THE STUDENT LOAN MESS

HOW GOOD INTENTIONS CREATED A TRILLION-DOLLAR PROBLEM

JOEL & ERIC BEST

"Written with clarity and grace. . . .
My highest recommendation."
—Jonathan B. Imber,
Editor in Chief, *Society*

The Atkinson Family
Imprint in Higher Education

The Atkinson Family Foundation has endowed this imprint to illuminate the role of higher education in contemporary society.

The publisher gratefully acknowledges the generous support of the Atkinson Family Imprint in Higher Education of the University of California Press Foundation, which was established by a major gift from the Atkinson Family Foundation.

The Student Loan Mess

How Good Intentions Created a Trillion-Dollar Problem

Joel Best
Eric Best

UNIVERSITY OF CALIFORNIA PRESS
Berkeley Los Angeles London

CONTENTS

FIGURES AND TABLE

FIGURES

TABLE

Introduction

In 2012, when we decided to write this book, student loans had become—really for the first time ever—a hot topic. Protesters in the Occupy Wall Street movement called for forgiving all student loan debt, even as the high unemployment rate encouraged more young people to stay out of the workforce and pursue a college education. There were news reports that total student loan debt had reached a trillion dollars, that Americans now owed more on student loans than on their credit cards. Young people leaving school were finding that their student loan debt made it vastly harder to launch careers, start families, or buy homes. Some critics warned about an expanding student loan bubble that would inevitably pop and drive the economy into another severe recession, while others challenged the established wisdom that going to college was the most promising route to fulfilling the American Dream.

How, you might ask, did we get into this mess?

This book tries to answer that question. But it doesn't concentrate solely on *this mess* (that is, today's complaints about that trillion-dollar debt, the frustrations of young people trying to deal with massive student loan debt on top of all the other challenges they face, or potential consequences should the bubble burst). Instead, we adopt a broader perspective. Our goal is to understand how we *got into* this mess. And that turns out to be a really interesting story.

It is a story of good intentions gone awry. (Recall the proverb, more than three hundred years old: "The road to hell is paved with good intentions.") Federal student loan programs started as a way to help young Americans get ahead during the Cold War years of the 1950s and 1960s: student loans seemed to offer a solution to what was then considered a social problem—too many bright kids couldn't afford to go to college, causing America to waste precious brainpower. We'll call that the *first student loan mess*.

The earliest student loan programs were inspired by idealism, but we're telling an ironic story. Policies designed to solve social problems don't always work as planned; they can create new, unexpected difficulties. Thus, while we might like to imagine that there is only a single student loan mess, our story is about a series of student loan *messes,* each a reaction to how people understood and tried to resolve an earlier mess. For example, solving the first student loan mess by creating loan programs that would give every promising young person access to college had an unexpected consequence: too many borrowers failed to repay their student loans, and that problem—deadbeat students—became what we'll call the *second student loan mess.* This cycle—the solution to one mess creating the conditions that came to be understood as the next, even bigger mess—has repeated itself several times and continues today. So the short answer to our question is that we got into our current student loan mess by trying to solve earlier messes, and our next mess is likely to be shaped by what we do to solve the one we're in right now. This is both a surprising story and an important one. We didn't wind up in our current mess by accident; we got there by creating well-intentioned policies without thinking through the likely consequences of our actions. And if we want to avoid setting the stage for an even bigger mess, we ought to ask ourselves what we can learn from the tangled history of student loans.

This book is the product of an intergenerational collaboration: Joel and Eric are father and son. We approach our topic from different orientations. Joel is a sociologist who studies social problems; he has been planning to write about student loans for years. Eric majored in economics, then worked in the corporate loan department of a major investment bank before returning to graduate school to earn a master's degree in economics and a PhD in disaster science and management. While working on his dissertation, Eric became interested in student loans and started publishing pieces on the topic.[1] Recognizing that the topic interested both of us but appreciating that we saw it from different angles, we decided to join forces.

OUR STORIES: FOUR GENERATIONS OF OLDEST SONS

Eric is Joel's oldest son. Joel, in turn, was the oldest son of Gordon Best (1919–1986), and Gordon was the oldest son of George Best (1882–1970). The four of us had very different experiences with higher education, and our stories say a lot about how education has changed in the United States.

George grew up on his father's farm, outside Walhalla, in the northeastern corner of North Dakota, just a few miles south of the Canadian border. After he retired from farming, George wrote and self-published a memoir.[2] As a boy, he finished normal school (eighth grade), and then went to work on the family farm. By 1902, when he was twenty, he had saved enough money to afford spending the winter months in town to further his education. The following year, he hoped to begin studying at "the A.C." (the agricultural college, North Dakota's land-grant college located in distant Fargo, today called North Dakota State University), but that summer brought a bad harvest. In his memoir, George recalled: "That was a black day in my life. With Father at that age, Mother and five minors needing a roof over their heads and something to eat, I was mentally shackled there." He would go on to marry Nellie Storey, herself a normal-school graduate who'd started teaching school when she was fifteen, and they had four children: "Nellie, who wanted to see them all through college, drove them relentlessly."

George reports that "Gordon, being the rebellious type, finally jumped school" after graduating from Walhalla's high school. Gordon went to work in town but was soon drafted in the run-up to World War II. He saw combat in the Pacific and became seriously ill; he spent much of the war in military hospitals. As soon as the war ended, he married Beth Greene, who was a college graduate and a schoolteacher. She encouraged Gordon to take advantage of the GI Bill. They held down expenses by living with her parents in Lincoln, Nebraska, while Gordon attended the state university and worked part-time. Gordon became one of the World War II veterans who graduated from college thanks to the support of the GI Bill.[3] His degree in business administration qualified him for a job at Minneapolis Honeywell, where he would have a thirty-year career in middle management.

Joel was a first-year baby boomer, born in 1946.[4] His family moved into a brand-new housing development in Roseville, a suburb just north of Saint Paul, Minnesota, filled with the young families being started by veterans, who were able to buy homes with low-interest veterans' loans. Roseville's schools had to expand to deal with all those boomers; most years, Joel was taught in a brand-new classroom. When he entered the University of Minnesota in 1964, tuition and fees totaled about $75 per quarter. Obviously, the state of Minnesota subsidized much of the cost of his education. In early 1967, tuition and fees were raised to $125 per quarter (about $875 in 2013 dollars), which inspired an outcry. Joel lived at home and commuted to the university; he also received a small scholarship ($125 per year) from Honeywell, and he worked a couple of summers and part-time while he was a student to earn a little money. Joel started graduate school with a fellowship from the National Institute of Mental Health; this amounted to a federal scholarship for graduate study that covered his tuition and fees, and paid a stipend of $1,800 during his first year of study. At the end of the year, he had more money in his savings account than he did at the start (possible because he did not own a car at the time). His out-of-pocket costs for his undergraduate and graduate educations, including tuition and fees, books, and supplies, probably totaled under $1,000; when he received his PhD in 1971, he had no debt.

When Eric started college in 2001, the educational landscape had changed. Anticipating that educating their two sons might be expensive, Eric's parents, Joel and Joan, had set aside what seemed like a fair amount of money. By the time Eric earned his bachelor's degree in economics, most of his share of that money had been spent; although he received his degree from the University of Delaware (where Joel taught and which charged children of faculty very little to attend), he'd had to pay for computing equipment, books, rent in off-campus apartments, and so on. After graduation, Eric worked for a couple of years in the corporate loan office of a major bank, where he handled syndicated loans, essentially large blocks of corporate debt.

Even before the Great Recession began, Eric began to find his job unfulfilling, and he decided to return to graduate school. Eric did not qualify for financial aid, nor was he offered an assistantship during his first year in grad school. Eric's bill for the first year was about $20,000 before fees, books, and other expenses. Eric chose to apply for a federal student loan to cover the cost of that first year of grad school, because he figured that retaining some savings was better than avoiding all debt. Without consulting with his parents, and applying for the loan on a website, Eric had his entire tuition paid by the U.S. government, in addition to receiving a one-time check for living expenses "related to school." After the first year, Eric received research assistantships that paid his tuition and provided a small stipend.

Eric took a tenure-track job at a university immediately after completing his PhD and does not expect paying back student loans to be more than a mild financial inconvenience. However, he was lucky to find a stable, relatively high-earning job immediately after graduation, something that is far from a given for current graduates. Although he is in a good position financially, something like a year of unemployment after school (a realistic possibility in the recent job climate) would have been disastrous.

Those are four stories from four generations of our family. It should be clear that our individual lives were shaped by what was happening in the larger society: George had to choose between furthering his education and fulfilling his responsibility to keep the family farm going. The draft and the GI Bill propelled Gordon from that same farm to a corporate career in a metropolis, while Joel rode the wave of the baby boom, and the global recession affected what happened to Eric. The sorts of education the four of us received and the ways we paid for it—what we could afford, and what we chose to buy—reflected big historical changes: what was happening in the world and what sorts of government policies were in place. We can't but wonder how social changes might affect the educational prospects of our family's next generation. Understanding these intersections between personal experiences and societal changes is what the sociologist C. Wright Mills called the *sociological imagination*.[5] Our goal is to show how big societal changes—and good intentions—led to a series of student loan messes.

OUR APPROACH

Our collaboration is interdisciplinary, as well as intergenerational. As a sociologist, Joel studies the processes by which social problems come to public attention. In this view, social problems are best thought of not as conditions that simply exist in society but as processes by which people come to recognize and try to arouse concern about particular topics; those efforts may lead policymakers to address what they now understand to be a troubling condition, and their policies in turn inspire different reactions.[6] This is a perspective that focuses on language, on what people *say,* on the words they choose when describing what's wrong and prescribing what ought to be done to fix it.

This book traces the shifting ways people have talked about student loans. The history of federal student loans is a story of successive redefinitions of the problem, each identifying a challenging aspect of the larger student loan problem—what we'll call a *student loan mess*. While lots of people have recognized that student loans pose a problem, they haven't all defined that problem in the same ways. Rather, at different periods, people's attention focused on particular aspects of the problem—on a particular mess. Our point is not that these various understandings were wrong, but rather that each mess drew attention to particular features of student loans, much the way a magnifying glass helps us better see part of a larger whole. But just as what isn't magnified tends to be out of focus or lost from view, focusing on a particular mess allowed people to ignore other aspects of student loans. As each successive mess attracted attention, social policies were invented, reformed, or replaced to address the current vision of the student loan problem. Often these policies had unexpected, ironic consequences, in that the ways people reacted to the new policies led to people discovering a new mess, as different aspects of the student loan problem now became the focus of attention. Joel has been thinking about this process, about the way the student loan problem keeps being redefined, for a long time. He's talked about writing a book on the changing definitions of the student loan problem for at least twenty-five years.

Eric studies how regulation (or lack of regulation) changes market behavior—that is, how economic theory relates to public policy. Most of his day-to-day work involves complex computer models and quantitative analysis, but while this book will show that the numbers related to student loans are important, the messes were not the result of creative accounting (although some interesting interpretations about repayment are involved). In Eric's view, the current student lending situation is not an accident or a cause for outrage. It is a story about how Americans incrementally and willingly created our current student loan mess over the last seventy years and what we can do to fix it. His is a perspective that focuses on the intersections of policy, institutional pressures, and individual behavior. The mission of this book is to explain what happened—and what might happen in the future—in a clear manner, free of complicated statistics.

Eric has firsthand experience with the insatiable demand for student loans on both the supply side, in the form of collateral in "student loan asset-backed securities" (SLABS) sold at the bank where he worked, and the demand side, in conversations with college and grad school friends about the costs of financing their educations. He's been badgering Joel to write a book about student loans for the past two years, going as far as publishing about the issue to prove there was interest in this type of research.

Because we come at the topic of student loans from different backgrounds, this book's analysis is rooted in interdisciplinary collaboration. Our conversations, often around holiday dinner tables over groans from the rest of the family, made us realize that we tended to notice different aspects of the topic. Joel emphasizes the social side of student lending and sees the current student loan mess as just the latest way of thinking about a rather old issue. Eric is more interested in the relationship between money and policy, and sees the current student loan policies as a disaster in the making, as much for institutions and the government as for individual students. Neither of us could have or would have written this book as a sole author, but we believe that together we can tell an interesting story and even offer some recommendations.

PLAN OF THE BOOK

This book does not focus on blaming particular people for the student loan messes, nor does it propose a single "solution" to the problem. What it does offer is an overview of student lending and higher education in the United States, as well as suggestions about ways to make future student loan messes—and they are inevitable—more manageable. With more than a trillion dollars of student loan debt in circulation and that total ballooning with each passing year, it is clear that we will not be able to make the problem disappear in a flash. Cleaning up a multigenerational problem is going to be mind-bogglingly expensive, but importantly, it will likely be cheaper than not cleaning it up. Everyone needs to understand that whatever reforms we devise

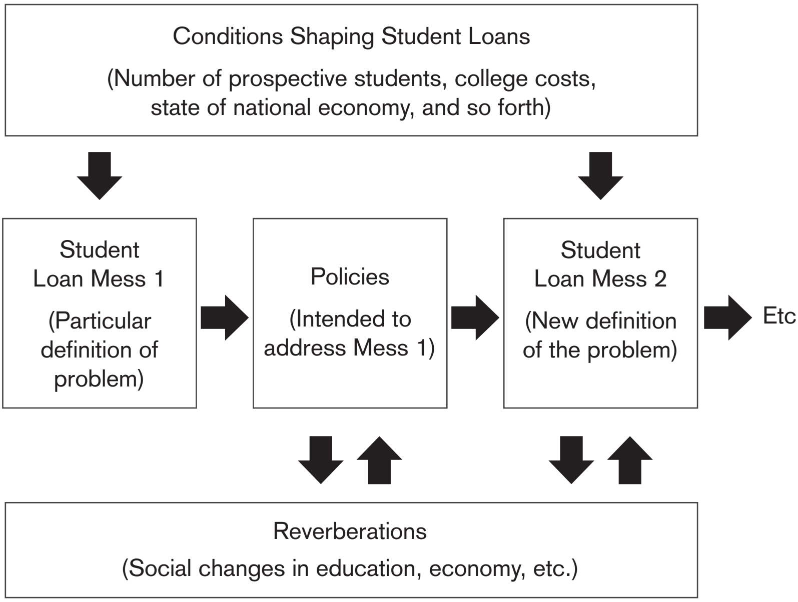

Figure 1. How student loan messes evolve.

are likely to lead to new messes, new discussions, and new policy recommendations.

The history we discuss isn't all that complicated, but it needs to be understood if we are to make sense of our current mess. Unless we acknowledge how our good intentions went awry, we run the risk of creating yet another, even bigger student loan mess as we try to "solve" the problem. Figure 1 illustrates how we conceptualize these processes.

Each chapter, then, examines a particular student loan mess. Each examines how people came to identify particular aspects of student loans as troubling; we then show how they devised social policies to clean up that mess. In addition, each chapter will identify what we call *reverberations*—social changes in the larger society. These changes were not always understood as important—or as directly related to student loans—and they tended to be ignored when people were thinking about devising student loan policies. Nonetheless, these developments, coupled with the unanticipated consequences of whatever policies emerged to address the current mess, helped shape the next student loan mess.

Chapter 1 describes the first student loan mess—the need to establish loan programs that could open access to higher education for all talented young people. This chapter concentrates on the period from 1958 (when the first broad federal student loan program began) until 1972 (when creating Sallie Mae seemed to guarantee stable access to loans). Chapter 2 considers the second student loan mess, when policymakers became alarmed by the unexpectedly high rates of default by borrowers; this topic began to attract attention in the mid-1960s and continued to be a focus of concern until 1998 (when it became nearly impossible for most borrowers to discharge student loan debts by declaring bankruptcy). The third student loan mess, discussed in chapter 3, focuses on growing student loan debt as a crushing burden; this chapter begins in the mid-1990s and ends—somewhat arbitrarily—during Barack Obama's first term. In fact, we are well aware that people continue to talk about crushing debt, that the third student loan mess has not yet ended. However, we also want to draw attention to what we call the fourth student loan mess, which is the subject of chapter 4: the concern that there is a student loan bubble (particularly in for-profit higher education) that threatens to collapse and cause widespread economic damage. This chapter outlines what can happen when market participants actively manipulate well-intentioned policies. People began actively worrying about this bubble shortly after the Great Recession began in 2008.

We argue that each mess was a product of what was ignored in the policies dealing with the preceding mess and of the reverberations in the larger society. Each successive mess has seemed more alarming than its predecessor. This raises the question, What's next? Will there be a fifth student loan mess, and a sixth, and so on? How bad can things get? Chapter 5 tries to imagine where the discussions of student loans are likely to head, by considering what the fourth student loan mess seems to ignore. Finally, chapter 6 offers our suggestions for thinking about and devising policies for student loans.

STUDENT LOANS—WHAT'S THE PROBLEM?

Our thesis, then, is that what might at first glance seem to be a single problem with a single name—student loans—is better understood as a series of problems, or messes. Each of these messes has had advocates who identified particular aspects of student loans as troubling and called for action—and those advocates were successful, in the sense that they changed social policies to address the aspects of student loans that concerned them. However, aspects that get ignored in one mess have a way of becoming central to the next mess.

One reason it has been easy to focus on a series of narrowly defined issues while ignoring the bigger picture is that discussions of student loans have been guided by a set of widely shared assumptions. While not absolutely everyone has shared each of these assumptions, there has been fairly broad consensus about all of them. These shared ideas have provided the foundation for the good intentions that got us here. We outline these assumptions here, and then revisit them later in this book. These key assumptions are:

1. Higher education is a good thing and should be encouraged—the more educated the nation's population, the better.
2. Because individuals who choose to receive more education benefit directly, they should bear most of the costs of that education. A major attraction of student loan programs is that they allow the government to help young people get more education while holding the beneficiaries of those loans responsible for repaying what they borrow.
3. Federal loan policies should not discriminate among educational institutions—young people should be free to choose what and

where they want to study, and they should be eligible for student loans to attend any school that will admit them.

4. Federal loan policies should not discriminate among borrowers. All students should have access to loans on essentially the same terms.

It is easy to nod along while reading over this list of assumptions; they all seem reasonable. But, as we will see, sharing—and not thinking critically about—these assumptions has had serious consequences.

In many ways, America's higher education system has come to resemble our health care system. Both systems are extremely expensive, compared to those in other democracies. Higher education consumes a larger share of our GDP—and costs vastly more per student—than it does in other countries.[7] Yet both systems produce somewhat disappointing results. Where the United States once led the world in the proportion of college graduates among its younger citizens, a number of other countries now boast higher college graduation rates. Perhaps the time has come to ask why we aren't getting a bigger bang from our higher education bucks.