

Biden's Student-Loan Fiasco

The Dow Jones Industrial Average fell more than 1,000 points on Friday, caused apparently by Fed Chairman Jerome Powell's attempt to use a brief speech to channel the ghost of Paul Volcker. Obviously, this was part of the market's worries, but the stage was set when the Biden Administration announced a student loan forgiveness program last week. The more we learn about this, the worse it looks.

The executive order would send an already very bad student loan system – a system designed more to create jobs for academics than to really help students – into overdrive, generating huge costs for taxpayers, soaring college prices, and a massive shift in resources toward the already bloated college sector, which already generates negative marginal value-added for both students and our country.

The Biden Administration says the changes would cost \$240 billion in the next ten years. The Committee for a Responsible Federal Budget says \$440 - 600 billion. A budget model from Wharton says \$1 trillion. But even that \$1 trillion figure might be way too low.

The key is that, as bad as it is, the cancellation of some student debt that already exists is only a small part of the policy change. The much bigger change, and the one that the market has finally begun to absorb, is limiting future payments on debts to 5% of income, but only after the borrower's income rises above roughly \$30,000 per year. For example, if someone makes \$70,000 per year, then no matter how much they borrow they're limited to paying \$2,000 per year (5% of the extra \$40,000). After twenty years, any remaining debt would simply disappear.

Think about the perverse incentives!

For the vast majority of students, choosing this "income-based repayment" system would be a no-brainer. And once they pick it, they wouldn't care at all whether their college charges \$35,000 per year (tuition, room, board, and fees), \$85,000, or even \$150,000. In fact, students would have an incentive to pick the priciest college with the best amenities they could find and pay for it all with federal loan money, because their repayments are capped. If you always wanted Rodney Dangerfield's dorm room from the movie Back to School, you're in luck!

Meanwhile, students would have the incentive to take out loans *greater* than what they need because they can turn the excess into cash for "living expenses." Then they could use it to buy crypto, throw parties, or pretty much anything else. Who cares?!? The government would limit their future repayments.

And here's what might be the worst part: colleges would have an incentive to enroll students even if they have horrible future job and earning prospects. By enrolling people no matter how poorly prepared they are, a college can charge whatever they want and get huge checks from the federal government. And the unprepared students won't care because they really don't have to pay it back. In effect, colleges could create massive and perfectly legal money-laundering schemes.

We are not legal experts and do not know whether the new proposal will be implemented fully. But, if it is, watch out: college costs are poised to skyrocket and academia is courting a political backlash of enormous proportions. Meanwhile, the market is attempting to digest just how far from economic reality politicians have become. The political allocation of capital is a recipe for economic disaster.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-31 / 8:45 am	Chicago PMI – Aug	52.4	52.1		52.1
9-1 / 7:30 am	Initial Claims – Aug 28	248K	245K		243K
7:30 am	Q2 Non-Farm Productivity	-4.4%	-3.9%		-4.6%
7:30 am	Q2 Unit Labor Costs	+10.7%	+10.7%		+10.8%
9:00 am	ISM Index – Aug	51.9	52.2		52.8
9:00 am	Construction Spending – Jul	-0.3%	+0.3%		-1.1%
afternoon	Total Car/Truck Sales – Aug	13.3 Mil	13.3 Mil		13.3 Mil
afternoon	Domestic Car/Truck Sales – Aug	10.9 Mil	10.5 Mil		10.7 Mil
9-2 / 7:30 am	Non-Farm Payrolls – Aug	300K	300K		528K
7:30 am	Private Payrolls – Aug	300K	300K		471K
7:30 am	Manufacturing Payrolls – Aug	15K	20K		30K
7:30 am	Unemployment Rate – Aug	3.5%	3.5%		3.5%
7:30 am	Average Hourly Earnings – Aug	+0.4%	+0.4%		+0.5%
7:30 am	Average Weekly Hours – Aug	34.6	34.6		34.6
9:00 am	Factory Orders – Jul	+0.2%	-0.8%		+2.0%