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Shifting the risk of higher education

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Borrowing to pay for college has helped shift more of the risk of investing in higher education onto students and their families. At the same time, federal loans to aspiring college students have put higher education within reach of people who otherwise might have been unable to enroll at all. These two truths highlight the challenge faced as we debate the significance of student debt, and it is not a new challenge. It is all about meaningful access.

The reallocation of higher education risk - the danger that a student's debt might exceed her ability to repay - is the result of two developments. First, tuition has risen at colleges and universities generally and at public colleges and universities in particular (even though most public institutions still charge lower sticker prices than most private institutions do). Second, household income and grant aid have not increased as quickly or as much, which means that students and their families turn to loans to pay those costs.

Because more and more students must use ever-larger amounts of debt to finance their ever-costlier education, they bear more risk. Students borrowing for college must think about higher education as an investment that will produce a return sufficient to cover their monthly payments.

Policy shifts and pricing trends have redistributed risks toward individuals in other settings in recent decades. Workers face the risk that we will not have enough money saved when we retire; those of us who forego health insurance face the risk of costly injury. Scholars like Jacob S. Hacker have analyzed these trends (check out his book, "The Great Risk Shift: The New Economic Insecurity and the Decline of the American Dream," Oxford University Press, 2008).

When policy effects such reallocations of risk, advocates typically offer two rationales. First, a risk should be borne by the person best able to prevent the adverse outcome from occurring. Second, a risk should be borne by the person best able to cope with the adverse outcome, should it occur. Allowing a health insurance provider to charge a higher premium to a consumer who smokes, for example, shifts some of the risk of a costly, adverse health event to the person best able to reduce its likelihood, thereby strengthening the incentive to be healthier. Prohibiting an insurer from charging more to someone suffering an illness over which the victim has no control shifts the risk from the individual to the institution that can better afford the cost. Tom Baker has analyzed this kind of redistribution of risk (see "Health Insurance, Risk, and Responsibility after the Patient Protection and Affordable Care Act" (2011)).

Shifting the risk of earning too little onto a student borrower does not readily satisfy either requirement. Students' job prospects too often may be well beyond their control; members of the class of 2008 can testify to that - they experienced one of the highest unemployment rates of any graduating class in recent years. Perhaps more importantly, not only do the wages associated with particular jobs change, but some students choose their careers based on criteria other than salary. There is evidence that students freed from the burden of student loan obligations are more likely to pursue careers in the public interest, and policy should encourage such ambitions. To some extent, federal policies, like the Public Service Loan Forgiveness Program, encourage this by offering loan forgiveness to borrowers who work as teachers or in other high-need but, often, relatively low-pay jobs.

If a risk is deemed too great for an individual to bear, or just too unfair, insurance offers a logical response. In the student loan context, that means covering the repayment obligation of a student who is unable to manage on her own, for some finite period. There is the possibility of what economists call "moral hazard," if students stop looking for work in order to get out from under their debts. But covering a student's payment obligation, month by month, contingent on that student's income, is a risk that we collectively, as a nation, can afford to take. Further, there is a benefit to helping people cope with adverse life events even if there is a cost.

The Obama administration is moving in the right direction with the adoption of flexible repayment programs that limit monthly payments based on borrowers' income. This resembles insurance, except that the plans extend the term of repayment and, because student borrowers do not pay a premium as they would for insurance coverage, the programs are politically vulnerable to criticism focused on the potential cost to taxpayers. These programs can go further.

Coming up with a way to help students cope with the downside risk of borrowing for college matters not just because the burden of repayment can grow too heavy for a subset of borrowers but also because debt affects students' willingness to seek higher education in the first place. Some students do not want to borrow, and because that rational impulse may be unevenly distributed across the student population, it may undermine the goal of enabling all students who wish to go to college to do so.

Debt also may undermine students while enrolled by leading them to work long hours at the expense of their studies. Debt poses an intangible burden on students distracted by worry about repayment. And of course, debt constrains those students fortunate enough to complete a course of study and have employment options. Indebted students may feel that they must pursue the highest-paying job they can, regardless of their own hopes or of their greatest value to society. Reducing the risk students bear as a result of borrowing would reduce these undesirable side-effects - which have an impact not just on borrowers but on prospective students and their families, too.

When talking about college costs, student debt and a national crisis, it is easy to forget that the loans offered by the Department of Education serve the critical purpose of enabling access and that for most students, college is a wise investment. The goal should remain putting college within reach of those who want to go, as President Lyndon B. Johnson put it upon signing the Higher Education Act of 1965, so that "a high school senior anywhere in this great land of ours can apply to any college or any university in any of the 50 states and not be turned away because his family is poor."

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