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Something to Think About

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COMMON CENTS

When I became the de facto ‘chief economist’ at my previous employer in, what, 2001, I assumed the responsibility of making any number of public presentations about the economy and markets. Since I don’t mind speaking in front of a crowd and most of my then co-workers did, this was no skin off my back. 15 years later, I will tell the 1st Quarter and the 4th Quarter are the busiest for talks, by far. Further, the worst the situation appears, the more I am in demand, although I am not sure that word is completely accurate.

This year is no different, as I have made, I think, 8 presentations to various groups and in differing levels of detail thus far in 2016. In a lot of ways, it is kind of the same old schtick for me, but it is all brand new to most in attendance. As you can imagine, this being an election year, folks are interested in just how the Presidential race will impact everything moving forward.

My response to these queries is pretty simple: “Given what we know of Hillary Clinton after being in the public eye for 25 years, and given what we have heard Bernie Sanders say about economics, I think it safe to assume the markets will consider a Republican victory as being more pro-business friendly, regardless of the ultimate GOP candidate. With that said, I have always maintained Presidents get too much credit and too much blame for the US economy. It the proverbial $18 trillion dreadnought battleship in the middle of the Pacific. It doesn’t stop on a dime, and the turn radius is best measured in miles.”

That back half of that comment ordinarily doesn’t please everyone, if anyone. In fact, I have people take significant issue with it after the presentation is officially over. However, I simply respond with the how our government operates: 1) the President heads up the Executive Branch which is empowered to enforce the laws, and; 2) the Congress actually makes the laws and funds the government. So, for any one President to throw the economy into the ditch, they would have to have, quite literally, hundreds of willing accomplices on Capitol Hill. Oh yeah, ‘we’ elect these people, all of them.

As you can imagine, we usually end up having to agree to disagree. Sure, you might not like a particular President’s policies, and they could indeed be the biggest numbskull in the world. However, it takes a multitude to tango in Washington, and the public issues the dance cards every other year, whether we like it or not.

With this said, I think many people are surprised a decidedly un-cool guy like Bernie Sanders has struck such a nerve with the electorate, particularly young voters. Yet, it isn’t too hard when you realize the man is talking about free education for everyone, or at least some variant thereof. Of course, nothing is completely free, and someone will have to pay either directly or indirectly for the multitude of students to go to school on the public’s dime. However, when you are 18 years old, legal to vote, and likely facing a mountain of student loan debt in the future, you know, free sounds nice, real nice.

In truth, the price of higher education has gotten ridiculous, so it is understandable why at least one candidate would make it a campaign issue. If the other candidates, in either party, have a firm

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position on the matter, it has certainly taken a backseat to Sanders. Shoot, backseat? Try in the trailer behind the car or truck, if that.

But is free the answer to what ails the education system? Probably not, as, again, nothing is free.

The underlying cause for the rapid increase in the price of a higher degree, cost isn't the right word, is demand. Simply put, there are more people looking to go to college than there were when I was a freshman in 1986. First, there were fewer folks, as the number of live births in the US in 1968 was 3,501,564. In 1998, 18 years ago, the number was 3,959,417.

What's more, fewer foreign students were looking to come to the US in 1986 as compared to today. From what I could easily glean, there were an estimated 350,000 international students in the US my freshman year. According to the most recent estimates, this number has climbed to around 875,000. If you assume an equal distribution across 4 years, that is an additional 131,000 students per class.

So, an additional 131,000 international students, and a potential additional 458,000 from the US, and that is a pretty significant increase in demand…..let alone the fact more kids are deciding to at least try college out at least one year at some point along the way. According to the NY Times, about 10% more since my senior year in HS (roughly, again roughly, about 56% compared to about 66%.

So, here are the numbers: .56 * 3,501,564 + 87,500 (which is 350K / 4) = 2,048,375.84 approximate college demand, of some sort, for the HS graduating class of 1986 PLUS international students. How does that compare? Well, .66 * 3,959,417 + 218,750 (which is 875K / 4) = 2,831,965.22. That is quite an increase; a 38.25% increase using this "back of the envelope approach." I can't stress this enough: these are mere scratchings. However, the actual data probably isn't that terribly different in relative terms. The moral is: the demand for college has gone through the roof, and so has the price as a result. This is Econ 101.

But why the high demand? I would submit 2 primary reasons: 1) parents want better opportunities for their children, and; 2) um, it is ridiculously easy, apparently, to borrow the money to go to college.

According to the Brookings Institution, the aggregate size of Federally-backed student loan debt was $72.403 billion when I was a freshman in 1986. In 2014, this number had ballooned, or blimped or zeppelined, to $1,130.000 billion or $1.13 trillion. That is a 1,461% increase, or roughly 10.3% per year for those 28 years.

In other words, Washington has held the spigot open, and universities have taken a big gulp. And why not?

If Bernie Sanders wants to drive down the cost of a higher education, or any other candidate for that matter, the best thing to do would be to sharply reduce the demand for it. Increasing the demand by giving it away only adds costs elsewhere….you can't get around basic economics, no matter how hard you try. So, how to do this? The low hanging fruit would be to get the Federal government out of the student loan business. Sure, honor the current debt outstanding, but then pull a Roberto Duran and say 'no mas.' That sound you just heard, that loud thud, was every university finance officer hitting the floor, grasping for their nitro.

Disclosure

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The next best way would be to drastically increase the cost of student loan debt by jacking up the rates. Again, this is basic economics. Sure, the debt loan per student might go up initially, but the aggregate demand for debt would plummet, resulting in lower tuition rates moving forward. As such, students wouldn't have to borrow as much. Thanks to the higher interest rate, the government would get its initial principal back much more quickly, meaning the inevitable defaults wouldn't sting quite as bad.

Finally, what would happen if everyone with a Federal student loan decided to let Washington worry about it after they had established their own credit history with a mortgage? After all, isn't the goal to have more Americans own their homes? It would seem the system is talking out of both sides of its mouth. Borrow the money and go to school. Now, borrow the money to buy a home. You can't because you had to borrow money to go to school?

Let's face it: not all of that increase in tuition has gone to increases in education or instruction. To that end, there were, what, a dozen guys in my freshman dorm suite. There was 1 phone for the hall, and no televisions. We shared 1 bathroom with two sinks, two shower heads, two commodes, and a urinal. The 2-man rooms were no more than 12' by 12', and didn't have air conditioning. Today, the new residence halls look like hotels.

Everyone ate in the school cafeteria, and that is just the way it was, as there were no other options. Today, there is a bar on campus, at least 2 Starbucks, a Chic-fil-A, Moe's Southwestern Grill, Subway, an Einstein Bros Bagel shop, and a couple of so-called 'markets.' The former cafeteria? Consider this: "Fondly known as "the Pit", the Fresh Food Company features foods prepared right before your eyes. Great exhibition cooking, ethnic dishes, American favorites, and a variety of healthy options combine to create a state of the art dining program."

We also had ethnic food back in the day. I think they served tacos on Tuesdays. The bar? Yep, a salad bar with perhaps not the freshest lettuce in Winston-Salem.

All of this is to say, the more money we make available for education, the greater the demand for it. The greater the demand for it, the more schools can jack up the prices. The more they can jack up the prices, the more Starbucks and Chic-fil-A outlets they can provide. Education? While there is unquestionably greater use of technology, you know, probability & statistics hasn't changed much over the last 30 years nor has calculus. Come to think of it, neither has 19th Century English literature or Western Civilization up to 1800. The dividend discount model is roughly the same, as is the calculation for duration. A credit is still a credit, and so is a debit. Spleens haven't moved, nor have gall bladders. A dangling participle is still just that, as is a comma splice and run-on sentences. Yo still means I in Spanish, and oui is yes in French.

Okay, I admit I sound like a Luddite and a grumpy old man. However, the point I am trying to make is: while an increase in population is to blame for some of the increase in education prices, the real culprit is the government's willingness to extend over $1 trillion in debt to students of various types, ordinarily at extremely advantageous interest rates given the borrowers' lack of credit history and collateral.

Whew.

In the end, if the government really, really wants to do something great for students in this country, it would gradually get out the student loan business and fund, and I mean mightily, a robust vocational & technical education system. The economy needs more master welders, masons, electricians, and other skilled craftsmen, a lot more, and a lot fewer over-indebted graduates with run of the mill diplomas/training from run of the mill universities. That might sound brutal, but the aggregate benefits for our society and our economy would be immense.

However, that would be political unpopular if not somehow incorrect, and it certainly wouldn't get any politician any votes anywhere. As such, it will never see the light of day, and we will just keep pushing the debt mountain down the road and wondering things like "why do skilled craftsmen cost so much?" and "why does that kid with the degree work in the coffee shop" and "why don't the millennials buy more homes?"

Perhaps I should end my next presentation with something along those lines. However, if I did so, I imagine I wouldn't be in demand quite as much. Hmm….perhaps I need to do a cost/benefit analysis. Have those changed much over the last 30 years?