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the corner

Tuesday, March 30, 2010

One Student Aid Right Sure Doesn't Fix All the Wrongs [Neal McCluskey]

President Obama has declared passage of student-aid reform — which he signed into law this morning — a major accomplishment, one that is especially terrific for would-be college students and, well, the entire American economy.

He really shouldn't do that.

Before tackling why the president is wrong to lionize legislation greatly expanding federal student aid, let's get one thing straight: Eliminating federal guaranteed lending — which does indeed wastefully subsidize banks and other lenders — is not the “takeover” of private student lending it's often said to be. The fact of the matter is that the federal government has dominated student lending for decades, and ostensibly private lenders like Sallie Mae have simply been leeches firmly affixed to taxpayers.

But just because supporters of going to all direct-lending from Uncle Sam got one thing right doesn't mean they've nailed anything else.

First, the leeches have hardly been burned off. Sallie Mae and a few other now-former lenders have been promised big federal contracts to service loans under the new regime, so don't worry — they'll still get theirs.

Second, though this isn't a federal takeover of anything close to a truly private market, it is marginally worse, from a free-market perspective, than the *status quo ante*. At least until the recent credit crunch, firms in the guaranteed-lending program got their money through capital markets, keeping at least a small amount of discipline about whether students won the capital that everyone was competing for. Now students will just take their dough from the Treasury.

In addition, some truly private student lending still goes on, but banks forced out of federal

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In addition, some may think private student lending will almost certainly get out of the much smaller private sector for lack of economies of scale. And, of course, Uncle Sam will offer terms on the taxpayer's back that are far more generous than any company with its own money at stake could proffer.

Oh, and don't expect an honest accounting of how much taxpayers are losing on the deal. As the CBO has made clear, there's a big difference between the rosy forecasts they have to make for official bill scoring and reality, which accounts for such non-trivial things as lending risk.

Third, the president's goal of having a greater percentage of college graduates than any other nation in the world by 2020 — which this expansion of aid is supposed to help accomplish — is economically dubious. We already have far more four-year degree holders than we have jobs for them — to say nothing of whether we have the *right* four-year degrees for the jobs — and the greatest numerical growth in employment in the coming decade is supposed to be primarily in jobs requiring only on-the-job training (see Table 2). So what we are heading for if the president gets his profusion of sheepskins is not a stronger economy, but a much less efficient one.

The biggest lie of all, though, is that this will make college more affordable. While the president and others carry on about the extra money and generous terms they'll put into Pell Grants and federal loans — the message that will buy them the most votes — they conspicuously ignore that colleges can and will raise their prices to capture all that aid (scroll down to "The Adverse Effects of Federal Student Aid" to see it). I mean, ever wonder why for decades college prices have risen much faster than incomes? It's largely because taxpayers have been paying more and more of the bill.

So the president is right: The legislation he just signed will end big federal subsidies that have for decades gone to student lenders to originate loans. On everything else, though, he is woefully mistaken.

— *Neal McCluskey is associate director of the Cato Institute's Center for Educational Freedom.*

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