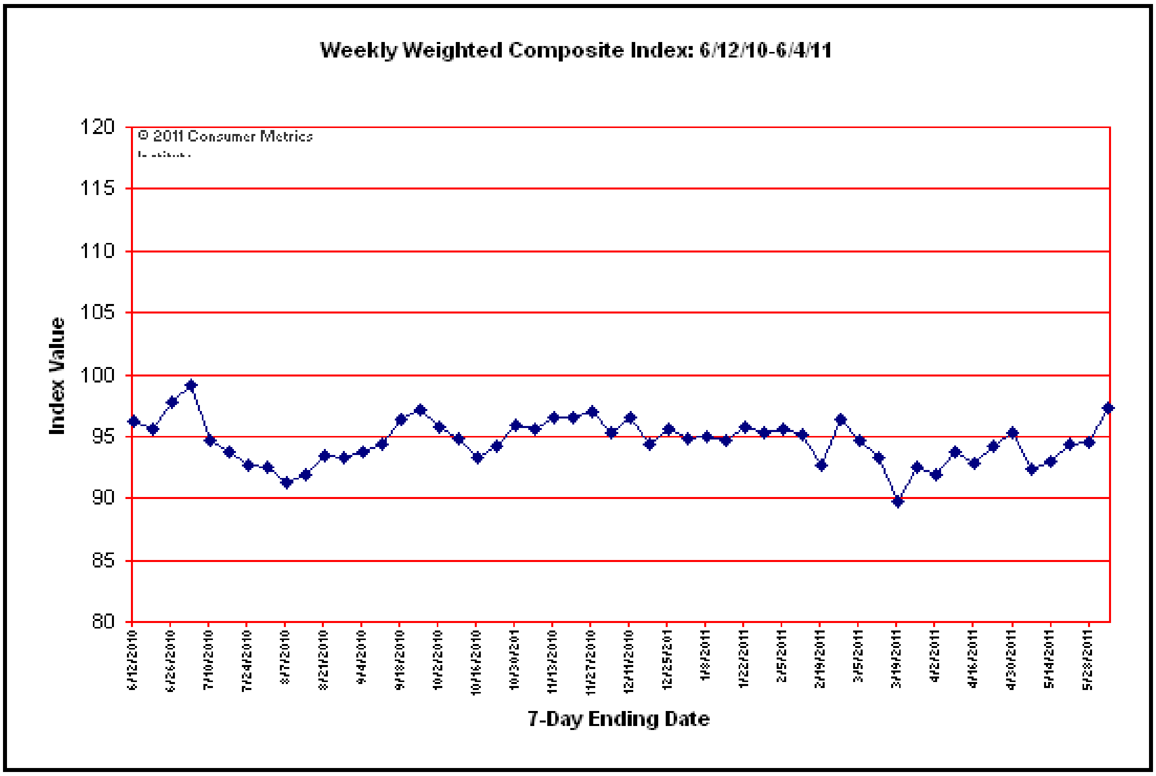
Consumer Metrics Institute Members News

June 5, 2011: Bottom Bouncing and Scholarly Debt End-Games

We have not had a daily Weighted Composite Index reading of 100 or more since May 3, 2010 - now 13 months ago. A Weighted Composite Index reading of 100 is neutral, with readings above 100 showing year-over-year growth and readings below 100 showing year-over-year contraction. We have now had 396 consecutive days of daily contractions:

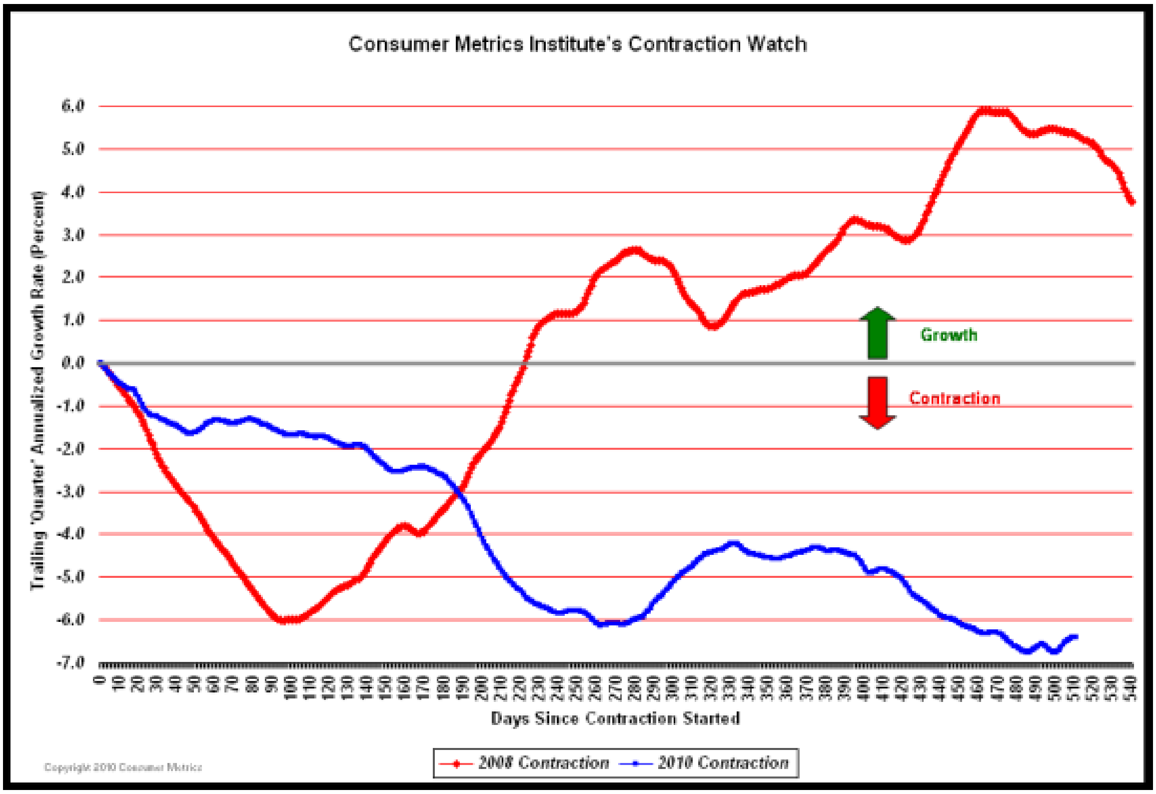


The important thing to remember is that our indexes are always year-over-year, so any period of contracting readings that extends for more than a year is now comparing itself to *levels that were already contracting in the prior year*. There are two aspects of this that bear repeating:

-- A steady 366 day reading of 95 in our Weighted Composite Index (representing on each day a 5% decline year-over-year) is recording a compounded 9.75% contraction relative to the economic activity two years earlier.

-- Even a return to a neutral reading of 100 would mean only that economic activity would be at the same level as last year, when it was contracting relative to the prior year.

Our best chart for visualizing this is our "Contraction Watch," which follows the course of our Daily Growth Index (actually just a 91-day moving average of the Weighted Composite Index, converted from the base 100 index to a +/- percentage) over the course of this recent contraction event. The chart also shows what the Daily Growth Index was doing during the consumer contraction that occurred within the formally defined "Great Recession." The progress of each event is recorded as a track of Daily Growth Index values commencing on the left margin on the date that the index first went into contraction**:**



We would expect that at some point the consumer economy will bottom, and when it stands at the same level as in the prior year our Weighted Composite Index will reach 100 again. But we're not holding our breath ...

Scholarly Debt End-Games

(In a number of recent articles we have explored potential "unthinkable" solutions to both the U.S. sovereign debt problem and the fiscal consequences of a suddenly balanced U.S. Federal budget -- given that a balanced budget would suck about 14% out of the country's GDP, meeting the clinical definition of a depression. We discussed the historical backdrop to sovereign debt end-games, and solutions possible without major regime change, others requiring modest regime change, yet more that involve radical regime changes, one that uses regime change to de-securitize the mortgage industry, another that would selectively stimulate "Main Street" America, and most recently one that would stimulate the economy through genuine reform to the health care industry. As a point of reference we have used the report from the Simpson-Bowles commission as a sample framework for how to balance the budget, and have assumed that to prevent a Simpson-Bowles induced depression some form of non-fiscal stimulus would be needed

that could provide excess growth to the U.S. economy on the order of 3% per annum over 5 or more years.)

In the U.S. one particular form of consumer debt is still growing, even as nearly every other part of the consumer economy is deleveraging. According to the Federal Reserve's G.19 report on consumer credit the only major category of non-revolving consumer debt that grew year-over-year between the first quarters of 2010 and 2011 was student loans ($billions, not seasonally adjusted, excluding loans secured by real estate):

Credit Type	Q1 2010	Q1 2011	Change
Total Revolving:	828.5	785.0	-43.5
Non-Revolving:			
Commercial banks	519.2	479.1	-40.1
Finance companies	471.0	440.9	-30.1
Credit unions	193.7	184.5	-9.2
Federal government (primarily Student Loans)	209.8	355.2	+145.4
Savings institutions	37.0	37.0	0.0
Nonfinancial business	45.3	44.8	-0.5
Pools of securitized assets	101.5	81.0	-20.5

We have stated before that the critical difference between good debt and bad debt lies in how productive the lent monies become. So, how good is this new student debt? Is it productive to the growth of the economy as a whole? Is early 21st century student debt spurring economic growth or, in fact, slowing it down?

It is an article of cultural faith that a good college education is the surest and most universal path to the "American Dream" -- and by virtue of that cultural dogma any debt incurred while acquiring higher education is irrefutably good debt.

We're not so sure. We could argue that in the early 21st century -- regardless of the U.S. cultural memory dating from the implementation of the first G.I. Bill through the 1980s -- the growth of student loans may be a major drag on the potential growth of the economy for at least two reasons:

-- The crippling effect that the enormous personal debts are having on the spending potential of a whole generation of consumers;

-- The cost effectiveness of the education being so dearly bought.

Or, in a politically incorrect nutshell, are we creating a whole generation of hopeless debtors by foisting on them an exorbitantly priced education that will be of marginal value when they graduate?

Granddad -vs- Junior

Granddad may have benefited greatly from an education acquired under the G.I. Bill. Dad and Mom may have benefited from taxpayer subsidized in-state tuitions during the 1970s and 1980s. But is Junior's $150,000 Bachelor of Arts from a private college going to benefit him similarly? And more importantly to our concerns here, is it going to add growth to the economy?

There are two critical economic differences between the educations received by Granddad and Junior:

-- **Subsidies -vs- Loans:** For the most part, the educational components of the various generations of "G.I." bills have been stipends or matching grants, not loans. And although Federal student loans have been a staple of higher education since the passage of Title IV of the Higher Education Act of 1965, the low in-state tuitions received by Mom and Dad as a result of taxpayer subsidies to the state universities meant that crippling levels of debt were seldom needed to complete a four year degree program. However, for the class of 2009 the Project on Student Debt estimated that the *average student* graduated with $24,000 in student loan debt -- and at one private school the *average student loan debt* was over $61,000.

How bad are these balances for new graduates? According to the Institute for Higher Education Policy 65% of the 2005 cohort of undergraduate degree students were not making "timely repayment" on their loans, with a full 49% of the cohort formally in delinquency or full default. And the less fortunate of these former students may carry their debts all the way to their graves -- since the ironically named "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" specifically prevents student loans from being discharged through bankruptcy. If the clearing of bad debt is essential to an economic recovery, the U.S. has managed to legislate an obstacle to clearing one of the fastest growing portions of that bad debt.

-- **Relative Cost:** According to the Trends in College Pricing 2010 report published by The College Board, a four year in-state education at a public institution is now priced at an average of $64,560 -- while the same four years at a private institution averages $147,972. In that same publication The College Board reported that the real price of tuition and fees at public four year institutions (i.e., *net of CPI inflation rates*) had grown to be over three and a half times as expensive as in 1980. Over that same time span median real personal income grew by less than 30% -- meaning that since 1980 the real price of tuition and fees at a public university has grown over eight times more than median personal income.

The parallels to the housing bubble are unmistakable to Malcolm Harris, who also quotes Marc Bousquet on the current sad state of classroom instruction:

"If you're enrolled in four college classes right now, you have a pretty good chance that one of the four will be taught by someone who has earned a doctorate and whose teaching, scholarship, and service to the profession has undergone the intensive peer scrutiny associated with the tenure system. In your other three classes, however, you are likely to be taught by someone who has started a degree but not finished it; was hired by a manager, not professional peers; may never publish in the field she is teaching; got into the pool of persons being considered for the job because she was willing to work for wages around the official poverty line (often under the delusion that she could 'work her way into' a tenurable position); and does not plan to be working at your institution three years from now."

So, why have the costs in tuition and fees grown eight-fold relative to median incomes since 1980 -- when tenured professors likely taught three of every four classes? Easy credit (and the cultural prestige of a college education) turned higher education into yet another "asset" bubble -- but secured in this case only by the garnishing powers of the lenders.

And it could also be argued that recently those increased costs have begun to yield diminished returns**:** salaries for 2010 graduates with majors in the liberal arts majors fell 8.9% nominally year-over-year, to $33,540 -- roughly 9% less than the average U.S. per capita *disposable income* (which, incidentally, had actually grown 2.2% nominally on the same year-over-year basis).

Instructional Parallels

The two economic issues are causally related: absent the exorbitant rise in tuitions and fees the debt levels would be more sustainable. Conversely, the availability of subsidized and securitized (and Federally guaranteed) loans -- coupled with politically expedient reductions in underwriting standards (to spread the benefits of higher education to the economically disadvantaged) -- empowered the rapid rise in tuitions and fees.

The parallels to the housing bubble can also be instructional. The solutions may have to be similar, and the higher education "industry" may experience the same kinds of pain as the housing industry has faced for the past several years. Among the plausible options might be:

-- Rescind the student loan provisions in the 2005 Bankruptcy Law. Hopelessly bad debts have to be cleared, and the court system is the best way to apportion debt forgiveness and lending haircuts to all parties -- according to their complicity in creating the mess in the first place.

-- Stop the lending madness. It simply isn't working if 65% of the 2005 cohort of students can't carry the debt. Among the "unthinkable" options are:

- Stop the securitization of student loans;

- Put the institutions at risk for non-performing loans by requiring that a substantial and progressive portion of loan values (perhaps 5% for the smallest loans and 50% for the largest loans) be secured by institutional assets. This would presumably encourage real underwriting;

- Cap the tuition cost per credit hour that can be supported by student loans;

-- Provide consumer protection to students and their families by requiring clear disclosure of the quality of the ingredients in the educational package. For example, there could be differential pricing of classes based on the credentials of the instructors and the class size, thereby avoiding the defacto "bait and switch" instruction quoted above. This could also allow students (including those who just don't fit a four-year degree program) a chance to engineer a "budget" educational experience.

-- Consumers are also harmed by institutional indifference to the number of years typically required to get a degree. Perhaps indifference is too kind a word**;** in fact the institutions have strong incentives to extend the educational "experience" as long as possible. A report from the U.S. Department of Education has found that only 34% of entering freshmen manage to get a degree from that same school in four years, with another 21% completing the task by the sixth year and yet another 7% still working on that degree beyond year six. Taking all transfers and sabbaticals into account, the chairman of the Spellings Commission observed that "the median time to a bachelor's degree is closer to six years than four years." The remedy could be as simple as putting the educational experience on a contractual basis, with a fixed maximum cost (tuition and fees) clearly stated for a prudently pursued degree program -- and with the institution contractually obligated to provide a reasonable opportunity and environment for students to accomplish the task in four years or less.

-- Make only the monies spent in direct classroom instruction exempt from institutional taxation. The annual tuition and fees for two-year public institutions in the western U.S. are only about 22% of the annual tuition and fees for four-year public institutions in the same region, and a mere 5% of the annual tuition and fees of four-year private institutions in New England. Although some of this can be attributed to differences in the quality of the faculties, a larger portion is administrative bloat. Encourage greater efficiency by taxing that bloat -- and other non-classroom funding revenues. If it walks like a sports franchise and quacks like a sports franchise, maybe it should be taxed like a sports franchise.

-- Create a national clearing-house for credit-hour transfers between all accredited institutions, with "real-time" balances of hours earned at each contributing institution. In time the hours-earned metric might largely replace the make-or-break "degree" hurdle for students not headed to graduate school -- enabling some sort of continuous measurement for higher education accomplishments. Plus, there is no better way to keep costs down than to provide consumers with plentiful and easily executed options for their spending.

-- Make the cost efficiency of an institution's degree programs a major criteria while awarding Federal research grants.

Finals

Because of the demographics of on-line shoppers, the stress being felt by recent graduates is disproportionately represented in our data at the Consumer Metrics Institute. That data documents that economic stress is real and continuing among our shoppers. The lingering impact of both unemployment and negative real estate equity mean that the purported end of the "Great Recession" is much worse than bureaucratic wishful thinking, it is a cruel and disenfranchising sign that nobody sees or cares about the plight of an entire generation of American shoppers -- feeding into a deep sense of betrayal only three years after they opted en mass for "change."

As a point of perspective, higher education in the U.S. consumes only about 3% of GDP (although that is twice what it was 40 years ago) -- only one sixth of the cost of health care. But the inefficiencies and bad debts created by the higher education industry have probably already reached the point where the overall growth rate of the economy is being negatively impacted. The opportunities for debt clearing and cost reductions in that segment of the economy could conceivably shift as much as 1% of GDP into higher growth discretionary spending.

Nothing we have offered here is new. Countless commissions and reports have covered it all. The only problem is that nothing has been done, largely because taking on the educational and financial vested interests and their cultural prestige would be nothing short of political suicide. Only someone willing to do the "unthinkable" could create a leaner educational industry that would still provide the universal path to the "American Dream," only without the crushing and inescapable debt that currently plagues an entire generation of former students.