PRO-CON

Should colleges foot the bill when students default on loans?

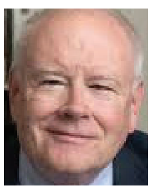
Brian Davies/The Register-Guard

University of Oregon graduates make their way through campus during the traditional Duck Walk preceding graduation ceremonies in Eugene in 2013.

PRO: US taxpayers shouldn't get stuck with a $1.5T loan default tab

ATHENS, Ohio — Not only have 45 million U.S. college students racked up more than $1.5 trillion in loan debt — more than the total for all outstanding credit card or car loan debt — more than 5 million student borrowers are delinquent or in default on their loans, and an even larger number have a loan deferment or "forbearance" — that is, they've been given permission to temporarily not repay their debt.

This massive record of nonpayment far surpasses that found for private debt such as home equity loans, car loans or credit card obligations. Literally hundreds of billions of dollars in obligations are at risk of nonpayment.



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What to do? While some nonpayment of loans results from tragic unforeseen circumstances such as illness or the death of a parent, a very large portion of it is highly predictable and avoidable.

U.S. colleges and universities admit many students who have very dubious prospects of graduating and/or of earning sufficient amounts of money upon finishing college to be willing or able to repay their loan obligations.

Why is this the case? Colleges, hungry for the tuition revenue students provide — and often for additional state government assistance tied to that enrollment — often knowingly admit students with very low prospects for graduation. There are zero incentives for schools not to admit these individuals, but positive inducements to accept them.

Yet for large portions of these students, attending college leads to bitter disappointment and financial hardship: They fail to graduate, thereby becoming stigmatized as academic failures, and they pile up debt obligations that are not even dischargeable in bankruptcy.

How can we dramatically reduce this problem? The creators of the problem are largely colleges and universities that knowingly admit large numbers of problematic students. We need to change the incentive system, making schools face financial consequences for accepting students with shaky academic backgrounds who are unlikely to complete college. Put more colloquially, colleges need to have some "skin in the game."

As the noted financial scholar Alex J. Pollock, former president and CEO of the Federal Home Loan Bank of Chicago, suggests: Make the schools pay 20% of the debt obligations of former students facing loan delinquency or default.

The schools have put a burden on American taxpayers already facing long-term severe financial consequences from the massive $22 trillion federal debt.

Having exacerbated the problem, make them pay at least some of the costs.

Doing this would have enormous positive effects. Colleges would be incentivized to admit fewer academically unqualified students, reducing the emotional and financial pain and distress faced by individuals who are better off pursuing other options rather than college.

The Government Accountability Office acknowledges that federal student loan programs are a financial drain on the federal budget and the "skin in the game" proposal would dramatically reduce and possibly end it.

Wouldn't the financial burden associated with this proposal threaten the existence of some colleges? It would, but that should be viewed as a positive.

In the private market economy, the principle of "creative destruction" moves resources to more valuable uses as companies close down or are forced to restructure for not adapting to changing tastes or potential efficiencies.

The "creative destruction" principle is needed in higher education as well, where colleges use government subsidies and private philanthropy to cushion themselves from market forces.

As falling birth rates lead to declining enrollments in coming years, the "death" of schools that fail to provide high value to their students should be welcomed. Skin in the games will help achieve that needed transition to fewer but more effective universities.

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CON: Holding colleges responsible won't reduce loan defaults

RALEIGH, N.C. — For many years, education policy experts whom I respect have argued in favor of making colleges have some "skin in the game" with regard to student loans. That is, they should have to bear at least some of the loss if a student they accepted later defaults on his federal loan.

That would be a step in the right direction, but it doesn't solve the problem.

GEORGE LEEF

Sound finance is based on the principle that the party extending credit should be the party who suffers the loss if the loan goes sour. That keeps lenders alert to the borrower's circumstances. If the risk seems too great, the lender will just say, "We don't want to make this loan."

That's not how it works in higher education, because colleges typically are not the lenders.

If colleges did lend to their students (and there is no reason why they can't, but it is unusual), then they should and would bear the risk of defaults. But the "skin in the game" policy is rooted in the assumption that the federal government will continue lending to students, and then the colleges that accept these students — and government money — would have to pay back some percentage of the loss if the student can't or won't repay.

That probably would make colleges more careful about which students they accept and also cause them to rethink their curriculum and standards. This would improve the incentives somewhat, but some (probably most) of the losses would still fall on taxpayers, so college officials will continue accepting academically marginal students in hopes that they'll pay back their loans.

For a fair number of colleges, turning away any students is unthinkable due to their precarious financial position.

We need to get at the root of the problem, which is that readily available federal grants and loans lure many people into college who are not prepared for or interested in higher education.

National Review writer Kevin Williamson nailed the truth in his recent article, "An Idea for Student Loans: Get Rid of Them," saying that the current system is just "a conveyor belt for carrying government money into the universities." It has enabled colleges to spend far more than in the past, while actually educating far less. The only way to stop the waste, of which student loan default is only the most visible evidence, is to close down what he calls the Bank of Uncle Stupid.

Federal college subsidies through loans and grants was one of the many bad ideas of President Lyndon Johnson's Great Society. In fact, there is no provision in the Constitution that authorizes the federal government to loan or give money to college students; but back in the 1960s, no legal challenge to any expansion of government was taken seriously. Once the faucet of federal money was opened, politicians just kept opening it more.

The massive amount of student debt and increasing default rates has people thinking about the issue, but the ideas being floated either would make only a slight improvement (like "skin in the game") or would make it much worse (like the proposals to make college "free" and forgive the debt of many students).

Our higher education system was far more sensible and efficient before the federal government began subsidizing it. We need to undo that mistake. But that won't happen until America realizes that the flow of federal money into higher education has transformed it for the worse. Turn off the faucet.

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