Student Debt: Trends and Possible Consequences

by Ericka Davis

Student debt in the United States totals more than $1.1 trillion, having expanded by $855 billion in the past 10 years. The rate of serious delinquency on student loans has averaged more than 11.25 percent over the past two years. Student loans are receiving increased attention from borrowers, lenders and policymakers as concerns mount over students’ heavier debt loads and their potential inability to repay.

So how do current student debt levels and delinquency rates, as well as trends over the past decade, compare to other major consumer lending categories? Should borrowers, lenders and policymakers be alarmed? And what are some possible consequences to younger borrowers?

Changing Trends of Consumer Debt

Chart 1 shows the rapid growth in student debt since 2003, surpassing the overall size of the credit card lending market and the auto lending market. Near the beginning of 2003, there was $688 billion in credit card debt, $641 billion in auto loans and just $241 billion in student loans. Since then, student loans have increased at a compound annual growth rate of nearly 15 percent—more than three times faster than for auto loans. Credit card lending—which increased prior to the Great Recession and then receded—is currently lower than its balance in 2003. As of June 2014, credit card debt stood at $669 billion, auto lending at $905 billion and student debt at $1.1 trillion.

Unlike auto loans and credit card lending, student debt continued to grow during and after the Great Recession. Of course, rising student debt levels might be expected as college enrollment expands and tuition rates and fees increase. And during the recession, the growth of student

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Chart 1 The Expanding Student Loan Market

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loans might have been the result of many workers returning to school to gain additional skills until more-promising job opportunities return. Even given recent trends of rising college costs and lower earnings upon graduation, research shows that the benefits of college still tend to outweigh the costs. Regardless, as costs for higher education continue to rise, college students seem likely to take on more student debt.

**Impact of Borrowers**

The unique circumstances of student loan borrowers coupled with the distinctive characteristics of student loans may lead to excessive borrowing, more delinquent payments and lower credit scores. Student loans are often originated when borrowers earn little income. Many borrowers have only a vague idea of their future earnings potential and ability to repay. Borrowers can defer payment of unsubsidized loans while enrolled in college, which results in an even larger debt burden. And many borrowers do not understand the structure and repayment options associated with student loans. Moreover, with the exception of certain programs or an undue hardship petition or death, student loans are rarely forgiven.

Since the end of the Great Recession, serious delinquencies (loans past due 90 or more days) have declined across all lending categories except student loans (Chart 2). At 10.9 percent, the second quarter 2014 delinquency rate on student loans was more than three times that of mortgages and auto loans, and more than 3 percentage points higher than the rate of serious delinquencies on credit cards. Although the causes of increasing student loan delinquencies require further research, the long-run implications for seriously delinquent borrowers likely include higher interest rates on other consumer lending products; greater difficulty in securing loans, housing and utilities; and lower credit scores. However, it is important to remember that these challenges can be mitigated if borrowers commit to diligent and timely payments.

**Younger Borrowers Face a Bigger Battle**

For younger borrowers, the consequences of high student debt combined with greater difficulties in making required payments can be even more devastating. Younger borrowers with student debt problems may have greater difficulty starting their own business or securing employment since some jobs require applicants to have a good credit history. According to Federal Reserve Bank of New York research, credit scores of student borrowers and nonborrowers have recently diverged (Chart 3). From 2003 to 2008, Equifax risk scores for 30-year-olds with student debt are nearly the same as those for 30-year-olds with no student debt. But after 2008, the risk scores for these two groups deviate: Average credit scores for 30-year-olds with student debt begin to stagnate or gradually slide, whereas average scores for
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those without student debt improve. By 2013, there is a 24-point differential in average scores between the two groups, which could result in broader implications for many sectors of the U.S. economy.

Indeed, the New York Fed study concludes that younger workers with student debt may have more limited access to housing and auto debt, which could also limit their options in these markets. Lower homeownership rates among younger workers suggest that the burden of student loans may have kept these potential homeowners from making major investments. According to the U.S. Census Bureau, homeownership rates for householders under 35 years of age fell to 35.9 percent in second quarter 2014, the lowest proportion of any young adult generation since 1982.

More Research Needed

Over the past decade, student debt has skyrocketed and delinquency rates have nearly doubled to levels much higher than for other consumer lending products. These trends are generally viewed as troubling. Recent research suggests that consumers with student debt are at a disadvantage in other lending markets and in their influence on economic activity. But other research continues to indicate that investing in a college education is a wise economic decision, despite recent trends in higher tuition costs and lower wages. While the choice to become more educated has numerous positive benefits, mortgaging future opportunities with more student debt may present considerable long-run, negative consequences. It is important that further research be conducted on the expanding student loan market to monitor and assess changing trends and to better understand potential implications to borrowers, lenders and the broader economy.

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4 For more information on consumer credit conditions, see the Dallas Fed’s Consumer Credit Resource Center, http://www.dallasfed.org/cd/ccc/index.cfm.
**Noteworthy Items**

**Federal Reserve Governor Jerome Powell provides remarks at the Federal Reserve and Conference of State Bank Supervisors community banking conference (Sept. 23, 2014)**
Powell discusses community banks’ important role within the economy. Powell also elaborates on the Federal Reserve’s commitment to understanding the challenges faced by the community banks. READ MORE

**President Richard Fisher provides remarks upon receiving the Woodrow Wilson Award for Public Service (Sept. 19, 2014)**
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**Federal Reserve Vice Chairman Stanley Fischer speaks in Sweden about the challenges the U.S. faced during the Great Recession (Aug. 11, 2014)**
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**Federal Reserve System releases the 2013 Federal Reserve Payments Study (July 24, 2014)**
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