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Indentured Students

Of the 1,650,000 bachelor's degrees conferred in 2009–10, the greatest numbers of degrees were conferred in the fields of business (358,000); social sciences and history (173,000); health professions and related programs (130,000); and education (101,000). At the master's degree level, the greatest numbers of degrees were conferred in the fields of education (182,000) and business (178,000). At the doctor's degree level, the greatest number of degrees were conferred in the fields of health professions and related programs (57,700); legal professions and studies (44,600); education (9,200); engineering (7,700); biological and biomedical sciences (7,700); psychology (5,500); and physical sciences and science technologies (5,100).

Source: U.S. Department of Education, National Center for Education Statistics. (2012) *Digest of Education Statistics, 2011* (NCES 2012-001)

The amount of student loans is now greater than either credit card debt or auto loans. After mortgages student loan debt is the second highest amount of consumer debt. It now totals over $1.1 trillion, while credit card debt is $850 billion.

Already it is a theme in the news and opinion industries. Articles are headed ‘Debt for Life’ and surveys attempt to detail the impact of debt on graduates’ decisions. One inquiry got the following responses from those just out of college: 27% say they had moved in with their parents because of debt, 40% had delayed major purchases like homes and autos, ‘Student Loans Stifling Home Sales’, 14% delayed marriage and 24% say debt has made them alter career choices. The claim is that while recent graduates should be establishing households and buying stuff, thereby growing the economy, they have instead become economic neuters because of debt.

The concern is a serious one. Two-thirds of new graduates leave college with debt and the average amount is $26,600. 13% have loans outstanding of over $50,000 and some owe more than $100,000. 43% of <u>all</u> 25 year olds are carrying student debt. Sidle up to a group of twenty somethings and it is a fair bet that pretty soon you will hear talk of their loans.

The student loan business had modest beginnings. Originally the loans, with federal guarantees, were targeted at

specific groups and had numerous restrictions. In 1992 the amount lent to students under federal programs was just $16 billion. By 2001 the entire amount outstanding was $170 billion, in 2004 it was $400 billion and by 2012 the debt had ballooned to $1,042 trillion. In the academic year 2011-2012 the amount of new borrowing was $105 billion. The cynic may note that the huge rise in college cost over the last two decades roughly parallels the availability of these loans. Between 1990 and 2011 the general price level rose 75% while college tuition on average rose 300%. Still, the program is politically popular and is unlikely to be curtailed.

Student loans are quite easy to get. The first type are ‘subsidized’, meaning the government pays the interest while the student remains in school, and for these the student must demonstrate some financial need. The second type are ‘unsubsidized’, meaning the student or the parent pays interest from inception, but these are available on request, with no financial qualification. In the first year of college the student may qualify for a subsidized loan of $3,500 with an additional $2,000 of unsubsidized loan there for the asking. By the third year of school the total amount of these two types can be $7,500. If the student can show that he/she is not economically dependent upon parents then the final amount goes to $12,500. A graduate student can get $20,500 per year, with no requirement to demonstrate need. The overall limit for an undergraduate is $57,500 while the graduate student may borrow up to $138,500 in combined undergraduate and graduate loans.

The term 'need' is liberally interpreted, such that one third of all subsidized loans go to students from families with incomes over $50,000 and over 13% of these loans go to those in families that have an income over $100,000 per year. Indeed, the reasonably comfortable $100,000+ family income is no barrier to, and no relief from, borrowing for education. More than 38% of unsubsidized loans go to students from such families and 48% of these students leave school with debt.

The other side of borrowing is repayment and this is becoming a serious problem. Of the roughly $1 trillion in outstanding student loans only a little over 14% is actually owed by students currently enrolled. Combined with loans which are

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in repayment mode and currently, or almost currently, paid up we have a total of just 56% which are actually performing as they should. $170 billion is over 90 days late and $89 billion of that is in 'default', meaning payments are over 270 days late and presumably won't be repaid. 27% are in some form of deferred status, essentially acknowledging that the graduate can't or won't repay. By comparison, only 2% of auto loans are ultimately written off. Curiously, while auto loans can be discharged in bankruptcy student loans are one of the very few kinds of debt that cannot be forgiven. Only death or total disability will get a student loan definitively discharged.

Financial commentators are already ruminating darkly that this is our next fiscal crisis. After bailing out the banks we now move to bailing out the middle and upper middle classes. To our already enormous federal deficit we must add the better part of another trillion that should be coming back to the government, but won't.

A perfect storm of rising college costs, easy loan availability and diminished college graduate prospects is at fault. It is not hard to understand that a young person following the career path that goes from a degree in holistic stage management to Starbucks is not going to be in a position to repay a lot of debt. This is true even though there is a variety of repayment methods.

The traditional and still most common method of repayment is the ten year payback, based on equal monthly installments. Here the monthly payment on the average balance of $26,600 at the current interest rate would be $267. This would be easily doable at just a modest starting salary, say that of a school teacher. But in today's environment even that can be a distant dream. The Obama administration has responded by creating a number of increasingly relaxed payment programs. We can imagine the conversation when a new graduate calls the Department of Education to discuss his loan repayment:

Loan Agent: So young fella you're out of school now, you owe $30,000 and you've had your six month grace period in which you haven't had to pay a nickel. I wish my creditors would give me that deal. Uncle Sam is pretty generous don't you think? (Silence) So now how does it feel to be an adult?

Graduate: It's just like I imagined it.

Agent: Well, let's put you on our standard plan, ten years. $30,000 at 3.8% means a monthly payment of $301. How does that sound?

Graduate: That's too much.

Agent: All right. If we have to we can put you on our extended payment plan. That would be twenty five years, same interest rate. The monthly payment will be $155.

Graduate: Can't do it.

Agent: You are in luck. The Obama administration has expanded your options. Now we can tailor your payments to your income. Let's try the Pay as You Earn plan. Your payment will be 10% of the amount you earn over one and one-half times the poverty line. If you make just over $25,000 per year your monthly payment would be $27 per month. You pay for twenty years and you are done, even if there is still a balance.

Graduate: I'm a barista. I earn eight bucks an hour. I don't make one and a half times the poverty rate.

Agent: OK. Maybe you need the Income Contingent Repayment Plan. The payments are anything we decide you can pay.

Graduate : That amount is zero.

Agent: I see. Well you probably qualify for what we call 'forbearance'. You won't owe anything for a year because your payments, on the ten year schedule, would be more than 20% of your income.

Graduate: Fine. What happens after a year?

Agent: You would be eligible for a three year 'deferment' if you are unemployed, go into the military or are experiencing 'economic hardship'.

Graduate: Put me down for economic hardship. Then what?

Agent: Call me in four years, but I will give you a hint. Try to get a job with the government or a non-profit.

What the agent is hinting at is a program of outright forgiveness. Anyone who works for any public agency, federal, state or local, qualifies. The agency does not have to be the government as such. It can be a transit or school district. It does of course include the military. It can be any non-profit, regardless of its purpose. It can in fact be any profit making institution that performs a 'public service', which certainly includes any medical facility but will undoubtedly be applied to an ever expanding group of service providers.

The program essentially says that anyone who works for such an agency for ten years and has made regular monthly payments on their loan for ten years can then have the balance forgiven. This is true regardless of the payment program. It is true even if the program requirements are so lax that the payment does not even cover the accruing interest; in other words if the ending balance is greater than the beginning amount.

Some occupations qualify for loan forgiveness. This includes certain health professions as well as some teachers who have particular specialties. Finally, federal agencies are authorized to offer $10,000 per year of loan pay down in return for a pledge to work for that agency over a period of three to six years.

In brief, Obama has taken the student loan crisis off the radar screen. Some economists think they have spied the next looming catastrophe, but very few people are going to see it. If the government had to declare a large number of loans uncollectable there would be a public outcry. But now an expanding fraction of those loans will be considered current and the borrowers will be abiding by their repayment agreements. When the balances ultimately end up not being paid they will simply disappear in the budget.

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