

Draft Answer to PP&P Assignment

Here is a very brief summary of a potential answer to the homework assignment for the Production, Property & Power lesson.

The idea behind student loans to pay for college and graduate school is that the borrower (the student) will be able to repay the loan out of future income (which is expected to be significantly higher thanks to the educational achievement). Since the value of education is embodied in the person, it has historically been the social understanding in the US that education beyond a basic K-12 education should be the financial responsibility of the person receiving the benefits of education. There is an alternative philosophy that society benefits from individuals who receive a higher education and therefore society should bear the financial burden.

The executive order which cancelled student loans represents a philosophical shift from individual responsibility to pay for higher education to societal responsibility to pay for college and grad school. Under the program of loan cancellation, the debt is paid for by taxpayers, either current taxpayers (if taxes are raised or other government programs eliminated), or by future governments (if the government borrows the money to cancel student debt). Since the executive order did not make any provision to pay for the cost of debt cancellation, we may assume that the program is paid for by borrowing the power from future governments and future taxpayers. This can be justified by claiming that the higher education will make the future society more productive and therefore in a position to bear the additional cost of paying for the loan cancellation order. (This is the same idea behind why the individual, who at 18-25 years of age is not financially stable, is able to take out a student loan. But instead of individual responsibility to repay the loan, the order shifts the responsibility to the taxpaying portion of society.)

Now let's try to see how the loan cancellation might affect the economy, using the PP&P model as a framework for analysis.

In the power cycle, the question is where does the government come up with the money to cancel student loans? We can assume that the loan cancellation is paid for by borrowing power from future governments.

What about the Production cycle?

If the government borrows from the future to pay for the cancellation of student loans, then cancelling student debt leaves more money in the household today (after tax). This will increase consumption and saving, but mostly consumption. Since one of the purposes of saving to pay for college has been reduced, if not fully eliminated, households can cut back their savings since their future household won't need as much money for college. Note that there is not a change in production. In fact, without the need to repay student loans, some households may cut back their hours of work, meaning less goods and services will be produced. More dollars spent by

households on consumption, without an increase in production, will cause inflation in order to rebalance the supply and demand for consumption goods/services.

Let's now consider the Property cycle of the model.

As noted above, there is now less need to save for college, savings will reduce. Less savings and increased borrowing by government (to pay for the loan cancellation) means there is less money available for entrepreneurs. There will be fewer business investments and more competition for the available funds. The result will be higher interest rates to reduce the demand for business investments. There will be less capital investment in innovation which will reduce the rate at which the standard of living improves. All is not bad news however. Lower investment in business innovation may be offset if there is a large enough increase in human productivity (thanks to higher education).

In summary, in the Power cycle, there is an increase in the size of government and ultimately government taxes, since people will be dependent on government for funding higher education. In the Property cycle there will be a reduction in savings as households do not have to save for future college expenses. As a result, there will be less money available for investment in business innovations, leading to a slower growth in the standard of living.

In the Production cycle, households will have more money allocated to consumption as they cut back savings. In the short run, this will cause inflation to rebalance supply and demand. In the longer run, as taxes are raised to pay for loan cancellations, inflation pressures will subside.