Student Loans, Rising College Tuition and the Social and Economic Effects in the United States

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The Asian Conference on Education & International Development 2015
Official Conference Proceedings

Abstract
Government involvement in student loans allowed many young Americans to go into debt and live beyond their means. Implied promises of high paying jobs in the future that would theoretically create an earning potential that could make student loan indebtedness seem like a rational investment. The U.S. Government's goal of "college for all" even for those who were better off without a college degree was certain to have dire consequences. (Dwyer, Hodson 2012) In the process of creating additional demand for higher education, the American government overlooked the most important thing that gave higher education value; scarcity. A person with a college degree in the past made more money than a person without it because a college degree was scarce therefore the demand for it was high. Prospective employers were willing to pay more for college educated employees. Today it can be argued that a 4 year college degree is worth less than a high school diploma was in the 1950's. Another unintended result of government subsidized loans is that young adults who are not sure what to study will often choose the easiest major or something they think they will academically excel at ignoring its utility in the job market. Government supported student loans are acting as a barrier and are preventing young Americans from comfortably entering the work force free of debt. Increasingly, only after graduating and incurring large student loan debt do recent college graduates realize what they have studied has little or no practicality in the current job market.

Keywords: Student Loans, Student Debt, Social Consequences, Economic Consequences

Introduction

In the past colleges in the United States were affordable. Academically qualified students could pay their tuition while working part time and attend college full time and graduate free of debt. College graduates did not carry the burden of large debt before securing a job and could take time and choose career fields wisely. In 1965, the U.S. government decided it wanted to become more involved in higher education. "In 1965 the U.S. Congress enacted the Guaranteed Student Loan Program, (GSLP) later called Stafford loans." (Beaver, 2008) The goal of the GSLP was to eliminate the role of due-diligence conducted by private lending institutions and offer students loans to prospective students regardless of their financial or future ability to pay. If anything went wrong and the borrower could not pay the lender, the government would assume the debt.

The government's rationale for becoming directly involved in student loans was its belief that if college was a good thing and people could make more money and pay more taxes there should be more of it and it would be a win-win situation for all parties involved. The college educated population would be more skilled, earn more money and have a better life. More importantly, the American working class would be able to pay more taxes and serve the government better by enriching their life-styles. The problem of student debt further escalated when American universities that wanted to raise their tuition fees started lobbying the government.

Whenever an outside force, such as government, encourages or demands that financial institutions make loans for reasons that may have nothing to do with the actual likelihood of repayment, higher degrees of financial loss are almost always inevitable. Over the past few decades because of many government instigated changes, student debt exceeded credit card debt and surpassed $1 trillion in 2012 (Ionescu, 2009) with the average student debt being over $29,400 in 2012 according to The Project on Student Debt Website (2014). To put that into perspective, student debt in 2001 was $25 billion just 1/40th the size it was in 2012. (Ionescu, 2009) Carrying the enormous burden of high debt causes many social and economic problems because a heavily indebted person can't survive on his/her own without a high income.

His or her choices become limited and dependency on government benefits or parents often becomes a necessity. Life changing decisions are postponed or delayed indefinitely further complicating society as a whole. Indebted unemployed young people often don't get married, have children, buy a home or car and of course don't pay taxes. An ever growing group of Americans not paying taxes also should be cause for worry for America's foreign lenders. Foreign purchasers of U.S. debt expect to be paid in full one day in the very distant future. Foreign purchases of U.S. debt need to weigh the consequences of further investment and loans to the United States considering as time goes by, there will be a smaller pool of people paying taxes just as liabilities such as Medicare and social security requests increase government costs. This paper explores government involvement in student loans, its effects and suggests solutions to it before it becomes another full-blown crisis that will require another very costly taxpayer bailout.

1. Effect of Guaranteeing Student Loans

The cost of college tuition has risen every year in spite of the financial crisis. One might wonder how this could be possible with the U.S. economy in such bad financial condition and unemployment high. Universities play a role in the student loan crisis by lobbying the government. Of the top 10 campaign contributors to the 2008 Obama Presidential Election, three were private universities. In fact, the top campaign contributor to the Obama election campaign was University of California contributing more than $1.8 million according to the statistics from Open Secrets Website (2014). It is widely known that campaign contributions are not in effect donations; they come with strings attached. Consider the following: investment banks Goldman Sachs, Citigroup and JP Morgan were also in the list of top 10 campaign contributors and they all received multibillion dollar bailout money from the government during the financial crisis. Even in times of financial crisis, financial contributions to political campaigns by private sector participants can help ensure an organization's financial survival and guide it to prosperity with the use of tax payer money.

While campaign contributions certainly contributed to the loan crisis, the U.S. government's direct involvement in federal and private student loans is a much more serious problem. The government decided to pay subsidies to insure lenders have funds to cover borrowers who default on their loans. Up until March 26th 2010 the Federal Family Education Loan Program (FFELP) allowed private lenders to make federally guaranteed student loans to both parents and students. According to the statistics from US Census Bureau (2013), forty percent of Americans over age 25 had associate or bachelor's degrees in 2011. The government involvement in higher education via guaranteed student loans has severely distorted supply and demand ratios. The supply of college educated Americans greatly exceeds the demand. The increased amount of Americans attending college distorts the price of a college education by artificially increasing its demand while at the same time, a larger pool of college graduates will be competing for the same jobs pushing down the price prospective employees will be willing to pay its future college educated employees. The cost of higher education is outpacing the financial gains of having a college degree. "Between 1993 and 2005 the college wage premium rose by 27% while real tuition and fees at public and private four-year colleges rose by 63% and 43% respectively." (Rothstein, 2011)

The government's underwriting of student loans has eliminated the need for private lending institutions to conduct due diligence on their borrowers before approving college loans. If a student defaults on his or her student loan payments the government will reimburse the lender and then sell the loan to a collection agency sometimes for pennies on the dollar. The result was a huge lending moral hazard. For a short time, everybody was happy and the system appeared to work well. Students with inadequate funds for college tuition could simply borrow the money from the government or private lending institutions. Student loans that were easily attainable made colleges happy because they could raise tuition every year. Easy borrowing made the private lending institutions happy because their loans were guaranteed by the government and the more money they lent the higher the profits for them. Students were willing to take on large student loan debts because during the time of the economic boom cycles of the Nasdaq equity bubble followed by the real estate bubble, jobs were plentiful and graduating students could quickly find jobs and make payments on their student loans. The amount of students borrowing money climbed to new highs and because of all of this borrowed money the cost of college tuition fees far outpaced the rises in home prices and all other costs included in the consumer price index.

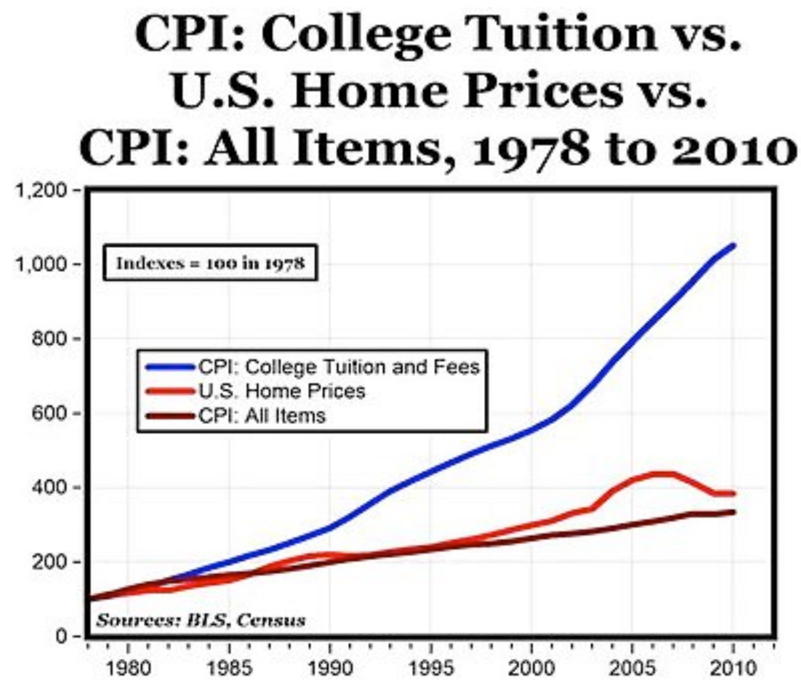


Figure 1. CPI: College tuition vs. U.S home price vs. CPI: All items

For a time it seemed as if rising student debt was not a problem at all as long as high paying jobs were plentiful. By 2008 things had changed the real estate bubble burst and unemployment surged.

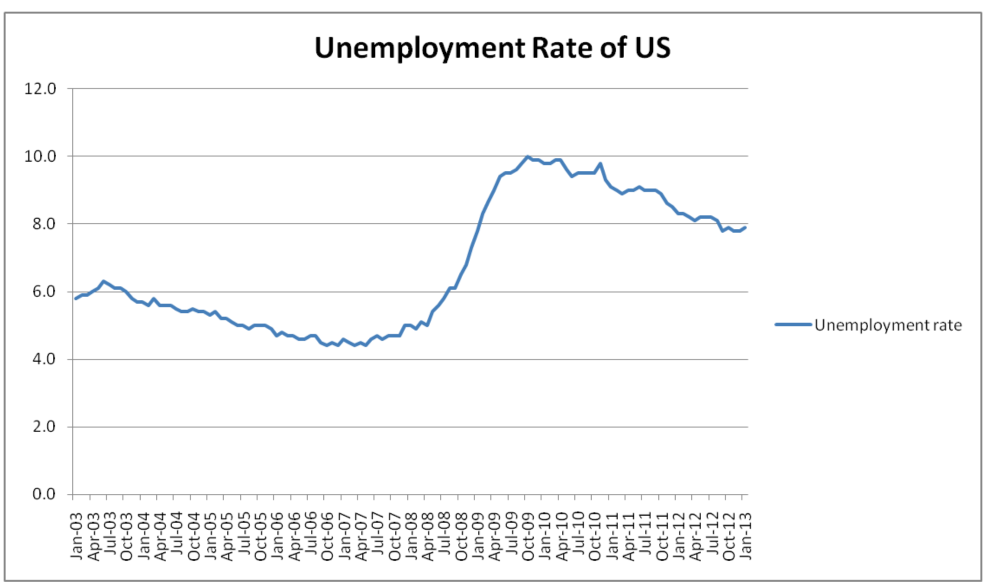


Figure 2. Unemployment rate of US

Source: U.S. Census Bureau

2. Effects of Reduced Lending Standards

Lending institutions were encouraged to grant any type of student loan as the process of lending was guaranteed to be profitable. Revenue maximization and profits for lending institutions are guaranteed "as they charge transaction fees and interest on loans that are underwritten by the federal government and so risk-free to the lender. (Shen & Ziderman,2009) If a student was unsure of what to study, he or she could pursue a degree in Liberal Arts. Liberal Arts degrees don't pay as much as degrees requiring a high degree of technical skill. Examples of some Liberal Arts Degrees that currently have little usefulness in the current economy are: Leisure Studies, Art, Philosophy, Religion Women's Studies, Camping, Art Therapy, Poetry, etc. Many students with Liberal Arts degrees find themselves working in the low paying service sector jobs such as: coffee shops, restaurants and retail sales. With official United States U6 unemployment at 15.9% in May 2012, average U.S. wages have been falling drastically since the start of the recession.

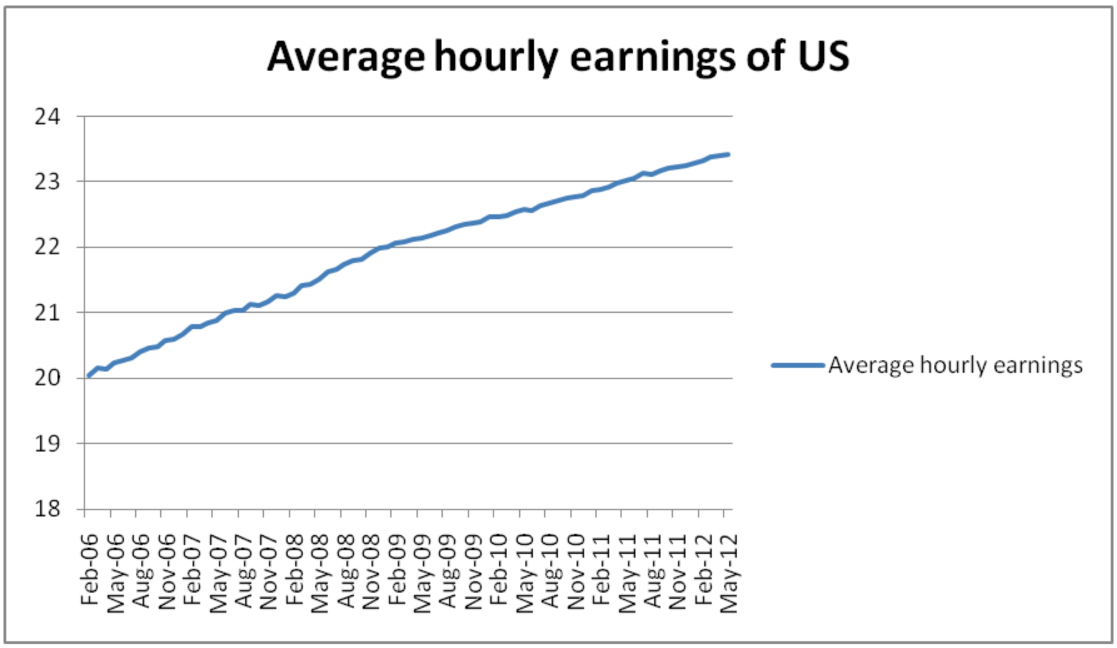


Figure 3. Average hourly earnings of US

Source: U.S. Census Bureau

With average earnings dropping so much, it soon became unaffordable for recent college graduates to support themselves. This resulted in an increasing number of people in their 20's either never leaving home or moving back in to live with their parents. When children move back in with their parents, many life changing decisions are postponed. Many major purchases such as: buying a house or car can become delayed. Life changing decisions like getting married and having children are also delayed to some unspecified future date. The charts below show that the United States median age for first marriages have been steadily rising while home ownership for 25-34 year olds has been has been declining steeply in recent years.

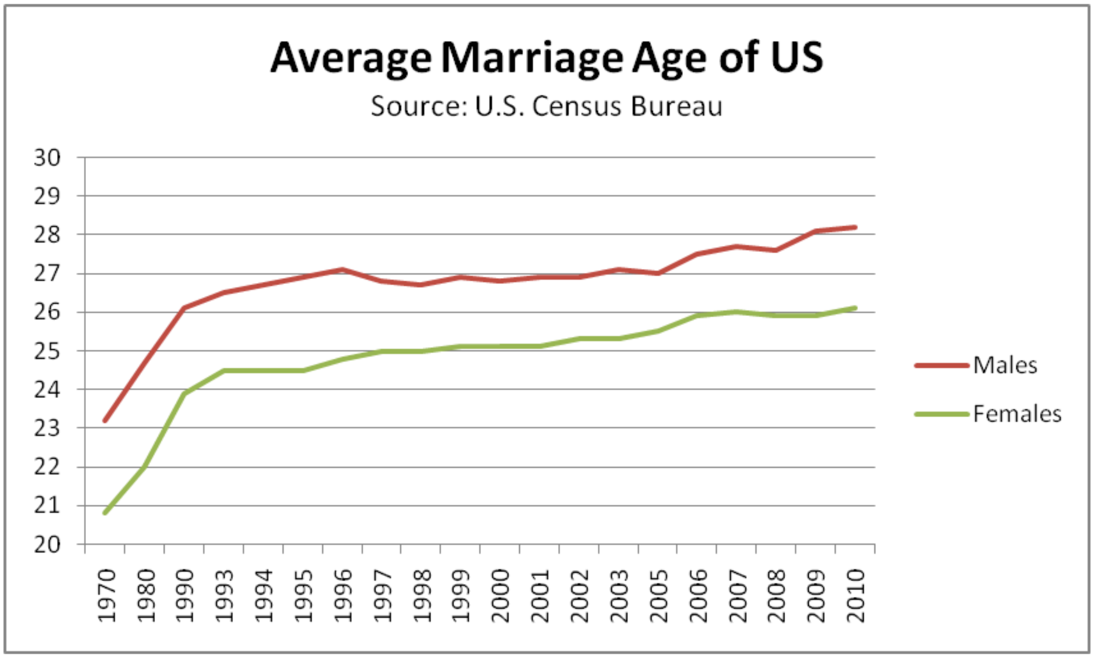


Figure 4. Average marriage age of US

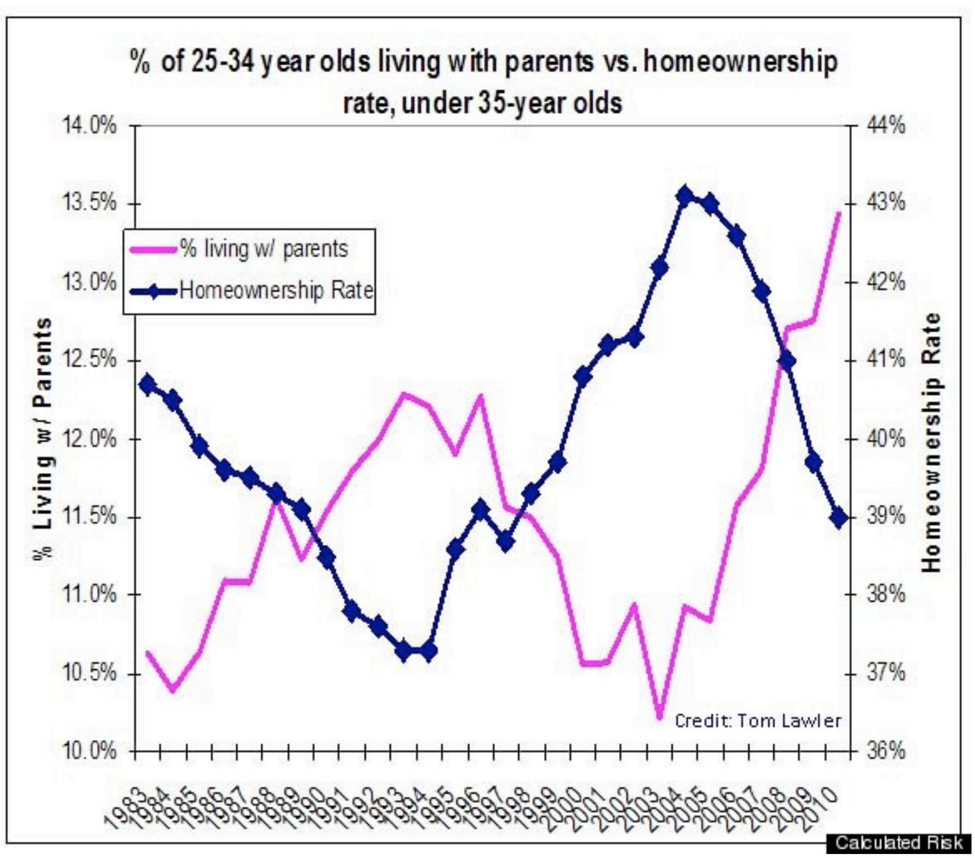


Figure 5. % of 25-34 years old living with parents vs. homeownership rate under 35-year olds

Recently, more loans have been cosigned by parents. When parents take out loans for children or co-sign loans they will find it more difficult to pay when they retire and their incomes decline. Living on social security is difficult enough for most senior citizens. Student loan payments will make life much more difficult and put parents at risk of losing homes, cars and other assets.

2.1 The Explosion of Student debt and Disgruntled Citizen Response

In the 1970's large amounts of students were able to graduate from college with no student debt at all. In 2010, two-thirds of college seniors graduated with loans and they carried an average of $25,250 in debt more than half the average GDP per capita. In comparison, in 2009 in Thailand "the average tuition fee per undergraduate degree is 180,000 Baht ($6,000) and public universities are 72,000 Baht ($2,200) per degree" amounting to just 20% and 25% GDP per capita in 2009 (Chapmana, Polsiri, Sarachitti, Sitthipongpanich 2010). American college graduates faced the highest unemployment rate for young college graduates in recent history at 9.1%. The vast majority of students struggling with student debt have very few ways of escaping it. Unlike a business loan, student loans are not applicable to bankruptcy protection. An additional consequence arises when an prospective applicant applies for a job at a company and the employer performs a credit check on the applicant. The applicant is often discriminated against and considered untrustworthy if it is found out that a prospective employee is delinquent on his or her student loan payments. This contributes to recent college graduates who are behind in payments to either work in dead-end low paying jobs or simply not work at all and receive government benefits such as welfare, food stamps and housing assistance. Others simply seek employment overseas where they won't be discriminated against.

Students have recently spoken out against government sponsored Sallie Mae, a private loan company that specializes in student loans, to try to end the $50 monthly fee that students have to pay when they ask for forbearance. "Patricia Christel, a Sallie Mae spokesperson, said the company changed its policy on Feb. 3, so that the $50 monthly fee goes toward the student's loans." "When customers experiencing temporary financial difficulty ask to suspend scheduled payments, we ask for a good-faith payment to emphasize the terms and long-term implications of their decision to use forbearance," Christel said. "We have been giving careful consideration to our policy for some time, and we are changing it to apply the good-faith payment to the customers' balance after they resume a track record of on-time payments."(The Project on Student Debt, 2014)

The wording from Sallie Mae was carefully scripted. Sallie Mae didn't say how long a track record of on-time payments was. Also that the $50 monthly forbearance fee would be applied to the student debt after the "track record" had been set not at the actual time of the forbearance payment giving apt time for the entire loan to accrue interest.

2.2 Entitlement Mentality

Americans will eventually become accustomed to defaulting on student debt and finally start defaulting the way students did in Ghana. The student loan scheme in Ghana had even worse consequences then the U.S. Scheme. "During 11 years of its operation, the scheme faced technical and administrative difficulties and became indebted to the Ghana Commercial Bank a total of c185,000 ($375,560) owed by students. Of this, less than c185,000 ($2,074) was paid." (Atuahene, 2008) more young Americans graduate from college with increasingly large amounts of debt and limited job opportunities; they will increasingly look to the government for financial and living assistance.Americans will not distinguish from money earned and money from the government and eventually completely quit looking for work. A positive effect could be that children can have two stay at home parents to look after them.

2.3 Consequences for Other Nations

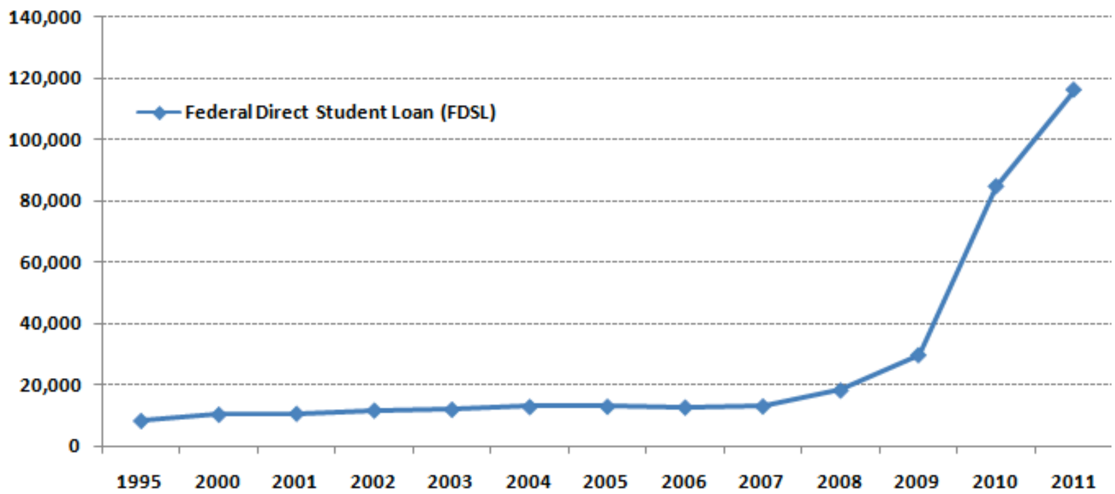
Foreign countries have invested trillions of dollars in U.S. debt under the incorrect assumption that it was a safe investment. The ability for the United States to pay its debt to foreign countries that rely on the capability of U.S. citizens to contribute large amounts of money to the domestic economy and subsequently pay large amounts of taxes to the government will be greatly diminished when fresh new groups of college graduates are not seeking employment. Young college graduates will quickly learn that it is much easier and more convenient for more and more college graduates to simply receive benefits from the government. The only choice the U.S. government will have is to continue to expand the U.S. money supply at faster and faster rates and devalue the purchasing power of the dollar.

3. Solutions

3.1 Limit Government Involvement in Student Loans

The U.S. government will not readily admit that the lending moral hazard it created is in fact a major contributor to the still worsening student loan crisis. The first step to solving, or at the very least, reducing the problems caused by guaranteeing student loans is limiting government involvement in the process. A free market solution is needed. It is likely that if left to the free market, college tuition will come down. With the help of government, universities and lending institutions have been luring young inexperienced Americans into the student loan trap by offering soft loans that are ultimately borne by taxpayers. "Lending conditions in virtually all government-sponsored loans schemes are softer on those on regular commercial loans and subsidies include: below-market interest rates on the loan, periods in which no interest is levied on outstanding debt, and repayments not linked to the rate of inflation(Belfield, 2013).

People that cannot afford to go to college and can't get loans from the free market should not be in college. The government needs to stop subsidizing student loans and stop creating moral hazards by guaranteeing all of them. "In the absence of insurance, private lending institutions are generally reluctant to lend without suitable collateral." (Cigno, 2009) As a result, there will be less demand for college and under normal circumstances tuitions will fall as enrollment declines. Subsequently, the college premium employers pay will rise as the pool of college graduates will shrink. In essence the free market will solve the problem of the education bubble if the government is just willing to get out of the way. Recent actions by the U.S. government indicate that it has no intention whatsoever reducing its involvement in the student loan industry and letting college tuition fees fall. When the financial crisis struck in 2007, private lenders were forced to scale-back their lending for student loans. The government modified its role as loan guarantor and dramatically increased its role in providing direct student loans through its Federal Direct Student Loans (FDSL) program.



Source: U.S. Census Bureau

Colleges have appreciated all of the extra demand for higher education created by the government and have rewarded them accordingly by paying much more tax. However, colleges probably won't like the reality of the fact that without the government created demand, they will have to become more affordable and start to lower tuition rates if they wish to try and maintain their current enrollment. If colleges oppose a decline in enrollment, a variety of spending cutbacks can be made which will enable colleges to reduce tuition rates. Much money can be saved by modestly lowering administrators salaries. "Currently, 31 university presidents receive more than $1-million a year, including one who heads a public institution, E. Gordon Gee, of Ohio State. At Vanderbilt, where Gee previously served, 10 administrators are paid more than $1-million, including one in health affairs who was paid $5-million in his final year." ("The self- exam," 2011) We have been lead to believe that top talent comes at a cost, but that cost need not be $1 million a year or more.

3.2 Allow Students to More Easily Discharge Student Loan Debt through Bankruptcy

There is an increasing sense of hopelessness among graduating college students saddled with an average of more than $29,000 of student loan debt. Student loans are not included in the bankruptcy code. People with unsustainable mortgage payments or credit card debt can have a fresh start by declaring bankruptcy. Unsustainable student loans can't be discharged but the debtors can still declare giving up making their payments. When debt takes over the consequences are dire and include but are not limited to:

- Delays in buying a car or purchasing a home
- Postponement of marriage and childbirth for financial reasons
- Parents feel pressure to take out loans or otherwise help with payments
- Risk for parents who co-sign loans of losing homes, cars and other assets
- Little ability to discharge student loans in bankruptcy

- Inability to get credit cards or home or car loans
- Inability to rent a home because of high debt-to-income ratio
- Being forced to deal with private collection agencies in the event of default
- Having liens placed on bank accounts or property in a default
- Facing collection fees of 25% of amount owed in a default
- No statute of limitations on collection efforts
- Having wages garnished
- Possible loss of state-issued professional licenses
- Reduction of Social Security payments
- Seizure of tax refund

The above consequences increase the attractiveness for indebted students to become life-long welfare recipients. Recipients of welfare do not need credit cards because government issued Electronic Benefit Cards serve most of the essential functions of for profit credit card companies. Welfare recipients need not worry about the costs of raising children. The more children welfare recipients have, the higher the monetary benefits. Private collection agencies are not able to garnish welfare payments or charge collection fees. There will be no seizure of tax refunds as no income is earned. There is also no need to save any money for a down payment to buy house, as welfare recipients can benefit from government supplied low-cost housing.

Conclusion

Direct government involvement in student loans has allowed many Americans to attend college that under normal circumstances would not have. If young adults had not been steered into college and wooed by empty promises of great paying jobs, they would have found more practical employment elsewhere. Many young Americans could have learned a trade at minimal cost and gained employment in a more stable career field such as a baker, an electrician, or a plumber. These core jobs are recession-proof and make up the foundation of any country require much less study time, are more cost efficient, and are always in high demand. Even in a financial crisis, very few people will stop eating bread, consuming electricity in their homes or refrain from using the bathroom. Thanks to government involvement in student loans, too many young Americans were steered away from practical career fields and instead acquired the heavy burden of debt and attended college only to find out later that their expensive degree had little or no use as the interest payments and the principle on their student loans continued to accrue.

The student debt crisis is potentially a much more serious financial crisis than the Internet equity bubble or the real estate bubble. While a personal bankruptcy would ruin consumer credit for 7 years or more during the previous bubbles, the Student Loan Bubble offers no means of escape for its borrowers if high paying jobs that can allow loan repayment to be repaid or at the very least allow the borrower to service his/her debt. The quick fix for the stock market collapse was to dramatically lower interest rates from 5 percent to 1 percent. However instead of re-inflating the stock market bubble, the near interest-free money sparked real estate speculation. There will be no long-term solution to the student loan crisis without major reform in the U.S. higher education system. As long as the government continues its involvement in the student loan crisis, it will only worsen.

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