THIRD WAY

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A Bipartisan Path for Graduate Student Loans

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The US economy will require significantly more workers with credentials beyond a bachelor's degree in the coming years. The Georgetown Center on Education and the Workforce estimates that by 2031, 27.6 million jobs will require a graduate degree. However, even as the demand for graduate degrees is set to rise, there are concerns about the ballooning cost and accumulated debt for programs of varied quality and outcomes. With nearly three out of four graduate students relying on financial aid to pay for their degrees and lending to graduate students making up over half the federal student loan portfolio, it's clear that graduate loans are a necessary tool for students to access advanced degrees. Yet exceedingly few parameters are in place to ensure federally-funded programs deliver financial returns on the taxpayer investment. [1] This has led some to propose the elimination of federal graduate student lending in favor of the private market. [2]

There are legitimate concerns about rising debt as well as poor-performing graduate programs for policymakers to address. At the same time, eliminating the federal graduate student loan programs would harm vulnerable students, and privatization could have damaging impacts on both access and completion. This memo explores alternative approaches to reforming graduate lending to prevent the accelerated rise in graduate borrowing for programs with poor outcomes while maintaining students' access and completion in quality degree programs that lead to promising careers.

Alternatives to Eliminating Federal Graduate Lending

Graduate borrowing has ballooned to a level that must be addressed. The root issue is that graduate students can access unlimited federal loans through the Graduate PLUS (Grad PLUS) Loan program. Direct Unsubsidized Loans for graduate students are capped at $20,500 annually and $138,000 in aggregate. Once students have reached their annual limit, Grad PLUS loans can be added on to provide funding for up to the cost of attendance as determined by the institution. Grad PLUS loans have been a lifeline for students who need to fund their degrees. But without change to how the Grad PLUS loan program operates, unlimited borrowing heightens the risk of students accumulating massive debts for programs with poor economic outcomes. [3] Instead of eradicating the current federal borrowing system, policymakers can focus on implementing strategic reforms that will keep access to quality programs intact while making good use of taxpayer dollars.

Establish Borrowing Caps on Grad PLUS Loans

There is an emerging consensus across the ideological spectrum that there needs to be some cap placed on federal loans, particularly Grad PLUS. [4] Key questions for policymakers to tackle are where to set the cap to maintain access while incentivizing lower prices and curbing student debt loads, and whether caps should be annual, aggregate, field-specific, or some combination.

An analysis of hypothetical Grad PLUS caps conducted by the Government Accountability Office (GAO) in 2018 showed that a $125,000 lifetime borrowing cap would meet the needs of 95% of borrowers and decrease federal loan disbursements by $4 billion. [5] Their modeling found that a $100,000 cap would be sufficient for 90% of borrowers, while a $50,000 lifetime cap would leave nearly 30% of borrowers with unmet needs. Third Way has proposed a $125,000 cap on Grad PLUS grounded in the GAO findings. This sum may provide slightly lower coverage than it would have six years ago but should still reasonably account for above 90% of borrowers.

Caps could also be set at the program level to adjust for variation in earning outcomes across different fields. Considering that a future doctor has much higher earnings potential than a future social worker, caps could be structured to allow those pursuing high-paying fields to take on more debt because they will have greater ability to repay, an approach put forth by the Cato Institute. [6] Implementing programmatic caps at both the annual and aggregate levels, as proposed by EducationCounsel, could likewise allow flexibility in borrowing amounts based on earnings potential while also guarding against universities raising tuition to offset a potential cutoff of federal funding. And incentive structures could be built in to reward strong outcomes by allowing quality programs to access additional Grad PLUS funding. EducationCounsel's proposal would also offer students $50,000 in extra loans above the set program limits if they are enrolled in high-ROI programs, identified as passing a debt-to-earnings rate and Pell Grant enrollment benchmark.

The various design decisions in setting borrowing caps offer policymakers useful and adaptable levers to achieve their goals of curtailing federal lending while maintaining access to degrees that will support workforce needs. The privatization of graduate lending, on the other hand, would take those decisions out of policymakers' hands and create a scenario that could significantly harm the working class—a population many in Congress say they want to help. Data on private student lending exposes that low-income students are at high risk of being targeted with high-interest loans from predatory lenders or completely cut out of the loan market altogether by lenders that prefer those with higher incomes, while federal lending provides key consumer protections for borrowers. [7]

Apply Earnings Tests to Strengthen Accountability

There is also bipartisan agreement that reasonable accountability metrics are needed to protect students and taxpayers. An earnings threshold that requires institutions to demonstrate that most of their students go on to earn more than someone with a lower credential in order to obtain and keep taxpayer-funded loans is one tool to help ensure students receive a financial return on their educational investment. Earnings tests as a means of accountability are extremely popular. Third Way polling has found significant support for the federal government holding institutions accountable if college graduates don't earn more than a high school graduate. [8] Over 70% of voters support a high school earnings test, and that appeal extends across the political spectrum, with 64% of Republicans, 70% of Independents, and 76% of Democrats in favor.

Earnings threshold proposals have also been integrated into graduate education accountability discussions. For example, the *Streamlining Accountability and Value in Education (SAVE) for Students Act*, sponsored by Senator John Cornyn (R-TX) and Senate HELP Committee Chair Bill Cassidy (R-LA), proposes establishing a baseline quality measure. All graduate degree programs must demonstrate that their former students' median earnings exceed the earnings of a bachelor's degree holder within the state. If not, they could lose access to federal loans. [9] Analysis from the Urban Institute revealed that 14% of master's programs would fail the bill's earnings test—driving the reduction in federal spending and incentivizing enrollment in higher-ROI alternatives. Additional considerations around adjusting earnings thresholds by field of study could support programs that lead to careers in social service professions (such as social work, teaching, and counseling), which tend to have lower earnings premiums and would have the lowest pass rates if this legislation was implemented. [10]

In addition to straight earnings tests, applying debt-to-earnings ratios and/or repayment rate thresholds as part of federal student aid eligibility for programs and institutions would enhance accountability and reduce taxpayer spending on low-performing programs. Debt-to-earnings ratios provide a measure of how affordable a student loan borrower's debt load is. Repayment rates indicate whether former students receive sufficient ROI to be able to make progress on their loans. Organizations like the American Enterprise Institute that favor eliminating the graduate loan program have suggested that policymakers could look at DTE ratios to cut off poor-performing institutions from federal graduate education dollars. [11] Third Way has proposed that programs should be flagged if their former graduate students have annual loan payments of more than 8% of their yearly earnings and 20% of their discretionary earnings (consistent with the gainful employment standard). Additionally, institutions should be held to an appropriate repayment rate threshold for their graduate programs to ensure they deliver sufficient return on investment to students.

Improve Student Choice Through Greater Transparency

Graduate students are often expected to be more informed about the programs they choose to enroll in, but data suggest that most of this demographic is left in the dark about their program's outcomes. [12] Public data on graduate programs are extremely limited, and greater transparency would help prevent students from selecting programs that will likely saddle them with high debts and no financial returns and promote better decision-making.

The Financial Value Transparency (FVT) data reporting requires colleges to provide data about their programs' costs, financial aid, and outcomes, which will be posted to a consumer-facing website. Students seeking to take their financial aid dollars to a graduate program that fails the standard debt-to-earnings measure will additionally be required to acknowledge they have received disclosures about these subpar outcomes before they enroll. [13] The FVT rule has support from stakeholders on both the left and right, with the American Enterprise Institute recently referring to it as a measure that "the incoming Trump administration should maintain and even strengthen." [14]

FVT reporting will provide a pathway to receive data about graduate programs that is largely unknown, such as net price, anticipated debt and repayment outcomes, and completion rates. This can help ensure prospective graduate students are fully informed before enrolling, improve choice by curtailing enrollment in programs where they would have to take on high levels of debt for weak returns, and generate cost savings for the federal government.

Conclusion

There is no doubt that reforms are needed to improve federal graduate student lending. There are valid concerns about graduate student outcomes. The rising costs, crippling debt, and poor outcomes from specific programs are inexcusable. While eradicating federal lending would do more harm than good, reforming the current system would allow for targeted policy solutions that make good use of taxpayer dollars.

In a highly polarized environment, there is support emerging across the spectrum for placing caps on Grad PLUS borrowing, deploying earnings thresholds as a means of strengthening accountability, and enhancing transparency to promote informed student decision-making. A cap on Grad PLUS loans would prevent borrowing from spiraling out of control while reducing the burden on those who want to access graduate school. Baseline earnings tests that institutions must meet to receive federal funding would curb the malinvestment of taxpayer dollars while holding institutions accountable for their student outcomes. And transparent data would ensure students, taxpayers, and the federal government are well-informed about their investment in graduate programs. As demand grows for advanced degrees, a federal lending system that supports graduate education while protecting students from unaffordable debt loads taken on to attend low-quality programs will most effectively promote a thriving economy and workforce.

ENDNOTES

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