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Forgiving Student Loan Debt

Who wins and who loses?

By Scott Niederjohn, Ph.D.

BADGER INSTITUTE

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Executive summary

Student debt forgiveness schemes are both inefficient and unfair policies for helping low-income families. First, it is clear that any plan to eliminate student debt across the board would end up benefiting doctors, lawyers and many others who have or are likely to get high-earning jobs and won't need help paying off their loans. Further, because the majority of student debt — both nationally and in Wisconsin — is held by those in the top 40% of the income distribution, such a plan would most benefit the wealthy, contributing further to income and wealth inequality. In addition, debt forgiveness would add to inflationary pressures, as the former debt holders have freed-up money to spend on other uses.

Debt forgiveness amounts to spending $1 trillion from the federal Treasury exclusively on people who went to — and in most cases graduated from — college. This essentially punishes Americans who didn't go to college and, because of that fact, are more likely to need government help.

In all, 58% of college student debt is held by students from the top 40% of incomes. Further, 56% of student debt is held by those with master's, professional or doctoral degrees. Such groups are not typically targeted for federal welfare or subsidy programs. But that is exactly what any across-the-board student loan forgiveness program would do. Further, such a plan seems exceedingly unfair for families whose children either didn't attend college or, if they did and borrowed money to do so, paid off their loans as most responsible borrowers do.

Introduction

Stories of young people struggling with student debt abound in the media. Their plans for home-buying and household formation are on hold as they rearrange their budgets to make payments. But beyond the anecdotes, how big is the problem? The overall numbers are huge. The current $1.6 trillion total of student debt exceeds that of auto loans and credit card obligations and is exceeded only by mortgage debt. The suffocating consequences have led some, including President Joe Biden, to float possibilities of forgiving some of these obligations. A reasonable assessment of such ideas requires an understanding of who actually holds this debt and how much they owe, both nationally and in Wisconsin, and what degrees the loans were used to finance.

Who holds student debt?

Data from the Federal Student Aid Office of the U.S. Department of Education reveals much interesting information[1] about the federal student loan portfolio, both nationally and in Wisconsin. The $1.6 trillion total for 2022 was spread among Direct Loans, Federal Family Education Loans and Perkins Loans, owed by 43.4 million borrowers. Approximately 6.4% of loans were held by those 24 and younger. Another 31% of loans were held by those 25 to 34 and 39% by those 35 to 49. The oldest group, those above 50, still held 24% of loan balances.

In Wisconsin, $23.2 billion in student loan debt is held by about 727,000 borrowers, leading to an average student loan debt per borrower of almost $32,000. The highest average student loan debt is in Washington, D.C., at almost $55,000 per borrower, followed by Maryland ($43,000 per borrower) and Georgia ($41,600 per borrower). In Puerto Rico and North Dakota, the locations with the lowest average student loan debt per borrower, the figure is just over $28,000 per borrower.

The distribution of student debt by amount owed is shown in Table 1. As the data demonstrates, both in the United States and Wisconsin, the largest share of borrowers owes between $20,000 and $40,000, followed by those owing between $10,000 and $20,000. About 17% of borrowers both nationally and in the state

Table 1

Debt outstanding (fiscal year 2022)

Amount owed	Share of borrowers in U.S.	Share of borrowers in WI
Less than $5,000	17.1%	17.2%
$5,000 to $10,000	16.2%	16%
$10,000 to $20,000	20.1%	20.2%
$20,000 to $40,000	21.2%	23.5%
$40,000 to $60,000	9.4%	9.3%
$60,000 to $80,000	5.7%	5.6%
$80,000 to $100,000	3.1%	2.7%
$100,000 to $200,000	5.3%	4%
More than $200,000	1.9%	1.5%

owe less than $5,000. At the top end, nearly 2% owe more than $200,000.

The Federal Reserve's Survey of Consumer Finances[2] shows how student loans are spread across different levels of household income and education (*see Table 2*). The figures confirm that upper-income households hold a disproportionate share. These earners have high incomes — a mean of just over $254,000 for the top 20%, who together hold 26% of the outstanding debt. Just a step down, the next 20% have mean incomes over $111,000 and owe 32% of the debt. That means the top 40% of wage earners owe almost 60% of outstanding student loan debt. At the other end, the lowest-income 40% of households hold under 20% of the outstanding debt.

Furthermore, student debt is concentrated in households with high levels of educational attainment (*see Table 3*). The same 2019 Fed study data shows that households with graduate degrees owed 56% of the outstanding education debt. To put this in perspective, only 14% of adults 25 or older in the U.S. hold graduate degrees.

Table 2

Outstanding student debt by income quintile (2019)

Income quintile	Mean income of quintile	Share of outstanding debt
First	$15,286	5%
Second	$40,652	14%
Third	$68,938	22%
Fourth	$111,112	32%
Fifth	$254,449	26%

Table 3

Outstanding student debt by educational attainment (2019)

Highest level of education of household head or spouse	Share of student debt
No college degree	8%
Associate degree	7%
Bachelor's degree	29%
Master's degree	36%
Professional/doctoral degree	20%

The importance of framing

Behavioral economists have pointed out the importance of "framing," or the way a problem is described. As framed in conventional media, debt forgiveness is a compassionate program to help struggling and worthy recipients. Although these accounts have elements of truth, a more analytical view sees "forgiveness" as a misleading framing.

Forgiveness implies that a wealthy entity forgoes a claim, compassionately accepting a lower return to help a less fortunate borrower. In the case of student loan forgiveness, however, the debt does not vanish but instead is transferred to others — taxpayers at large and the public.

What is the relative worthiness of the recipients and the donors in student loan forgiveness? The numbers reported in this policy brief paint a different picture from what is commonly portrayed in the media.

Consider two borrowers, Chris and Pat, who each owes $30,000 in debt. Chris went to trade school and took out the $30,000 loan for a work truck. Pat went to college and took out the loan for tuition and expenses. Because of the greater earning power of college graduates, Pat is likely to have far higher lifetime income than Chris.

Student loan forgiveness provides a taxpayer-funded advantage to Pat and no relief for Chris. Not only that, but Chris will face higher taxes partly to finance Pat's education. Conventional media accounts, as framed, portray Pat sympathetically while ignoring Chris. (A third borrower, Terry, who had borrowed and repaid $30,000 in student loans would likewise be ignored.)

Student debt forgiveness plans

U.S. Sen. Elizabeth Warren (D-Mass.) has proposed forgiving the first $50,000 of student loan debt for all borrowers. President Biden has indicated that he is more comfortable forgiving $10,000 or less per borrower. Who would win and lose under such plans?

Given the data presented in this policy brief, it is clear that student debt forgiveness schemes are both inefficient and unfair policies for helping low-income families. First, it is apparent that any plan to eliminate student debt across the board would end up benefiting doctors, lawyers and many others who have or are likely to get high-earning jobs and won't need help paying off their loans. Further, because the majority of student debt — both nationally and in Wisconsin — is held by those in the top 40% of the income distribution, such a plan would most benefit the wealthy, contributing further to income and wealth inequality. In addition, debt forgiveness would add to inflationary pressures, as the former debt holders have freed-up money to spend on other uses.

Debt forgiveness amounts to spending $1 trillion from the federal Treasury exclusively on people who went to — and in most cases graduated from — college. This essentially punishes Americans who didn't go to college and, because of that fact, are more likely to need government help. While polls have shown strong support for some debt forgiveness, it's less clear how voters would respond to such a broad cancellation — especially those who paid full freight for college costs or who already have repaid expensive loans.

Conclusion

In all, 58% of college student debt is held by borrowers from the top 40% of incomes. Further, 56% of student debt is held by those with master's, professional or doctoral degrees. Such groups are not typically targeted for federal welfare or subsidy programs. But that is exactly what any across-the-board student loan forgiveness program would do. Further, such a plan seems exceedingly unfair for families whose children either didn't attend college or, if they did and borrowed money to do so, paid off their loans as most responsible borrowers do. One can't help concluding that this inefficient and inequality-increasing program can be designed for only one reason — to cater to young voters in an effort to win elections this fall.

About the author

Scott Niederjohn is a professor of economics and director of the Free Enterprise Center at Concordia University Wisconsin in Mequon and a Badger Institute visiting fellow.

Endnotes

[1]https://studentaid.gov/data-center/student/portfolio

[2]https://www.federalreserve.gov/econres/scfindex.htm