Three facts about student loan debt:

1. Total student loan debt outstanding has quadrupled since 2003.
2. Student debt now exceeds all other forms of consumer debt—even credit cards.
3. Student debt has the highest delinquency rate of any consumer loan category.

Is this something that warrants the attention of Federal Reserve policymakers? In light of the Fed’s responsibility for promoting the health of the financial system and the economy, the answer is a tentative yes. Nearly all experts agree that the returns on graduating from college still far outweigh the cost, and the good news is that enrollment remains strong. In fact, the Federal Reserve Bank of Cleveland has been emphasizing for many years that education is the key to success for both individuals and regions. For individuals, the benefits of education are straightforward: higher pay and better job prospects. For regions, an overwhelming amount of research, including extensive work done at the Cleveland Fed, demonstrates the importance of educational attainment in helping cities grow and thrive. Our research has shown that education is one of the two most important drivers of regional income growth (innovation is the other).
While it’s clear that educational attainment is a crucial factor in economic growth, the debt associated with it can have some limiting effects. The implications of student loan debt reach beyond the borrowers themselves and can have a dampening effect on overall economic growth. This means that policymakers would be wise to watch the trajectory of student debt carefully, be mindful of its longer-term implications, and consider policy alternatives that can minimize its drag on the economy.

**Student debt is growing, but there is no crisis**

The Consumer Financial Protection Bureau (CFPB) estimates that student loans outstanding total around $1.2 trillion, spread among 40 million borrowers, or an average debt of nearly $30,000 per student. Other statistics put the median student debt at close to $14,000. Being $30,000 (or even $14,000) in debt is certainly significant for borrowers. But looking at it another way, these figures are comparable to auto loans, which borrowers have been managing quite well over time. Of course, $30,000 is the average; the range of debt burden varies tremendously from student to student, though many of the graduates with the heaviest debt burden land high-income professional jobs—doctors or attorneys, for example—that put them in a strong position to repay the debt.

**Trends to watch**

Although college is a good investment for students and society at large, and it appears to be cost effective for the government for now, there are some issues policymakers might want to keep an eye on. First and foremost, student loan debt is growing rapidly and has doubled since 2007. Experts point to the aftermath of the recession, rather than rising college tuition, as the primary driver. As parents have been less able to cover the costs of educating their children, increasing numbers of students have turned to loans for financing.

According to Pew Research, 19 percent of US households had student loan debt as of 2010, and 68 percent of 2012 grads left school with more than just a diploma. Not surprisingly, such debt is more prevalent among younger households: 40 percent of those headed by someone younger than 35 carry student loan debt.

Another trend to watch is the rise in delinquency and default rates on student loans. Nearly 17 percent of borrowers in repayment are delinquent; other adjusted calculations put the share closer to 23 percent. Student debt has the highest delinquency rate of any consumer loan category; by some estimates, $100 billion in debt is now delinquent 90 or more days.

Experts believe that a majority of student loan defaults are concentrated among those who did not complete their education; their default rates are four times higher than those of graduates. This is not surprising, since many of these dropouts, unlike graduates, are no better able to repay than they were before enrolling. The problem is exacerbated by high dropout rates at for-profit institutions, where nearly 90 percent of students take out loans. In addition, completion rates may be declining at all institutions under the stress caused by student loan debt. An Ohio survey reveals that 22 percent of four-year public college students occasionally consider dropping out because of finances, and 9 percent think about it frequently. These statistics are even higher among students of four-year private schools and two-year schools.

Relatedly, since much of the nation’s student loan debt is directly loaned or backed by the federal government through various programs, taxpayers still bear some risk, even though the programs are currently operating in the black. However, if default rates were to rise further or if an aggressive policy change such as debt forgiveness came into play, taxpayers could be on the hook.

It’s important to note that the student debt burden lies not only with the students, but also with their families. Parents and grandparents often co-sign for these loans and may be saddled with costly repayment when they are retired or trying to save for retirement. According to the Federal Reserve Bank of New York, people who are 60 or older owe $43 billion in student debt. Of course, co-signers’ ability to make payments does not improve because of increases in the students’ educational attainment.
Economic impact
In the larger economic picture, the effects of mounting financial obligations associated with student loans go beyond student borrowers and their families. The drag on economic growth is becoming more evident as debt levels rise, and the effects are likely to be felt far into the future.

As recent graduates settle into the workforce, they often grapple with sizable payments on their student loan debt. A report from the CFPB suggests that the burden of student loans is a factor in the significantly lower 401(k) enrollment and contribution rates among those under 30. Because of the importance of early saving, borrowers who allocate income to student loan payments rather than to retirement significantly reduce the final value of their retirement savings.

In a more immediate sense, student borrowers face financial barriers to reaching the milestones of early adulthood. Statistics indicate that household formation rates are down by wide margins since the onset of the recession. Financial obligations associated with student debt decrease borrowers’ ability to take on additional expenses, making them less likely to move out of their parents’ homes and creating a drag on household formation. Moody’s estimates that each new household formed creates $145,000 in economic impact. Furthermore, borrowers are less able to save for down payments on a home, to qualify for mortgage loans, or to be approved for other consumer loans, including auto financing. The National Association of Realtors reports that 77 percent of respondents to a 2013 survey described student debt as an obstacle to homeownership, and 49 percent called it a “huge” obstacle. With so many young adults saddled with sizable student loans, industry experts observe that the presence of first-time home buyers is declining and the ripple effects are visible throughout the housing market.

Student loan debt may also prevent recent college graduates with an entrepreneurial spirit from starting a new business or expanding an existing one. It can also limit small business owners’ ability to qualify for loans, preventing growth and payroll expansion. Finally, student loan debt may affect young professionals’ career choices. For example, doctors may avoid low-paying but much-needed specialties, such as caring for the elderly or for children. Talented teachers may leave their profession in search of higher-paying careers in order to offset the impact of student loan payments on their personal finances. Thus, at least in terms of career choice, the social costs of college debt are likely to grow as debt levels rise.

Proposed policy alternatives
The Federal Reserve Bank of Cleveland’s 2013 Policy Summit on Housing, Human Capital, and Inequality, held in September, featured two sessions on the subject of student loans. Academics and practitioners shared their research findings and observations with participants and led active discussions on policy considerations. While none of these proposals is a solution in itself, they might help bring about a less-indebted generation of students, while minimizing negative consequences to educational attainment.

Education, education, education
One thing we heard over and over is that apart from being educated in their chosen fields, students should be educated about borrowing for college. Experts have proposed providing resources and counseling to students to give them an accurate perception of the debt they are taking on, the future costs, and the long-term value of their education. “You’d be amazed at how many people come into my office every day and say ‘I borrowed $30,000. I have a 10-year repayment. I’ll repay $3,000 a year, and we’re cool.’” says Bryan Ashton, senior program coordinator at Ohio State’s Student Wellness Center. “The concept of interest isn’t there.” Helping students anticipate their future financial situations in the short term could go a long way. But being proactive needs to start even earlier: Financial education in K–12 is crucial because by the time students are on the college campus, it may be too late despite every good intention.
Students should also be aware of the factors that increase the likelihood that they will complete their education. For instance, statistics show that dropout rates are higher for students who live at home with parents or who hold off-campus jobs. Furthermore, by encouraging students to complete college in fewer semesters, schools can increase graduation rates and enable students to finish with less debt. Since the outcomes of their decisions aren’t always intuitive, the more schools and agencies can educate students, the better. A student may feel inclined to work extra hours during the school year to offset their tuition costs, but according to Ashton, that decision might not make financial sense if it causes the student to take a lighter course load and incur a semester or two of additional debt.

All practitioner experts at the Policy Summit—Ashton, Karol, and president and CEO of the National Association of Student Financial Aid Administration Justin Draeger—recommended taking steps to incentivize schools to promote timely graduation and to reduce overall borrowing by minimizing the number of semesters. Also, students who might benefit from alternative paths should consider them, including the completion of early courses at community colleges at a substantially lower cost.

Finally, while the CFPB has taken steps to address some issues related to for-profit schools and the disproportionately high levels of debt and default associated with them, the recommendations have not been fully implemented and do not adequately tackle the problem. Before deciding whether to enroll at for-profit colleges, students should consider several factors, such as the relative costs of the programs, the economic value of the degrees and certificates they offer, average completion rates, and the limitations on transferring credits among schools.

Some experts assert that there isn’t a student loan debt crisis per se as much as a student loan repayment crisis.

Educating students on the potential return on investment associated with their degree choices is another approach that experts think will minimize future financial strain. According to Scott Karol, director of program evaluation and technology at Clarifi, a non-profit community resource devoted to lifelong financial literacy, incoming students need to make purposeful degree choices with the resulting financial picture in mind. While Karol stressed that the value of a college degree is definitely worth it, he also suggested striking a balance between the cost of the degree and the associated earning potential. If, for example, you apply to several schools to earn a certain degree and “take on four times the amount of debt load [at a very prestigious school] as would be necessary to get the same degree at a more inexpensive university, was that a smart decision?”

Also a topic of discussion was the potential for removing subsidies entirely or withholding loans for certain degrees and fields of study. While none of the presenters advocated such a drastic measure, associate professor at Seton Hall University School of Law Michael Simkovic did propose that interest rates on student loans should reflect the value of various degrees in the workforce. Under this system, for example, science, technology, engineering, and mathematics (STEM) degrees would feature low interest rates, while liberal arts students would pay higher rates on their loans.


**Borrowing and repayment alternatives**

Both the academic and practitioner experts gathered at the Policy Summit agreed that more can be done to ensure suitable loan repayment options for students. In fact, both academic Daniel Kreisman, postdoctoral research fellow at the Gerald R. Ford School of Public Policy at the University of Michigan and practitioner Draeger assert that there isn’t a student loan debt crisis per se as much as a student loan repayment crisis, “especially for those who may not have been prepared for college, took out loans, and then didn’t complete their educations,” says Draeger.

Although alternatives beyond the standard 10-year repayment schedule are available, most students are unaware of these programs and accept the default option without careful consideration. Several presenters recommended broadening the repayment alternatives, including discharge of debt through bankruptcy in limited instances.

Additional suggestions addressed borrowers’ ability to repay, with the goal of reducing the future risk of non-payment. Structuring repayment schedules to account for income levels and growth in income over time may enable borrowers to shift the repayment burden to later in their careers when they more financially settled and in a better position to make payments. Alternatively, a longer standard repayment period would lower payments and enable debtors to weather periods of job loss or reduced income.

To implement income-sensitive repayment schedules, Kreisman suggested a partnership with the IRS to track income levels, adjust payments accordingly, and authorize automatic withholding. Practices utilized by the Social Security Administration would be helpful in shaping such a program.

Interest rates that better account for the cost of lending would benefit some borrowers a great deal, according to Kreisman. Since interest rates on student loans are locked in at the time of graduation, students may face a much heavier debt burden if they graduate during a less favorable interest rate period. Because this debt cannot be refinanced, students have few options for addressing the associated costs at a later time.

Presenters also suggested that private student loans should have the same level of consumer protection as other types of consumer debt. Private student loans make up roughly 14 percent of outstanding student debt, and servicing these loans is associated with many complaints, according to the CFPB.

Finally, several of the experts addressed the issue of underwriting standards and whether ability to repay was a fair consideration in awarding student loans. They agreed that steps should be taken to consider the debt burden associated with repayment and a borrower’s future ability to repay, though the focus must remain on making loans available to students who need them.

**Keeping a watchful eye**

As students continue to graduate (or not) into a tough job market, there are opportunities to shed light on some crucial aspects of student loan debt. Talks with the experts will continue, as will research into how the economy can continue to benefit from its citizens’ educational attainment while at the same time managing their debt. With Cleveland Fed research clearly showing the link between educational attainment and economic prosperity, it’s only right to do so.

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**Read more**

Learn more about how education affects economies in *Altered States: A Perspective on 75 Years of State Income Growth* at [www.clevelandfed.org/about_us/annual_report/2005](http://www.clevelandfed.org/about_us/annual_report/2005)

For videos, presentations, and more from the 2013 Policy Summit on Housing, Human Capital, and Inequality, visit [www.clevelandfed.org/community_development/events/ps2013](http://www.clevelandfed.org/community_development/events/ps2013)