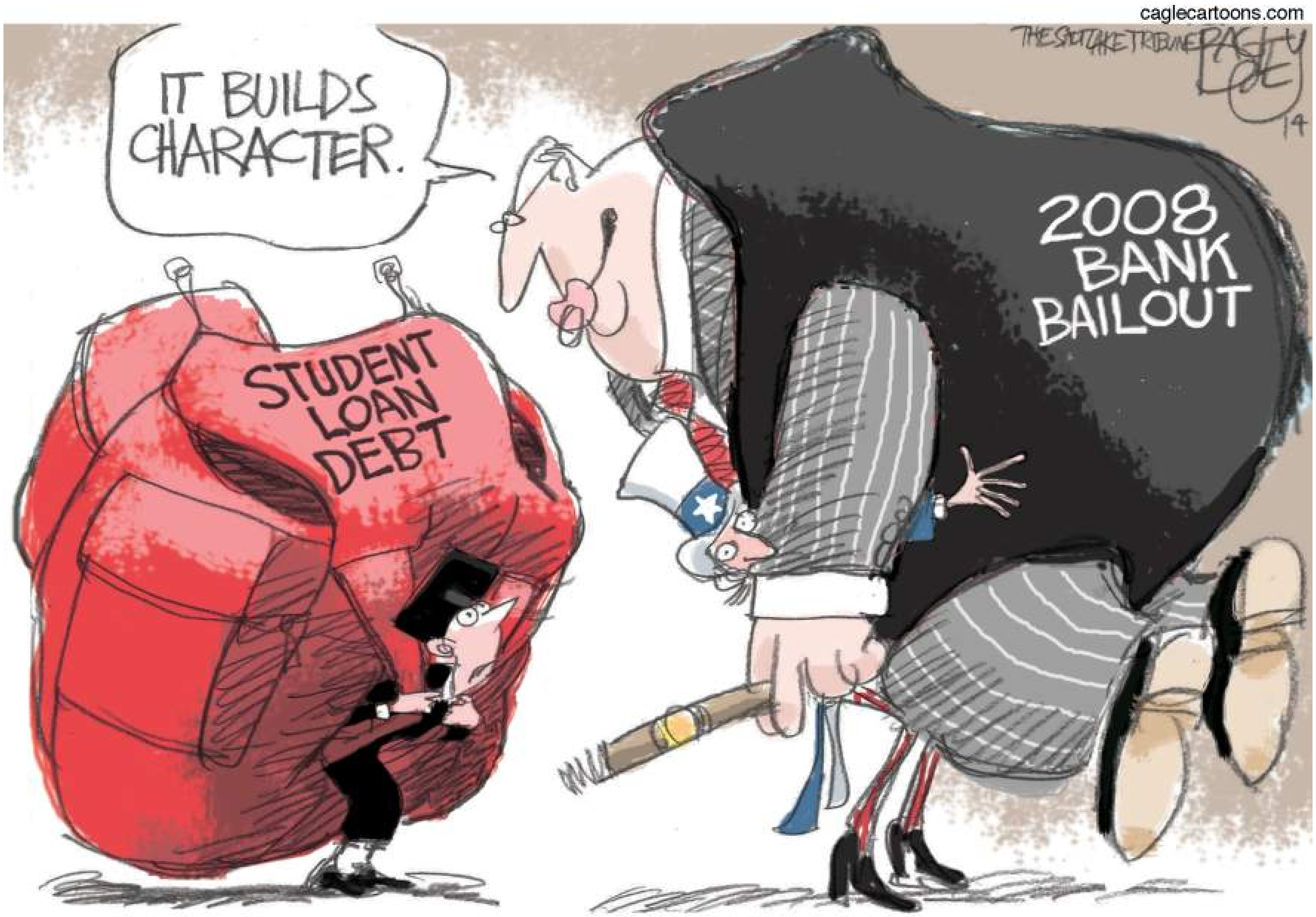
The disease that is government



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We don't expect our elected leaders to never make mistakes. But is it asking too much that they learn from them? Given the president's renewed call for student loan forgiveness, one wonders.

Not even a decade has passed since the housing bubble burst, taking with it over $1 trillion in economic output, and already our leaders are walking the exact same road with student loan markets that they did with mortgage loan markets. We all remember how that ended.

Politicians and bureaucrats manipulated mortgage markets, fundamentally altering the pool of borrowers applying for loans. When those (ultimately unqualified) borrowers could not repay their loans, the housing bubble and crash ensued. Today, that same fatal flaw is inflating and, ultimately, will burst the college education bubble.

Getting the causality backward, government acted as if home ownership caused success. So starting in the late 1970s, the government required banks to lend more money to low-income home buyers (through the Community Reinvestment Act and the Riegle-Neal Act), provided tax breaks for home loans (the Taxpayer Relief Act), and allowed banks to profit from lending while forcing taxpayers to bear the cost of bad loans (via Fannie Mae and Freddie Mac).

But here's the catch: Since lower-risk borrowers had little trouble obtaining mortgages, the government's intervention simply increased the number of higher-risk borrowers.

Getting the causality backward again, government acts as if a college degree causes, rather than results from, success. As it did in the housing market, the government requires banks to lend to high-risk borrowers (via Stafford and Perkins loans), provides tax breaks for college loans (the Taxpayer Relief Act), and forces taxpayers to subsidize student loans (via the Department of Education).

Last year, President Obama expanded his student loan forgiveness program, wherein taxpayers pay for college loans that students can no longer afford. In January, the president proposed that taxpayers underwrite students to attend community college.

But here's the catch: Since more talented and harder working students have less trouble getting into college, encouraging more borrowing for college largely means encouraging less talented students to take out college loans. As with the housing market, this will simply alter the pool of borrowers. The influx of college students will drive up tuition in the same way that the influx of home buyers drove up housing prices.

Less talented students who drop out or graduate with degrees for which there are no jobs will find themselves saddled with debt that they cannot repay. Many will default on their loans, as did the high-risk homeowners.

Taxpayers will be forced to pay for the bad college loans, just as they were forced to pay for bad home loans. Demand for college will plummet, as did demand for housing. Some colleges will go bankrupt and others will seek bailouts, as did the banks.

Like the bank presidents, university presidents will be vilified for accepting students' tuition dollars without concern for whether those students could succeed.

Politicians will beat their breasts and point fingers at the “free market” and call for more regulation of lending markets and oversight of universities. And, as today, politicians will have missed the lesson entirely and so be doomed to repeat it yet again. In the housing market, in the college loan market and in whatever market comes next, government isn't the cure.

It is the disease.

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