis of NPSAS 2007–08 data using the Undergraduate Data Analysis System.

Chart 13. Average Amount of Aid Among Full-Time, Full-Year Undergraduates Attending Public, 4-Year Institutions and Receiving Institutional Aid, by Income



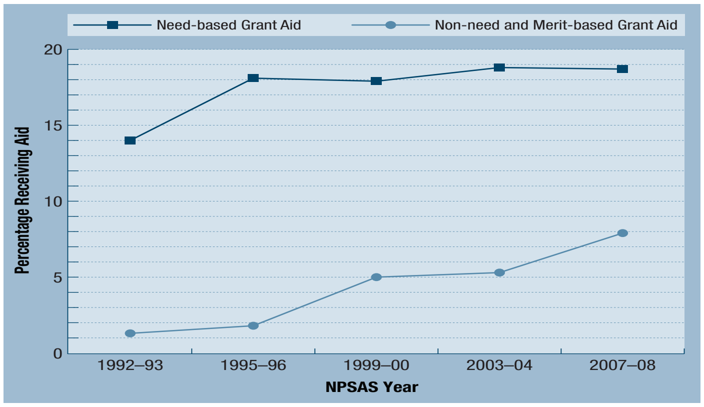
Source: Laura Horn and Katharin Peter, *What Colleges Contribute: Institutional Aid to Full-Time Undergraduates Attending 4-Year Colleges and Universities* (Washington, DC: National Center for Education Statistics, 2003). Tables 1a and 1b. Updated with author analysis of NPSAS 2007–08 data using the Undergraduate Data Analysis System.

“merit aid,” a catch-all phrase that unfortunately has come to encompass all non-need-based aid programs.

Universities also use a substantial amount of their discretionary aid dollars to attract students who do have academic merit, at least as measured by factors like class rank and SAT and ACT scores, both of which contribute to the influential *U.S. News & World Report* college rankings. Prestige in higher education is partly a function of attracting “better” students to enroll, and prestige has a price.

State governments have also shifted their priorities in recent years. As **Chart 14** shows, state governments were, back in 1993, almost exclusively in the business of giving financial aid to students who need financial aid. Fourteen percent of full-time undergraduates received some form

Chart 14. **Percentage of Full-Time, Full-Year Undergraduates Receiving State Grant Aid, by Aid Type**



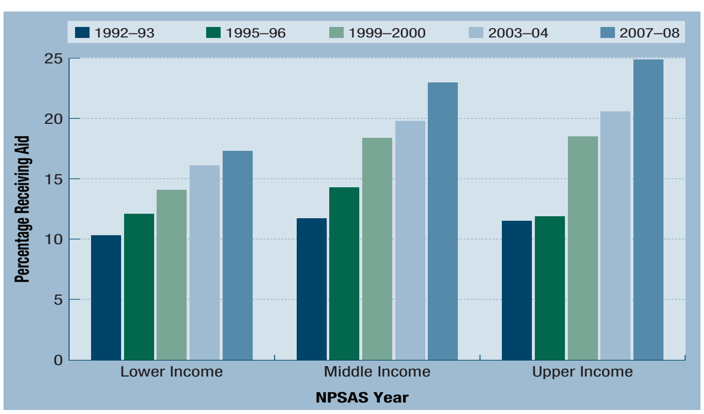
Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

of state-funded need-based aid, compared to just over 1 percent of students receiving non-need based aid.

Over time, state investment in need-based aid rose from 14 percent of students to nearly 19 percent, but increased by only 1 percent between 1996 and 2008. At the same time, the percentage of students getting "merit" or non-need based aid increased by a factor of six. During that time, Georgia's popular, lottery-funded "Hope Scholarship" program shifted the focus from low-income to middle- and upper-class students, as state policymakers fought to keep academically promising students in-state—and assuage the anxieties of middle-income families growing increasingly alarmed about college cost. Other states copied the Georgia program, funneling hundreds of millions of dollars into what has become, for all intents and purposes, a new middle class entitlement—on top of the implicit subsidy that comes through subsidized tuition at state universities.

As **Chart 15** shows, the changes in state aid and institutional aid at four-year colleges are part of a larger trend of more "merit" aid going to upper-income students.

Chart 15. **Percentage of Full-Time, Full-Year Undergraduates Receiving Non-Need and Merit-Based Aid, by Income**



Source: U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Survey (1993–2008). Author analysis with Undergraduate Data Analysis System.

In 1993, nearly as many low-income students received "merit" aid as upper-income students. But, since then, the percentage of upper-income students receiving "merit" aid has more than doubled to 25 percent, surpassing both low-income and middle-income students.

If tuition increases continue to grow faster than inflation and family income and grant aid fails to keep pace, more students will be left with few choices beyond student loans—and, increasingly, private loans. This course is particularly risky for low-income and minority students, who have historically been more likely to default. The fact that the biggest increases in loan amounts and loan participation are occurring in the fast-growing for-profit sector—which historically has had higher default rates—suggests that worrisome default rates are likely to worsen in the future if more effective financial aid policies are not adopted.

Recent efforts to solve the problem may not be enough. President Obama's proposal to substantially increase funding for the federal Pell Grant Program and to tie annual increases to the Consumer Price Index will ensure that federal grant aid increases regularly each year. But even though Pell grants are well-targeted and an important source of grant aid for low-income students, they only constitute one-third of total grant aid.[5] State grant aid and institutional grant aid make up over half of total grant aid, and as this report shows, those grants are increasingly going to middle- and upper-income students.

Even more significantly, the president's proposals do nothing to address the single biggest driver of higher education unaffordability: rapidly escalating tuition costs. Until federal and state governments work with institutions to restrain prices while simultaneously re-focusing financial aid on needy students, the tide of college debt will continue to rise.

Endnotes

1. College Board, "Average Published Tuition and Fees in Constant (2008) Dollars, 1971–72 to 2008–09," *Trends in College Pricing*, available at: http://www.collegeboard.com/html/costs/pricing/index.html

2. Diana Jean Schemo, "With Few Limits and High Rates, Private Loans Deepen Student-Debt Crisis," *New York Times*, June 10, 2007 and Deanne Loonin, *Paying the Price: The High Cost of Private Student Loans and The Dangers for Student Borrowers*, (Boston, MA: National Consumer Law Center, March 2008).

3. Erin Dillon, *Hidden Details: A Closer Look at Student Loan Default Rates* (Washington, DC: Education Sector, 2007).

4. College Board, *Trends in Student Aid*, 2008. Available at: http://www.collegeboard.com/html/costs/aid/index.html

5. College Board, *Trends in Student Aid*, 2008.