RESEARCH BRIEF • JUNE 2024

What Went Wrong with Federal Student Loans?

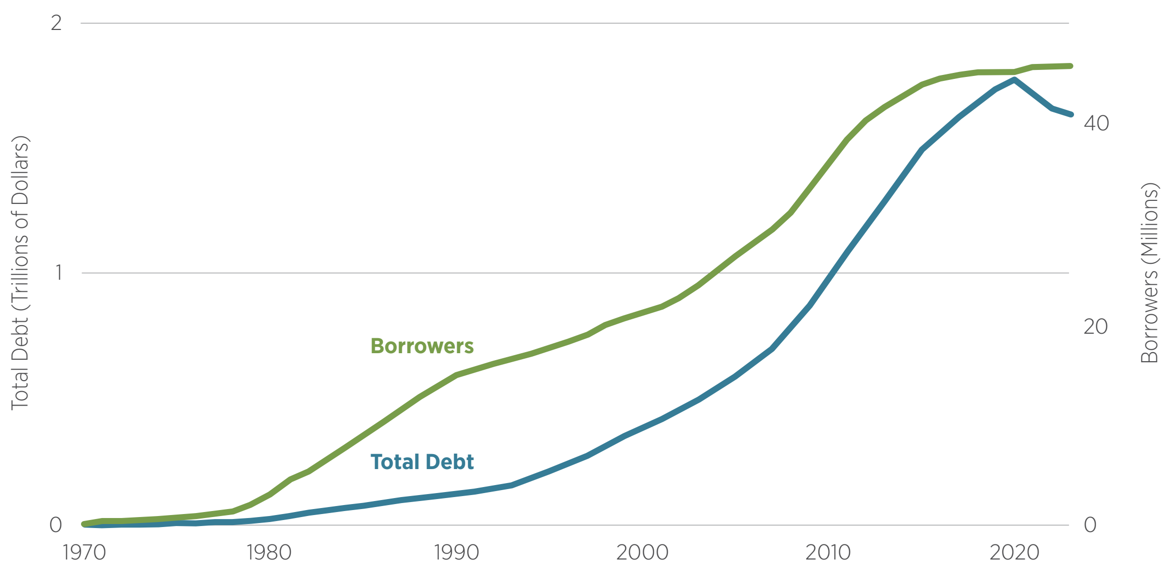
Based on BFI Working Paper No. 2024-60, "What Went Wrong with Federal Student Loans?" by Adam Looney, University of Utah; and Constantine Yannelis, University of Chicago

The increase in aggregate student debt and the struggles of today's borrowers can be traced to changes in federal policies intended to broaden access to educational opportunities, which increased enrollment and borrowing in higher-risk circumstances.

Recent research from UChicago economists shows that students who are admitted to college earn more than their rejected peers, and that the gap between workers with and without a college degree is wider than ever. At the same time, the United States faces a student loan crisis, with over 45 million borrowers owing a total of over $1.6 trillion in borrowed federal dollars. What went wrong?

In this paper, the authors argue that federal policy is to blame. They describe a process by which policymakers weakened regulations that

Figure 1 • Total Borrowers and Total Debt



Note: This figure plots the total number of borrowers and total student loan debt in the US. Debt is reported in trillions of 2022 dollars, and the number of borrowers is reported in millions.

View the Interactive Research Brief at bfi.uchicago.edu/what-went-wrong-loans had constrained institutions from enrolling aid-dependent students, causing rising enrollment among relatively disadvantaged students at poor-performing institutions where students often failed to complete a degree, struggled to repay their loans, defaulted at high rates, and floundered in the job market.

The authors trace the history of federal lending from its advent in the 1950s to today's crisis. Read their working paper, or view the timeline for a summary.

Figure 2 · Changes in Federal Loan Policy and Debt Crises

1944
Introduction of the GI Bill
Though not a loan program, the "GI Bill" is the first major federal effort to support students in the pursuit of a college degree. It causes a surge in postsecondary attainment, but also leads to a wave of low-quality, for-profit schools.

1944
New Rules Enacted
Soon after passage of the GI Bill, Congress enacts rules to limit eligibility to certain schools and to create accountability standards.

1957
First Student Loans
Following the launch of the Sputnik satellite in 1957, the first federal loans are enacted to support students pursuing technical fields. These funds are limited to state-run and nonprofit schools.

1965
Higher Education Act
The Cold-War-era student loan program is expanded to other fields, creating today's federal student loan program. The new legislation includes rules governing the eligibility of postsecondary educational institutions to participate in federal student aid programs.

1972
Sallie Mae Expands Access
Congress passes legislation to create the Student Loan Marketing Association (Sallie Mae) to encourage more banks to offer student loans.

1980s
Widespread Access Leads to Crisis
The vast majority of students have access to federal student loans, and the federal student lending system plunges into its most severe crisis.

1989
Congress Boosts Oversight
In response to the crisis, Congress legislates changes tightening institutional oversight. More than 1,000 institutions to close or otherwise exit the lending program and there is a dramatic decline in the student loan default rate.

1998
Oversight Reversed
Congress defangs the key accountability provisions that it had just enacted. These changes allow for the advent of very large online education institutions and programs, which subsequently enroll millions of Pell grant recipients, GI Bill recipients, and student loan borrowers.

2000-2014
Another Crisis
For-profit institutions triple their enrollment and community college students triple their rate of borrowing. The student loan default rate rises by 75 percent.

READ THE WORKING PAPER

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bfi.uchicago.edu/working-paper/2024-60

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