MEMORANDUM
TO: US Congress
FROM: Alex Hinton, Policy Analyst
RE: Reform on student loan discharge
DATE: April 12, 2018

Introduction

This memorandum addresses key concerns related to the current financial policy of disallowing graduates of higher education to file for bankruptcy due to an inability to repay student loans. While this policy of not allowing student loan bankruptcy was not always the case, since it has come into effect multiple problems have arisen. These problems include a debt among borrowers that was 7.5% of US GDP in 2016 (Student Loan Hero, 2018), which is also growing exponentially; an inability to escape crushing debt, especially among low-income borrowers; and a less diverse workforce as a result of a fear of inescapable debt. It is my hope that through the information presented in this memo that a change in policy may be considered due to the multiple negative externalities that arise from the current policy on student loans—and, more specifically, the policy on discharging student loans through bankruptcy.

Background

Whereas with credit card debt, gambling debt, and car loan debt one may absolve their debt through bankruptcy, student loan debt is all but ineligible for the same grace. Before 1976, all loans were treated similarly in regard to the opportunity to discharge them through bankruptcy. In 1976, however, financial policy was altered so that loans made by the government or non-profit colleges and universities could not be discharged for the first five years of payment. In 1984, Congress applied the same concept to private student loans. In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act which made all education loans ineligible to be discharged through bankruptcy—except in the case of undue financial hardship.

As of 2016, educational debt is at $1.4 trillion which is 7.5% of the national GDP. Around 43 million adults in the US have student loan debt and the average balance is $30,000 according to a study done by the Federal Reserve Bank in New York (Lucca et al., 2017). In another study, reported by Bill Fay, a contributor to Debt.org, student loan debt has aggregately risen "from $260 billion in 2004 to $1.4 trillion in 2014"; and "average debt [per graduate] jumped from $18,650 to $38,000" (Fay, 2018). He goes on to explain that in order to pay off the average $38,000 in ten years, it would cost just under $400 per month—or an annual salary of *at least* $47,000 if the borrower is single. In a 2015 estimate, for non-STEM degrees (aside from Business), the average salary of recent graduates was under that $47,000 benchmark (Poppick, 2015). This statistic is further reflected in a CCAP study which found that one-third of borrowers, regardless if they graduate or find a job related to their credentials, are financially burdened for the majority of their lives by their debt obligations and thusly do not become economically productive citizens (Vedder et al., 2014).

Policy Problems

While there are multiple people content with student loan debt being, for all intents and purposes, unforgiveable except through complete repayment, there are multiple problems that arise from the lack of an efficient and fair discharge procedure for educational debt, primarily economic in nature. These problems include:

1. Continuously increasing tuition costs
2. Large percentage of college graduates financially burdened for life
3. Less diverse pool of graduates

(1) Continuously increasing tuition costs present a multiple of issues to potential college students, as well as to the economy as a whole. "Since 1980, tuition costs at public universities has" jumped by "344%", whereas "food and electivity costs have risen about 150% and gasoline prices…[by] 200% over the same period" (Fay, 2018). On both a macro- and micro-level, increasing tuition costs without increased post-graduate income or an increased level of excludable aid to needy students affect the economic standing of localities, states, and the nation as a whole. However, since student loan debt is, except in rare cases, ineligible for discharge, both public and private universities are relatively free to continue to increase tuition without fear of not receiving the money. While this upward trajectory has slowed in recent years, it must be said that continually inflating tuition costs without inflating starting salaries or financial aid is unsustainable for a healthy economic state.

(2) As was stated earlier, the average salary to afford to pay off student loans within a decade is estimated to be around $47,000; yet in 2015, estimates for the salaries of 2016 graduates of all non-STEM degrees were either just at or under that $47,000 benchmark. Most well-paying jobs require a college degree to start a job with a livable salary, so it is almost a necessity in the modern world to have some sort of degree. However, when starting salaries do not meet the needs of indebted graduates, they begin missing payments. According to Debt.org, "70% of college graduates leave school with student loan debt that averaged $38,000 in 2017", where "63% of [Millenials] owed more than $10,000 in student loan debt" (Fay, 2018). Without an adequate salary to make payments on student loans, and an inability to discharge student loan debt through bankruptcy, the debt stays. According to Fay, the "number of people over [age] 60 with student loan debt has quadrupled from 700,000 to 2.8 million [Americans]" (Fay, 2018). Keller furthers confirms this statistic by pointing to the case of *Conway v. National Collegiate Trust,* where a borrower (Conway), though declaring bankruptcy and making a salary well-under the $47,000 benchmark, did not have student loan debt forgiven due to the subjective nature of the "undue hardship" test. The subjective nature of the undue hardship rule is a primary reason why student loan borrowers are burdened for life; the example of *In re Conway* further explains the problem with not having a more objective route for discharging student loan debt.

(3) It may be easily surmised through the previous two statements that as a result of increasing tuition costs and college graduates being burdened for decades—if not life—there will be a less diverse pool of graduates for employers to select from. College students will either be encouraged to pursue a vocational job rather than a white-collar career or to pursue a STEM or business degree instead of degrees that lead to lower-paying jobs (like the arts and social sciences). While STEM or business-related degrees are helpful to society as a whole, an entire pool of graduates pursuing the same sort of degrees and jobs produces both oversaturation of qualified individuals in those career fields, and less diverse graduates educationally. Expounding on this, diversity in terms of race, ethnicity, socioeconomic status, and gender suffers just as much—if not more—than diversity in degree-type. This is largely due to the economic burden unsolvable student loan debt places on individuals. If these students come from households with low-income or a history of being discriminated against in fields traditionally filled by white men, they will be less likely to pursue degrees.

Key Stakeholders

1. Past/Current/Future Students
   Students are the most obvious stakeholders in relation to non-dischargeable student debt. They have the most to gain or lose by addressing—or not addressing—the issue. If a policy change to make student loan debt dischargeable was enacted, past and current students may be able to lift themselves out of debt more easily knowing regardless of success or failure, there is an option to discharge debt for something that was promised to give an edge; future students might have the burden of potential failure lifted to a level where, while not ideal, financial failure does not mean endless debt.

2. Business Leaders
   As Fay explains in his article, student loans can have an adverse effect on credit scores, budgets, and your ability to take out loans to buy expensive goods like cars or houses. In fact, Fay also points to the burden of student debt being a "key factor in young graduates not starting a business" or getting married (Fay, 2018). As businesses are in the business of making money and having an expanding market, they have a stake in the student debt crisis. As student loan debt rises, the ability of average consumers to buy goods—especially luxury goods—decreases. Their stake is in the growth of the economy; and unduly burdensome debt on an average American does *not* make for economic growth.

3. US Government
   As it stands now, US student loan debt is at $1.4 trillion. This undoubtedly affects the economy, as individuals who may need to spend a quarter of their pay on repaying student loans inherently have less disposable income. While a policy change would not necessarily solve the issue of indebted individuals having less disposable income, having a policy change could at least relieve blame from the US government for causing undue

stress; and, in the case that the financial burden becomes too heavy, debtors could petition for bankruptcy to absolve the debt.

4. Lenders
   In contrast to other stakeholders, banks and other money lenders may be more averse to changing policies concerning student loan debt. Currently, the policy indicates that the investment made by the lender *will* be returned at some point. If the policy were to change, this assurance may disappear despite the repayment procedure relating to bankruptcy filings.

Evaluation Framework

When considering the policy options relating to this issue, it is vital to have a set of guidelines to determine the effectiveness of each of the proposed options. This section will describe the parameters I have found to be most important when considering moving forward in a specific policy.

1. *Political Feasibility*
   As the policy in question deals primarily with an issue with legal framework concerning economic considerations, it is necessary for any proposed policy to have the feasibility to be passed in the legislature. If the recommended policy does not have the support of a plurality of Congress, whether it is the state legislature or national legislature, the policy will most likely fail, regardless of any problems it might solve.

   There is an issue in measuring the political feasibility of any given policy, however—especially concerning a policy that is rarely discussed, as is the case with student loan discharge. Without a source of accurate polling information, it is difficult to ascertain the majority opinion concerning a change in policy—both publically and Congressionally. For the most accurate measurement, one would need to survey members of the National House and Senate on their opinions of the issue. If a plurality of those surveyed is in favor or neutral to policy alteration, we may consider the alternative policy politically feasible.

   In the absence of a ready-made and efficient polling system of government officials, for the purpose of this analysis we will consider a policy politically feasible *if there is no discernible proof to the contrary.* While this process of analysis is lacking in a multitude of ways, it is the most cost- and time-effective strategy for analyzing the proposed policy alternatives in a reasonable time frame.

2. *Retain Students in Higher Education*
   The purpose of a policy change in student loan discharge is *not* to increase the burden on current or future students. *If a proposed policy significantly increases a burden on students to provide for their education*, which may cause these same students to avoid

going into higher education or drop out of their respective colleges due to monetary constraints, we may consider it not being conducive to retaining students in higher education.

The best method to assess this is to conduct in-depth research of each policy alternative. For the purposes of this assessment, hypothetical situations will be considered as to determine the potential impact of a policy change on an individual level.

3. *Economically Viable*
   In much the same way we might consider a substantial adverse impact individual a determining factor in a policy's desirability, we must also consider any adverse impact to the economy as a whole. We may consider a policy not economically viable *if it would likely produce a substantial adverse effect on businesses, money lenders, universities, or any other integral area of the economy.* Like with the previous criterion, a policy's economic viability will be assessed through hypothetical situations relating to economic sectors.

Alternative Policies

There is potential for a wide variety of alternative policies to deal with the inability to discharge student loan debt. As this is largely an issue relating to national law, many of the policy alternatives have to do with altering U.S. law; however, it is not exclusive to a change in law. This section will present and assess three policy options to address the issue presented in this report. There are three alternatives presented, and the status quo, which equate to a variety of specific options in each. The alternatives include *changing US law, changing the lending policy of the US government and/or private lenders, and changing higher education policy.*

Change in Law

Changing the law relating to student loan discharge can take multiple forms, which will be presented in three ways in this assessment.

(1) *Repeal Laws Preventing Discharging of Student Loans*
    This proposed change would seek Congress to repeal the section of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act that ended the US policy to allow graduates to discharge student loan debt through bankruptcy. Before this 2005 law, graduates had to wait five years after graduation to file for bankruptcy with student loans. As such, congressmen and women could additionally seek to revert US policy on student loan bankruptcy to pre-1976 levels, when graduates could file for bankruptcy on student loans as immediately as needed.
(2) *Replace Current Laws with a Middle-Ground Option*
    Instead of seeking a hard-repeal of bankruptcy policy loans, lawmakers could instead seek to replace current US law with policies that reflect 1976 and 1984 policies which allowed for students to seek bankruptcy, but only after a period of at least five years.

Lawmakers would need to assess the best course for reflecting these laws; however, new policies regarding a discharge of student loan debt could point to a ten-year gap between graduation and filing for bankruptcy, in an attempt to better reflect the benefits of the current policy.

Change in Lending Policy

Instead of targeting US law as a whole, another option for policymakers is to seek a change in lending policy. Lending policies could be changed through lawmaking; however it is not necessary to pursue this option. A change in lending policy would entail more stringent capping on the amount of loans one could receive in relation to their socio-economic status or college major. There are already federal regulations on the amounts younger students can receive in Federal student loans; however, these policies tend to discount the feasibility of students to repay loans, whether it is through the help of their parents or a future career. Lending policy could be changed to cap the amount of loans a student/graduate pursuing a less lucrative career or major at a lower rate than those seeking degrees or careers that provide a more insurable income to ensure the loans will be repaid—or if not repaid, not creating an undue burden on the debtor. This change would need to begin in the federal government; however, pending its success, there is a high possibility that private lenders would begin to exhibit this practice in their own businesses.

Change in Higher Education Policy

Policymakers may instead seek to alter the policies of institutions of higher education. These changes can best be encapsulated in a change in standards of universities—i.e. bottlenecking the number of students allowed in the school as a way to reduce the number of borrowers in the system—as well as capping college budgets to prevent students being loaned increasing amount of money.

(1) *Raise Standards for Entrance to Colleges*

This change seeks to prevent students who may not be able to repay student loans from going to college in the first place. Students who perform higher would be accepted to higher education institutions; and those who perform higher as students are likely to perform better in careers. By ensuring only the best-of-the-best getting into college, this option could mitigate the number of students taking out loans they cannot repay.

(2) *Cap College Budgets*

Another change policymakers might pursue is a cap on university budgets. It seems to many that colleges are constantly raising budgets for frivolous things—like sports, gymnasiums, or other things not directly related to education. In addition, many schools hire new professors, temporary staff, and give raises to tenured staff each year—which requires an increased budget. If there were to be a cap on the amount state-sponsored schools could budget for each year, the issue of constantly increasing tuition and fees could be avoided; and a change in lending policy or law would be null and void.

Evaluation of Alternatives

Status Quo

The status quo simply means keeping policy the same. It requires no effort on the part of policymakers and is by-far the easiest option to pursue. As of now, there is no immediate threat to the system as it stands. The issues regarding the status quo policy have already been outlined in previous sections; however, it is politically feasible as there is no strong push by policymakers to change this policy either way, except maybe during election years. By keeping the policy in place, it is likely the number of current students in higher education will stay the same. This current policy is by no means ideal; however, as has been previously mentioned, it presents no immediate threat to the well-being of university enrollment. The one area the status quo does not fit as neatly in is economic feasibility. While it is not an immediate threat, rising student debt and an inability to discharge that debt is increasing the public debt of the United States. This decreases the credibility of our nation's own payments, and makes the government look irresponsible when it comes to taking care of the well-being of citizens. Additionally, while rising student loan debt may not affect the economy in huge ways now, in 10-15 years the number of graduates unduly indebted and unable to discharge that debt may produce an effect that causes economic recession due to an inability for a large percentage of adults to participate in economic action.

Change in Law

A change in law seems the obvious and most effective option. Changing law—whether through repeal or replacement—would eliminate the issue presented and is relatively cost-efficient. For both options presented [(1) and (2)], there does not seem to be activity against a change in law. Many constituents on both sides of the political spectrum would likely support a change. However, this does not take into consideration the political feasibility *once debate surrounding the topic begins.* While right now a change in policy may seem politically feasible, once partisan politics takes a hold it may be impossible to change the policy due to a lack of compromise in the legislature. In order to retain political feasibility, then, policymakers would need to approach the issue from a neutral—rather than partisan—stance.
Both (1) and (2) would likely have positive effect on retaining students, if not increasing the number of students enrolling. Taking away the threat of *never* being able to repay a loan or discharge it would relieve stress from low-income students especially; and there would be less pressure to leave school to seek out a profitable career even before schooling ends.

The issue of repealing law (1) comes into focus when considering the economic viability of changing policies. The 2005 law was put into effect largely to insulate the economy from those who would seek to abuse bankruptcy for their own gain. Additionally, not allowing for the discharge of student loans ensures lenders will continue to fund education. If such protections were taken away, loans from private and public lenders could very well decrease—which would affect student retention (as contrary to what was stated above to the effect of the policy), and then economic productivity of lenders, especially if a large number of graduates file for bankruptcy at once.

Replacing law with a middle-ground option (2) is a much more economically viable option. While it would not provide immediate relief for debtors, following a period of time (probably 5-10 years as it was pre-2005), these people could file for bankruptcy. It would provide a window for payments to be made, so if graduates do eventually find undue hardship relating to loans they can file *after* making years of payments—and lenders would have the benefit of knowing they will have a fuller reimbursement of funds even if there is a large number of bankruptcy filings.

Change in Lending Policy

The change in lending policy as presented in this assessment is unlikely to succeed except in terms of economic viability. Capping the amount a student could take out in loans as related to their economic status—current or future—would be wholly unpopular by both the public and colleges, the former because it would be seen as punishment for being poor and the latter for whitewashing (both racially and economically) institutions of higher educations. For those reasons alone, it can be said that the policy would be politically infeasible—if not political suicide. Additionally, this policy violates the criterion of student retention. Rather than retaining students, colleges would likely see a dip in enrollment as a result of liberal arts students being underfunded to attend school. This would decrease the prestige of schools and cause less desire to enroll in school—and the entire higher education system may be undermined as a result of this policy.

A change in lending policy *may* be feasible economically, if for no reason other than there would be less people taking out student loans so the issue would be more localized than widespread. However, in reducing the number of students taking out loans for school, universities would be less profitable, and the workforce would have less qualified people in it. As a result, the economy would likely suffer—however, it is not certain if the economy would *definitively* suffer.

Change in Higher Education Policy

In terms of changing the policy of higher education institutions, both alternatives in this category are relatively feasible. (1) is feasible politically, because it would like place blame for the changes on schools rather than lawmakers. Additionally, this would largely be a state issue to deal with so national legislators would not be as impacted politically by any blowback. In any case, it is more likely that a raising of qualifications to enter school would be seen as a good thing. It is a common fear among US citizens that the country is falling behind in terms of educational prowess; as a result, making school more difficult to enter could be seen as a way to get the US ahead educationally. (2) is feasible politically due to the constantly increasing price of school. In 2015, tuition and fees at schools were increasing at a faster rate than inflation was—and as a result, the so-called “sticker price” of college was becoming more and more burdensome. Capping a university’s budget and how much they can charge students would likely be seen as the government protecting students from undue burdens, which could work to the advantage of legislators.

In terms of retention, (1) would likely have a negative effect, but not immediately. The reduction in number of students would come after a few years, as it would be a poor decision to force already-enrolled students to be reaccepted to their school. In the short-term, the current number of students would be maintained; only after a few years would the number of students be reduced. Following option (2) would likely see no change in student retention.

The economic feasibility of both these options is hard to quantify. (1) would *probably* benefit the economy because the "best and brightest" of society would be the most qualified and in the economic leadership. However, the overall number of well-qualified graduates would be decreased, and as a result overall economic productivity in the US may fall. For (2), the economic implications are even more unsure. It is unpredictable how preventing colleges from setting increasingly high budgets would affect the economy; however, as a capped budget indicates less economic activity, it is likely that there would be a marginal—yet significant—impact on the economy due to institutions of higher education playing less of a role in their local economies.

Recommendation

As a result of the previous cost-benefit analysis, it is my recommendation that Congress pursue a multifaceted approach to altering the issue of non-discharge of student loan debt. Many of the proposed solutions involve reducing the number of borrowers in the economy, options which have their own merit. I think it necessary to approach the issue from a legal and financial standpoint—meaning, Congress should seek to replace current laws with middle-ground laws as to meet both lenders and borrowers in the middle; and Congress should also pursue capping the budget of universities so as to prevent excess in borrowing that may otherwise be avoided. Pursuing this sort of change in policy would both address the current issue of increasing debt by allowing borrowers to file for bankruptcy following a set amount of time, and any future issues of excess borrowing that may be prevented if the amount colleges set aside to function is stifled.

Conclusion

Student loan debt is constantly increasing and is increasingly becoming a burden on the common American citizen. It is irresponsible for Congress *not* to act on this issue, as the problem will only get worse with time. Though there are multitudes of possible policies, I have proposed a policy which addresses the current issue of there being no way for essentially-bankrupt individuals to file for bankruptcy related to student loan debt, as well as seeking to address future issues as related to student loan debt in general.

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