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KEY INSIGHTS

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United States: Macroeconomic Effects of Rising Student Debt

By: Alexandra Webb, Elizabeth Rust, and Robert Wescott, Ph.D

Key Insights

- Borrowing for college benefits the U.S. economy overall by improving access to education and increasing students' lifetime earning potential.
- Rising aggregate student debt does not pose a systemic threat to U.S. credit markets, but the heterogenous distribution of debt indicates that certain types of borrowers are disproportionately at risk of default.
- There is some evidence that student debt is causing young adults to delay forming households and making big-ticket purchases like homes and autos.
- Student debt is unlikely to cause a recession — but individual borrowers will be especially vulnerable when the next downturn occurs.

Total outstanding student loan debt reached nearly $1.5 trillion in 2019.

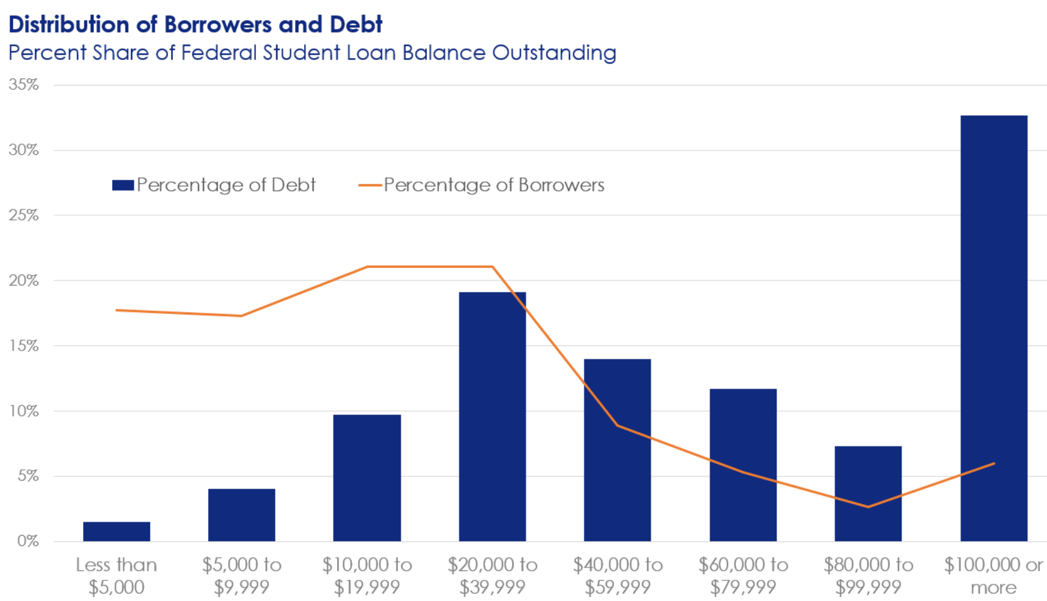
What's happening? In 2019, total U.S. student loan debt outstanding reached nearly $1.5 trillion. Student loan debt is the largest category of U.S. consumer debt outstanding behind mortgage debt and is nearly double the amount of total credit card debt.

Significance? Student debt is weighing strongly on the minds (and bank accounts) of many Americans, warranting a rigorous look at the facts underlying the headlines. Anecdotal evidence abounds that hefty student debt burdens are crushing the millennial generation — the cohort of Americans born between the early 1980s and mid-1990s — by preventing them from accumulating wealth and causing them to delay major life milestones like marriage and home ownership. Student debt relief has already become a key issue in the 2020 U.S. presidential race, with a number of Democratic hopefuls releasing proposals to partially or completely cancel outstanding student debt as they vie for their party's nomination.

Background. As of 2017, over 44.7 million Americans had some amount of student loan debt,[1] nearly 14% of the total U.S. population. For the past fifty years, the federal government has been by far the largest lender to postsecondary students. Rates of borrowing and college attendance took off in the 1970s with the creation of the Student Loan Marketing Association (later known as Sallie Mae) to add liquidity to the U.S.'s nascent guaranteed loan program, which initially offered subsidized loans to economically disadvantaged students through their institutions. Direct lending from the federal government to students began in the early 1990s along with the introduction of unsubsidized loans available to all students. Today, federal loans make up about 89% of all student loans issued, of which over half are unsubsidized.[2]

Contrary to popular perceptions, students with more than $100,000 in debt are rare, accounting for fewer than 6% of borrowers.

Distribution of student loan debt. Despite the prevalence of stories about recent graduates with six-figure debt and poor job prospects, such cases are the exception and not the rule. **Figure 1** shows the distribution of borrowers and debt by outstanding balance of federal loans as of 2018.[3] Students with more than $100,000 in student loan debt account for fewer than 6% of borrowers but account for around 33% of total outstanding debt. Over half of the value of outstanding federal student loan debt is held by just one-seventh of individual borrowers with greater than $60,000 in debt — outstanding federal loan debt for the average student borrower is closer to $30,000.



A bubble ready to burst? It has become common for commentators to characterize the increase in college costs and student debt a 'bubble,' even comparing the uptick in aggregate student debt to the explosion of mortgage debt that preceded the 2008-09 financial crisis. The implication is that students who

[1] Federal Reserve Bank of New York Quarterly Report on Household Debt and Credit, Q1 2019.
[2] College Board Trends in Student Aid Report, 2018.
[3] U.S. Department of Education Federal Student Loan Portfolio, 2018.

choose to go to college are greatly overestimating the value of doing so — a position not generally supported by the data.

Although tuition costs have risen faster than wages, college is still a good investment for most students.

It is true that college costs have risen substantially faster than wages for college graduates over the past several decades, possibly driven by the expansion of guaranteed student loan programs.[4] On average, however, college is still a good investment for most students. Students who earn a college degree can expect higher lifetime wealth accumulation than their peers without a degree even after factoring in student loan repayment obligations and the opportunity cost of attending college rather than working full-time.[5] According to the Bureau of Labor Statistics 2018 Current Population Survey, high school graduates age 25 and older without a college degree were unemployed at a rate of 4.1% compared to just 2.8% for those with an associate degree and 2.2% for those with a bachelor's degree.

Enrollment figures suggest that demand for postsecondary education is actually cooling down, contrary to the rapid escalation in demand characteristic of asset bubbles. The number of students enrolled in U.S. postsecondary institutions peaked in 2010 at 21.0 million students and fell monotonically to 19.8 million students by 2017. The rise and fall of enrollment rates is largely consistent with trends in U.S. birthrates, which experienced a corresponding spike in in 1991. As U.S. birthrates continue to fall (possibly compounded by debt-driven demographic changes discussed below), a sudden surge in demand for postsecondary education appears unlikely.

Students who do not graduate and who attend for-profit universities struggle disproportionally to pay off their student loans.

Major exceptions. There are two major exceptions to the general finding of positive returns for students who borrow: those who borrow but do not graduate and those who borrow to attend for-profit universities. A commonly-used benchmark for college completion is the 150% graduation rate, the proportion of first-time, full-time, bachelor's degree-seeking students at 4-year postsecondary institutions who finish their degree within 6 years. The 150% graduation rate for the cohort that entered school in 2010 was just 60%,[6] meaning that 40% of students who attended college lost both time that could be spent earning wages and, for those who borrowed, money spent paying off loans without the earnings premium from having a degree.

Table 1 shows the 2-year federal student loan default rate for borrowers entering repayment in the 2011-12 academic year by institution type and degree status.[7] For-profit universities tend to cater to non-traditional students who are older and have greater familial responsibilities, making them less able to pay for college in the first place and more likely to drop out before completing their degree program. Cost of attendance at for-profit universities has also consistently outpaced that of

[4] Gordon & Hedlund, "Accounting for the Rise in College Tuition" (2016).
[5] Avery & Turner, "Student Loans: Do College Students Borrow Too Much—Or Not Enough?" (2012).
[6] National Center for Education Statistics Digest of Education Statistics, 2018.
[7] Looney & Yannelis, "A Crisis in Student Loans? How Changes in the Characteristics of Borrowers and in the Institutions They Attended Contributed to Rising Loan Defaults," Brookings (2015).

non-profit universities, along with both drop-out and loan default rates. Higher default rates for students with only some college help explain why two-thirds of all defaults are for borrowers with under $10,000 in student loan debt.[8] Small student debt balances are a significant challenge for the financial security of individual borrowers who do not make earnings gains as a result of their student loans, but the relatively low balance of most loans in default suggests that the default rate itself does not imply broader systemic risks to U.S. credit markets.

Most defaults are for borrowers with relatively low balances.

Table 1: 2-Year Federal Student Loan Default Rate

	All Institutions	Private Nonprofit 4-Year	Public 4-Year	For-Profit	Public 2-Year
Graduated	**9%**	5%	6%	14%	17%
Did Not Graduate	**24%**	15%	18%	28%	29%

A drag on consumer spending? Even if the buildup in aggregate student debt is unlikely to be the trigger point for the next U.S. recession, student debt may still have negative effects on the U.S. economy. Given a 10-year repayment plan at 5.05% interest (the current direct federal student loan interest rate), a student can expect to pay around $320 per month to service their student loans, money that isn't spent on consumption of goods and services. There is limited empirical evidence, however, that student debt payments are crowding out consumer spending on a macroeconomic scale. A 2018 Federal Reserve report found that, assuming student debt payments reduce consumption at a 1:1 ratio (which is unlikely given an average savings rate above zero), the total reduction in real GDP growth would be less than 0.05% in any given year since 2001.[9]

Young adults may put off marriage, homeownership, and purchasing a car because of their student loan obligations.

Housing and autos. Student debt may crowd out spending for big-ticket items like houses and cars. A 2017 staff report by economists at the Federal Reserve Bank of New York, for example, found that tuition and student debt increases explain 11-35% of the 8% decline in homeownership among 28-30 year-olds during 2007-2015.[10] Declining rates and delayed onset of household formation, another driver of low rates of homeownership, may also be precipitated by student debt burdens. It is common for young adults to delay getting married or having children until they feel financially secure. For those with student loan debt, financial security may be elusive for years following graduation. Declining car purchases by millennials, the generation most closely associated with student debt burdens, have also been cited as an explanation for persistent weakness in the U.S. auto sector. One complication to assessing the impact of student loans themselves on millennials, however, is that many graduated from college during the worst U.S.

[8] "Investing in Higher Education: Benefits, Challenges, and the State of Student Debt," White House Report (2016).
[9] Feiveson, Laura, Alvaro Mezza, and Kamila Sommer "Student Loan Debt and Aggregate Consumption Growth," FEDS Notes (2018).
[10] Staff Report No. 820, 2017.

labor market in decades, depressing lifetime wealth accumulation (and the returns on postsecondary education).

Harder to save? In addition to making it harder for borrowers to accumulate savings, student loans may impede access to credit that can be used to make larger purchases. Although the rate of delinquency for student loans has remained remarkably stable, the delinquency rate likely understates the true effects of student loans on consumer credit. Students and families may, for example, be substituting other forms of credit, such as credit cards and home equity line of credit (HELOC) loans, for student-specific aid. Additionally, younger Americans may be forced to choose between paying off student and other types of loans, potentially explaining the recent uptick in auto loan and credit card delinquencies among borrowers aged 39 and younger. Students and their families may also be putting off saving for retirement to finance students' education, the effects of which may not fully materialize for decades.

Student loan debt is unlikely to trigger a downturn in the broader U.S. economy, but individual borrowers will be especially vulnerable in a slowdown.

The bottom line. In general, the weight of the evidence suggests student borrowing continues to be a net positive for the U.S. economy by increasing access to education and boosting graduates' earning potential. Although total debt outstanding has ballooned in recent years, most borrowers should be able to pay off their loans even if it requires delaying the age at which they feel financially secure. Student debt is a significant financial burden for certain types of borrowers, but not generally for graduates with six-figure debt; rather, students with just a few thousand dollars in loans who do not complete their degrees are at the highest risk of default. Although postsecondary education does not display the characteristics of a typical asset bubble, individual borrowers will be especially vulnerable when the next economic downturn occurs.

KEYBRIDGE
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3050 K Street NW, Suite 220
Washington, DC 20007
Phone: 202.965.9480
Web: keybridgedc.com