Ignore the debt hype. College is a great investment

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June 11, 2012

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Borrowing for college is one of the best investments a young person can make, argue two researchers and participants in the loan market.

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Recent sensational stories about crushing student debt burdens leave the impression that borrowing for college is unwise. The reality is that few students carry enormous debt loads. A recent report from the New York Federal Reserve Bank showed that fewer than 1 in 30 students have debt loads above $100,000.

We are both economists who have studied colleges and labor markets for decades. The first author has more than 25 years of experience in paying off more than $40,000 in student loans, incurred for a B.A. and master's at a rather expensive East Coast institution.

As both researchers and participants in the loan market, we state -- without hesitation -- that borrowing for college is one of the best investments a young person can make. College graduates earn more than other workers. They are more likely to have health insurance and pensions -- a good thing, since they live longer.

When a small number of consumers suffer, the answer is not to upend the entire market but to tighten consumer protections. The mortgage crisis spurred an overhaul of financial regulation. It did not lead us to decry home ownership as not "worth it," or rally to forgive all outstanding mortgage debt. That would have been a disproportionate response to a serious but limited problem.

No undergraduate can acquire $70,000 or $120,000 in debt when borrowing from the federal Stafford loan programs. The caps in these programs hold total debt to $31,000 for dependent students and $57,500 for older students.

Undergraduates who get deep into debt typically do so through private borrowing. This is where consumer protection comes in.

In 2005, Congress handed a valuable gift to the private loan industry: loans made to students by private lenders were granted the same bankruptcy protection as federal loans. The survival of private loans in bankruptcy proceedings makes them an unusually safe bet for lenders.

This creates a classic moral hazard problem: Lenders extend too much credit to borrowers likely to struggle in repayment since they know the borrowers can never escape the debt. Congress should repeal the protection from bankruptcy that it extended to private lenders in 2005.

For the overwhelming majority of students, debt loads are much lower than what the press reports.

As the Fed study showed, 43% of student borrowers have less than $10,000 in debt, and 72% have less than $25,000. And the College Board shows that, in 2009-10, 56% of those graduating with a B.A. from a public college took out a loan. The average debt of these borrowers, after adjusting for inflation, was $22,000.

Is $22,000 too much debt? Paid off over ten years, monthly payments would be $217 at an interest rate of 3.4% (the current subsidized rate) or $253 (if the rate goes up to 6.8% in July, as scheduled).

Under the graduated payment plan, the initial payment would be $140. Another policy option would be to allow students to pay this debt over 20 years instead of 10, thereby cutting the monthly bill to just $126 ($168 if rates go up).

By way of comparison, Fed data show that the average new car loan is $27,000. This corresponds to a minimum monthly payment of $500 (assuming an excellent credit score, which few students have).

The car loan would have to be paid off over five years: No bank will let you spread a car loan over decades, because a car has little market value after just a few years.

But a college education pays off over a lifetime, which is why paying for it over a long horizon makes sense. Spread the payments over the lifetime of the asset: a basic economic principle that we should keep in mind when designing student loan policy.

College is a good gamble but not a sure bet. Federal loans provide some protections: Payments can be deferred during school and unemployment. But some borrowers can't find a decent job or have medical problems that keep them from working to full capacity.

Here, the income-contingent option makes sense, with payments capped at 10% of discretionary income (as of 2014) and the balance forgiven after 25 years. Less than 8% of borrowers choose this option.

The Obama administration announced recently that it is making it simpler for borrowers to apply to this program. The president could take it a step further and make this payment plan the default, allowing students to opt into a flat payment plan if they prefer.

There are good reasons not to go to college: low grades in high school, a fabulous job offer from Facebook. Students should not charge into college without weighing its costs as well as its benefits.

Students should keep their job prospects firmly in mind. Planning a career in fine arts or cosmetology? Keep tuition and loans to a minimum, since the earnings prospects are not great. Heading into engineering or economics? Borrowing more is fine, since the job outlook is good.

Fear of student loans is a poor reason to skip college. Borrowing from the federal government is a sound choice for students who are ready for college. ■

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