



AMERICAN
COMPASS

Student Debt Relief the Old-Fashioned Way

**MAKE STUDENT DEBT DISCHARGEABLE IN BANKRUPTCY
INSTEAD OF CANCELING LOANS**

WHAT'S THE PROBLEM?

Policymakers have promoted “college-for-all” and offered **open-ended subsidies for student borrowing to finance it**, driving up tuition costs.



Determined to facilitate loans that the market would never offer on the belief that college education is always a good investment, policymakers have **prohibited discharging student loans in bankruptcy**.

This has led to a **student debt crisis**: Colleges collect tuition without concern for whether the debt will be repaid, and policymakers offer relief to borrowers through loan cancellation.

STUDENT DEBT IS NOT SACRED

America’s “college-for-all” mythology has produced a perverse financing system for higher education. Because policymakers regard a college education as the key to opportunity, they grant higher education a sacred status unlike other goods and services—and since 1976 have given the associated debt a sacred status as well: protection from discharge in bankruptcy.

The results have been a disaster. College costs have skyrocketed, supported by a flood of government subsidies, yet fewer than one-in-five Americans move smoothly from high school to college to career. Students are more likely to drop out of college, or else land in a job that does not require their degree. Student loan debt has become the nation’s largest form of non-mortgage debt, growing from \$260 billion in 2004 to \$1.53 trillion in 2020.

Proposals to forgive student debt outright foolishly double-down on the damaging view that college and student debt are sacred. Such proposals only worsen the cycle of perverse incentives and deepen our national commitment to a failed system.

WHAT'S THE SOLUTION?

Under section 538(A)(8) of the U.S. Bankruptcy Code, student debt is dischargeable in bankruptcy proceedings only if the borrower can prove “undue hardship,” an exceedingly difficult standard to meet.

Congress should **eliminate Section 538(A)(8), placing student debt on equal footing with other debt in a bankruptcy proceeding**. The American bankruptcy process works well, giving indebted individuals a fresh start when they need it, while imposing substantial costs to ensure that those who can afford to repay their debts usually choose to do so.

FIX THE PROBLEM, NOT THE RESULT

Bankruptcy **focuses relief** on those borrowers who are most genuinely and seriously defeated by their debt loads and are willing to accept the serious financial and social consequences of filing for it.

Unlike blanket forgiveness, **bankruptcy ensures that relief does not flow to those who merely regret their educational choices or wish to enjoy unearned forgiveness**—and certainly not to those high-earners who hold the majority of U.S. student debt, and who stand to benefit from forgiveness.

Combined with sensible reforms that would force colleges and universities to bear the burden when their students do default, **bankruptcy offers relief where it is needed and creates incentives for all involved that will strengthen the higher education system**.



FREQUENTLY RAISED OBJECTIONS

“THIS IS A “GET OUT OF JAIL FREE” CARD FOR STUDENT BORROWERS”

Declaring bankruptcy is not at all an easy choice. Few suggest the existing bankruptcy system offers a free pass to those who need and use it for relief from other debts. Bankruptcy brings numerous consequences, including damaged credit scores; increased difficulty and costs in borrowing; and embarrassment in front of friends, family, and neighbors—not to mention anyone who runs a background check for employment, housing, or other purposes. This is why declaring personal bankruptcy is relatively uncommon in the U.S. Even before Congress started treating educational debt differently in 1976, less than 1% of student loans were discharged in bankruptcy.

“COLLEGE IS THE TICKET TO THE MIDDLE CLASS, AND WE SHOULD BE INVESTING IN EXPANDING ACCESS TO IT”

This aspiration sounds laudable, but it poorly serves the majority of Americans consistently failed by the college pathway. That pathway should remain open to those who wish to pursue it, but the nation has an obligation to invest at least as much in effective noncollege pathways that can offer tickets to the middle class as well.

“THIS WILL ONLY ENCOURAGE MORE BLOAT AND INCREASED COSTS IN HIGHER EDUCATION”

Making student loans dischargeable in bankruptcy should be paired with policies that require colleges and universities to finance their own product, placing them on the financial hook for student outcomes and ensuring they both control their costs and focus on education that aligns with workforce needs.

FURTHER READING

Oren Cass. “The Banality of Student Loans.”
American Compass, 2022.

An in-depth white paper making the case that student debt does not deserve its “sacred status” and should be dischargeable in bankruptcy.

“A Guide to College-for-All.”
American Compass, 2022.

A data-driven overview of the “college-for-all” model’s failure.

Oren Cass & Richard Oyeniran. “The False Promise of Good Jobs.”
American Compass, 2022.

An analysis of the misalignment between the American education system and labor market.

“Student Borrower Bankruptcy Relief Act”
A bicameral bill that would repeal Section 528(A)(8).

“FRESH START Through Bankruptcy Act”
Senators Durbin (D-IL), Hawley (R-MO), and Cornyn (R-TX)
A bill that removes the unreasonable “undue hardship” threshold after 10 years in repayment.

KEY FACTS

1 in 5 Young Americans who go smoothly from high school to college to career¹

About **20%** Loan borrowers in default at the start of 2020²

1M+ Student loans entering default annually before the start of the COVID-19 pandemic³

2nd U.S. rank in per-student spending on higher ed (behind only Luxembourg)⁴

\$400B Estimated cost of President Biden’s student loan forgiveness plan⁵

ABOUT AMERICAN COMPASS

Our mission is to restore an economic consensus that emphasizes the importance of family, community, and industry to the nation’s liberty and prosperity. American Compass is a 501(c)(3) non-profit organization.

For more information, visit americancompass.org

¹ American Compass analysis of U.S. Department of Education and Federal Reserve Bank of New York data.

² Pew. “Student Loan Default Has Serious Financial Consequences.”

³ *Ibid.*

⁴ OECD iLibrary. “Education at a Glance 2021: OECD Indicators.”

⁵ Congressional Budget Office. “Costs of Suspending Student Loan Payments and Canceling Debt.”