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# Are student loans fundamentally flawed?

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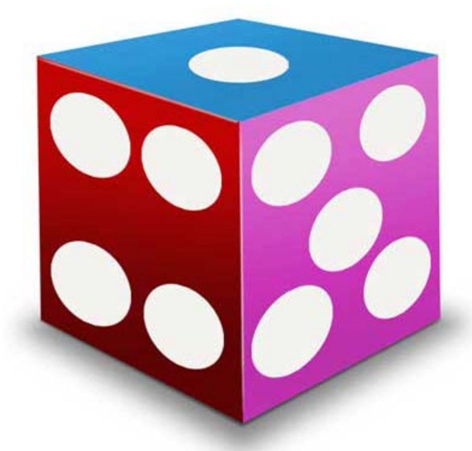
## Are Student Loans Fundamentally Flawed?

Higher education in the United States is very different than in most other countries in the world. In most countries, higher education is considered part of the public education system and is funded in the same way, through taxes, and priced the same way, so it is basically free. There are increasing exceptions to this model, most notably the United Kingdom where tuition at most universities is currently about £9,000—still a very sweet deal relative to the typical American private school and even many public institutions.

The history of these differences and the impact on quality and equity are a topic for another time, but the American model requires a very different funding method, even for state institutions who have some (but increasingly less) tax support. The basic revenue sources, as almost all Americans know, are tuition, alumni support (annual fund type gifts) and endowment (basically past alumni and friends' support). The tuition piece is then financed by students and families either through current income, savings or borrowing.

Some commentators on higher education have become increasingly worried about student loan debt. *Forbes* has a five part series on how we pay for college, and in the first installment author Josh Freedman examines the history of student borrowing and laments the fact that student loans place the risk of repayment directly on the borrower, rather than socializing or sharing the risk the way insurance markets do. (In health insurance markets, for example, the healthy cover the costs incurred by those unlucky enough to get sick.) By sharing the risk, Freedman argues that society should share the re-payment burden of possible negative outcomes (or even if the borrower "wants to start a family") once a student graduates.



But his analogy seems to me to be fundamentally flawed. Education and student loans are not designed primarily to be insurance against a bad outcome in life, but rather an investment in human capital. The outcome of that investment is largely, though not entirely, controlled by the individual investor/student. Society does not get any of the upside benefits of higher income and upward social mobility (save more tax revenue) so to suggest that we socialize the potential downside seems to be asymmetric.

Certainly not every student will make an investment that will pay off, though evidence suggests that the vast majority will. To socialize the losses from defaults on student loans would create an incentive problem that would go exactly in the opposite direction hoped for by those who worry about growing student loan debt—students would have an incentive to take on more debt, though in that case the rest of us would be responsible for the downside risk.

Freedman concludes his piece by writing:

> *By concentrating risk on individuals – who are least able to mitigate the downsides if something goes wrong – our current student loan system has made college more expensive, turned higher education into an individual, rather than a communal, good, and generated serious negative economic and social risks.*

An alternative reading of the current situation could be:

> *By concentrating risks and rewards on individuals—who are the primary beneficiaries of the investment in human capital—our current college loan system has made college more accessible and turned higher education into the means by which individuals have improved their socio-economic status and by which America has become the richest country in world history.*

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## About the Author: Michael Hemesath

Michael Hemesath is the 13th president of Saint John's University. A 1981 SJU graduate, Hemesath is the first layperson appointed to a full presidential term at SJU. You can find him on Twitter [at] PrezHemesath.