Is There a Student Loan Crisis? Not in Payments
Joel A. Elvery, Economist

The number of people obtaining student loans is rising—and so is the average loan balance. But a Cleveland Fed economist notes that monthly payment amounts are less of a hindrance than many believe.

Outstanding student loan balances reached $1.2 trillion in the fourth quarter of 2015, making student loans the second largest category of debt after mortgages. And according to estimates from the Federal Reserve Bank of New York, student loan balances are rising faster than any other category of debt. Accounting for inflation, overall student loan balances almost tripled between the start of 2005 and the end of 2015. This dramatic growth has spurred concern that students are coming out of college with so much debt that their ability to purchase homes or start businesses is limited.

Much of the attention paid to the growth of student loans has focused on balances, overlooking payments. However, a loan balance may be an abstract concept to a borrower, while a payment is the immediate responsibility that affects his or her daily life.

Student loans are like mortgages: A large balance gets paid over time in a series of payments, the amount of which is typically fixed, such that even a large balance may be manageable month-to-month when viewed in these terms. The amount of student loan payments paints a different picture of student loan debt than one gets from balances. In fact, while outstanding balances have risen 280 percent since 2005, the average payment rose just 50 percent in that same period.

In the second quarter of 2015, the average student loan payment for those in the 20- to 30-year-old range was $351, according to the Federal Reserve Bank of New York's Consumer Credit Panel data. This amount is just more than 50 percent higher than it was in 2005 ($227 when adjusted for inflation).

But a small fraction of borrowers have very large student loan payments, pulling up that average. Fifty percent of the borrowers had payments of $203 or lower, and another 25 percent had payments between $203 and $400. This means that 75 percent of student loan borrowers in this age range would be, in the simplest sense, better off with a student loan if going to college increased their monthly take home earnings by $401 or more. In 2014, labor force participants aged 20 to 30 who had at least some college on average earned $2,353 per month, $750 more than people the same age with just a high school degree. This is more than double the average monthly student loan payment, suggesting that the increase in earnings from going to college more than offsets the cost of student loan payments for most borrowers.

Student loans have an attractive feature that most debt doesn't have: payments can adjust to current income levels. Direct federal student loans enable borrowers to apply to make their payments a fixed percent of their discretionary income, with the percent ranging from 10 percent to 20 percent depending on the program. These programs also set a maximum number of years that people have to pay, up to 25 years, and any debt remaining at the end of that period is forgiven.

There are other advantages that student loans have over most other forms of debt. During periods of unemployment, a borrower can apply to suspend payments on federal student loans until the borrower resumes work (note this doesn't apply to private student loans). And interest paid on these loans is tax deductible up to $2,500 annually. One downside, though, is that student loan debt is extremely difficult to eliminate through bankruptcy.

Recent research has looked at the link between student loans and homeownership and wealth accumulation. Researchers from the Federal Reserve Bank of Boston find that compared to other people who attended college, student loan borrowers are less likely to own a home and that a 10 percent increase in student loans is associated with about 1 percent lower total net worth.

But, if people can only afford college by borrowing, we would want to compare student loan borrowers to people who never went to college. Stephan Whitaker of the Federal Reserve Bank of Cleveland finds that millennials with student loans were more likely than millennials without student loans between 2007 and 2015 to move to a higher-income neighborhood, a sign of economic mobility. The people without student loans included both people who never attended college and people who attended college. If it were possible to compare student loan borrowers only to people who did not attend college, the differences in mobility would almost certainly be even larger.

Forecasts suggest that postsecondary education will continue to be increasingly important, both for individuals' incomes and for the growth of our economy. According to the latest estimates from the National Center for Education Statistics, 79 percent of high school graduates from high-income families enroll in college 1 year after graduation versus 64 percent of graduates from middle-income families and 46 percent of graduates from low-income families. If the share of young people pursuing college degrees is going to rise, it will probably be because of increases in college enrollment by low- and middle-income students, to whom student loans are especially important. Like any borrower, a potential student loan borrower should focus on whether the debt is enabling her or him to make a valuable investment in the future.

Sum and substance: Student loan debt is on the rise, but average student debt burdens are more than offset by students' average financial gain in the long-term.

Did you know?
Student debt has ballooned to unprecedented levels in recent years. Read "Are Millennials with Student Loans Upwardly Mobile?" to find out how student loan debt may be affecting social mobility.