



## DYSFUNCTIONS IN THE FEDERAL FINANCING OF HIGHER EDUCATION

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Conventional wisdom suggests that expansions in federal student aid will result in a more affordable and equitable postsecondary education system. While this belief has motivated significant expansions of federal aid for students, rapidly increasing costs and student loan default rates are raising questions about its validity.

In “[Dysfunctions in the Federal Financing of Higher Education](#),” [Mark J. Warshawsky](#) and [Ross Marchand](#) provide an overview of the relationships among student aid, educational costs, wages, and student loan defaults. Their study finds support for the theory that federal aid has increased the cost of education and discredits the notion that broad subsidization of college education will reduce wage inequality, a mix of outcomes that should motivate policymakers to rethink the current approach to postsecondary education.

### THE EFFECT OF FEDERAL AID ON THE COST OF EDUCATION

A major strand of the economic literature on higher education examines whether increases in federal financial aid increase or decrease the cost to students of attending college.

- From 1980 to 2014, gross tuition and fees for the average full-time undergraduate student increased by 229 percent in inflation-adjusted dollars.
- This increase coincided with an explosion in federal aid for students. Inflation-adjusted government spending on higher education ballooned from less than \$18 billion in 1970 to more than \$166 billion in 2016, with a peak of \$190 billion in 2010.
- Former secretary of education William J. Bennett posited that increases in federal aid will be absorbed by universities in the form of higher tuition instead of improving affordability for students, a theory that has found empirical support.
- Indeed, large average real increases observed in costs persist even after grant money is taken into account: increases in financial aid to students have been offset by increases in tuition, room, and board across all university types.

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## THE COLLEGE WAGE PREMIUM

Another strand of research has suggested that policies that subsidize higher education may reduce wage inequality by lowering the premium paid to college-educated workers.

- The flagship study supporting this hypothesis suffers from severe methodological problems, and related studies have found that labor demand, not supply, has been more influential in determining earnings inequality.
- Furthermore, for workers who graduated college but did not obtain graduate degrees, plateauing wages coupled with a rise in net tuition have led to financial difficulties, subtracting from any earnings “premium” gained from attending college.
- Indeed, the relative supply of college graduates has gradually increased from 1991 to 2014 while the relative value of a college degree has remained constant, challenging concerns of a supply-driven increase in the college wage premium in recent years.

## THE STUDENT DEBT PROBLEM

Much of the federal support for students comes in the form of student loans that have increasingly become a burden that borrowers are unable to bear.

- Across all types of students and institutions, lifetime default rates increased significantly from 2002 to 2011, with loans to students who attended for-profit schools, two-year public institutions, and certain nonselective four-year colleges the least likely to be repaid.
- The number of these nontraditional students increased rapidly in the first decade after 2000. These students are less likely to complete their programs than traditional students are, and they often live in poverty following enrollment.
- These are not the only students at risk, however. Over the 2002–2011 period, the increases in default rates for attendees at two-year public institutions, underclassmen at four-year institutions, and upperclassmen at four-year institutions are 36.0 percent, 47.0 percent, and 62.5 percent, respectively.
- These results call into question the justification for federal spending on postsecondary education: that a college education is supposed to increase the wages of graduates, enabling them to pay back loans with sufficient earnings left over to finance a higher standard of living.

## CONCLUSION

These findings should be disappointing to policymakers and taxpayers because they indicate policy failures and dysfunctions. Indeed, the increase in financial aid may be encouraging some young people to waste the precious years of young adulthood in a largely unhelpful college education that results in a heavy debt burden. The massive expansion of federal resources to higher education may harm rather than help many students while failing to advance important public policy goals of prudent financing, broad access, improved efficiency, and enhanced productivity.