

Actually, the Student Loan Rate Hike's a Good Thing

By Neal McCluskey – July 1st, 2013

The wailing and gnashing of teeth has begun over today's arrival of "6.8 Day": the day interest rates on subsidized federal student loans rise from 3.4 percent to 6.8 percent. But is it really the day that college affordability died, as much of the coverage surrounding the matter has suggested? Hardly. If anything, it might actually do a bit to improve the Ivory Tower.

In the short-run, this will certainly cost students who take out subsidized federal loans — about 9.4 million people — a bit more, but keep in mind that this will only affect new loans, so it's not as if everyone in college will suddenly see all the rates on their loans double. Plus the average subsidized loan in the 2011-12 academic year was just \$3,645. And this assumes that Congress doesn't lower rates retroactively, which sounds like the plan in the Senate.

So how could this be a good thing? Because the evidence is pretty powerful that cheap student aid largely fuels rampant tuition inflation. It both encourages students to demand things they otherwise wouldn't — more expensive programs, lots of educationally superfluous amenities — and enables colleges to raise their prices, since cheap aid ensures that students can pay them.

This likely hurts many of the people the aid is supposed to help. Based on the best — though flawed — numbers we have, roughly half of the people who go to college will never finish. They'll never get the certification or degree that is the key to earning the money they'd need to pay back their debt and thrive. Basically, they've been handed cash to do something many simply weren't cut out to do.

Finishing a degree doesn't end the waste, however. Of people with a bachelor's degree, about a third are in jobs that don't require the credential. And then there's credential inflation, in which degrees have become a minimal signal of employability because they are so easy to get. Fail to get one, and many employers assume there is something wrong with you.

Raising interest rates might actually discourage students a little from demanding educationally wasteful things. It wouldn't be much of a change, but it would be a tiny move in the right direction. Unfortunately, if this whole episode has revealed anything, it is the extent to which politicians will avoid doing something that makes practical sense if it doesn't maximize benefits to motivated interest groups.

President Obama and House Republicans actually agreed on a basic reform — peg student loan rates to 10-year Treasury Bonds — because it simply made more sense than having Congress set a rate lasting several years. As a result, for a long time it looked 6.8 Day would be easily averted. The POTUS and House differed on how much rates should be plussed-up and whether they should vary over the life of the loan, but the basic structure was the same.

Just as it seemed Washington was on the verge of a rare compromise, however, President Obama called a student-and-pony press show to declare the House bill unacceptable. Rather

than negotiating, he attacked. And the Democratic leadership of the Senate? All it seemed to want was to freeze the rate at 3.4 percent, and to accuse Republicans of trying to reduce the deficit “on the backs of students.” That seems to be why it turned away a bipartisan compromise offered by Senate members, as well as provided no meaningful support for the president’s proposal.

Unfortunately, economics and basic reality make clear that, if we want college prices to be reasonable, we need to cut the humongous subsidies given to students by the federal government. But right now, we can’t even get small fixes that even many supporters of student aid find reasonable.

So, hooray, the rates have doubled! And, boo, the rates have doubled.