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Free college comes at a price

Politicized proposals calling for it don't make the grade.

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BOTTOM LINE:

As the Labor Day holiday weekend approaches, marking the unofficial end of summer, many of us are carting our college-aged students back to school. But with the high cost of college today, and the staggering amount of student-loan debt parents and students are shouldering, the economics of a college education have become a political hot potato. Wading into the 2020 presidential election campaign, several candidates are proposing to make college free and provide amnesty for $1.6 trillion of already accumulated student loan debt. While they're quite obviously pandering for votes, do their proposals make sound economic sense? Our conclusion: if college is expensive now, just wait 'til it's free.

What's the problem? According to the Department of Labor, college and graduate-school tuition costs so far this century have risen at triple the rate of core CPI inflation of 2.2%, and the elite private colleges regularly boast an all-in sticker price north of $70,000 per year. To finance this, student loan debt has tripled in the last 15 years, growing at an annual pace of about 9%, resulting in a total of $1.6 trillion and 45 million people in debt. Today, the average college senior graduates with more than $30,000 of debt, and one out of every six carry a debt load of more than $50,000.

The repayment period for these student loans has doubled over the past generation to 20-25 years, and many middle-aged Americans are still struggling with student loans. People 50 and older account for 20% of total student loan debt, and 10% of households are headed by someone shouldering more than $33,000 of student debt. More than two million people have defaulted over the last six years, and a staggering 1,400 new people default on student loans every day. In our view, this trend has had a deleterious impact on housing and auto sales over the past few years.

Graduate programs are a bigger nut While 45% of all student loans are used to attend undergraduate public colleges and universities, some 40% are taken out for graduate or professional school, such as Ph.D. programs and medical, business or law school, with average loan balances of $100,000 or more. But young doctors, lawyers and accountants should be in a much better position to repay their outsized loans without government help.

It pays to invest in your own education People who earn a college degree typically make more money and experience lower levels of unemployment over the course of their careers. Americans with an undergraduate degree earned an average of $77,000 per year in 2018, according to Labor, versus $45,000 for high school graduates. The Wall Street Journal reports that college graduates earn about $1 million more over the course of their careers than those with high school diplomas. Since 2000, the average inflation-adjusted wage growth of workers with some college but no degree has actually declined by 2%, compared with a 6% increase for college graduates, according to the Economic Policy Institute. Finally, during the depths of the Great Recession, when the unemployment rate (U-3) peaked at 10%, the rate for those with a college degree peaked at 5%, topping out at half that for those with a graduate degree.

But college isn't for everyone Many people may be better off with a vocational degree or an apprenticeship right out of high school, however, rather than pursuing an expensive 4-year college degree in a field with poor job prospects. In our view, it's better to be a well-paid carpenter, plumber, welder or electrician, for example, than to amass $100,000 in student loan debt pursuing a poorly chosen major.

What's on the "free-lunch" menu? Senators Bernie Sanders (Vt.), Elizabeth Warren (Mass.) and Kamala Harris (Calif.), among other 2020 hopefuls, have proposed making all 2-year community colleges and 4-year public colleges and universities tuition free. Sanders' self-proclaimed "revolutionary proposal," which would cost an estimated $2.2 trillion over 10 years, would also eliminate all student-loan debt. Warren supports a more limited $1.25 trillion approach over a decade that focuses on helping low-income households. Warren plans to forgive $640 billion of student debt (up to $50,000 per person), for families earning less than $100,000 per year. As the debtor's household income rises to $250,000 and higher, the amount of loan forgiveness falls to zero. Harris wants to refinance student loans at lower interest rates, with the monthly repayment amount contingent on the debtor's current income. Her goal is to help minority groups afford college.

Who's going to pay for all this? Sanders plans to finance his proposal with a Wall Street financial-transactions tax of 0.5% on stocks, 0.1% on bonds and 0.005% on derivatives, with an offsetting tax credit for people with incomes under $50,000 or couples under $75,000. But the Journal reports this tax would not raise enough money to pay for his plan, although it could push traders overseas and make capital markets more illiquid. The ensuing decline in asset values would harm 401(k) plans and public pensions, they argue, while raising costs for institutional investors. Warren plans to enact an annual 2% "ultra-millionaires" tax on household net worth of $50 million or more, although such a tax may be unconstitutional. The Journal concludes that taxes on the middle class would have to be ramped sharply to pay for these proposals.

Moral hazard According to a 2017 Journal/NBC News poll, 60% favored and 34% opposed a generic proposal to eliminate tuition at public colleges for families earning less than $125,000 per year. But there's broad pushback on blanket amnesty to wipe the slate clean on $1.6 trillion in existing student loan debt. A student who borrows to finance his education must be sure that his future earnings will be sufficient to pay off his legal obligation.

The Journal asks why the 98.5 million Americans who didn't attend college, and the 106 million who did, but who didn't take out student loans or have already paid them off, should be forced to subsidize these loans. These debt-forgiveness proposals punish those students and their families who did the right thing: they saved, scrimped and sacrificed, lived frugally, and worked longer and harder. How is that fair?

A more palatable alternative for voters might be an expansion of the Public Service Loan Forgiveness Program. Graduates serve in the military, practice medicine or teach in rural areas, for example, in exchange for having some of their debt cancelled year by year. Debtors essentially trade a public service for the monetary forgiveness they desire over time.

Making education affordable From the student's perspective, if family resources are tight, they can reduce the cost of their education by attending free community college for their first two years, attend a low-cost, in-state public college to finish their undergraduate degree, and attend graduate school at night while living at home and working full time during the day. They can also select a practical field of study that will earn them enough money to pay off their loans. Not a glamorous game plan, to be sure, but an affordable one.

From the college's perspective, tuition is only 20% of the total cost to attend a university. Money is wasted on lavish buildings to elevate the school's peer ranking, and they can also economize by cutting money-losing clubs and sports teams. Another troubling industry trend, highlighted by a professor at California Polytechnic University, is that the total number of full-time faculty at the school grew 3.5% from 1975 to 2008, while the number of largely superfluous administrators rose by 221%. Many top school officials earn multi-million dollar salaries with lavish perks, and some star football and basketball coaches are the highest-paid employees in their states. More modest wages and sharply reducing the number of administrators should make college more affordable.

Additionally, schools can use their massive endowments to better support financially struggling students. Lastly, with benchmark 10-year Treasury yields at 1.5% and with student loans extended at an average of 8.5%, the federal government can do a much better job of extending and refinancing lower-cost loans, perhaps around 5%.

Research assistance provided by Federated summer intern Michael Ware.

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DISCLOSURES

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Consumer Price Index (CPI): A measure of inflation at the retail level.

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