Chapter One

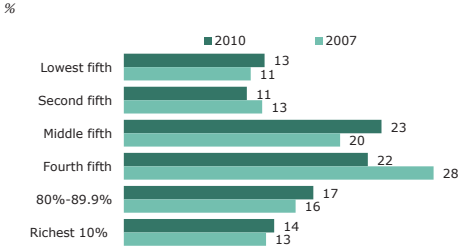
The Worst-Case Scenario

Everyone talks about the $1.2 trillion U.S. student loan bubble, but few have focused on the people most negatively affected by this crisis. Why? Because sometimes the truth is so painful, and solutions are so difficult to come by, that everyone just instinctively looks the other way.

Buried in mounds of federal student loan data, a picture is forming of an entire class of people who reached for the American dream and lost. People who had hopes and ambitions but are now watching their dreams for the future fade away under the weight of student debt. This debt can't be discharged through bankruptcy and will likely follow them to their graves.

These faces of debt belong to America's lower and lower-middle classes, which in 2010 together carried 47 percent of the higher education debt in the U.S.—at that time nearly $1 trillion.[1]

Share of Outstanding Student Loan Debt Owed by Household Income Group, 2007 and 2010



Note: Includes education loans that are currently in deferment and loans in scheduled repayment period.

Source: Pew Research Center tabulations of Survey of Consumer Finances data

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Fig. 1.1

The lowest wage earners, those from households with incomes below $37,000, held 24 percent of all outstanding student loans. That's more than $240 billion in debt weighing on the shoulders of America's poorest citizens. To put it in perspective, those households will spend anywhere from 10 cents to 24 cents of every dollar earned to pay student debt.

And the lower-middle class has its own problems. Households with annual incomes of between $37,000 and $60,000 held 23 percent of the $1 trillion total, or more than $230 billion. They pay 12 cents of every dollar earned toward student loans on average.[2]

But the picture gets worse. Among students with the lowest household incomes, about 79 percent of those who start college will never graduate.[3] Nearly all of those students will nonetheless owe money on the loans they took out to attend the school.

The purpose of this book is to tell the story of those people who find themselves in what I'm calling 'the worst-case scenario': Individuals from lower income households who enter college and never earn a degree, but end up with an overwhelming amount in student loans to repay and little prospect for household income growth. It's time to begin a discussion about ways to help those people.

These worst-case scenario individuals didn't realize they were taking the financial risk of their lives. Who would agree to take on tens of thousands of dollars of debt if they knew their chances of earning a diploma were less than one in four? Not many. Particularly not low-income individuals who would face returning to the same low-paying jobs they held before they took that risk.

Those living with this worst-case scenario reached for the American dream—looking to education as the ticket to a better life—and saw their actions backfire. The combination of high debt and no degree places a young adult or family into economic distress for decades, perhaps forever, almost ensuring they can never club out of their socioeconomic class and in many cases driving them further down the social ladder.

College debt wasn't always as troublesome for Americans. The U.S. Census Bureau found that the average student loan amount jumped 83 percent to $27,547 between 1993 and 2011.[4] The current situation is a result of higher tuition costs combined with a reduction in student aid by many states. The annual growth rate of college tuition and fees has outstripped increases in health-care costs, new home prices and the consumer price index since 1978.

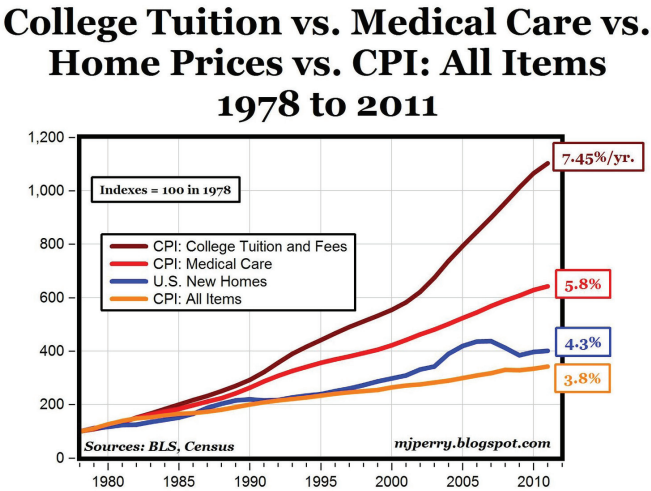

Fig. 1.2

And borrowers increasingly are having trouble meeting their obligations. In 2012, about 32 percent of all borrowers were 90 or more days delinquent in repayment. The delinquency rate was about 20 percent in 2004.[5] The ability of borrowers to pay off their loans is generally dependent on whether they received a diploma or not. In 2005, of those who left school without graduating, 33 percent became delinquent and 26 percent defaulted.[6] So 59 percent of those who didn't graduate had significant problems paying their loans.

The consequences of becoming delinquent or defaulting on student loans are severe. Late payments are reported to national credit bureaus and remain on a student's credit report for up to seven years, making it difficult to borrow for a house or car. The federal government has the right to, and does, garnish wages, tax refunds, Social Security payments and other public benefits. Loans that go into default are turned over to collection agencies and the borrower is responsible for the original balance, accrued interest, court costs and collection fees.[7] Student loans are one of the only debts rarely discharged through bankruptcy and can literally follow a person to the grave.

With $1.2 trillion outstanding, the amount of student loans outstrips the value of auto loans and credit card debt, and so do the delinquency rates. Adults under the age of 35 hold 40 percent of all outstanding debt.[8]

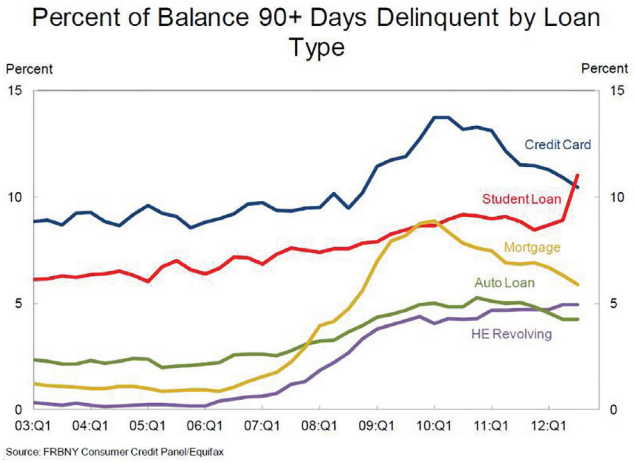

Fig. 1.3

So how did we get to this place where the quest for the American dream became the American nightmare? It all began with good intentions—the federal government's desire to ensure every American could afford a college education. Congress opened up the federal pocket book in 1965 with Title IV of the Higher Education Act, creating the first federal grant and loan programs. Or, as an advisory group for the Federal Reserve Board of Governors put it, the U.S. allowed "significant growth of subsidized lending in pursuit of a social good."[9]

These programs provided loans and grants for anyone with a desire to go to college regardless of their income or credit rating. The less households earned, the more likely it was that they would receive federal assistance. In the 2012–2013 school year, the federal government issued $105.4 billion in higher education loans, a 11 percent increase from 2009.[10]

New Student Loan Volume (Non-Consolidation)

Program Volume[1]	FY2009	FY2010	FY2011	FY2012	FY2013[2]	FY2014[2]
New Loan Volume ($millions)						
FFEL	$65,674	$19,618	0	0	0	0
Direct Loans	28,858	80,665	$109,807	$105,351	$106,434	$112,062
Total	94,532	100,283	109,807	105,351	106,434	112,062
Number of Loans (thousands)						
FFEL	14,264	5,220	0	0	0	0
Direct Loans	6,098	16,601	24,038	22,181	21,205	21,891
Total	20,362	21,821	24,038	22,181	21,205	21,891

Notes: Details may not sum to totals due to rounding. Loan volume and number of loans reflect net commitments.
[1] Includes Subsidized and Unsubsidized Stafford Loans, and PLUS loans originated in each fiscal year.
[2] Estimated volume.

Fig. 1.4 U.S. Department of Education

The influx of federal money nearly guaranteed a steady flow of students for colleges. Unfortunately, starting in the 1980s, schools saw they were able to increase tuition well beyond the rate of inflation without a decline in student enrollment. In fact, student enrollment actually increased even as tuition rates continued to rise!

The irony is that even as student debt loads have risen along with tuition, so has the value of college endowment funds. The aggregate market value of these nontaxable funds, which are used to finance portions of a school's operating, scholarship and capital needs, jumped a whopping 9 percent between June 2009 and 2010 alone to $356 billion.[11]

So the non-profit universities in America have $356 billion safely invested in tax-exempt funds, while households with incomes less than $37,000 now carry more than $240 billion of student debt. This certainly wasn't the economic outcome the federal government intended, but here we are.

I believe these facts tell the real story behind the student debt crisis. It's a story few U.S. politicians and news organizations have publicly addressed. The bottom line is the current system of higher education—high tuition costs funded by free flowing federal financial aid—is broken, and the failure to fix this has placed an entire generation of lower and lower middle class people into economic jail.