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One inexpensive and easy fix for the student loan problem

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A key Republican Education Department official and Trump Appointee, A. Wayne Johnson, recently resigned his position and made a radical call for student loan cancellation. Johnson noted that the lending system was "fundamentally broken" and called for loan cancellation for all loan holders up to $50,000. He also called for a tax credit of the same amount for those who have already repaid their loans. Interestingly, Johnson's plan sounds very similar--and in some ways even more generous--than what presidential candidate Elizabeth Warren is proposing.

This is strong stuff coming from a Republican, particularly one who ran the federal lending program. Johnson's comments could indicate that this problem is far worse than the Department of Education has said publicly. He noted that he came to this conclusion after having a "firsthand look" at defaults, which we already know are running at about 40% for 2004 borrowers. And those borrowers were only borrowing one-third of what students are borrowing currently. One can only wonder how bad the internal projections must be for more recent students.

Johnson is to be applauded for calling out this big-government lending monstrosity, and even for his call to get the government out of the lending business. In the absence of both bankruptcy protections and statutes of limitations, the Department of Education has become one of the largest lenders on earth, and a viciously predatory one at that. Johnson is also correct in pointing out that the various forgiveness programs run by the Department are failing badly. Additionally, at least a portion of the $50+ billion that the department makes in profits every year are being used to fund unrelated social programs (like Obamacare), despite President Lyndon B. Johnson's declaration in 1965 that these loans would be "free of interest."

However, there were problems with Warren's plan, and these have not gone away under the current proposal.

For example, despite the rising default rate, many borrowers are doing fine. They enjoyed the benefits of their loans and now they are successful enough to make the payments. There is no particularly good reason to cancel their debt. Conversely, there are many borrowers who owe far more than $50,000, who have seen their debt explode with penalties, fees, and interest, such that writing them down by $50,000 really wouldn't make much of a dent. In short, Warren's "one-size-fits-all" approach makes little sense. And at a price of $925 billion, it's expensive.

Also, any cancellation program would be administered by the Department of Education, which has a well-documented history of bungling such programs. For example, of the roughly 40,000 people who thought they were getting cancellation this year through the Public Service Loan Forgiveness Program, fewer than 100 (less than 1%) actually will. Similarly, a whopping 57% of people in the Income Based Repayment Program (IBR) were disqualified for administrative reasons. This means that many borrowers have been cruelly left owing far more than they would if they had never entered it.

To be blunt: the Department of Education cannot be trusted to administer yet another loan cancellation program. As they have done before, they will surely find ways to disqualify the vast majority of borrowers so that the agency captures the wealth rather than those who it was intended for.

A far more efficient solution to this problem is simply returning standard bankruptcy protections to these loans. The founders called for uniform bankruptcy in the Constitution before even giving Congress the power to raise an army or declare war, and the student lending system is proving their wisdom. Borrowers must have bankruptcy protections on their side in order for the lending system to be fair. It is only with this threat that lenders will act with a modicum of good faith. It will help restrain lending and force college prices down to rational levels.

Bankruptcy is also a far less expensive solution than Warren's. At first, there would be an unavoidable spike in filings, but bankruptcy scholar Robert Lawless has estimated that in the “steady-state”, annual discharges would come to less than $3 Billion per year. Even if it turned out to be double or triple this rate, that is still far less than Warren's proposal -- not to mention that this would require no tax hikes. This could be achieved by simply repealing the one line in the federal code that exempts student loans from standard bankruptcy protections.

There is legislation in Congress that would achieve this: HR. 2648, a bipartisan bill, and its Senate companion, S. 1414. Alternatively, President Trump could simply direct the Department of Education to stop opposing student loan borrowers in bankruptcy court. Either way, we would get a much more efficient and well suited outcome.

Not to mention: The Founders would agree.

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