William C Dudley: Higher education - financing, costs and returns

Opening remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Conference on "Higher Education Financing and Costs and Returns of Higher Education", Federal Reserve Bank of New York, New York City, 7 December 2017.

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Good morning. It is my pleasure to welcome you to the New York Fed for today's conference on the costs and returns of higher education and higher education financing. I am delighted to see such broad interest and attention from the academic community on this topic. The role of education and education financing in today's labor market and economy has never been more important. It is a topic that I have spoken about frequently during my tenure here at the New York Fed, especially with regard to education's importance for economic mobility. Understanding educational investment decisions and their macroeconomic implications requires rigorous analysis from top academic researchers like you. Let me briefly discuss some developments that I find particularly significant and worthy of investigation. As always, what I say represents my own views and not necessarily those of the Federal Open Market Committee or the Federal Reserve System.[1]

As has been well documented by Raj Chetty and his co-authors, income inequality has increased in recent decades, while economic mobility has stagnated. Meanwhile, absolute mobility appears to have fallen, indicated by the declining share of children who earn more than their parents. The combination of high inequality and low mobility is problematic, because it means that being born into a low-income family is more consequential today than in the past. Since education is a key determinant of upward mobility, one way to increase economic mobility in the United States would be to increase overall post-secondary educational attainment. There are, however, a number of important barriers to achieving that goal.

First, many high school students and their parents appear to lack accurate information about the returns obtained from a college education. New York Fed research shows evidence of systematic underestimation of the average benefits—and overestimation of costs—of a college education, with larger biases among lower-income and non-college households. Research by Caroline Hoxby and Sarah Turner shows that among low-income high school students, even very high achievers are poorly informed about the academic options that are available and their effects on career opportunities. This research finds that the provision of relevant information can lead to markedly better outcomes.

A second impediment is the lack of preparedness among new college entrants, with large numbers of those students needing remedial courses that earn no college credit. Low readiness contributes to persistently low college completion rates, especially among lower-income, part-time, and nontraditional students. Higher dropout rates, in turn, contribute to a substantial reduction in the net expected and realized returns from college attendance.

The third major barrier to college attendance and completion is the rise in the cost of a college education. While a college education is generally a good investment, the cost of attending a four-year college has risen considerably faster than wages over the last several decades. This means that college has become increasingly unaffordable—which can act as a drag on economic mobility and the growth of a college-educated workforce, and by extension, on productivity growth and living standards.

As has been well documented by my New York Fed colleagues, many young Americans have adjusted to rising tuition and fees by taking on more debt. This trend highlights the importance of the federal student loan program, which has helped mitigate the impact of the shift in financing of higher education from state and local funding to students and their families over the past few decades. However, the end result is that more students leave college with significantly higher amounts of debt. Student loan debt has more than tripled over the past two decades and now totals over $1.4 trillion.

It is important to consider what these changes in financing higher education mean for economic mobility. First, New York Fed researchers have documented that a large percentage of student borrowers—especially those who attend less selective colleges or drop out—have trouble staying current on their loans, and often become delinquent and default on their debt. We also know that these factors—slow repayment, delinquency, and default—are most prevalent among those from more modest family circumstances. In addition, there is evidence that student debt acts as a drag on homeownership. Specifically, our research indicates that when college tuition rises in a state, it leads to higher levels of student debt and a lower homeownership rate. These factors matter for inequality and social mobility, because increasing home equity is the major form of wealth accumulation for the great majority of American families. Thus, rising tuition and changes in the way that college is financed appear to have diminished the ability of higher education to lift people from poverty into the middle class.

Of course, students' reliance on debt and the returns from graduating vary across educational institutions. Of particular interest here is recent work by Raj Chetty and his co-authors showing that some colleges—some of which can be found in the CUNY and California state systems—appear to be much better at fostering economic mobility than others. In other words, they accept relatively large numbers of lower-income students while also producing large numbers of high earners, which means that these institutions facilitate considerable upward mobility. Learning exactly how they do it and how it can be replicated strikes me as a first-order question for further study. Recent research by Caroline Hoxby to assess differences in productivity across educational institutions makes important progress in that direction.

In summary, academic research on the financing, costs, and returns of higher education is more important now than it has ever been. We are pleased to have many of those researchers participating in this conference. I would like to thank Raji Chakrabarti and Wilbert van der Klaauw and the New York Fed's Research Group for organizing this timely conference, and for bringing together this superb group of scholars. Thank you all for your participation. I wish you a very productive and enjoyable conference.

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[1] Betsy Bourassa, Rajashri Chakrabarti, Andrew Haughwout, and Wilbert van der Klaauw assisted in preparing these remarks.