Student Loans, the Next Big Threat to the U.S. Economy?

By Caroline Salas Gage, Janet Lorin
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Tiffany Roberson works for the state of Texas as a parole officer, teaches part-time, and is living with her parents after having completed her master's degree. She's held off marrying her boyfriend of four years and starting a family because she owes more than $170,000 in federal and private student loans that she took out to pursue her education in criminal justice. "I've never gone into default," the 30-year-old says. "What really hurts is people say I'm a bum for living at home."

Stories like Roberson's are sadly common in the U.S. Student loans today are one of the only deteriorating pockets of consumer credit, with balances and delinquency rates rising to record highs even as a strengthening economy allows Americans to reduce total borrowing. Outstanding student debt topped $1 trillion in the third quarter of 2013, and the share of loans delinquent 90 days or more rose to 11.8 percent, according to the Federal Reserve Bank of New York. By contrast, delinquencies for mortgage, credit card, and auto debt all have declined from their peaks.

The New York Federal Reserve's move to measure the size of the student loan load says a lot about how concerned the central bank is about a possible threat to the economy. "Our job is to really understand what's happening in the financial system," and the "very rapid rise in student loan debt over the last few years" can "actually have some pretty significant consequences to the economic outlook," New York Fed President William Dudley told reporters in November. "People can have trouble with the student loan debt burden—unable to buy cars, unable to buy homes—and so it can really delay the cycle."

The federal government is the source and backer of most of the loans. "I'm always made very nervous by a credit market that benefits from government guarantees and is expanding very rapidly," Jeffrey Lacker, president of the Federal Reserve Bank of Richmond, said on Jan. 10 at a Greater Raleigh Chamber of Commerce event in North Carolina. "That's what we're seeing with student loans, and it's what we saw with housing." As the New York Fed's Dudley explained in November, "to the extent that student loan burdens become very, very high, there are presumably going to be losses" to the federal government.

Economists at the New York Fed are analyzing student debt as part of their quarterly reports on national household credit. That project got started six years ago as the financial crisis unfolded, and the researchers and their then-boss, Timothy Geithner, realized there wasn't a good way to study total consumer borrowing. As they began assembling their own figures, relying on a sample from credit reports from Atlanta-based Equifax, they discovered that data on student borrowing were particularly sparse because of gaps in the frequency and types of information available.

The U.S. Department of Education releases default rates on federal student loans once a year, and only for borrowers who haven't made the required payments for at least 270 consecutive days during the two- and three-year periods after they graduate or drop out. The default rates don't include students who get extensions on their loans, which can be another sign that borrowers are under stress. The Education Department's calculations also don't cover private loans, which account for about 15 percent of the market. The department, in an effort to be more informative, began publishing more details about student loan data on its website in July.

"We didn't realize there was so little data," says Wilbert van der Klaauw, one of the economists involved in the New York Fed analysis. He and his colleagues, economists Donghoon Lee and Andrew Haughwout, say they are trying to understand how the rising student loan burden influences living arrangements—such as those of college graduates like Roberson who can't afford to move out of their parents' homes. They are also trying to understand the effect of such living arrangements on marriage and birth rates. The share of 25-year-old Americans with student debt increased to 43 percent in 2012 from 25 percent in 2003, while the average loan balance rose 91 percent, to $20,326 from $10,649, New York Fed data show.

There remain a lot of "missing pieces" in the analysis, Van der Klaauw says. These include the link between debt levels and specific universities or courses of study. The subject a student majors in can have a direct effect on his or her ability to service a loan. "If you're a pre-med student, you're an engineering student, and you take out $40,000 or $60,000 of loans, I have no problem with that," John Silvia, chief economist at Wells Fargo, told the audience at the January Chamber of Commerce event in Raleigh. "But if you're going to be a French major, you're going to study social welfare, and you're going to take out $60,000 of loans, who is making the economic judgment there?"

While undergraduates are limited in how much of their education they can finance through federal programs, parents and graduate students can borrow much more. They can take out federal Plus loans to cover the cost of tuition, room, board, transportation, and personal expenses, minus any aid received.

A student loan crisis would "force parents and students to think about" their expected financial return on education, Silvia said in Raleigh. "Like in housing, we learned by going through that craziness, and now hopefully the next generation won't make that same mistake."

Roberson is looking for a third job, partly because rising interest rates have increased her debt to about $72,000 in federal loans and $102,000 in private loans. She pays almost $1,000 a month on the latter and about $33 on the federal loan through a program that calibrates payments to income. "These payments eat up my paycheck," she says. "It puts a huge drain on living the American Dream."

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