DIVIDED WE FALL

Mass Student Debt Cancellation: The Rich Get Richer, The Root Problem Gets Worse

Neal McCluskey

September 17, 2021

The intention behind federal student loans is good: college access for all. But if it is good, why are we having a huge national debate – and this small one here – about massive student debt cancelation? It is because good intentions without clear thought are a recipe for pain.

A Profitable Exchange

The idea behind federal student loans is simple. If the price of college is uncomfortably high for some people, the government should help them pay. And because the higher education payoff is generally substantial, loans will be a win-win; students will get an education that significantly increases their earnings, and taxpayers will have their money restored with interest.

In the main, this works for borrowers. The average four-year degree holder makes six to seven figures more during their life than someone who ended their formal education with a high school diploma. Meanwhile, in 2019 the average graduate of a four-year, non-profit college who took on loans left school with only about $29,000 in debt. That's a profitable exchange, and a major reason why blanket cancellation is a bad idea. Student debt is not only often manageable, for many, it is quite profitable.

The Price of Education is Soaring while its Value is Decreasing

Of course, just because many people benefit from federal loan programs does not mean federal loans are a good deal for all borrowers or for society. The most apparent problem is that easy credit has enabled colleges to raise their prices at breakneck speeds. Tuition, fees, room and board at the average private, non-profit, 4-year colleges rose 172 percent *after* adjusting for inflation between the early 1970s and today, hitting $50,770. They grew 147 percent at public, four-year institutions. Colleges have, essentially, captured student aid through higher prices.

That is just one aid-fueled problem. Another is that as aid has enabled greater credential acquisition – but not commensurate learning increases, as captured by declines in literacy among those with postsecondary schooling – it has fueled credential inflation. Employers increasingly demand degrees for jobs that previously did not require them. So people need more schooling just to stay in one place.

The Impact on Graduate School Student Loans

Given this, it is not surprising that debt for graduate education has grown especially fast. Unlike federal loans to undergrads, which are capped at between $5,500 and $12,500 per year depending on a student's dependency status and year in school, graduate PLUS loans are capped at the price of attendance set by the schools.

Between the 1990-91 and 2019-20 school years, undergraduate federal borrowing rose from $15.3 billion to $50.3 billion or 229 percent. At the same time, graduate borrowing rose from $5.4 billion to $37.3 billion or 591 percent. In 2019-20, the average full-time-equivalent undergraduate took on $4,092 in federal loans. The average graduate received $17,466. Like bachelor's degrees, graduate diplomas typically pay off, with the average graduate degree holder making $1.1 million to $1.5 million more over their lifetime than someone with just a high school diploma.

It Pays to Stay in School

Again, that makes mass cancellation impossible to justify. And while people with big debt would get the biggest windfalls, they struggle the least with repayment. It is disproportionately small debtors who feel the pain, folks who were often unprepared for college, or unable to balance schooling with families or jobs, and who did not finish the program that would have led to a debt-handling pay increase. A 2015 analysis found that 34 percent of borrowers who left school in 2009 with $1,000 to $5,000 in debt had defaulted by 2014. Only 18 percent of those with $100,000-plus had done so.

A huge problem is that the feds perform essentially no assessment of prospective borrowers' risk. They basically say "take whatever you need," regardless of a potential borrower's academic track record or proposed field of study.

The Logistics of Mass Forgiveness

Washington compounds all of this by suggesting that a lot of debt will not *really* have to be repaid. Federal income-driven repayment programs promise forgiveness after 20 or 25 years, depending on the plan. Public Service Loan Forgiveness (PSLF) dangles forgiveness after ten years. No wonder a 2017 LendEDU survey indicated that half of college students thought they would get their loans forgiven.

But forgiveness is not that easy to obtain. PSLF requires 120 on-time payments while working in a qualifying job, with much employment not qualifying. 20-year-plus timeframes for income-driven repayment are pretty lengthy.

With all These Problems, Why not go with Mass Forgiveness?

First and foremost, because most borrowers will get big payoffs from their loans, and there is no justification for sticking taxpayers with the bill for their profit. Even *without* mass forgiveness, a June 2021 federal assessment estimated that long-term taxpayer losses from federal loans would be $68 billion. And that is low-end; in 2020, an estimate conducted for the U.S. Department of Education projected a $435 billion loss.

Mass forgiveness would also worsen over-borrowing, perhaps by huge magnitudes. Why not borrow twice as much, or three times, what you otherwise would have, if you think it will be forgiven? How could the feds justify giving one generation forgiveness and not others?

The good news is current debtors can get relief, especially via repayment plans that adjust payments to income to keep them manageable. The government could perhaps do more to advertise them.

Federal Student Loans can be Beneficial to Everyone

In the long run, the solution is to phase out price-inflating, credential-ballooning, debt-driving federal student loans. The fear, of course, is that low-income people would miss out on education. But it is almost certainly unfounded for students with good academic backgrounds who want to study in-demand fields. Because of the generally big college payoff, private lenders would have strong incentives to work with even very low-income students. Both borrower and lender would profit.

Indeed, private lending would be a boon for people who do *not* get loans. Because lenders would risk their own money, they would have strong incentives to objectively assess potential borrowers. If a borrower were unlikely to succeed because they are academically unprepared, or the price is too high, or the field of study is not in demand, the lender will tell him, sparing both parties future pain.

Barring the phasing out of all federal student loans, the government should eliminate — or at least cap — PLUS loans, which come in a parent as well as grad variety and which give colleges near *carte blanche* to charge whatever they want. The feds could also start assessing prospective borrowers' academic preparation and intended fields of study. There is reason to worry about giving the government that sort of power, but it would likely be better than the status quo.

Mass student debt forgiveness, like student lending itself, is no doubt well intended. But we do not need more painful consequences driven by good feelings. We need to eliminate the problem: federal student loans.

Neal McCluskey is director of Cato's Center for Educational Freedom.