Accounting for Intrinsic Values in the Federal Student Loan System

Yoaav Isaacs & Jason Iuliano[*]

Over the past decade, the total amount of student loan debt in the United States has nearly tripled. The figure now exceeds 1.5 trillion dollars—an amount higher than automotive or credit card debt.[1] Although the rapid increase in outstanding educational debt is suggestive of a problem, the larger cause for concern is the high default rate. As it stands, more than eleven percent of student loans are in default—compared to less than one percent of auto loans or home mortgage loans.

Even the high student loan default rate, however, paints a far too optimistic picture. Owing in part to deferment and forbearance options, only sixty percent of all educational debts are in active repayment. Growing numbers of debtors are pushing off repayment as long as possible—a strategy that buys time but ultimately yields significantly heavier debt burdens.[2] For these reasons, it should come as no surprise that there is widespread concern over this issue. Senator Dick Durbin, for instance, has called student loan debt "one of the biggest threats to millions of working families," and individuals as varied as Senator Elizabeth Warren and Mark Cuban have warned of a "bubble" in the student loan sector.

Unfortunately, despite these warnings, the problem is only getting worse. Over time, more and more students have been taking out larger and larger student loans. Today, for graduating seniors, the average educational debt is close to forty thousand dollars.[3] Couple this figure with the high interest rates that are characteristic of student loans, and for many individuals, this sum becomes too much to repay. Making matters even worse, Congress has excepted most student loans from the normal bankruptcy discharge process—effectively ensuring that loan decisions that students make at eighteen years of age will haunt them for the rest of their lives.

It is clear that the student loan system is in need of significant reforms. Seeking to address this growing problem, politicians and scholars have proposed two main types of solutions: expanded governmental intervention and expanded free market options. Unsurprisingly, this division breaks down along party lines. Whereas Republicans prefer private, free market lending, Democrats believe that greater federal involvement is necessary.

Although Democrats have offered a variety of solutions, from lowering interest rates to expanding income-based repayment programs,[4] the most notable proposal to take hold on this side of the political aisle is free college tuition. Following the success of Bernie Sanders—who made free tuition a central pillar of his presidential campaign[5]—Democrats went so far as to incorporate this idea into their 2016 party platform by promising "[b]old new investments by the federal government" that would make "debt-free college a reality."[6]

Fearing that free college tuition would add to the U.S. debt and unfairly place the burden on taxpayers, Republicans have rejected this plan and offered a very different set of reforms. Keeping with the party's traditional concern over budget deficits, Republicans have focused their proposals on reducing federal grants, cutting federal loan programs, and encouraging private lenders to step in and fill the gap.[7] Along this line, Senator Marco Rubio has set forth one solution which he describes as "student-investment plans."[8] Under Rubio's proposed system, private institutions would pay a student's educational expenses in exchange for a portion of that student's income over an agreed upon period of time.

One of the most popular proposals among Republicans, however, is risk-based lending. Under the present system, Congress fixes the interest rate for federal student loans. This means that all individuals who borrow under a given loan program pay the same rate. By contrast, a risk-based lending approach would vary the interest rate according to the individual borrower's likelihood of repayment.[9] Specifically, students who are deemed to be at higher risk of default would have higher interest rates, and those who are deemed less risky would be able to borrow at lower interest rates. In arguing for such a system, the Heritage Foundation wrote, "In a truly private lending market, student loans to pursue gender studies at an institution with a poor track record should come with a much higher interest rate than loans to pursue a degree in chemical engineering at MIT. After all, these factors have a great deal of bearing on a student's future ability to repay."[10]

This argument has a certain level of intuitive appeal. Risk-based lending is, after all, the model with which people are most familiar and the model that underlies nearly every other type of consumer credit arrangement. From car loans to home loans to credit card agreements, lenders charge different interest rates based on the likelihood that the borrower will honor her debt obligations. Indeed, supporters of risk-based lending often highlight this fact to bolster their argument.

In this chapter, we argue that drawing too strong of an analogy between the educational loan market and other consumer credit markets obscures a fundamental point: In providing student loans, the government's primary goal is not to make a profit; rather, it is to benefit society. Accordingly, when deciding on how to allocate student loans, all benefits—not just monetary benefits—must be taken into account. And one significant benefit that risk-based lending ignores is the intrinsic value that students obtain through their education and careers.

Intrinsic Values Matter

If student loans were given so that lenders could make a profit, then a borrower's expected ability to repay a loan would be the sole determinant of what kind of loan the borrower would be offered. Those with high expected ability to repay a loan would be offered large loans at low interest rates, while those with low expected ability to repay a loan would be offered small loans at high interest rates. In general, educational programs which are more likely to lead to financial success would be funded more readily than educational programs which are less likely to lead to financial success.

But student loans are not given so that lenders can make a profit. Although there are private lenders who operate under a profit motive, the primary agent in the U.S. student loan market is the federal government itself.[11] Notably, the federal government does not issue student loans with the intention to earn a profit.[12] Instead, the federal government issues student loans with the intention of benefiting society. Some of these benefits are supposed to result from positive side effects of increased erudition, such as improved political decision making. But the primary beneficiaries of student loans are the student borrowers themselves.

This is not a controversial claim but rather one that policy makers understand well. Indeed, when discussing the importance of student loans, politicians focus on the benefits that accrue to borrowers. They cite studies showing that college graduates earn significantly more than non-graduates. They point out that jobs requiring a college degree generally offer better health benefits and retirement packages than those which require only a high school degree. And they emphasize

that college graduates are less likely to be laid off during a recession than non-graduates.

Given that a major goal of the federal student loan system is to benefit students, it is possible to articulate how student loans should be allotted. Specifically, the more benefit a student is liable to receive from a loan, the more deserving that student is of the loan. Although unobjectionable on its face, this claim raises an obvious question: how should one calculate the expected benefits of a loan?

A very natural thought is that the figure can be determined by calculating the expected increase in the student's lifetime earnings. Better educated people earn more money, and that extra money is a very natural way of determining the value of an education. Such a system for allocating student loans would not differ much from a risk-based system. In both cases, those who were expected to make the most money would receive the most generous loans and those who were expected to make the least money would receive the least generous loans. This calculation, however, is incomplete. In particular, it accounts only for extrinsic values and fails to account for the intrinsic values that follow from the use of student loans.

The notions of intrinsic value and extrinsic value date back to Plato and Aristotle—the latter of whom is often credited with drawing out the distinction.[13] According to Aristotle, a thing of intrinsic value is good for its own sake, while a thing of extrinsic value is good only for the sake of something else. Differentiating the intrinsically valuable from the extrinsically valuable is, as you might imagine, a controversial matter. Still, one can get a general sense of how this concept works.

The most oft-cited example of intrinsic value is pleasure. A great reason to want pleasure is that, well, it’s so darn pleasurable. In other words, we value pleasure in itself and not for any instrumental benefits it may provide. Now, contrast pleasure with money—the paradigmatic example of extrinsic value. Money is good only because it provides instrumental benefits. If it could not be used to purchase other goods that we desire, such as televisions, books, or plane tickets, there would be no reason to value money. Although pleasure may produce instrumental benefits, it doesn't have to do so in order to be worthwhile. By contrast, if money does not produce instrumental benefits, then you might as well throw away your money.

In his writings, Aristotle contended that the intrinsically valuable has primacy over the extrinsically valuable. The only point of the extrinsically valuable is, after all, to get the intrinsically valuable. This distinction provides important insight into how one should account for the true value of a student loan. If we think of the value of one’s choice of major or career as being determined by its monetary compensation alone, then we foolishly give instrumental value primacy over intrinsic value. This is, unfortunately, exactly what many policy makers do.

Individuals in the labor market, however, intuitively understand that intrinsic values matter. To the extent that a job is enjoyable, esteemed, and safe it will—other things being equal—command less monetary compensation than a job that is unpleasant, disreputable, and dangerous. In short, it takes less money to make a nice job worth doing than it does to make a nasty job worth doing. Contemporary economists refer to such non-monetary factors as “compensating differentials.” A brief example will serve to illustrate how a failure to account for these non-monetary benefits could distort the student loan market to the detriment of student borrowers.

Consider professions in teaching or in the arts. These jobs require a great deal of talent, training,

and work but are paid modestly because of how intrinsically desirable they are. Teaching and artistry are each enjoyable (at least for many), highly-esteemed, and safe. But even if the total value of being a middle school art teacher exceeds the value of being, say, an Alaskan crab fisherman, a system that focuses solely on earning potential will make it much harder to procure loans to study secondary education than loans to study Alaskan crab fishing.[14]

Admittedly, one can make more money fishing for Alaskan crabs than by teaching middle school art, but that's not because Alaskan crab fishing is a better job than middle school art teaching. In fact, it’s because of the exact opposite. Given the choice, most people would opt to teach art because it is a career that confers more intrinsic value.

In light of this differential in intrinsic value, it would be particularly tragic for student loan rates to only take earning potential into account, as such a system would ensure that the future art teacher will be burdened much more by loans of a given size than the future Alaskan crab fisherman will be. In effect, risk-based lending subsidizes careers that provide lower total overall value simply because they command higher wages. Given the purpose of the federal student loan system, such a result is less than optimal, to say the least.

Although modern politicians frequently miss this point, some legislators who were behind the earliest federal student loan programs understood the importance of intrinsic benefits. As one congressman stated on the floor of the House of Representatives:

> It is quality, not quantity alone, that we must seek in our higher education, but that quality must extend to and embrace all educational fields and not just science and mathematics. As important as these subjects are, they must be part of a composite picture, which includes all fields of learning and particularly those fields that relate to the welfare and betterment of man as an individual being endowed with a human soul rather than as a robot responsive to the tick of some scientific gadget. The spiritual must ever prevail as the dominant feature of our system.[15]

Despite our endorsement of this principle, we do not dispute the counterpoint that money has value. We merely maintain that it would be absurd to think that money is the only thing of value. After all, the only reason to value money is that it can be used to purchase other things.

Money can buy enjoyment. But it would be absurd to value the enjoyment that can be bought with money and to discount the enjoyment that is an intrinsic part of enjoyable work. Money can buy safety. But it would be absurd to value the safety that can be bought with money and to discount the safety that is an intrinsic part of safe work. Money can buy esteem. But it would be absurd to value the esteem that can be bought with money and to discount the esteem that is an intrinsic part of estimable work. To most people, this is an intuitive point.

It is, in fact, already obvious that salary alone does not constitute total compensation; health benefits are clearly part of total compensation, though they do not feature directly in salary. Health benefits are, admittedly, easier to quantify than enjoyment, safety, or esteem. But that does not mean that healthcare matters while enjoyment, safety, and esteem do not. It only means that it's not easy to quantify total compensation, and thus that it is not easy to quantify how worthwhile any given line of work is. But that's just to say that it’s not easy to figure out what needs to be figured out.

We are understandably wary of leaving the determinations of what sorts of work are more intrinsically valuable than others (and by how much) to the private judgments of government officials. It's very hard to appropriately value lives radically different from one's own and to distinguish questions of value from questions of taste. We have little idea what the life of a beekeeper is like, and although we're sure that we wouldn't want to be beekeepers, that's plausibly because we are so ill-suited for beekeeping.

We are also wary, however, of merely deferring to the judgments of individuals. People can make bad decisions, so the mere fact that a life is chosen does not demonstrate that it is choiceworthy. In light of these vexing problems, a purely monetary theory of value has undeniable appeal. It is comparatively easy to quantify and allows one to evaluate alternative options with a high degree of precision. But representing a concept as complex as wellbeing by a single economic number is both misleading and misguided. As Robert F. Kennedy once observed,

> Too much and too long, we seem to have surrendered community excellence and community values in the mere accumulation of material things. Our gross national product . . . if we should judge the United States of America by that—counts air pollution and cigarette advertising, and ambulances to clear our highways of carnage. It counts special locks for our doors and the jails for those who break them. It counts the destruction of our redwoods and the loss of our natural wonder in chaotic sprawl. It counts napalm and the cost of a nuclear warhead, and armored cars for police who fight riots in our streets. It counts Whitman's rifle and Speck's knife, and the television programs which glorify violence in order to sell toys to our children.
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> Yet the gross national product does not allow for the health of our children, the quality of their education, or the joy of their play. It does not include the beauty of our poetry or the strength of our marriages; the intelligence of our public debate or the integrity of our public officials. It measures neither our wit nor our courage; neither our wisdom nor our learning; neither our compassion nor our devotion to our country; it measures everything, in short, except that which makes life worthwhile.[16]

Kennedy was far from alone in highlighting the limitations inherent in a purely monetary theory of wellbeing. Economists, too, have driven home this point. In fact, Simon Kuznets, the individual most responsible for the modern measure of Gross Domestic Product, cautioned that income offered an incomplete account of welfare: "no income measurement undertakes to estimate the reverse side of income, that is, the intensity and unpleasantness of effort going into the earning of income. The welfare of a nation can, therefore, scarcely be inferred from a measurement of national income . . . ."[17]

Today, entire subfields of economics—including welfare economics and public economics—have emerged with the goal of quantifying real economic value and determining how the government should act to improve social welfare. Economists working in these traditions have dedicated much time to understanding the notion of wellbeing. Although there is no firm consensus, economists have proposed a number of measures. Some have posited that it is worth giving weight to people's subjective feelings of happiness or to a psychologist's judgment of a subject's happiness.[18] Others have argued that it is better to measure the revealed preferences of individuals or the degree of liberty and freedom that individuals possess.[19] We are not welfare economists and cannot speak

competently to what non-monetary factors ought to be weighed and how they ought to be weighed. But we can say with confidence that the question of wellbeing is not one that student loan subsidy policy can blithely ignore. Some non-monetary considerations are surely relevant, and it is worth society's effort to figure out which.

Although we have focused on non-monetary compensation, we acknowledge that there is something unexpected to be said for giving disproportionate weight to the value of monetary compensation. The government taxes income, but it does not tax general wellbeing. When your job gives you a lot of money, some extra money goes to the public. However, when your job gives you a lot of satisfaction, that satisfaction goes only to you. There is, therefore, a positive externality associated with monetary compensation—a societal benefit that might not be factored into a market equilibrium. If someone is self-interestedly indifferent between a job that pays more but is less intrinsically worthwhile and a job that pays less but is more intrinsically worthwhile, then it's objectively better that he take the former job than the latter. Despite this fact, our primary point still stands. Money is not all that matters, and there are many times that a higher-paying job is objectively worse than a lower-paying job.

As policymakers evaluate changes to the existing student loan system, they, too, should keep in mind the lessons that economists have taught us and avoid relying on an overly narrow conception of benefit. As we have argued, there are many jobs that are humbly paid not because they are of little value, but instead because they are of so much value. Student loans should be orchestrated so as to facilitate—rather than undermine—such noble endeavors.

[*] Author ordering is alphabetical; the authors contributed equally to this chapter.

[1] Total U.S. auto loan debt is around $1.1 trillion. Michael Corkery and Stacy Cowley, "Household Debt Makes a Comeback in the U.S.," The N.Y. Times, last modified May 17, 2017, https://www.nytimes.com/2017/05/17/business/dealbook/household-debt-united-states.html. Total U.S. credit card debt slightly exceeds $1 trillion. "Consumer Credit - G.19," Board of Governors of the Federal Reserve System, accessed December 26, 2017, https://www.federalreserve.gov/releases/g19/hist/cc_hist_sa_levels.html.

[2] Although the government subsidizes certain federal student loans when the borrower meets certain deferment conditions are met, such loans represent only a small portion of all outstanding federal student loans.

[3] "A Look at the Shocking Student Loan Debt Statistics for 2017," last modified September 13, 2017, https://studentloanhero.com/student-loan-debt-statistics.

[4] Martin O'Malley, a 2016 Democratic presidential candidate, was a prominent proponent of these solutions. Martin O'Malley, "Federal solutions to our student loan problem," The Washington Post, last modified April 23, 2015, https://www.washingtonpost.com/opinions/federal-solutions-to-our-student-loan-problem/2015/04/23/a9ab9f6c-e69a-11e4-9767-6276fc9b0ada_story.html?utm_term=.5c4428070aaf.

[5] "It's Time to Make College Tuition Free and Debt Free," last accessed December 26, 2017, https://berniesanders.com/issues/its-time-to-make-college-tuition-free-and-debt-free.

[6] "2016 Democratic Party Platform," The American Presidency Project, last modified July 21, 2016, http://www.presidency.ucsb.edu/ws/index.php?pid=117717.

[7] Megan McClean Coval, "Worse Than It Sounds," last modified September 15, 2017, https://www.insidehighered.com/views/2017/09/15/why-congress-shouldnt-cut-pell-grant-reserve-fund-essay (discussing a Republican budget plan to cut funding for Pell Grants by $3.3 billion).

[8] Stephanie Czekalinski, "Rubio: Here's How to Make College Affordable," last modified February 10, 2014, https://www.theatlantic.com/politics/archive/2014/02/rubio-heres-how-to-make-college-affordable/430614/

[9] For a thorough discussion of—and argument in favor of—a risk-based student loan system, see Michael Simkovic, "Risk Based Student Loans," *Washington & Lee Law Review* 70 (2013): 527. For an argument against such a system, see Jonathan D. Glater, "The Unsupportable Cost of Variable Pricing of Student Loans," *Washington & Lee Law Review* 70 (2013): 2137.

[10] Mary Clare Amselem, "The Case for Private Student Loans," The Heritage Foundation, last modified May 23, 2017, http://www.heritage.org/education/commentary/the-case-private-student-loans.

[11] The federal government originates and services approximately ninety percent of all student loans. Mary Clare Amselem, Soaring Student Debt Costs us All, http://www.heritage.org/education/commentary/soaring-student-debt-costs-us-all

[12] Although costs are a major consideration in the setting of government policy, in light of its taxing power, the government does not possess the same profit-making imperative that drives for-profit corporations. Accordingly, it is able to (and, indeed, often does) pursue socially desirable programs (such as the student loan program) even when such programs generate losses.

[13] Aristotle, *Nicomachean Ethics*. In more recent times, William Frankena has provided an extensive list of intrinsic goods. William K. Frankena, *Ethics* (Englewood Cliffs: Prentice Hall, 1973), 87–88.

[14] Although our fundamental point is far broader, it is nonetheless worth noting that some coastal community colleges and universities do offer programs that provide students with skills relevant to crab fishing. Alecia T. Devantier & Carol A. Turkington, *Extraordinary Jobs in Agriculture and Nature* (New York: Ferguson, 2006), 31.

[15] 1958 CONG. REC. H16684-5 (daily ed. Aug. 8, 1958) (statement of Rep. Elliott).

[16] Robert F. Kennedy, Remarks at the University of Kansas, March 18, 1968, https://www.jfklibrary.org/Research/Research-Aids/Ready-Reference/RFK-Speeches/Remarks-of-Robert-F-Kennedy-at-the-University-of-Kansas-March-18-1968.aspx.

[17] Simon Kuznets, 1934. "National Income, 1929–1932." 73rd US Congress, 2d session, Senate document no. 124, page 6-7

[18] A similar proposal is known as "happiness economics." This field advocates the maximization of happiness rather than wealth and derives measures of happiness from psychology and sociology. Carol Graham, "The Economics of Happiness: Insights on Globalization from a Novel Approach," *World Economics* 6, no. 3 (2005): 41–58; David G. Blanchflower, "Happiness Economics," *NBER Reporter Online* 2 (2008): 7–10.

[19] Consider the capabilities approach. This theory maintains that, once individuals reach a certain level of economic welfare, other factors such as liberty rights become a more significant determinant of overall wellbeing. Amartya Sen, "Utilitarianism and Welfarism," *The Journal of Philosophy* 76, no. 9 (1979): 463–489.