OPINION

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What's Really 'Immoral' About Student Loans
It's not so much the interest rates charged. It is, rather, the principal of the thing.

By GLENN HARLAN REYNOLDS
Unless Congress acts, interest rates for government subsidized student loans will double to 6.8% from 3.4% on July 1. In May, House Republicans passed a bill that would index rates on new loans to the rate on 10-year Treasurys (currently about 2.6%), plus 2.5 percentage points, with an 8.5% cap. But with little Democratic support in the Senate, that bill is dead in the water.

Most Democrats want to lock the current 3.4% rate in place for two more years while Congress debates a "fairer" solution. Massachusetts Sen. Elizabeth Warren has even proposed letting students borrow directly from the government at the same ultra-low rate that banks currently get on short-term loans from the Federal Reserve—0.75%. She calls the Republican proposal "immoral."

In the student-loan world, there's immorality to spare—not in the still historically low interest rates, but in the principal of the thing. Student debt, which recently surpassed the trillion-dollar level in the U.S., is now a major burden on graduates, a burden that is often not offset by increased earnings from a college degree in say, race and gender issues, rather than engineering.

According to an extensive 2012 analysis by the Associated Press of college graduates 25 and younger, 50% are either unemployed or in jobs that don't require a college degree. Then there are the large numbers who don't graduate at all. According to the National Student Clearinghouse Research Center, more than 40% of full-time students at four-year institutions fail to graduate within six years. The National Center for Education Statistics reports that almost 75% of community-college students fail to graduate within three years. Those students don't have degrees, but they often still have debt.

Why do students have so much debt? According to a recent study by Mark Perry, a professor of economics and finance at the University of Michigan at Flint, between 1978 and 2011 college tuition in the U.S. increased at an annual rate of 7.45%, vastly exceeding the rate of inflation and the almost-stagnant rate of growth in family incomes.

The difference has been made up by more and more debt. With costs above $60,000 a year for many private schools, and out-of-state costs at many state schools exceeding $40,000, some young people are graduating with student loan debts of $100,000 or more, sometimes much more. A study released last month by Fidelity Investments found that 70% of the class of 2013 is graduating with college-related debt—averaging $35,200.

According to a recent study by the New York Federal Reserve, "the share of twenty-five-year-olds with student debt has increased from just 25 percent in 2003 to 43 percent in 2012" and "student loan delinquencies have also been growing." Almost 12% of student loans are more than 90 days overdue. Student-loan debt, the New York Fed study found, also delays marriage, home purchases and other "adult" decisions that once followed graduation from college.

Now here's where the real immorality kicks in. The skyrocketing cost of a college education is a classic unintended consequence of government intervention. Colleges have responded to the availability of easy federal money by doing what subsidized industries generally do: Raising prices to capture the subsidy. Sold as a tool to help students cope with rising college costs, student loans have instead been a major contributor to the problem.

In truth, America's student loan problem won't be solved by low interest rates—for many students, the debt would be crippling even if the interest rate were zero.

If we want to solve the very real problem of excessive student-loan debt, college costs need to be brought under control. A 2010 study by the Goldwater Institute identified "administrative bloat" as a leading reason for higher costs. The study found that many American universities now have more salaried administrators than teaching faculty.

Another way to approach costs is to remove the incentives for universities to accept government-subsidized student-loan money regardless of a student's prospects of graduation or gainful employment. Under the current setup, incentives run the other way: Schools get their money up front via student loans; if students are unable to pay the loans back, the burden falls on taxpayers (if the loan was "guaranteed" by the federal government), and the students themselves, while the schools get off scot-free.

A serious student-loan fix would change this incentive. First, federal aid could be capped, perhaps at a national average, or simply indexed to the consumer-price index, making it harder for schools to raise tuition willy-nilly. Second, schools that receive subsidized loan money could be left on the hook for a percentage of the loan balance if students default. I would favor allowing students who can't pay to discharge their loan balances in bankruptcy after a reasonable time—say, five to seven years, maybe even 10—with the institutions that got the money being liable to the guarantors (i.e., the taxpayers) for, say, 10% or 20% of the balance.

You can bet that under this kind of a rule, universities would be much more careful about encouraging students to take on significant debt unless they are fully committed first to graduating, and second to a realistic career path that would enable them to service that debt over time. At the very least, schools would be more likely to warn students of the risks.

Even thinking about the impact of such a "skin in the game" rule for colleges helps to illustrate the irresponsible—even, in Elizabeth Warren's words, "immoral"—way that colleges up to now have dealt with costs and with debt. If lawmakers were serious about helping students pay for college, Congress would be considering more than simply continuing low interest rates on ever-higher student-loan balances.

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