



Written by [William P. Hoar](#) on February 15, 2010

Scheme to Nationalize Student-loan Industry

Item: Following the State of the Union address, Bloomberg News reported on January 28 that President Obama “urged the U.S. Senate to join the House in overhauling the federal student-loan system, saying such a move would end ‘unwarranted taxpayer subsidies’ to banks.... Obama said the cost of the higher-education initiatives would be offset by money saved from his plan to provide all new federal loans directly to students, instead of through private lenders.”



Item: *Currently, said the Washington Post for January 29, students “can choose between direct lending and a federal program that guarantees student loans made by private banks.... By cutting banks out of the equation, the administration expects to reap \$80 billion over the next decade for increased student aid, community colleges, early childhood education and other programs.”*

Correction: The federal government is not in the *giving* business. What Washington does do is to *take* wealth from real producers and *redistribute* it for political gain. It does, however, produce higher prices, economic distortions, and other inefficiencies. And headaches.

Is it expensive to go to college these days? Of course it is. And billions of dollars’ worth of aid from the government have helped drive up those costs. When someone else is picking up the tab, or much of it, demand goes up. With the extra money bidding up prices, colleges find it in their interests to raise tuition or reduce their own scholarship packages or both.

Yet, having caused many of the problems, Washington is responding not by stepping back, but by diving in even deeper. In the case of student loans, the federal government wants to go from subsidizing that business to nationalizing it.

Many students *are* experiencing difficulty in paying off their student loans. The President’s solution: Divvy up those bills, in many instances, to those who chose not to go to college or found other ways to pay for their schooling. Presumably if those taxpayers go broke, there’s always welfare.

Even liberals used to recognize that having the “government” underwrite college expenses was akin to a “policy of robbing the poor to pay the soon-to-be rich.” Under the latest scheme in Washington, a hairdresser or blue-collar worker, for example, would be forced to pay even more for the university student to get his degree. They would also foot the bill for more of that student’s debt — and do so even sooner if the graduate goes into “public service.”



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It should be noted as well that an awful lot of those “public servants” make more than their supposed masters who pay their salaries. Civilian federal employees in 2008 received an average annual salary of \$79,197, according to data from the Commerce Department’s Bureau of Economic Analysis, which amounts to more than \$29,000 a year above that made by the average private employee. At the state and local government level, employees get paid a full third more than the average worker in the private sector, with the difference being even greater when pensions and benefits are taken into consideration.

As has been asked by Uwe Reinhardt, an economics professor at Princeton: “Where is the justice in taxing a young auto mechanic to provide a heavily subsidized education for a friend who will earn three times as much money when he gets out?”

There is no doubt that the current federally subsidized student-loan business has more than its share of problems, with a federal audit last year revealing that abuse and waste in the various programs are costing taxpayers \$1 billion a year. Yet another audit in 2001 uncovered \$22 billion of student loans in default. Yet, if the Obama administration gets its way, the taxpayers would be on the hook for 100 percent of federal student-loan defaults. Moreover, should the government take over the federal student-loan business outright, what’s left of non-government college loans will be likely crowded out of the marketplace.

Then there is the matter of the supposed “savings” of \$80 billion or so (as quoted previously), which has been projected if the government nationalizes the student-loan business. That is overstated considerably. (Never mind that virtually all the “savings” would just be handed over to other programs and then spent.) It turns out that the Congressional Budget Office did not include in its estimates about \$40 billion in estimated losses that the government would incur from loan defaults. In July 2009, as pointed out in a Heritage Foundation “Web Memo”:

CBO Director Douglas W. Elmendorf acknowledged that the original CBO projection did not adjust for the cost of market risk of increasing defaults that the federal government will assume with the shift to direct lending. In addition, there is a danger that taxpayers’ costs could balloon if the federal government proves less efficient in administering and collecting loans than current private-sector lenders, which have an incentive to administer and collect loans efficiently in order to maximize profits.

Problems are not solved because more money is hurled in their direction. And there are a lot of greenbacks involved. The student-loan industry that the President would have Washington consume is estimated at \$103 billion for 2009-2010. About 14.3 million of 17.5 million student loans are federally subsidized.

While there are experts and interested parties who differ on the details of how much of college cost increases can be attributed specifically to federal aid, virtually all honest analysts agree that the government’s hand has had a significant role in tipping the scale. As Education Secretary William Bennett wrote in the *New York Times* in 1987: “If anything, increases in financial aid in recent years have enabled colleges and universities to blithely raise their tuitions, confident that federal loan subsidies would help cushion the increase.” At that time, keep in mind, the feds were not interfering nearly as much in the marketplace.

Similarly, a decade or so later, a committee at the University of Pennsylvania pointed out that “financial aid is directly tied to tuition; if not for the higher level of financial aid expenditures, we would not have been able to increase tuition rates over the past ten years at the levels we did.”



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An astute analysis by Hillsdale College Professor Gary Wolfram written in 2005 still has validity today. For example, he examined decades of data in numerous studies and found an extremely high correlation rate between tuition increases and boosts in federal financial aid. The professor noted that the empirical literature had been consistent in showing the student aid had boosted the demand for higher education — which should hardly be surprising. In his analysis (“Making College More Expensive: The Unintended Consequences of Federal Tuition Aid,” Cato Institute), the professor cited a variety of studies on the topic. For instance, Judith Li of Harvard

found, using data on individual students and institutions, that private four-year colleges increased listed tuition prices by more than two dollars for each dollar increase in Pell Grants, and public four-year colleges increased their listed tuition by 97 cents for every dollar increase. She found that public four-year institutions were able to increase net tuition by 68 cents for every dollar of Pell Grant increase, while private four-year institutions raised their net tuition by 60 cents. That means that both public and private colleges and universities actually raised tuition by more than the amount of the Pell Grant.

Dr. Vedder, director of the Center on College Affordability and Productivity and author of *Going Broke by Degree: Why College Costs Too Much* (AEI Press, 2004), further observed: “When the feds created tuition tax credits in the late 1990s, I called it the ‘faculty salary enhancement act,’ since colleges could capture much of the tax break by raising tuition fees and then used some of the money to reward their staff. Money moved as much from taxpayers to university staff members as to the pockets of student consumers.”

Those college students with subsidized loans may think they are getting a break on their college debt — and there is an immediate benefit to the recipients — but because of such favors and many others to privileged groups, they will inherit a mountain of overall debt. Washington’s spending is out of control because of such schemes for various constituent groups. Yet, there still ain’t no such thing as a free lunch. Nor is deficit spending free. Figures from the Congressional Budget Office show, according to the *Wall Street Journal*, “over the first three years of the Obama Presidency, 2009-2011, the federal government will borrow an estimated \$3.7 trillion. That is more than the entire accumulated national debt for the first 225 years of U.S. history. By 2019, the interest payments on this debt will be larger than the budget for education, roads and all other non-defense discretionary spending.”

Nationalizing another industry is hardly the appropriate response at any time, but especially when the economy is vulnerable and the taxpayers already overburdened.

If such federal aid were to be phased out instead of being puffed up, the ivory towers of academe really would not tumble to the ground. Financial institutions would still have an incentive to deal with would-be borrowers, whose future higher incomes would benefit both them and the lenders. Without the artificial boost provided by the federal monies, tuitions would tend to drop to meet the actual demand of the students and their parents.

In short, college would be more affordable and at least one segment of the economy might remain in the private sector rather than serving as a plaything for politicians.

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