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Staying in College Longer Than Four Years Costs More Than You Might Think

Jaison R. Abel and Richard Deitz

This post is the second in a series of four Liberty Street Economics *posts examining the value of a college degree.*

In yesterday's blog post and in our recent article in the New York Fed's *Current Issues* series, we showed that the economic benefits of a bachelor's degree still outweigh the costs, on average, even in today's difficult labor market. Like others who assess the value of a bachelor's degree, we base our estimates on the assumption that a student takes four years to finish the degree. But it is not uncommon for people to take longer than that. In fact, recent data indicate that among those who complete a bachelor's degree within six years, only about two-thirds finish in four years or less. What does it cost to stay in college for a fifth or sixth year before finishing that degree? Perhaps more than you might think.

How should we measure the costs of taking an extra year or two to complete a bachelor's degree? The most obvious cost is the extra tuition and fees that must be paid (room and board are not really an extra cost from an economic perspective, since they have to be purchased regardless of whether one is in school). In our recent article, we showed that the average net tuition cost—which reflects what the average student actually pays out-of-pocket when various forms of aid and tax benefits are taken into account—is a little more than $6,500 per year. However, in economic terms, tuition is only a small part of the extra costs incurred for that fifth or sixth year of school. There are also opportunity costs to consider, and these add up in ways that may not be obvious at first glance.

First, students who spend an extra one or two years in school as a full-time student incur an opportunity cost in the form of forgone earnings. Economists measure this cost as the wages one could have earned with a college degree had one graduated a year or two earlier. Second, entering the job market a year or two late damages students' lifetime earnings profile. In addition to giving up one or two years of college-level earnings while in school, students miss out on a year or two of experience and the extra push that gives their wages over their working life.

While we don't directly observe people who graduate in five or six years, we can use our analytical framework to simulate what the added costs would amount to, based on the average wages of college graduates in general. Using our estimates, we determine that someone who finishes a bachelor's degree in four years would earn, on average, about $37,500 their first year on the job. By the time that person reaches the age of twenty-five, they earn an average of about $45,500, having racked up a few years of experience and commensurate raises. If we assume that a five - or six-year graduate follows the same earnings path but starts working a year or two later, we find that a five-year graduate would earn $43,000 at the age of twenty-five ($2,500 less than a peer who graduated in four years), and a six-year graduate would earn only about $40,000 ($5,500 less). This earnings "wedge" persists throughout one's career. The differences add up each and every year, so that those graduating later never really catch up to those who graduated earlier.

In the table below, we use the 2013 lifetime earnings profiles from our article to estimate the costs of taking an additional year or two to complete the bachelor's degree. All in all, an extra year of staying in school costs more than $85,000, and for those who take two extra years to finish, it costs about $174,000. The net present value of these totals, using a 5 percent discount rate, yields a cost of about $65,000 for each additional year spent in school.

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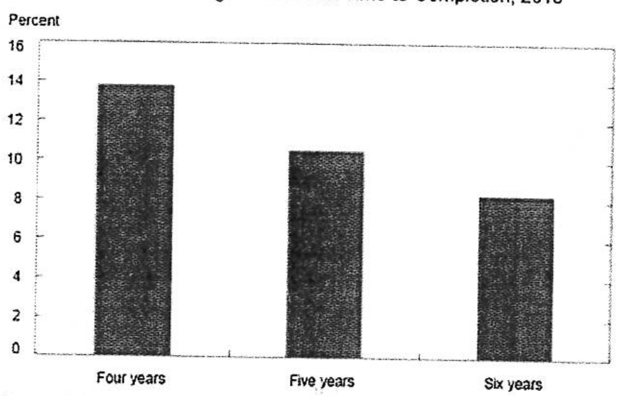
Costs Incurred for Fifth and Sixth Years of College

	Fifth Year	Fifth and Sixth Years
Tuition and fees	$6,547	$13,094
Opportunity cost of extra time in school	$37,486	$77,738
Opportunity cost of earnings wedge	$41,396	$83,212
Total	$85,430	$174,044
Net present value (5% discount rate)	$65,319	$129,118

Sources: U.S. Census Bureau and U.S. Bureau of Labor Statistics, 2013 Current Population Survey, March Supplement; U.S. Department of Education, Digest of Education Statistics 2012; The College Board, Trends in College Pricing 2013 and Trends in Student Aid 2013.

Alternatively, we can look at how the return to a bachelor's degree declines as time to completion increases, as shown in the chart below. Using 2013 data, we estimate that the rate of return for the average student who finishes the degree in four years is about 14 percent. That figure gets shaved down to about 11 percent for a five-year completion, and to 8 percent for six years. Overall, the rate of return plummets by 40 percent for the six-year plan compared with the traditional four-year plan.

Return to Bachelor's Degree Based on Time to Completion, 2013



Sources: U.S. Census Bureau and U.S. Bureau of Labor Statistics, 2013 Current Population Survey, March Supplement; U.S. Department of Education, Digest of Education Statistics 2012; The College Board, Trends in College Pricing 2013 and Trends in Student Aid 2013.

The upshot of our discussion? For students who require five or six years to graduate, the value of a bachelor's degree no doubt remains substantial, but staying on in college certainly takes a financial toll.

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Get There

When you can max out student loans — and not have to pay it all back

A 15

By **Jonnelle Marte** September 10 Follow @jonnelle

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Programs that set student loan payments based on a person's income and offer loan forgiveness after a certain number of payments are meant to encourage people with college debt to choose jobs based on the merit of the work and not the size of the paycheck.

But they may offer an unintended benefit for people going into public sector or nonprofit jobs — the ability to borrow more heavily than is necessary for a degree without having to pay it all back.

A paper released Wednesday by the New America Foundation argues that many students planning to take public sector jobs, especially those earning graduate and professional degrees, can see a large chunk of their debt forgiven by the income-based repayment (IBR) program. In some cases, the debt forgiven can amount to most of the cost of a graduate degree, says Jason Delisle, lead author of the report.

"If they think they're going to end up working at a nonprofit or for the government, then they should borrow as much money as they can get their hands on," Delisle says, "and go to whatever school they want to go to. "

People could use student loan money for any number of expenses beyond tuition: to cover rent, books, food, travel or even car payments. So those who borrow more than they need to could milk the benefit, he says.

Here's how the program works: People who sign up for IBR would make monthly payments based on how much they make, not how much they borrowed. So if they end up in low-paying jobs, and receive loan forgiveness on top of that, they may see much of their total debt load discharged.

Forgiveness can be more generous for borrowers who take qualifying jobs in the public or nonprofit sectors because they would be eligible to have their debt forgiven after 10 years of payments. For instance, a social worker earning in the 75th percentile would be responsible for the first $28,000 in loans, even if they took out the typical debt load of $49,000 – before interest– according to the New America Foundation.

People who make more will pay more. For a lawyer whose earnings are in the 75th percentile, the tab would be larger, adding up to about $117,000, compared to the median debt load of $140,000.

Most people with federal loans will qualify for IBR, which limits payments to roughly 15 percent of their income, after subtracting an exemption that is based on the federal poverty level, and forgives debt after 25 years of payments. People with direct loans taken after October 2007 will qualify for a program that limits payments to about 10 percent of income and offers forgiveness after 20 years of payments. (If the payment required under the standard 10-year repayment plan is smaller than the income-based amount, then borrowers would pay that.)

The programs apply only to federal loans, meaning that people who also have private student loans would only be able to have the public loan portion of their debt forgiven. (Required payments would be 10 or 15 percent of income after the exemption, or the regular payment amount under the standard 10-year repayment term — whichever is smaller.)

People with graduate degrees may get the biggest benefit out of the program, Delisle says, because they can take out more in federal loans. There is a lower cap on how much people can take out in federal loans for an undergraduate degree.

Of course, millennials seem especially averse to piling on more debt. That said, many will probably try to minimize their debt loads on the chance that plans change after graduation. People who later land lucrative jobs or decide against joining the public sector could then be on the hook for most, if not all, of their bill, says Lauren Asher, president of the Institute for College Access & Success, a nonprofit that works to make college more affordable.

People's plans may change after an illness or a major family event, Asher says. Some people may intend to work in a low-paying field but then see their household income jump if they marry someone who makes much more, she adds.

It's also worth noting that people with graduate degrees, who tend to have larger debt loads, also make more on average than people with only undergraduate degrees, which could minimize the benefit they get out of the program, Asher says. "No one can know for sure what their job or earnings will be in the future," she says.

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POLITICO Pro

MEDIA COVERAGE OF STUDENT DEBT SKEWS HIGH

8/11/14 4:06 PM EDT

Recent media coverage of student debt has emphasized borrowers who owe significantly more than is average, a new Hamilton Place Strategies analysis found.

While the average 2012 graduate carrying debt owed $29,400, the average debt reported in anecdotal news stories is $84,400. If the anecdotes were a random sample, the paper says, there would be a .000007 percent chance reporters would get this result. The analysis includes close to 100 articles over an unspecified three-month period.

"The greatest concern with this skewed coverage," the report says, "is the potential to impact aspiring students who may make decisions based on news coverage."

— Allie Grasgreen

[HPS] LEADING THINKING

Hamilton Place Strategies
www.hamiltonplacestrategies.com
202-822-1205

The Plural Of Anecdote Is Data (Except For Student Debt)

Findings:

- **The average amount owed by students with debt graduating in 2012 was $29,400.**
- **The average debt reported in anecdotal news stories is $84,400.**
- **If the anecdotes were a random sample, there would be a 0.000007 percent chance reporters would get this result.**

Matt McDonald
Pat Brady

Hamilton Place Strategies provides analysis, communications, and advocacy solutions at the intersection of business, government, and media.

Here is your assignment: "‹Insert name› was a student at ‹insert local university›, but after graduating last spring they still can't find a job and are facing ‹insert outrageous sum› in debt." Congratulations, you've just finished the lede for your student debt article!

Unfortunately, you also may have missed key facts in the college affordability debate that are too often ignored.

Between the proverbial rock-climbing walls and the humanities majors with six-figure debt who didn't complete their degree, the problems with higher education financing are being well documented. And while these problems are not to be dismissed, there is another side to the story that is also true but has been less widely reported.

A college education is one of the best investments one can make. College graduates are more likely to be employed, and when they are employed they make more money.

A closer look at some of the particulars around college financing reveals more nuance than overall media coverage has indicated. While tuition has consistently gone up, the net price actually paid has been much flatter as universities offer more tuition assistance and discounts to entice attendance. And while the average amount of debt incurred has been increasing over time, the increase in monthly payments is typically manageable.

It is possible that one of the biggest problems graduates face is less the increasing cost and debt associated with a college degree, but actually the economy they enter. Returns to a college degree (i.e., income) have largely been flat over the past decade, not to mention the impact of the financial crisis. So while a degree is still a good investment, it is necessarily a less good investment than it was a decade ago.

This nuance makes the debate and discussion more interesting, but is it getting captured accurately in the anecdotal stories that are highlighted in the press?

To test this, we examined close to 100 articles over a three month period which had stories of students and families burdened by student debt. We wanted to get a sense of what levels of debt are being highlighted in the media and compare that to actual average debt loads as collected in government statistics (NCES: 2011-2012 NPSAS).

The news stories covering student debt are distinctly unrepresentative of the actual facts around student debt. For those graduating in 2012, government statistics indicate the average amount owed for those who had student debt was $29,400. But the average level of student debt reported in news coverage is $85,400 (Figure 1). If this reporting were a random sample of students for stories about debt, there is a 0.000007 percent chance reporters would get these results (that's 7 one-millionths of a percent).

The news stories covering student debt are distinctly unrepresentative of the actual facts around student debt.

Another way to view this is that the average debt level reported through anecdotes represents the 98th percentile of all who have debt. This would be the statistical equivalent of surveying a selected group of American workers, finding an average income level of $360,000, and therefore reporting that the economy is doing well.

It's pretty clear based on the facts of the reporting that coverage of the college cost and student debt issue is skewed. And there are a few arguments that might justify individual stories that are so at odds with the typical facts

Fig. 1: Distribution Of Student Debt, Actual vs. Anecdotal Reporting

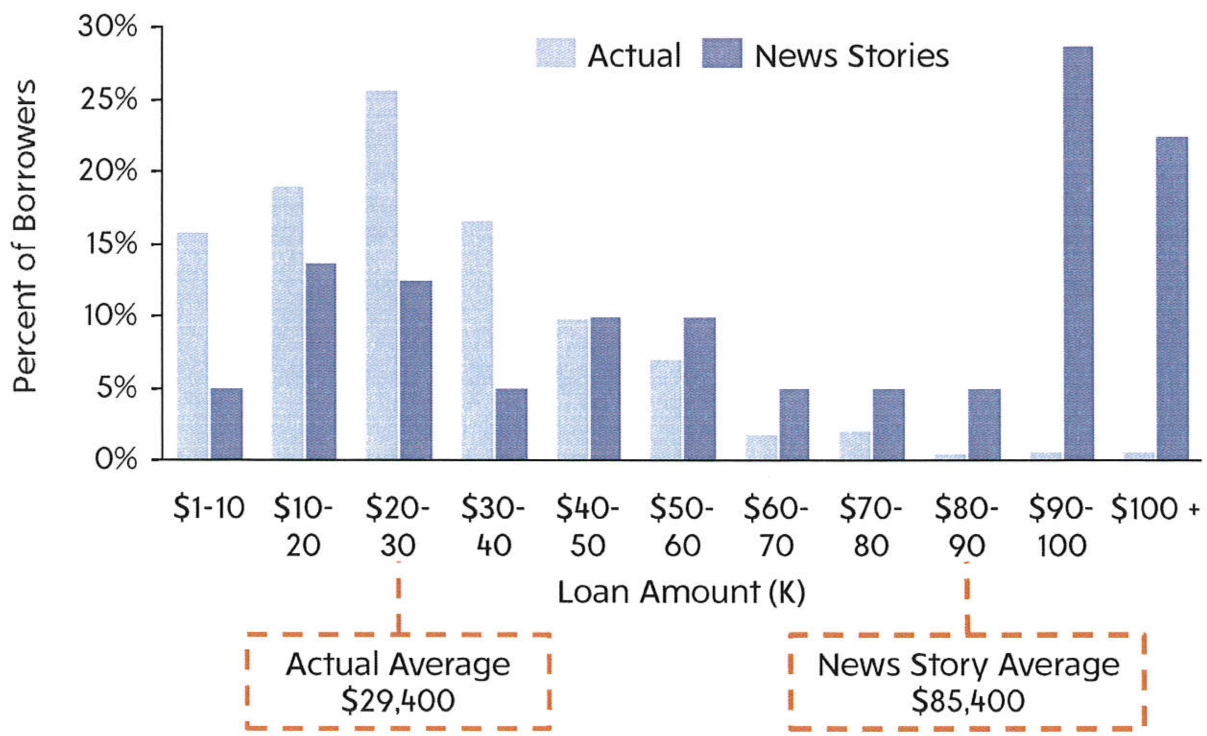
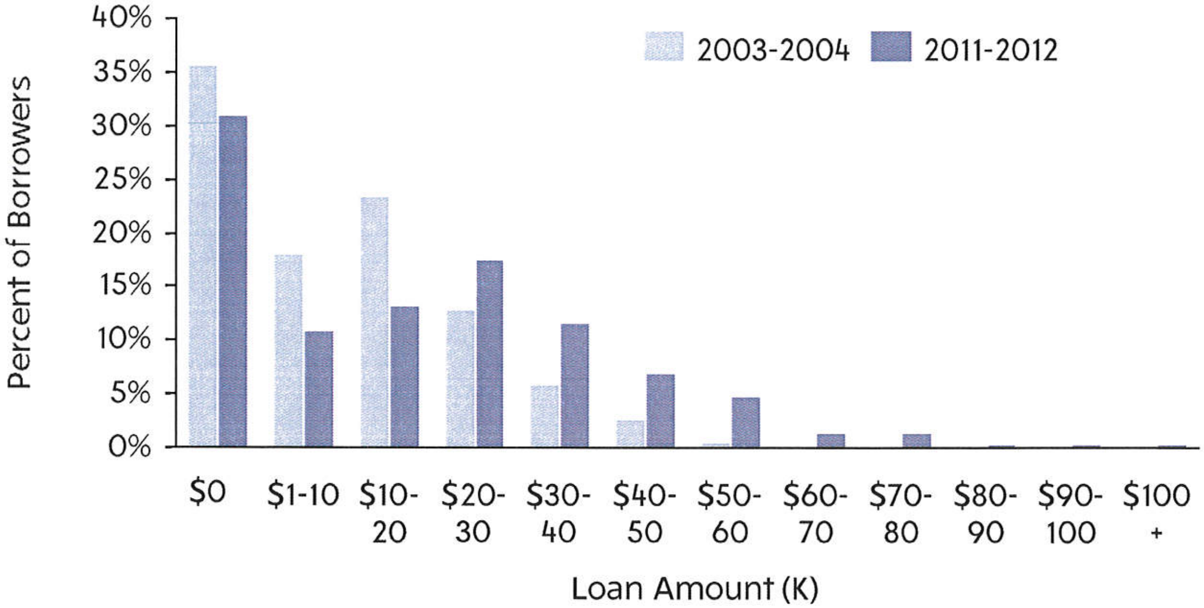


Fig. 2: Nominal Change In Distribution Of Student Debt



across the entire population. One is that these are special cases, and that is the definition of being news-worthy. That is true, but then these articles are human interest stories, and should not be serving to illustrate the larger discussion around student debt.

The other possibility that could justify systemic reporting of very high debt levels is more interesting. It is possible that the real problem with college debt is not actually the average debt incurred, but is actually the rare cases where students take out much larger amounts of debt, and while still rare, such a trend is increasing.

There is some evidence of more people incurring higher levels of debt. More people are taking out loans for college, and the amount borrowed has been increasing (Figure 2). But while this is a mild trend, the number of people with debt at elevated levels is still very small compared to the overall population of people borrowing for education, even in nominal terms. If we look at the real change in average debt held by individuals graduating with debt, it increased from about $22,700 to about $29,400 over the period 2003 to 2012.

The greatest concern with this skewed coverage is the potential to impact aspiring students who may make decisions based on news coverage. There are two scenarios here. The first is that potential students get the incorrect impression that a degree is not worth it and they take a pass on higher education all together. This would be a mistake individually and would come at an economic and social cost collectively. The second scenario is that students are more judicious about their college selection and think through their plans of how to pay for school and what they want to accomplish while pursuing their degree.

The greatest concern with this skewed coverage is the potential to impact aspiring students who may make decisions based on news coverage.

We should hope it's the latter outcome, but just in case, a little more perspective in the coverage of the student debt issue would probably be a good idea. []