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Democracy Dies in Darkness

The silver bullet for student debt: Bankruptcy

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American higher education badly needs reform. Over the past two decades, universities have regarded the availability of hundreds of millions of dollars in federal student loans as an excuse for staggering tuition increases. Now students graduate with intolerable levels of debt, in an economy where they often can't find jobs to pay it back. And too many universities have become political-indoctrination factories or intellectual babysitters instead of providing useful educations and preparing students for the adult world.

But there's a silver bullet that could cure all three ailments: bankruptcy.

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In an entrepreneurial society, it's essential to know that you can take risks and, if you fail, there is a path to try again. The ability to declare bankruptcy as a last resort and to start afresh has long been a vital element of American dynamism, yet it is denied to young people who borrow for their education.

That wasn't always the case. Until the late 1970s, Americans unable to pay off education loans were permitted to dispose of them with a Chapter 7 bankruptcy petition. That changed in 1978 when U.S. bankruptcy rules were overhauled. Defaults on student loans weren't a significant problem — tuition was much lower then, and jobs awaited most graduates — and legislators simply decided that it was a bit much to expect the government to guarantee loans and then absorb the cost of bankruptcy.

No one thought that we'd see anything like today's student-debt levels or that bankruptcy rights for education loans would be desperately needed.

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In assessing 20 years of tuition increases, U.S. News & World Report found last year that tuition at national universities (defined as those with a full range of undergraduate majors and master's and doctoral programs) spiked 157 percent for private institutions. At public national universities, out-of-state tuition and fees rose 194 percent, while in-state tuition and fees swelled 237 percent. Inflation across that period was 53 percent.

As the cost of education mounted, so did the student debt load. Since 2006, the amount that Americans owe in education loans has tripled, to \$1.53 trillion, according to the Federal Reserve. Once again, ill-advised government interventions played a role, including the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act, which barred private student loans from protection, and the Affordable Care Act, which in 2010 largely made the government directly responsible for student loans. About 80 percent of student loans are owed to the feds.

If many millennials have been radicalized, if they've given up on free markets, it's hard to blame them. They've been slapped in the face by free markets in the form of the student-loan racket. What many young people need is relief from overwhelming debt burdens through bankruptcy.

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Private lenders would object, naturally, as would people who've struggled to pay off some or all of their student debt. Problems like that arise whenever a country transitions to a more efficient regime, but it shouldn't get in the way of urgently needed reform. The U.S. deficit would increase if direct government loans were made dischargeable. But it's not as though everyone would stop paying off student loans: Declaring bankruptcy comes at the price of damaged credit ratings and years of being unable to obtain loans or credit cards, or doing so at much higher interest rates. Most people who have jobs and are able to continue paying their loans would want to avoid bankruptcy. But countless other young Americans would be liberated from debt and more likely to invigorate the economy, helping make up for government's added costs.

What about the universities themselves? They've created the problem, and they should be part of the solution: Hold them financially accountable, in whole or part, when their graduates declare bankruptcy on student loans. Universities should be given time to clean up their acts — say, until 2020 — and after that they would have to agree to indemnify the federal government for student-loan bankruptcies. Schools would think twice before running up the tuition tab. They might even start bringing it down.

Universities might also rethink the kinds of courses they offer. If they bore some or most of the cost of bankruptcies, they no doubt would start paying close attention to whether their graduates can get jobs. Too many universities offer too many frivolous courses, and majors, that make employers run the other way from applicants. Such graduates aren't good bets to repay their loans. If the university bore the financial risk, it would almost certainly change what it teaches.

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Would all this be thoroughly disruptive? Most certainly. But U.S. higher education badly needs a measure of creative destruction.

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