No More Harvard Debt

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Joe Mihalic is a recent graduate from the Harvard Business School (HBS) who managed to pay off $91,000 in student debt in seven months. He is currently enjoying his fifteen minutes of fame because he documented the details of his journey in a blog. His story is one of determination and commitment to a goal. Some of the strategies that Joe deployed in order to save money might seem a bit extreme, like taking a flask to bars in order to avoid buying drinks. But the principles that worked for him are simple and well known: make a budget, reduce base expenses, cut discretionary spending, take on a second job, take in renters, and sell assets.

Is there a useful lesson in Joe's story for other graduates burdened with debt? At first glance, it might appear not to be so. Joe is among the elite, with an MBA from HBS (one of the most elite degrees possible) and a $100,000+ job at Dell. Also, at age 25 Joe owned 1 house, 2 cars and multiple motorcycles and bicycles. He also had two years of contributions to his company's 401K. This is a far cry from the median or typical college graduate with a job paying $40,000 and no assets.

However, there are some parables that can be drawn from Joe's experience that have broad applicability. The first is that if you are going to pay down debt or increase net worth you must spend less than you make. Sure, this is lot easier if you make $100,000 than if you make $40,000, but the principle is the same. After all, the guy making $40,000 is far richer than 99.9% of all the people who have ever lived on the planet. Even today, at least one billion people make do with a family income of less than $1,000 per year.

As an aside, I am reading a book[1] co-written by Esther Duflo who is a professor at MIT and the winner of a MacArthur "genius award" and the Bates Medal for the best economist under the age of 40. Professor Duflo's research focuses on people living in extreme poverty, defined at $2 per day per person. About 1 billion people on the planet are currently in extreme poverty, and Duflo is studying how they live their lives in an effort to design policies or interventions that can reduce extreme poverty. It is remarkable how sophisticated and industrious these people are. In a sense, they have to be great risk managers because even a modest setback can be deadly. They learn to smooth consumption and insure against surprises by saving, even at $2 per day!

If someone can save money on $2 per day, then surely it is possible for nearly anyone in the US to increase their saving rate.

Second, you should evaluate the value of the benefits against the cost of the debt. Joe borrowed $91,000 and gave up two years of earnings in order to pursue a Harvard MBA. Was it worthwhile? This depends on what he was making before. If his prior salary was also $100,000, then the total cost of his MBA is $91,000 in debt plus $200,000 of foregone (pre-tax) income, and his benefit is zero ($100,000 in the Dell job minus $100,000 in the prior job). In this case the debt would not have been productive.

It is more likely, however, that Joes' prior income was well under $100,000; let's assume it was $70,000. In this case, the cost of the MBA is $91,000 plus $140,000 of foregone income and the benefit is a growing stream beginning at $30,000 per year. In all likelihood, Joe's return on the HBS investment will be much greater than the cost of the debt.

Of course, before the fact the return on the education investment was uncertain. If Joe had dropped out of HBS or if he did not land a good job the investment would not have turned out so well. Joe would have accumulated substantial debt with nothing to show for it. The point is that high levels of debt create the possibility of financial distress, if things don't work out as planned.

To summarize, lesson number 1 is to consume less than you earn, lesson number 2 is that it is smart to borrow so long as the rate of return is greater than the cost of funds, and lesson number 3 is that notwithstanding lesson 2, be careful about borrowing so much that the probability of distress is high if your plan does not work out.

[1]Abhijit Banerjee and Esther Duflo, Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty, 2012