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ISSUE BRIEF | Higher Education Reform Initiative

Seven Major Problems with the Biden Administration's Borrower Bailout

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TOPLINE POINTS

- ★ President Biden's student loan bailout transfers debt from college grads to taxpayers, sets a precedent for future waves of bailouts, and adds further fuel to the inflation fire.
- ★ This bailout plan is grossly unfair because it will concentrate benefits on a small slice of the population: collegegoers who freely choose to take on debt and, in most cases, can afford their loan payments.
- ★ Instead of fixing the serious problem of skyrocketing tuition rates, this loan cancellation will direct even more money into a broken system by incentivizing students to borrow more.

On Wednesday, August 24, President Joe Biden announced a broad plan to cancel student loan debt up to $20,000 per borrower for those earning less than $125,000 ($250,000 for families). The administration also extended the pandemic pause on federal student loan repayment, now in its third year, for an additional 4 months. When repayments resume in January, a new income-driven repayment plan will be in place that will cap payments for eligible borrowers at 5% of their disposable income and cancel certain balances after 10 years. Important details of the plan have yet to be disclosed, but several things are clear. The borrower bailout will create additional inflationary pressures, effectively launch a new entitlement program by executive order, redistribute wealth to college-education professionals, and undermine efforts to contain college costs by encouraging price hikes and overborrowing. It is also an unconstitutional exercise of undelegated authority that appears to be unpopular with Americans.

1. **President Biden's borrower bailout will add fuel to the inflation fire in the broader economy.**

The Committee for a Responsible Federal Budget finds that President Biden's student loan bailout will "create additional inflationary pressure over time" (CRFB, 2022a). As Larry Summers, former President of Harvard University, Treasury Secretary under President Bill Clinton, and Director of the National Economic Council under President Barack Obama, explained, "Student loan debt relief is spending that raises demand and increases inflation. It consumes resources that could be better used helping those who did not, for whatever reason, have the chance to attend college. It will also tend to be inflationary by raising tuitions" (Summers, 2022). Summers has credibility on the issue, having warned that early Biden Administration spending bills were likely to have significant inflationary consequences. Expert estimates of the inflationary effects of loan cancellation in the short term, for 2023, range from 10 to 30 basis points (Rockeman, Dmitrieva, and Tanzi, 2022). Additional fiscal stimulus targeting college-educated Americans is especially unwise at a time inflation is already running at a 40-year high.

2. **The unexpected provisions of the borrower bailout effectively create an expensive new entitlement program.**

The $10,000 bailout was widely anticipated. Other provisions of the announcement were not. The borrower bailout makes up to $20,000 in loan cancellation available to students who received Pell grants. It also extends the repayment pause for an additional four months. Significantly, it promises a new regulation will be announced in the coming days that will introduce an income-driven repayment (IDR) plan for lower- and middle-income earners designed to "protect more income from loan payments" (Department of Education, 2022a). The proposed rule will reduce the monthly payment of eligible borrowers to 5% of discretionary income (from 10-15% under current plans), and it will increase the definition of nondiscretionary income to 225% of the federal poverty line (Federal Student Aid, 2022). It will also make loan balances eligible for forgiveness after ten years of payments if the original balance was under $12,000 and "fully cover… unpaid monthly interest" (Department of Education, 2022a).

A full assessment of the new income-driven repayment model and its budgetary implications will have to wait for additional details. What is certain is that under these provisions of Biden's plan, additional balances will be wiped out long before borrowers repay the loan's principle in future years. Underline that point in red: notwithstanding White House efforts to paint loan cancellation as a one-time pandemic-related action, the coming rulemaking will create a program that forgives debt each year, thereby imposing ongoing costs on taxpayers. Taken together, the changes represent a massive new entitlement program that will ensure some students pay back only a fraction of their loans.

This means that the initial cost estimates of the borrower bailout, generally in the range of $300 billion, wildly understate its true, long-term cost to taxpayers (Penn

Wharton Budget Model, 2022b). CRFB's analysis suggests that the total cost of the action will rise to between $440 billion and $600 billion over the next 10 years, including these provisions (CRFB, 2022b). The revised Penn Wharton budget model puts the total price tag at $605 billion, noting that the final figure could reach $1 trillion over the next decade depending on the details of IDR and associated behavioral changes (Penn Wharton Budget Model, 2022c). This is in addition to costs associated with the pandemic repayment pause that began in early 2020 and has already cost $102 billion, according to a Government Accountability Office report (GAO, 2022).

3. President Biden's borrower bailout will redistribute wealth from blue-collar workers to college-educated professionals.

Forty-five million people owe balances on federal student loans. According to the White House, the borrower bailout will "provide relief to up to 43 million borrowers, including canceling the full remaining balance for roughly 20 million borrowers" (White House, 2022). Borrowers whose loans defaulted before the March 2020 pandemic repayment pause are eligible for relief (Federal Student Aid, 2022). Those who have continued to pay off their loans during the pandemic can even ask for a refund of payments posted in the last 2 and a half years (Ibid.)

About 1 in 8 Americans will qualify for some form of payout, which is to say the benefit of the action will be concentrated on a narrow slice of the population, many of whom obtained more than just a 2- or 4-year degree. This includes lawyers, doctors, and bankers. The bailout will also extend relief to very recent graduates who earn under $125,000 today but can be expected to have a lifetime income in the top 1% of earners, such as surgeons after they complete their residency when incomes are temporarily low. In contrast, every taxpayer will be on the hook. According to an analysis by the National Taxpayers Union Foundation, just the cancellation element of the borrower bailout (not including the new IDR plan or extended repayment pause) will cost the average taxpayer over $2,500 (Lautz, 2022). For those earning between $100,000 and $200,000, the average bill will be closer to $3,800.

The bailout is also manifestly unfair, punishing people who avoided student debt to begin with or were successful in paying it off on their own. Construction workers, small business owners, Uber drivers, and many others who choose not to (or judge they cannot not afford to) attend college or university will be forced to assume the cost of the Biden Administration's generalized cancellation of student debt. Many such workers took on other forms of personal debt to advance their own careers or build small businesses, including by paying for training programs out of pocket that were not eligible for Title IV aid. Taxpayers who have already paid back their student loans will not benefit from the borrower bailout either. Nor will families that made responsible decisions to minimize the student loan debt they took on, whether by attending in-state schools or working two jobs to avoid overborrowing. But they are the ones saddled with the consequences of a higher national debt and greater inflationary pressures.

4. The borrower bailout is unnecessary and overbroad

The Biden Administration's borrower bailout is akin to using a sledgehammer to swat a fly—a solution completely out of proportion to the problem and very likely to do more harm than good. Most loan balances are modest in size, which means many of those who benefit from the borrower bailout have more than sufficient income to repay obligations they freely undertook. According to 2021 figures, 54% of loans issued under the largest federal programs had balances under $20,000 (an additional 21% of loans had balances between $20,000 and $39,999) (Ma, 2021, p. 40). Only 7% of borrowers owe more than $100,000, but they represent 37% of the total outstanding loan debt. These are professionals with advanced degrees in high-paying fields with immense lifetime income potential (Ibid.). For example, 80% of medical students borrow to fund their education, and those who graduated in 2015-16 took on loans averaging $223,060 (National Center for Education Statistics, 2019).

Borrowers with the lowest balances have the highest rates of default (in fact, 66% of defaulters owe less than $10,000), suggesting that the problem is largely under-prepared students matriculating at schools with terrible graduation rates. Those who take on higher levels of debt tend to complete their degree, providing them with the wherewithal to repay it in most cases (The College Board, 2016, p. 21). The pandemic-era behavior of borrowers repaying private loans, who were not eligible to suspend repayments, provides further evidence that broad cancellation is unnecessary: in aggregate, they *accelerated* the rate of paydown, aided, perhaps, by repeated rounds of stimulus payments (Federal Reserve Bank of New York, 2022).

There are many pathways to family-sustaining employment available to those wishing to attend college that do not require taking on large student loans. The proportion of active undergraduate students who were *not* borrowing under a federal student loan program has increased over time, from 63% in 2010-11 to 74% in 2020-21 (Ma, 2021, p. 40). The percentage of degree-completers who take on debt is also falling, from 59% in 2009-10 to 55% in 2019-20 (Ibid., p. 43). For those who do borrow, several income-driven repayment plans have been available to borrowers with modest incomes for many years, ensuring that they face manageable monthly loan payments. Several targeted loan forgiveness programs already exist. They make relief available to borrowers who are permanently disabled, built careers in the public or nonprofit sector, fell victim to predatory admissions schemes, and whose schools closed. It would have been reasonable to study the success of these programs, identifying gaps and unfilled needs. Likewise, policymakers could have focused their attention on those with small, defaulted balances who did not earn a degree and truly lack the wherewithal to repay their loans. Addressing bona fide problems could have been achieved by refining existing programs and much narrower policy changes.

5. President Biden's borrower bailout will put additional upward pressure on tuition rates.

Skyrocketing tuition rates are a serious problem, especially given falling standards and broad dissatisfaction with the workplace preparation of college graduates. The borrower bailout will not address these problems, however. Arguably, it will cause prices to rise even faster. The first law of higher education finance is that colleges and universities raise every penny they can and spend every penny they raise (Martin and Gillen, 2009). The "revenue theory of cost" (or Bowen's law) suggests that the availability and expansion of federal financial aid accounts for a large proportion of the rise in tuition rates (Lucca, Nadauld, and Shen, 2017).

President Biden's loan cancellation will direct even more money into a broken system by creating incentives for students to borrow more. By signaling to students that some of their loan debt may ultimately be assumed by taxpayers—by a subsequent cancellation or under the new income-driven repayment plan for those who qualify—the bailout encourages students to overspend on college. Colleges and universities are the big winners because what they can charge is limited to what students are willing to pay. This creates a pernicious incentive for colleges and universities too, which will have even more to gain by spending money on the amenities that attract students to campus—glitzy facilities, luxury services, and niche programs—but make negligible contributions to actual learning. Given that the Department of Education issues approximately $84 billion in new student loan debt every year, the total outstanding student loan debt can be expected to return to the pre-bailout levels within a short timeframe.

6. The executive branch does not have the authority to transfer student loan liabilities to taxpayers.

Congress established federal student loan programs, making credit available to families at very favorable rates, with the clear expectation that those loans would be repaid *by borrowers* (Carter and Pidluzny, 2022). The Biden Administration's borrower bailout is an unconstitutional exercise of power that wildly exceeds the authority delegated by Congress to the Secretary of Education (Rubinstein, 2021)—a hesitation President Biden seemed to share before he took office (Tumulty, 2020). Congressional leaders agree. As House Speaker Nancy Pelosi explained this summer, "People think that the President of the United States has the power for debt forgiveness. He does not. He can postpone. He can delay. But he does not have that power. That has to be an act of Congress" (Pelosi, 2022).

The Education Department published a dubious legal justification for the action claiming authority under the Higher Education Relief Opportunities for Students (HEROES) Act, a 2003 law passed to ensure servicemen and women deployed to Iraq were not adversely affected with respect to their student loans due to their military status (Department of Education, 2022b). The act's clear purpose is to provide targeted relief to active-duty servicemen and National guardsmen working in a national security context or, in the words of the "findings" section of the statute, to "support the members of the United States military and provide assistance with their transition into and out of active duty and active service." The law does include a "national emergency" clause, but it is an ancillary provision—designed to allow the Secretary of Education to address particular cases of hardship that occur domestically but align with the measure's overriding purpose. The Biden Administration nonetheless uses that clause of the HEROES Act to justify broad debt relief on the purported rationale that it authorizes the Secretary of Education to "effectuate a program of categorical debt cancellation directed at addressing the financial harms caused by the COVID-19 pandemic." It claims a second authority even further removed from the text, too: to make "determinations regarding the amount of relief, and the categories of borrowers for whom relief is necessary." In effect, the Biden Administration claims that Congress hid an elephant-size power in a mousehole. Federal courts are not likely to agree. As Justice Antonin Scalia has explained, Congress does not "alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions" (Whitman v. Am. Trucking Ass'ns, 2001).

7. The American public was not supportive of the borrower bailout concept, even before its details were released.

A Scott Rasmussen National Survey asked 1,200 registered voters about a theoretical plan to forgive student debt in a survey fielded from May 31 to June 1, 2022. Seventy-one percent of respondents either opposed forgiveness or wanted to see eligibility capped below $75,000. Only 29% of those who have already paid off their student loans said that "loan forgiveness [is] fair to people who have already paid off their student loans." And only 35% said that "loan forgiveness [is] fair to people who never went to college." Opposition to the measure was highest among those who are retired, only 13% of whom said loan cancellation is fair to those who have already paid off their student debt.

CONCLUSION

Article 1, Section 9 of the U.S. Constitution explains, "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law." Policies that deliver expensive benefits to a narrow constituency while imposing highly salient costs (like an increased tax burden) on a much broader group are, quite appropriately, difficult to enact by Congressional action. It can be achieved where there is a sufficiently compelling need for the policy that most of our elected representatives are persuaded to support it. Congress has done this many times—generally with large, bipartisan majorities. Examples include the Social Security Act, the Medicare and Medicaid Act, and the Higher Education Act.

Where Congress chooses not to act, however, it is completely inappropriate—and in this case, very likely an unconstitutional exercise of undelegated authority—for the executive branch to contrive an action that achieves the same result by fiat. It is difficult to think of a close historical analogy to the Biden Administration's borrower bailout—in terms of the audacity of the claimed authority or the immense cost to taxpayers. The action is destructive in ways that go beyond its fiscal recklessness: as an egregious example of overreach, it will deepen distrust of government, and by transferring wealth from blue-collar workers to college-educated professionals, it will deepen societal resentments.

There is only one force powerful enough to discipline colleges and universities, and it is a functioning higher education marketplace. Building one should be the focus of higher education policy reform efforts. Unleashing competition requires changing how we pay for college and who can deliver educational programs. Opening the market to new and innovative entrants first requires creating an outcomes-assessed alternative to our current dysfunctional accreditation system. We can also build new pathways to family-sustaining employment by creating apprenticeship programs and workforce education programs nested within business and industry. Colleges and universities should also be forced to repay some proportion of defaulted student loans (or take on insurance to protect taxpayers in the event of borrower default) so that incentives to deliver a worthwhile education at a price families can afford are strong. Absent reforms that change the higher education risk-reward environment for schools, tuition will continue to skyrocket, borrower debt loads will continue to rise, and public confidence in the U.S. higher education system will continue to decline.

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