Student Loan Consequences: Real, Costly, and Personal

The consequences of making low-interest loans to unqualified buyers created the real-estate bubble that popped in 2007, resulting in the Great Recession. According to Gary Jason at the *American Thinker*, it's about to happen again, only this time over student loans. He wrote: "This bubble has been fueled by the federal government's lavish subsidization of the student loan program … in a way similar to how the housing bubble was fueled by government agencies pushing subprime mortgages."

Under the Student Aid and Fiscal Responsibility Act (SAFRA) signed into law as part of ObamaCare in March of 2010, students may borrow money directly from the federal government regardless of their credit score or any other financial "issues" they may be facing. They are not priced according to any "individualized measure of risk" nor are there loan limits. They are instead politically determined by Congress with undergraduates receiving lower interest rates than graduate students, but graduate students allowed to borrow more than undergrads.

This forced entry by the government into what was once a private market transaction has numerous consequences, nearly all of them negative, and most of them predictable.

First, private lenders disappeared from the market as they could not compete with taxpayer funds and taxpayer guarantees and the resulting below-market interest rates that became available.

Second, the growth in the education industry expanded far beyond what was normal as college administrations saw their opportunity to dip into the "honey bucket" of federal funds, with the consequent growth in administration overhead and higher tuition fees. According to a study by Bain & Company (yes, Mitt Romney's Bain), "operating expenses are getting higher [at major colleges and universities such as Cornell, Harvard, and Princeton] and they're running out of cash to cover it." According to that study, the growth in those colleges' debt and rate of spending on new buildings and equipment rose far faster than did their spending on actual education itself. Said Bain, "Boards of trustees and presidents need to put their collective foot down on the growth of support and maintenance costs. In no other industry would overhead costs be allowed to grow at this rate — executives would lose their jobs."

Thirdly, this growth in the cost of obtaining what was once a coveted possession, a college degree, makes any mathematical justification or cost-benefit analysis highly questionable. Many students are entering a job market with degrees that over-qualify them for what the market is able to provide. According to Jason, "over half of all recent college grads are unemployed (or employed only at jobs not requiring a college education)."

The unnatural increase in the flow of funds into the education industry has predictably driven prices higher. As Jason Bower pointed out at *The Freeman*,

> Since 2000, tuition at public, four-year colleges has risen by an inflation-adjusted *72 percent*, and

> over the past 25 years it has increased at an annual rate *6 percentage points higher than the cost of living.* [Emphases added.]

Fourth, when the deferred payments on these loans start, the newly-minted grads without work cannot make them and they go into default. In a recent Department of Education study, loan default rates have risen in each of the last five years, and at an increasing rate, touching almost one in every seven students with a loan.

Fifth, those loans cannot be dissolved or forgiven in bankruptcy except in extreme circumstances, leaving students in a figurative "debtors' prison" interminably. As *The New American* noted,

> Inasmuch as the student borrowers are uniquely required by law to repay under [nearly] any circumstances, the student loan business is the closest thing … to debtor prison in modern society.

With such a debt burden, students are forced to make, or avoid making, life choices, such as getting married or buying a home. Who would want to take on a partner who owes tens of thousands to the federal government on the day of the wedding?

And then there is the issue of bribery and insider-dealing. Lenders found ways to entice school officials to direct students needing money to them in exchange for incentives. In addition, administration officials found it profitable to support candidates willing to enhance the loan programs for the benefit of the schools. Peter Wood, executive director of the National Association of Scholars, put the matter succinctly:

> The "free market" in this case was never anything close to lean and efficient. To the contrary, it was (and still is) inefficient and frequently corrupt, dominated by players who found it easy to bribe college officials, wring favors from politicians by means of campaign contributions, bilk the Department of Education, and live off generous subsidies.

All of these consequences come from first causes: the belief that the government has the right to impose its ideological position onto students and then force taxpayers to pay for those consequences when they inevitably arrive. As Kevin Villani, former chief economist at Freddie Mac, wrote in the *American Banker*, the progression from ideology to practice is fraught with danger. First, he says, the government must

> declare that the opportunity to … go to college, is a basic right. Then [set] a goal for … college attendance well above private individual demand. When budgets become tight, have government lenders replace private lenders.

This cements into place the "moral hazard" that provides government loans to students without concern about how they might be paid back, because ultimately all government promises are backed by the taxpayer.

The ultimate consequence is borne by the student himself. Once he realizes his predicament — like a lobster trap — it's too late.

For 36-year-old Nick Keith, it's too late.

When he decided to go to culinary school, Keith was persuaded that he could indulge his interest in food by learning the food service industry. The school provided him with all the answers to his questions (for which the school later was successfully sued for making false statements but far too late to help Keith), and pointed him to the sources to lend him the money.

Said Keith, "I should have seen all the signs. [The campus tour guide] had a used car salesman's answer for everything," including the lie that 99 percent of all graduates found work after graduation. It turned out later — much later — that the real number was closer to 48 percent, and that counted graduates who had to find work outside of food service. Keith's first job upon graduation was working on a meal assembly line, making $10 an hour.

But that's when his student loan payment program kicked in. He had to make a choice: Pay the rent, or his student loan, but not both.

It's now nearly a decade since his graduation. His debt, with interest compounded upon interest, is $142,000 at a 17-percent interest rate. He can't get out:

> I get my groceries at the local food bank. I have sold or lost 99 percent of everything I ever owned.

He can't get work because his bad credit turns off prospective employers. He lives in an aged minivan, relies on the Salvation Army for meals, and parks his van at highway truck stops. For all intents and purposes, he is homeless.

Solutions abound, at least in theory. The government should get out of the student loan business altogether and let the private market take over. And Congress should allow students to declare bankruptcy over their loans when necessary. Even there, however, the consequences are towering. There is more than $1 trillion in student loan debt. Almost 15 percent of loans are already in default. The Department of Education would have to receive special funding from Congress — the taxpayer — to be able to write off the bad loans that would result.

The costs of college education would rise to more normal, market-driven levels, keeping some qualified students away. Colleges and universities would have to make massive, perhaps draconian, cuts in their overhead. It would take years for some semblance of balance between supply and demand to return to the education industry. And changing the laws would have precious little immediate impact on people such as Keith.

Restoring freedom through private markets, however, is worth the effort despite the pain. The alternative — a continuing debtors' prison for students and a continuing of the corrupt educational cartel and its incestuous relationship with politicians — is unthinkable.

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