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Economic Commentary

Ten Years After the Crash: Today's Student Loan Crisis

In the fall of 1966, I entered the Wharton Graduate School of Finance in Pennsylvania to work toward my MBA degree. During my second and final year at Wharton, I had numerous on-campus job interviews and I received 21 job offers. More than one-third of the students who started with me in 1966 failed to graduate. The reason was they had too many job offers that were not contingent on their graduating, and consequently they took the job they wanted and dropped out.

Almost ten years later while I was working in the Investment Research Department at Citibank in New York City, I came across an internal personnel study from the 1950s that piqued my interest. At that time the average age of a first level officer was 49 years, for the next level it was 53 years, and for vice presidents it was 58 years. During that era, there was so little turnover that promotions only occurred when incumbents retired.

By the mid-1970s while I was working at Citibank, the comparable average officer ages were 25, 28, and 31 respectively. Citibank was promoting people much more rapidly in the 1970s, but those same people were leaving at a much higher rate than their peers from the 1950s. From these observations I inferred that I was among the fortunate who arrived in the workplace when the demographics of business organizations were very favorable to new entrants. That has not been the case for graduates seeking to enter the job market from 2008 to 2016, the years following the Great Recession of 2008.

Typically when an economic downturn occurs, there is an increase in the number of individuals seeking to attend graduate school to enhance their employability. Looking back, when I needed to borrow money for graduate school interest rates on loans were 3.25% in an environment where the U.S. Treasury was borrowing money at 5% for long term bonds. However today, upon graduation students are often looking at loan rates of 8% in an environment where the U.S. Treasury is borrowing money at 3.25%. This is the rather odd consequence that occurred after the economic downturn that began in 2008. In the ensuing years the Department of Education took over the student loan business from the same banks that had made loans to me and others in the 1960s.

The consequences to current student loan debtors have been well documented. This Gen-Y demographic has deferred marriage and generally been slow to purchase homes. This is a significant cause of the declining birthrate and therefore smaller family size. Large outstanding debt balances increase financial stress on individuals and lead to other sociological problems. No wonder that many people in this age cohort believe that free enterprise has failed them and they are drawn to the promises of "Democratic Socialism."

Current Progressive candidates for political office frequently include "Free College" as part of their platform. By this they mean community colleges and state universities. The key selling point is that the cost of a student's education would be borne by someone other than the student. Of course, were such a proposal to become a reality, those former students with $1.4 trillion in aggregate debt would insist on their plight being not only addressed, but solved.

During President Barack Obama's Administration, the Department of Education created a number of programs designed to reduce the financial burden of servicing student loan debt. One significant feature of some of the programs, involved the forgiveness of the debt if the former student worked for some level of government or a non-profit enterprise. While well intentioned, this type of approach effectively froze many individuals into jobs and careers that did not suit them. This situation is reminiscent of the draft deferments granted to seminarians and teachers during the Vietnam War, and the subsequent spike in young men entering those professions. That well intentioned program did not work out well for either schools or congregations over the ensuing years.

Those individuals carrying large student loan balances today face a dilemma on a par with all those homeowners who lost their homes after the housing market collapsed in 2008-2009. At least homeowners could declare bankruptcy and get a fresh start, a legal option that is not available to individuals with student debt. The typical mechanism for working out this student loan debt arrangement, is to refinance at a lower rate and extend the loan period. There are some private lenders today willing to do this, but they are obviously seeking to refinance only the most creditworthy individuals.

There are no costless solutions to this ongoing and growing debt situation. It is unlikely that anyone thought the housing crisis of 2008-2009 would give rise to the student loan crisis of today. The best outcome for all involved would be for robust economic growth, resulting in an abundance of higher paying jobs. This would enable borrowers to not only service their loans, but to repay them and remove that financial burden. Here's hoping.

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