e·p·s·a
Department of Education Policy and Social Analysis
Teachers College, Columbia University

February 15, 2019

Dear Senator Jones, Senator Warren, Senator Harris, and Senator Cortez Masto:

Thank you for your recent letter (dated January 3, 2019) soliciting input from stakeholders on how to address racial disparities in student loan debt and in college outcomes more broadly. As an economist studying higher education, I have testified to the U.S. Senate three times as an expert on financial aid research and policy, and my recent research has focused on alarming patterns of student loan default, particularly among African Americans and those who enroll at for-profit institutions. In this letter, I respond to your inquiry by highlighting some relevant findings from my research and by suggesting some specific directions for policy reform.

Identifying the problem

First, it is important to be clear that the student debt patterns observed for (non-Hispanic) Blacks are distinct from those of persons of color defined more broadly. This is not to minimize the real challenges of student loan repayment facing borrowers of all races and ethnicities, but simply to note that the experience of Black college students is distinct. For example, while Black students are 17 percentage points more likely to borrow and owe nearly twice as much on average as (non-Hispanic) Whites, borrowing rates and average amounts owed among college entrants who self-identify as Hispanic or Asian/Pacific Islander are actually similar to or lower than those of Whites.[1] While 20 percent of Hispanic college entrants experience a default within 12 years of starting college — compared to just 12 percent of White college entrants and 6 percent of Asians/Pacific Islanders — the equivalent rate for Black entrants is 38 percent (unfortunately, sample sizes for Native Americans are too small to compute estimates reliably).

Nor are the patterns for Black students synonymous with those of low-income or first-generation college students. For example, among bachelor's degree recipients, the Black-White total debt gap four years after graduation is five times bigger than the debt gap by parental education, and almost twice as big as the debt gap between those who received Pell grants as undergraduates and those who did not.[2] Moreover, the Black-White gap is the only gap that more than triples in size in the four years after college graduation.

In one of my recent reports, I decompose the 27-percentage point Black-White gap in student loan default rates (among borrowers only) to examine what portion can possibly be explained by racial

[1] See Table 2 in "The looming student loan default crisis is worse than we thought," by Judith Scott-Clayton (January 11, 2018), *Evidence Speaks vol. 2 no. 34*, Washington, DC: The Brookings Institution. URL: https://www.brookings.edu/research/the-looming-student-loan-default-crisis-is-worse-than-we-thought/.

[2] See Figure 7 in "Black-White disparity in student loan debt more than triples after graduation," by Judith Scott-Clayton and Jing Li (October 20, 2016), *Evidence Speaks vol. 2 no. 3*, Washington, DC: The Brookings Institution. URL: https://www.brookings.edu/research/black-white-disparity-in-student-loan-debt-more-than-triples-after-graduation/.

BOX 11, 525 WEST 120TH STREET, NEW YORK, NY 10027-6696 ● PHONE (212) 678-3165 ● FAX (212)678-3589
http://www.tc.columbia.edu/epsa

differences in other observable characteristics and college experiences.[3] I find that even after accounting for student and family background characteristics (such as family income, parental education, and wealth), total amounts borrowed, college experiences (including type of institution attended, degree attainment, and college GPA), and post-college job status (employment and income), an 11 percentage point Black-White disparity in default rates still remains. It is important to recognize that the variables I include do not fully capture differences in students' economic circumstances post-college, in their family support and information networks, and/or in the quality of service that they receive from their institutions and loan servicers as they navigate repayment. This large unexplained gap highlights the need for better data, and for more research/policy attention devoted to understanding this issue.

Justifications for reform

First and foremost, the high default rate among Black borrowers is cause for concern due to the potential financial ramifications of default. When a student loan enters default, the entire balance becomes immediately due, and the borrower loses access to options that might otherwise have applied, such as deferment and forbearance. If the borrower does not make arrangements with their servicer to get out of default, the loan may go to collections. Fees of up to 25 percent of the balance due may be added as a result. Defaulting on a student loan can also lower credit scores, making it harder to access credit or even to rent an apartment in the future. In some states, default can lead to revocation of professional licenses, and credit histories may be evaluated as part of employment applications, making it harder to find or keep a job. Also, students cannot receive any additional federal student aid while they are in default, making it more difficult to return to school.

Second, racial disparities in student loan default can undermine access to college, which we know is a high-return investment. If student loans are excessively risky and burdensome — or are differentially risky and burdensome by race — they will be less effective as a tool for reducing disparities in college access at the front end. Yet in order to sustain an era of mass postsecondary education, student loans are likely to remain a critical component of college finance. Efforts to minimize students' access to federal loans (which is done, for example, at some community colleges) have been shown to backfire as students without access to loans complete fewer credits, earn lower GPAs, and are less likely to transfer to four-year programs.[4] If we cannot figure out how to make student loan debt safe and manageable for all students, we will lose an essential tool in our college access policy toolkit.

For the reasons described above, it should be straightforward to motivate policy attention to this issue purely from a social cost-benefit perspective. But even beyond that, in considering how to prioritize this issue among the many pressing issues on the Senate's agenda, it is important to consider the history that led to the current racial disparities in student loan outcomes, and the role of the government (both state and federal, via action and inaction) in that history. A longstanding, pernicious legacy of bias and discrimination can help explain why the patterns observed for non-Hispanic Blacks are distinct relative to persons of color or low-income students generally. I believe this creates an additional, moral obligation for state and federal governments to look for ways to repair this damage.

---

[3] See Figure 4 in "What accounts for gaps in student loan default, and what happens after," by Judith Scott-Clayton (June 21, 2018), *Evidence Speaks vol. 2 no. 57*, Washington, DC: The Brookings Institution. URL: https://www.brookings.edu/research/what-accounts-for-gaps-in-student-loan-default-and-what-happens-after/.

[4] See Benjamin M. Marx and Lesley J. Turner (2017), "Student loan nudges: Experimental evidence on borrowing and educational attainment." NBER Working Paper No. 24060. URL: https://www.nber.org/papers/w24060.

Directions for reform

I suggest a number of directions for policy efforts in both the short term and longer term which could strengthen protections for current students and borrowers, and provide much-needed relief for borrowers who are struggling now.

- Provide more support to borrowers to increase utilization of existing income-contingent repayment plans, which offer significant protection against the worst outcomes of student loan debt.

Income-contingent loan repayment options, including the newest and most generous REPAYE plan, adjust borrowers' monthly payments according to their income and ultimately forgive debts that remain after a set period of repayment. In theory, such plans can help borrowers of any race manage even relatively large amounts of debt, and these plans have been shown to reduce the risk of default.[5] The paperwork burden currently associated with such plans can be daunting, however, and too often students do not learn about income-contingent options until after they are already in trouble—having missed payments, accumulated fees, and damaged their credit. As a solution, some scholars have proposed automatically enrolling borrowers in income-contingent repayment, and administering it via the tax system so that payments adjust immediately and automatically to changes in earnings.[6] While a complete overhaul may take time to take shape, in the meantime the government could provide additional resources to support third-party, non-profit organizations who commit to helping borrowers navigate the paperwork to take advantage of these options.

- Increase regulation of loan servicers to ensure they are providing high-quality, unbiased service to all borrowers.

Some of the unexplained Black-White gap in defaults may relate to the quality of loan servicing, which could vary by race or may simply have greater consequences for African American borrowers. Research has found that variation in the quality of individual agents who conduct loan servicing calls has a significant impact on borrower outcomes.[7] At the same time, loan servicers are facing a number of lawsuits accusing them of providing poor advice, in some cases steering borrowers away from the income-contingent plans described above.[8] The federal government should re-examine loan servicing contracts to ensure that they contain appropriate incentives for high-quality service, and providing evidence of race-neutral customer service should be considered an important element of servicer quality.[9]

---

[5] See Daniel Herbst (2018), "Liquidity and insurance in student loan contracts: Estimating the effects of income-driven repayment on default and consumption," unpublished manuscript, Princeton University. URL: http://conference.iza.org/conference_files/Education_2018/herbst_d26912.pdf.

[6] See Susan Dynarski and Daniel Kreisman (2013). "Loans for educational opportunity: Making borrowing work for today's students" (Hamilton Project Discussion Paper No. 2013-05). Washington, DC: Brookings Institution, The Hamilton Project.

[7] Herbst (2018).

[8] https://www.washingtonpost.com/news/grade-point/wp/2018/06/29/california-plans-to-sue-one-of-the-nations-largest-student-loan-companies/?utm_term=.1c3443d8eaf0

[9] Note that while loan servicers likely do not have indicators of race per se, assumptions about race may be made by agents implicitly based on a borrower's name, voice, and educational history. From a data perspective, to enable servicers to monitor outcomes by race, race could be imputed with a high degree of reliability using strategies previously been employed to monitor racial disparities in a range of contexts (including in health services and mortgage lending, which often similarly lack direct measures of race).

- Continue and strengthen efforts to regulate the for-profit sector.

While it is certainly true that there are good and bad institutions in all sectors, the probability of experiencing a student loan default is dramatically higher for students entering for-profit institutions. My research shows that of all students starting at a for-profit institution, 47 percent — almost half! — experience a default on a federal student loan within 12 years of entry. That is nearly four times the rate of default experienced by entrants at private not-for-profit four-year institutions (13 percent), public two-year institutions (13 percent), or public four-year institutions (12 percent). Since many students experience a default for the first time even beyond this 12-year follow-up window, these rates almost surely understate the proportion of for-profit entrants that ultimately experience a default. Unlike any other sector, a terrible outcome is a typical outcome for students entering for-profit institutions. This institutional and regulatory failure hits African Americans particularly hard: Black students are almost three times as likely as White students to start at a for-profit institution (24 percent versus 9 percent), and among Black students beginning at a for-profit, *63 percent* experience a loan default within 12 years.

- Consider targeted debt forgiveness to relieve borrower distress now, focusing on populations at greatest risk of default.

Many of the policy directions suggested above will take time to implement and show results. This is, of course, no reason not to pursue them. The challenges of student loan repayment are not going away anytime soon, and it is important to lay the groundwork today for better outcomes tomorrow. Still, what can be done to provide to relief to borrowers who are at risk or already in distress now? Targeted loan forgiveness may be a valuable tool in a broader package of solutions. In considering alternative proposals, I suggest focusing on small-balance borrowers, who are at the greatest risk of default, rather than on borrowers with the most debt. Default risk is actually inversely correlated with the size of the loan, because borrowers with greater debt typically have higher levels of attainment. By focusing on small borrowers, the same amount of total relief can help a greater number of borrowers in distress. Focusing on small-balance borrowers is also attractive from an equity perspective: It can be viewed as a way to enable past students to share in the benefits of recent efforts in many states to make the first two years of college tuition-free.

While detailed simulations and cost estimates are beyond the scope of this letter, one possible forgiveness strategy would be to focus on borrowers who took out up to $6,125 in undergraduate loans (this is equivalent to the sum of current Stafford loan limits for the first and second year of enrollment). Among first-time students beginning in 2003-04, an estimated 537,000 students acquired between $1 and $6,125 in Stafford loans, with an average of $3,545 in Stafford loans borrowed among this group.[10] Almost 40 percent of borrowers in this group, including nearly 70 percent of Black borrowers in this group, experienced a default within 12 years of entry. A back-of-the-envelope estimate thus implies that forgiving these amounts borrowed, for this subset of undergraduate borrowers in one entry cohort, would cost $1.9 billion dollars. Forgiving a flat $6,125 among those who borrowed more than this amount would cost an additional $10.7 billion for the 2003-04 entry cohort.[11] Since, on average, total loan balances shrink over time as borrowers

[10] Tabulation of underlying statistics from the BPS:04/09 survey for those borrowing between $1 and $6,125 in Stafford Loans can be found here: https://nces.ed.gov/datalab/index.aspx?ps_x=bfbbmch31.
[11] Tabulation of underlying statistics from the BPS:04/09 survey for those borrowing more than $6,125 in Stafford Loans can be found here: https://nces.ed.gov/datalab/index.aspx?ps_x=bfbbmcdc.

pay off, the actual amount could be significantly lower than that for a given entry cohort, though applying this policy to multiple entry cohorts would obviously increase the cost proportionally.[12]

- Use existing federal data sources to provide researchers and policymakers with better and more frequent data on student loan repayment patterns by race.

Finally, another policy effort that could yield results immediately is to make better use of existing federal data sources for research. To better understand possible causes, consequences, and remedies for racial disparities in student default, researchers and policymakers need access to better data on debt and repayment patterns by race. The federal government has the ability to make such data available now, at low cost. In late 2017, the Department of Education released new data that linked two existing, nationally representative surveys of beginning postsecondary students (BPS 95-96 and BPS 03-04) to existing administrative data on debt and repayment over time from the National Student Loan Data System (NSLDS). Since the NSLDS does not include any indicators of race but the surveys do, this linkage enabled a wealth of new research that had not previously been possible. Unfortunately, the BPS surveys miss important segments of the college population (such as older, returning students) and are conducted only every eight years. The Department of Education could link NSLDS data to the National Postsecondary Student Aid Survey, a nationally representative survey which covers the full undergraduate and graduate student population and which is conducted every four years. The Department could also clarify its data policies to encourage institutions to use NSLDS data in conjunction with institutions' own existing administrative databases, to better understand the repayment and default patterns of their own student populations.

Thank you again for your interest in understanding and addressing this important issue. If I can be of further assistance as you continue your efforts, please do not hesitate to reach out.

Sincerely,

Judith Scott-Clayton

Judith Scott-Clayton
Associate Professor of Economics & Education
Senior Research Scholar, Community College Research Center
Faculty Research Associate, National Bureau of Economic Research
Teachers College, Columbia University
525 W. 120th St., Box 174
New York, New York 10027
scott-clayton@tc.columbia.edu

[12] Please note these calculations have been done with imperfect data and limited time, and as such are only intended to be suggestive. Additional work would be required to more rigorously estimate cost and equity implications.