REVIEW & OUTLOOK

Telling Students to Earn Less

Obama now calls for reforming his bleeding college loan program.

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The federal student loan program is becoming so costly to taxpayers that even President Obama is pretending to fix it. Readers will recall Mr. Obama as the man who has spent much of his Presidency expanding this program, creating new ways for borrowers to avoid repayment, and then campaigning about these dubious achievements on campuses nationwide.

Now Team Obama is acknowledging that his policies are turning out to be more expensive than he claimed. Participation in federal debt-forgiveness programs is surging. In a mere six months the number of borrowers who've signed up for such plans has increased to more than 1.3 million from less than a million, with total balances rising to $72 billion from $52 billion. Maybe the White House didn't understand that when you give people an economic incentive not to repay a loan, more people won't repay.

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Taxpayers can suffer in many ways from federal education lending, because most loans are issued regardless of a borrower's ability to repay. So loose is this form of credit that in the slow-growth Obama economy it has become a vehicle to fund basic living expenses, with tens of thousands of borrowers consuming aid even when they're not enrolled for courses.

But the immediate taxpayer S.O.S. concerns Mr. Obama's Pay As You Earn program. We've warned for years about the risks of this program as Mr. Obama has worked to expand the number of eligible borrowers and sweeten its terms.

Pay As You Earn allows students under certain circumstances to borrow an unlimited amount and then cap monthly payments at 10% of their discretionary income. If they choose productive work in the private economy, the loans are forgiven after 20 years. But if they choose to work in government or for a nonprofit, Uncle Sugar forgives their loans after 10 years.

For aspiring community organizers who go to college and then grad school before moving into a job that the government defines as public service, the forgiven debt can be $150,000 or more, courtesy of the taxpayer. And unlike with some other federal programs, when the government forgives the debt of one of the exalted class of nonprofit or government workers, the do-gooder doesn't have to report it as income to the IRS. Who wouldn't want to pick up $150,000 tax-free?

Energized by Mr. Obama's 2011 expansion, Pay As You Earn has been a slow-motion bailout for law schools, which saw diminishing applications in the wake of the financial crisis. Now the money is still rolling in thanks to more leveraged students. Upon graduation the median law school grad in 2012 was carrying more than $128,000 in grad-school debt, up from $77,000 in 2004.

But how much of it will ever be repaid? At least one creative school, Georgetown, last year offered to pay the students' monthly bills under the Pay As You Earn program while simultaneously raising tuitions. This essentially makes taxpayers pay the entire cost and turns the loans into six-figure grants.

The White House is finally admitting there's a problem, albeit sotto voce. The President's 2015 budget proposes to "reform the [Pay As You Earn] terms to ensure that the program is well-targeted and provides a safeguard against rising tuition at high-cost institutions." But it seems the White House is more concerned with the appearances of this taxpayer fleecing than the reality. Later in the budget tables the White House notes that its plan to "expand and reform student loan income-based repayment" will cost taxpayers even more than the status quo—by more than $3.5 billion over 10 years.

As for the status quo, Jason Delisle of the New America Foundation has been tracking the expanding red ink. He notes that in 2010 when the President first sketched out the idea for Pay As You Earn, the cost of permitting past borrowers to use the program's "more generous terms was approximately $1.7 billion. The administration reported the cost for the same proposal in 2013 as approximately $3.5 billion. In 2014 it quoted the cost at approximately $7.6 billion." Look for the estimates to keep rising—especially after this fall's election.

This might seem like a windfall for the students, but the only clear winners are the universities that are the ultimate recipients of the taxpayer money. While the students may technically get the freebie, the impressionable youngsters, who likely have little or no wealth, are being given an enormous financial incentive to pursue careers in government or at low-paying nonprofits.

The consequences for our economy are no less tragic than for the individual borrowers. They are being driven away from the path down which their natural ambition and talent might have taken them. President Obama keeps talking about reducing income equality. So why does he keep paying young people not to pursue higher incomes?