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## **The Risks of Attending and Financing College**

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Federal Reserve System  
Community Development Research Conference  
Renewing the Promise of the Middle Class  
Washington, DC  
May 9, 2019

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FEDERAL RESERVE BANK OF CHICAGO

The views expressed today are my own and not necessarily those of the  
Federal Reserve System or the FOMC.

## The Risks of Attending and Financing College

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Thank you for the introduction, and good afternoon to you all. As co-hosts with the Board of Governors for this event, I along with my colleagues at the Chicago Fed would like to extend a slightly belated welcome to everyone. As always, I must preface my remarks by saying that I am expressing my own views and not necessarily those of the Federal Reserve System or the Federal Open Market Committee (FOMC).

My talk today will focus on the complexities of choosing to go to college. Going to college is one of the most important pathways to upward mobility—a key theme of this conference. Both extensive academic research and conventional wisdom point to the evidence that the investment in college pays off, on average.<sup>1</sup> But I want to focus on how risks faced by students obscure important nuances in this conclusion and how these risks do not equally apply to all. I will also discuss some interventions and policies that focus on helping students better recognize and manage their risks.

To help diagnose the challenges for young adults as they make choices about college, let me describe four kinds of risks that they face. The first one is institution risk, or the risk of choosing the wrong school; the second, the uncertainty of being able to complete a degree; the third, uncertain earnings prospects during one's working life following

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<sup>1</sup> Oreopoulos and Petronijevic (2013); and Barrow and Malamud (2015).

graduation; and the fourth—as if the first three were not enough—financing risk, in particular, the risk of not being able to pay back student loan debt.

Let's start with the first risk, that of choosing the wrong school. To make the best choices for themselves, young people considering college need accurate information about the opportunities available to them. They also need to have a good guess as to how they will pay for school. But how does one go about acquiring this information? For some, the expertise of school counselors and the experiences of friends and family provide useful guidance. For others, acquiring good information is harder. For example, research suggests that high-achieving, low-income students often do not apply to selective colleges because of a lack of information.<sup>2</sup> Many of these students do not have information about financial aid and the costs of attending college—which research suggests acts as a deterrent to even applying to select schools.<sup>3</sup> As another example, some students may unintentionally enroll at schools with predatory practices, high tuitions, and low-value-added degree programs that underprepare graduates for job opportunities. Students from disadvantaged backgrounds are more likely to attend these schools, and I will say more about that later on.<sup>4</sup>

The second risk—graduation risk—refers to whether a student actually completes the degree program. Finishing college and acquiring skills are key to unlocking a degree's earnings potential. Today, around 60 percent of students at four-year schools graduate

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<sup>2</sup> Hoxby and Avery (2013).

<sup>3</sup> Dynarski and Scott-Clayton (2008); and Scott-Clayton (2012).

<sup>4</sup> Looney and Yannelis (2015).

within six years.<sup>5</sup> A staggering 40 percent do not. There are many reasons why students may not complete their degrees. They or their family members may get sick. They may need to get a full-time job to pay for an unexpected expense. Or they may misjudge the challenges of the curriculum and decide it's not for them after they've enrolled. Without graduating, students are unable to fully benefit from their investment, but still incur the cost of having gone to college.

Next, earnings risk relates to fluctuations in labor markets that affect how much you earn once your schooling is complete. On the whole, college graduates have fared relatively well amid all the labor market changes over the past 50 years. Our economy is dynamic and will continue to be so in unpredictable ways. Most of us have heard the refrain that children entering grade school today may have a job—early in their working years—that doesn't yet exist, possibly in an industry that doesn't yet exist. So, should you go to college? And what should you study to prepare for this uncertain future? If today's labor markets are a guide, then the expected average earnings gain from going to college is large, and it is even higher than for past generations.<sup>6</sup>

That said, there is earnings risk because post-college earnings depend on what you study, your occupation, where you work, and luck.<sup>7</sup> And it is difficult to predict the skills and majors that employers will demand in the future. Over the course of a working life, there is the risk of switching careers and needing new training as old industries phase out and new ones emerge. And, apart from choosing the right field of study, there is the

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<sup>5</sup> See the National Center for Education Statistics' "Fast Facts" webpage, <https://nces.ed.gov/fastfacts/display.asp?id=40>.

<sup>6</sup> Oreopoulos and Petronijevic (2013); and Barrow and Malamud (2015).

<sup>7</sup> Barrow and Malamud (2015).

risk of graduating into a recession, which research has shown to have lasting effects on long-term earnings.<sup>8</sup>

Unlike earnings, graduation, or institution risks, the fourth risk—financing risk—applies only to students who borrow to pay for their education. Among today’s college graduates, around half borrowed to pay for their schooling.<sup>9</sup> Compared with other loans, student loans can be unforgiving by demanding preset payments over a fairly short repayment period. There are at least two reasons why. First, many borrowers report challenges with their loan servicers who are responsible for processing payments and for enrolling them in alternative payment plans. There have been reports that servicers may not be taking sufficient steps to help borrowers avoid default, even when there are reasonable alternatives that would allow them to repay their debt.<sup>10</sup> Second, borrowers run greater risk of missing payments when they find themselves earning low incomes, dropping out of college, or enrolling in low-value-added degree programs. Because student loan debt is not dischargeable in bankruptcy, it becomes a drag when borrowers encounter financial distress.

Of course, these risks interact with each other. Going to college makes it easier to pick up skills and stay employed as industries evolve and employers demand new skills. If a student does not graduate, they face the risk of worse labor market outcomes.

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<sup>8</sup> Kahn (2010); and Oreopoulos, von Wachter, and Heisz (2012).

<sup>9</sup> Board of Governors of the Federal Reserve System, Division of Consumer and Community Affairs, Consumer and Community Development Research Section (2017). See, in particular, this report’s “Education Debt and Student Loans” section, available online, <https://www.federalreserve.gov/publications/2017-economic-well-being-of-us-households-in-2016-education-debt-loans.htm>.

<sup>10</sup> Consumer Financial Protection Bureau (2015).

Repaying student debt—even modest amounts—is also more burdensome.<sup>11</sup> In fact, among borrowers who default, most owe less than \$10,000.<sup>12</sup> Borrowers attending schools with predatory practices and low-value-added programs are more likely to default relative to students at private nonprofit and public schools.<sup>13</sup> When contemplating how these risks can compound, prospective students may question whether going to college will be worth it—that is, whether the upside potential of a college degree will outweigh the downside risks.

I am concerned that the four risks may compound more and lead to greater downside risks for certain students. I am particularly concerned about how these risks may affect “nontraditional students.” Though I did not coin this term, let me explain that nontraditional students include first-generation college students, older students who live independently from their parents, part-time students, those from low-income and minority families, and students attending nonselective institutions, including for-profit colleges.<sup>14</sup> They are called nontraditional students because, historically, they have not made up a large share of those going to college and taking on student debt. However, since the mid-1990s, they have become a growing share of college students and borrowers, as well as a large share of student loan defaulters.<sup>15</sup>

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<sup>11</sup> See Baum et al. (2018, p. 21). The data presented in that College Board report are also available online, <https://trends.collegeboard.org/student-aid/figures-tables/federal-student-loan-repayment-rate-completion-status>.

<sup>12</sup> Looney (2018).

<sup>13</sup> Looney and Yannelis (2015).

<sup>14</sup> Looney and Yannelis (2015).

<sup>15</sup> Looney and Yannelis (2015).

Nontraditional students appear to face greater downside risks than their traditional counterparts. Among the four risks I discussed, nontraditional students face high institution risk as they make up a large share of students enrolled in for-profit schools with low-value-added degree programs and predatory practices. Some of these schools aggressively advertise themselves as being a “good fit” for nontraditional students.<sup>16</sup> Nontraditional students face more impediments to finishing college and are less likely to graduate than traditional students enrolled at four-year institutions.<sup>17</sup> Because of their less advantaged backgrounds, nontraditional students face more limited job opportunities and greater downside earnings risks. Lastly, they face greater financing risk—they are more likely to borrow, take on larger amounts of debt, default at a higher rate, and take longer to repay their student loans.<sup>18</sup>

Among traditional students, managing these four risks appears to be a reasonable endeavor. These students tend to be those who graduate from four-year private nonprofit and public schools. Compared with nontraditional students, they face better odds of graduating, and once they do, they face low unemployment rates and land jobs with strong earnings, on average.<sup>19</sup> They also have lower student loan default rates than nontraditional students despite having larger loan balances.<sup>20</sup>

To be effective and limit unintended consequences, interventions will need to target specific risks and take into consideration their interaction. It’s instructive in some ways

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<sup>16</sup> Deming, Goldin, and Katz (2012); and U.S. Government Accountability Office (2010).

<sup>17</sup> Cellini and Turner (2019).

<sup>18</sup> Armona, Chakrabarti, and Lovenheim (2018).

<sup>19</sup> Looney and Yannelis (2015).

<sup>20</sup> Looney and Yannelis (2015).

to look to the past to see how students managed these risks in different times. In addition to the G.I. Bill, larger taxpayer subsidies to public universities and community colleges, lower tuition, and more on-the-job training opportunities compared with today's levels were policies that mitigated the four risks. A common assumption is that things were better in the good old days. But there are many reasons why past policies may not be well suited to the present. Importantly, the profile of the typical college student has changed: Higher education was generally not an opportunity available to many people we today characterize as nontraditional students—or to women, for that matter.

In my remaining time, I'd like to look to the future and highlight some interventions occurring in our Federal Reserve District that are showing some promise. Even though my focus is on the Seventh District,<sup>21</sup> which the Chicago Fed serves, I should recognize that similar and other interventions are occurring across the country.

Let me start with the state of Michigan. Since 2015, the University of Michigan's HAIL<sup>22</sup> Scholarship has been targeting low-income, high-achieving high school students. Through personalized mailings, the university encourages such students to apply to U of M and promises them that if they're accepted, they will receive financial aid covering four years of tuition and fees. Rigorous research based on randomized control trials finds that information about the HAIL Scholarship has helped mitigate institution risk, by steering low-income students away from less-selective four-year colleges.<sup>23</sup> The

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<sup>21</sup> The Seventh Federal Reserve District comprises all of Iowa and most of Illinois, Indiana, Michigan, and Wisconsin. Further details about the District are available online, <https://www.chicagofed.org/utilities/about-us/seventh-district-economy>.

<sup>22</sup> HAIL stands for High Achieving Involved Leader. See Dynarski et al. (2018).

<sup>23</sup> Dynarski et al. (2018).

scholarship has also largely eliminated financing risk. After additional years of follow-up, researchers will have more to say about the HAIL Scholarship’s effects on mitigating graduation and earnings risks for low-income, high-achieving students.

Closer to home, One Million Degrees—or OMD—is a Chicago-based nonprofit supporting low-income community college students through a package of interventions. OMD works closely with the City Colleges of Chicago and offers “last-dollar” scholarships to fill the gap between financial aid and the all-in costs of college. The nonprofit also provides skill-building workshops, advising, and coaching. Early results from randomized controlled trials suggest “high-touch” interventions may nearly double the rate of degree completion.<sup>24</sup> Future research will evaluate OMD’s effects on mitigating graduation and other risks.

Across the five states in our District, nonprofit and private-sector organizations are partnering with universities to provide new student loan programs. Through these pilot programs, the organizations finance a portion of a student’s college education. In some cases, the financing is obtained before a student matriculates. In other cases, organizations take on existing student loan debt once a student graduates.

These programs vary in how repayment is structured. Some programs are designed to allow for more flexible forbearance, loan forgiveness, and restructuring once a borrower encounters financial hardship. Others are structured as income-sharing arrangements, whereby the borrower’s post-college earnings determine the size of the borrower’s loan repayments. So a student landing a well-paying job immediately after college will repay

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<sup>24</sup> Scrivener et al. (2015); and Hallberg and Bertrand (2018).

more than a student with a less favorable job outcome. Some of these income-sharing arrangements allow for lower amounts of principal repayment for graduates with lower earnings.

These types of private-sector repayment programs are very new, so it will take some time before we fully understand whether they mitigate financing and other risks for students. One benefit seems to be that these programs feature innovative ways to flexibly restructure debt repayment. In contrast, the federal student loan program has been criticized by some for being bureaucratically rigid with regard to forbearance, income-driven repayment, and loan forgiveness.<sup>25</sup> For example, critics have highlighted the complex paperwork required to apply for an income-driven repayment plan from the federal government, the lengthy and bumpy process, and the inconsistent implementation of the plan across loan servicers.<sup>26</sup> In addition, some have criticized the income-driven repayment program for disproportionately benefiting high-balance borrowers, who tend to have high earnings, as the program forgives remaining loan balances after 25 years of capped payments.<sup>27</sup>

However, I offer the following cautions about the additional risks these new repayment programs may introduce. First, unless the programs offer subsidies, students may have to pay for greater flexibility, perhaps by way of higher interest rates or financing charges. Second, these new programs may lead borrowers to prioritize loan repayment over other uses of their earnings, which may have unintended consequences for how

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<sup>25</sup> Dynarski (2018).

<sup>26</sup> Dynarski (2018); and Consumer Financial Protection Bureau (2015).

<sup>27</sup> Looney (2018).

borrowers save or use other forms of credit. Third, access to these programs may be limited to select students, such as those majoring in subjects with high earnings potential. In contrast, under the federal student loan program, a borrower's access does not depend on the major chosen. If these new pilot programs were to grow and attract students studying subjects with high earnings potential, the federal student loan market may have destabilizing features, including challenges for nontraditional students to access credit. Lastly, as with all new loan products, limiting the scope for unfair, deceptive, and abusive practices will be important.

I'd like to finish my remarks with some thoughts on how far these and other small-scale interventions can go to mitigate risks for students. Some of you may know that my usual day job is monitoring the performance of our nation's economy. With over \$1.5 trillion in outstanding student debt,<sup>28</sup> knowing how to help young adults better recognize and manage their risks related to higher education is an important input into my assessment of our economy.

My interpretation of the research is that disadvantaged students in particular experience significant risks associated with their choice of institution, likelihood of graduating, earnings potential after college, and ability to repay student loans. So, for these students, it is not always obvious that college is an investment that pays off. And while there are some promising interventions under way to help mitigate some of these risks, further research is needed to help policymakers and practitioners determine what types of interventions may be most effective. Among the many important research questions

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<sup>28</sup> See the Federal Reserve's G.19 statistical release, <https://www.federalreserve.gov/releases/g19/current/>.

we need to ask, the one I am particularly interested in is this: How can we make acquiring and financing higher education less risky for nontraditional students?

I hope you enjoy the conference. Thank you.

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