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The Student Loan Debt Bubble

Curse of the First "Austerity Generation"

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It was announced last summer that total student loan debt, at $830 billion, now exceeds total US credit card debt, itself bloated to the bubble level of $827 billion. And student loan debt is growing at the rate of $90 billion a year.

There are far fewer students than there are credit card holders. Could there be a student debt bubble at a time when college graduates' jobs and earnings prospects are as gloomy as they have been at any time since the Great Depression?

The data indicate that today's students are saddled with a burden similar to the one currently borne by their parents. Most of these parents have experienced decades of stagnating wages, and have only one asset, home equity. The housing meltdown has caused that resource either to disappear or to turn into a punishing debt load. The younger generation too appears to have mortgaged its future earnings in the form of student loan debt.

The most recent complete statistics cover 2008, when debt was held by 62 % of students from public universities, 72 % from private nonprofit schools, and a whopping 96 % from private for-profit ("proprietary") schools.

For-profit school enrollment is growing faster than enrollment at public schools, and a growing percentage of students attending for-profit schools represent holders of debt likely to default. In order to get a better handle on the dynamics of student debt growth, it is helpful to sketch the connection between the current crisis in public education and the recent rapid growth of the for-profits.

Crisis of Public Education Precipitates Private School Growth

Since the most common advise to the unemployed is to "get a college education", and tuition at public institutions is at least half or less than private-school rates, public higher education institutions have been swamped with an influx of out of work adults. This has resulted in enrollment gluts at many state colleges. At the same time, tuition is increasing just when household income and hence the affordability of higher education are declining.

Here is how this scenario unfolds:

With few exceptions, state-funded colleges and universities set tuition rates based on policy and budget decisions made by state legislatures. High and increasing unemployment and declining wages have resulted in declining public revenues. This in turn leads to budget cut directives from legislative bodies to public higher education institutions, often accompanied by the authority to increase tuition.

For example, a 14% budget cut to an institution may be “offset” by giving the governing boards of the school the authority to raise tuition by a maximum of 7%. Often the imbalance created by a cut to the base budget and an increase in tuition is made worse by limits on enrollment. A state legislative body may cut an institution’s budget, allow it to increase tuition, but not provide per-student funding increases to keep pace with the accelerating enrollment demand.

This affects tuition rates at for-profit institutions. More students who would otherwise attend a state institution or a private, non-profit school are finding themselves without a seat at over-enrolled campuses. More students are pushed into the online and for-profit sectors, and proprietary schools sieze the day by inflating their tuition costs.

Because online colleges lack the enrollment constraints of a physical campus, they are uniquely poised to capture huge proportions of the growing higher education market by starting classes in non-traditional intervals (the University of Phoenix, for example, begins its online classes on a 5-week rolling basis) and without regard to space, charging ever-increasing rates to students who have no other choice.

Instead of waiting for an admissions decision or a financial aid package from a traditional college, students can enroll immediately online. This ease of use and accessibility to any student has allowed the for-profit sector to capture a growing portion of the higher education market and a growing proportion of education-targeted public money. Enrollments at for-profit colleges have increased in the last ten years by 225%, far outpacing public institution increases.

Thus, the neoliberal assault on public education not only tends to push more students into private institutions, it also generates upward pressure on tuition costs. This results in growing pressure on enrollees at proprietary schools to take on student loan debt.

How Healthy Are Student Loans?

The extraordinary growth of student debt paralleled the bubble years, from the beginnings of the dot.com bubble in the mid-1990s to the bursting of the housing bubble. From 1994 to 2008, average debt levels for graduating seniors more than doubled to $23,200, according to The Student Loan Project, a nonprofit research and policy organization. More than 10 percent of those completing their bachelor’s degree are now saddled with over $40,000 in debt.

Are student loans as financially problematic as the junk mortgage securities still held by the biggest banks? That depends on how those loans were rated and the ability of the borrower to repay.

In the build-up to the housing crisis, the major ratings agencies used by the biggest banks gave high ratings to mortgage-backed securities that were in fact toxic. A similar pattern is evident in student loans.

The health of student loans is officially assessed by the “cohort-default rate,” a supposedly reliable predictor of the likelihood that borrowers will default. But the cohort-default rate only measures the rate of defaults during the first two years of repayment. Defaults that occur after two years are not tracked by the Department of Education for institutional financial aid eligibility. Nor do government loans require credit checks or other types of regard for whether a student will be able to repay the loans.

There is about $830 billion in total outstanding federal and private student-loan debt. Only 40% of that debt is actively being repaid. The rest is in default, or in deferment (when a student requests temporary postponement of payment because of economic hardship), which means payments and interest are halted, or in forbearance. Interest on government loans is suspended during deferment, but continues to accrue on private loans.

As tuitions increase, loan amounts increase; private loan interest rates have reached highs of 20%. Add that to a deeply troubled economy and dismal job market, and we have the full trappings of a major bubble. As it goes with contemporary bubbles, when the loans go into default, taxpayers will be forced to pick up the tab, since just about all loans to date are backed by the federal government.

Of course the usual suspects are among the top private lenders: Citigroup, Wells Fargo and JP Morgan-Chase.

Financial Aid and the Federal Tilt to Private Schools

A higher percentage of students enrolled at private, for-profit ("proprietary") schools hold education debt (96 %) than students at public colleges and universities or students attending private non-profits.

Two out of every five students enrolled at proprietary schools are in default on their education loans 15 years after the loans were issued.
In spite of this high extended default rate, for-profit colleges are in no danger of losing their access to federal financial aid because, as we have seen, the Department of Education does not record defaults after the first two years of repayment.

Nor have the disturbing findings of recent Congressional hearings on the recruitment techniques of proprietary colleges jeopardized these schools'
access to federal funds. The hearings displayed footage from an undercover investigation showing admissions staff at proprietary schools using recruitment techniques explicitly forbidden by the National Association of College Admissions Counselors. Admissions and enrollment employees are also shown misrepresenting the costs of an education, the graduation and employment rates of students, and the accreditation status of institutions.

These deceptions increase the likelihood that graduates of for-profits will have special difficulties repaying their loans, since the majority enrolled at these schools are low-income students. (Forbes magazine, Oct. 26, 2010, "When For-Profits Target Low-Income Students", Arnold L. Mitchem)

A credit score is not required for federal loan eligibility. Neither is information regarding income, assets, or employment. Borrowing is still encouraged in the face of strong evidence that the likelihood of default is high.

Loaning money to anyone without prime qualifications was "subprime lending" during the ballooning of the housing bubble, when banks were enticing otherwise ineligible candidates to buy houses they could not afford.

Shouldn't easy lending without adequate credit checks to college students with insecure credit also be considered "subprime lending"?

Government's Bias Toward the Private Educational Sector

In 2009 President Obama initially pledged $12 billion in stimulus funds to help community colleges through the economic crisis. Last March that sum was slashed to $2 billion. The umpteenth example of a broken Obama promise.

We see a drastic cut in federal stimulus funding even as state funding for higher education is expected to fall even further. At a time when community colleges across the country are overflowing with returning students seeking new skills and high school graduates who can't afford ever-rising tuition rates at many four-year schools, the majority of education-bound stimulus funds are going to for-profit institutions, not community colleges. (Our home state of Washington illustrates the general direction of the administration's "reform" of higher education: for the first time in the state's history, public funds no longer pay the majority of higher education costs.)

Apart from stimulus funding, overall government student aid is disproportionately aimed at those attending proprietary schools. Nearly 25% of federal financial aid is spent on students attending for-profit colleges, even though these colleges enroll less than 10% of the nation's college students.

Proprietary schools now rely on federal financial aid – PELL Grants and federal loans – as their primary source of revenue.

Even the most profitable proprietary schools receive the majority of their funding from federal financial aid programs. According to a U.S.-Senate-sponsored study, The University of Phoenix, the largest private university in North America, receives 90% of its funding from the federal government. Not-so-incidentally, proprietary schools are among the largest donors to Education Committee members.

Proponents of the system defend it by pointing out that public colleges also rely on taxpayer subsidies for the majority of their revenue. But this overlooks a decisive difference: what proprietary schools don't have that public schools do, is an obligation as a state agency to deliver a high quality education to its students. Instead, proprietary schools have a legal fiduciary duty to their stockholders, like any other for-profit enterprise. As a result, according to a PBS Frontline investigation, the sector spends 20 to 25 % of its budget on marketing and only 10 to 20 % on faculty.

The Track Record of For-Profit Colleges

The track record of for-profit colleges does not justify their disproportionate share of government largesse.

Drop out rates are higher than they are at public and non-proprietary private schools, often as high as 50 %. Irrespective of whether a student drops out, the for-profit college has already pocketed tuition and fees. The student is left still burdened with a substantial loan obligation.

As for graduation rates, a 2008 report by the National Center for Education Statistics puts the graduation rate for students at for-profits beginning their studies in 2002 at 22%, an 11% drop from students enrolling in 2000. The same cohort attending public and private non-profits graduated at rates of roughly 54% and 64%, respectively. Graduate or not, the debt burden remains.

Suppose the student does not drop out but either seeks to transfer to a public or another non-profit, or completes her studies and enters the job market with a proprietary degree? Many students assume that credits are transferable to a public or nonprofit, but they aren't, so they pay twice to attain their degree. The school holds out the lure of high-paying jobs upon graduation, but either no such jobs exist or they require education or experience beyond what the school provided. Congressional studies have shown that the earnings of proprietary graduates are the lowest of all graduates. According to a 2009 Bloomberg report on salary comparisons between traditional and online degree-holders, graduates with bachelor's degrees from traditional colleges earn a median salary of $55,200, while those with degrees from the University of Phoenix earn only $50,500, and $43,100 from for-profit American Intercontinental.

On top of these earnings and job-prospect disadvantages, proprietary graduates bear the heaviest academic debt burden. The Education Department reports that 43 % of those who default on student loans attended for-profit schools, even though only 26% of borrowers attended such schools. Many of those who attended for-profits don't earn enough to repay their loans. It's not uncommon for a student who either paid out of pocket or took out a loan for a $30,000 degree to find herself stuck in a $22,000 a year job. This only adds insult to injury: a Government Accounting Office study reports that "A student interested in a massage therapy certificate costing $14,000 at a for-profit college was told that the program was a good value. However, the same certificate from a local community college cost $520.00."

Paying back student loans out of low income and over a long period of time can rule out the possibility of making other financial investments required for the vanishing American Dream, such as buying a house, or saving for retirement or for one's children's education.

All in all, the for-profits' track record is more than dismaying. In too many cases, students leave proprietary schools in worse financial shape than they were in before they enrolled. The problem is not limited to proprietary graduates: most of this generation of college grads now possess more debt than opportunity.

You might think that the unflattering record of for-profit schools would restrain government gift-giving. After all, the Obama administration's current education policy would punish "underperforming" public schools and teachers. But these policies target the public sector exclusively: the aim is to undermine teachers' unions and encourage privatization by boosting charter schools. It is entirely consistent with Washington's agenda that the dismal performance of proprietary schools does not jeopardize their future access to public financial aid funds – as long as the student does not default on their loan within two years of dropping out.

The Career College Association, the lobbying arm of publicly traded colleges, finds all this to be irrelevant. It relies on a different type of indicator from the rest of the higher education sector to measure the success of its for-profit colleges: stock prices. Remarkable. We see the disproportionate flourishing of "schools" whose primary concern has nothing to do with education.

Proprietary Schools and the Military

Proprietary schools target the military market with an aggressive and highly successful marketing campaign. For-profit colleges are the destination of high numbers of active duty and recently discharged military personnel. Data from the US Army and Defense Department show that the University of Phoenix is the third largest receiver of education funding from the US Army.

29% of military enrollments are in the for-profit sector, and 40% of annual tuition assistance to veterans winds up going to proprietary schools. Often targeted while still enlisted, military personnel are attracted to the relative ease with which they can attend school, often at night, on the weekends, or for active-duty military, even while deployed. With the recent reduction of troops in Iraq, more service members are returning to the United States. Waiting for them are generous G.I. Bill benefits, allowing them to pursue vocational or baccalaureate degrees at accredited colleges. The for-profit sector is poised to corner that market as public institutions squeeze their enrollments, raise tuition and watch public support of higher education dwindle in the current resurrection of pre-Keynesian economic policy.

The job prospects for military personnel at for-profits are predictably poor. A Bloomberg report quotes a retired Marine Corps Colonel who now directs human resources for U.S. Fields Operations at Schindler Elevator Corp., as saying "we don't even consider" online for-profit degree-holding candidates for the company's management development program.

THE PRIVATE LENDERS: SECURITIZATION AS USUAL

The two largest holders of student loans are SLM Corp (SLM) and Student Loan Corp (STU), a subsidiary of Citigroup. SLM -Sallie Mae- was originated as a Government Sponsored Enterprise (GSE) in 1972. The idea was to prime it for eventual privatization. In 1984 the company began trading on the New York Stock Exchange under the ticker symbol SLM. In 2002 Sallie Mae shed the its GSE status and became a subsidiary of the Delaware-chartered publicly traded holding company SLM Holding Corporation. Finally, in 2004 the company officially terminated its ties to the federal government.

As the nation's largest single private provider of student loan funding, SLM has to date lent to more than 31 million students. In 2009 it lent approximately $6.3 billion in private loans and between $5.5 billion and $6 billion in 2010.

In the 1990s, well before its full privatization, Sallie's operations were increasingly swept into the financialization of the economy. It jumped whole hog onto the securitization bandwagon, lumping together and repackaging a large portion of its loans and selling them as bonds to investors. SLM created and marketed its own species of asset-backed securitized student loans, Student Loan Asset Backed Securities (SLABS). When derivatives trading went through the roof following the 1998 repeal of Glass-Steagal, increasingly diverse tranches of Sallie-Mae-backed SLABS entered the market. The company is now also buying and selling the obligations of state and nonprofit educational-loan agencies.

Student loans were included in the same securities that are blamed for the triggering of the financial crisis, and financial products containing these same student loans continue to be traded to this day. The health of these tranches and securities is, as we have seen, highly suspect.

SLM's risk was minimized as long as the feds guaranteed its loans. But as part of last March's health care legislation, starting in July 2010 federally subsidized education loans were no longer available to private lenders. What do education loans have to do with health care? Since the government took federal loan originations in-house, making them available only through the Department of Education, it no longer has to pay hefty fees (acting as the guarantee) to private banks. The Obama administration expects to save $68 billion between now and 2020. $19 billion of this will be used to pay for the $940 billion health care bill.

SLM will do quite well despite this seeming setback. The company anticipated the change in government lending policy by executing an ingenious trick as a borrower. Early last year it made its insurance subsidiary a member of the Federal Home Loan Bank of Des Moines, which agreed to lend to big-borrower SLM at the extraordinary rate of .23%. And anyhow, subsidized loans are almost always insufficient to cover the entire cost of a college degree. For a while the student gets to enjoy the benefits of a government loan. Interest rates are lower and during deferment interest does not accrue. But eventually many students must also take out a private loan, usually in larger amounts and with higher interest rates which continue to mount during deferment.

THE WORST-CASE SCENARIO: GOING BANKRUPT

Credit card and even gambling debts can be discharged in bankruptcy. But ditching a student loan is virtually impossible, especially once a collection agency gets involved. Although lenders may trim payments, getting fees or principals waived seldom happens.

The Wall Street Journal ran a revealing report on the kinds of situation that can lead to financial catastrophe for a student borrower. ("The $550,000 Student Loan Burden: As Default Rates on Borrowing for Higher Education Rise, Some Borrowers See No Way Out", Feb. 13, 2010) Here is an excerpt:

"When Michelle Bisutti, a 41-year-old family practitioner in Columbus, Ohio, finished medical school in 2003, her student-loan debt amounted to roughly $250,000. Since then, it has ballooned to $555,000.

It is the result of her deferring loan payments while she completed her residency, default charges and relentlessly compounding interest rates. Among the charges: a single $53,870 fee for when her loan was turned over to a collection agency.

Although Bisutti's debt load is unusual, her experience having problems repaying isn't. Emmanuel Tellez's mother is a laid-off factory worker, and $120 from her $300 unemployment checks is garnished to pay the federal student loan she took out for her son.

By the time Tellez graduated in 2008, he had $50,000 of his own debt in loans issued by SLM… In December, he was laid off from his $29,000-a-year job in Boston and defaulted.

Heather Ehmke of Oakland, Calif., renegotiated the terms of her subprime mortgage after her home was foreclosed. But even after filing for bankruptcy, she says she couldn't get Sallie Mae, one of her lenders, to adjust the terms on her student loan. After 14 years with patches of deferment and forbearance, the loan has increased from $28,000 to more than $90,000. Her monthly payments jumped from $230 to $816. Last month, her petition for undue hardship on the loans was dismissed."

THE FIRST AUSTERITY GENERATION'S JOB PROSPECTS

Most of those affected by the meltdown of 2008 had completed their education and were either employed or retired. The student loan debt bubble signals a generation that enters the work of paid work cursed with what is more likely than not to be a life of permanent indebtedness and low wages.

Both recent trends and the most informed projections for the future of the labor market reveal that most of the current cohort of indebted students will face earnings prospects far poorer than what job seekers could expect during the period of the longest wave of sustained economic growth and the highest wages in US history, 1949-1973. The present generation will experience the indefinite extension of Reagan-to-Obama low wage neoliberalism.

According to the National Association of Colleges and Employers more than 50 % of all 2007 college graduates who had applied for a job had received an offer by graduation day. In 2008, that percentage tumbled to 26 percent, and to less than 20 % in 2009. And a college education has been producing diminishing returns. For while a college degree does tend to correlate with a relatively high income, during the last eight to ten years the median income of highly educated Americans has been declining.

Every two years the Bureau of Labor Statistics issues projections of how many jobs will be added in the key occupational categories over the next ten years. The projected future jobs picture indicates that the grim employment situation is not merely a temporary reflection of the current unusually severe downturn. But you miss this if you get your news only from mainstream sources. The New York Times's report on the most recent BLS projections, issued in December 2009, paints an unduly optimistic picture of future employment opportunities. (Catherine Rampell, "Where the Jobs Will Be", Dec. 15, 2009) Here is how a misleading report can be produced without falsifying the facts:

BLS releases two job projections, on the Fastest Growing Occupations (www.bls.gov/emp/ep_103.htm <http://www.bls.gov/emp/ep_103.htm>) and on Occupations With the Largest Job Growth (www.bls.gov/emp/ep_table_104.htm). The Times focuses on the former, where the two fastest growing occupations, biomedical engineers and network systems and data communications analysts, require a college degree. The Times echoes BLS's comment that occupations requiring postsecondary (a bachelor's degree or higher) credentials will grow fastest. This is redolent of the ideology of the "New Economy" : the US is turning into a society of professionals and knowledge workers, and the key to success in this upgraded economy is a college education.

But we need more information, about the degree requirements of the total number of job categories listed in both projections, and about the number of new jobs expected to materialize in each projection. Of the total jobs listed, only one of five require a postsecondary degree. By far the fastest growing category is biomedical engineers, projected to grow 72.02 %, from 16,000 in 2008 to 27, 600 in 2018. That's 11,600 new jobs. Is that a lot? Well, compared to what? The percentage figure, 72.02, is high, but what about the number of new jobs? Let's compare that Fastest Growing occupation with retail salespersons, the fifth occupation on the Largest Growth list. Retail sales workers will grow by a mere 8.35 %. But that amounts to almost 375,000 new jobs, an increase from 4,489,000 jobs in 2008 to 4,863,000 jobs in 2018. Compare that to the 11,600 new jobs at the top of the Fastest Growing list. Just do the simple math on all the categories on both lists: the great majority of new jobs will be low-paying.

The US is a nation of knowledge workers? Most new jobs will offer the kind of wage we would expect from an economy in which, according to one of Obama's most repeated mantras, "we" will "consume less and export more". BLS avers as much when it projects 51 million "job openings due to growth and replacement needs," fewer than 12 million of which will require a bachelor's degree.

Our first austerity generation will be in debt to its teeth and stuck with low-wage work. The relative penury will require more debt still. Michael Hudson calls this debt peonage. We need to begin thinking of political organization that has little to do with the ballot box. And thinking won't be enough…

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