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How The $1.2 Trillion College Debt Crisis Is Crippling Students, Parents And The Economy

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Total Student Loan Debt: $1 Trillion

Two-thirds, that's right, two-thirds of students graduating from American colleges and universities are graduating with some level of debt. How much? According to The Institute for College Access and Success (TICAS) Project on Student Debt, the average borrower will graduate $26,600 in the red. While we've all heard the screaming headlines of graduates with crippling debt of $100,000 or more, this is the case for only about 1% of graduates. That said, one in 10 graduates accumulate more than $40,000.

College (Photo credit: 401(K) 2013)

It's a negative sum game for both student-borrowers and the economy. According to the Consumer Financial Protection Bureau, student loan debt has reached a new milestone, crossing the $1.2 trillion mark — $1 trillion of that in federal student loan debt.

This pushes student loan debts to dizzying new heights, as they now account for the second highest form of consumer debt behind mortgages. With the federal debt at $16.7 trillion, student loan debts measure at 6% of the overall national debt. This is no small figure, and national debt carries many consequences including slowing economic growth (translating into fewer jobs being created) and rising interest rates. Capital will not be as easy to access.

The majority of student loans are backed by the U.S. government through banks like Sallie Mae, or since 2010, by the Department of Education. Translation: the creditor in this scenario is the U.S. tax payer, who if students default on these loans will be subject to carry the burden of these loans.

Federal Loans are Safer than Private

Lauren Asher, president of TICAS, a nonpartisan policy group, says that government loans are the safest type of loans to take while financing education. “Federal student loans are the best way to borrow if you have to in order to get through.” She identifies a lack of information as a major problem in the debt game as she identifies growing private loan debt as a major problem. “Half of those taking out private loans have not maxed out on federal loans.”

Why the preference for federal loans with federal debt being such a hot topic? “Federal loans are subject to income based payback, fixed interest rates, and take nine months to default on, making them a much safer loan for students to take,” Asher explains. Conversely, private loans have done away with late fees, and in the fine print have redefined the right to claim default on the loan after missing a single payment. Default is a one way ticket to bad credit. “Any ding in credit rating can affect [a borrower] more now than ever, even employment,” says Asher.

Asher argues, however, that higher education “is still the best investment in your future.” The college degree is getting more and more weight as political leaders are calling for upwards of 60% national higher education attainment by 2025. And the demand for higher education is increasing. “When the economy is down, more people turn to higher education to get an edge in the job market, but have less money to finance it,” explains Asher.

Debt and Community Colleges

If you are under the impression that only four-year schools are subject to debt, think again. Of those students completing an associate’s degree from a community college in 2008, 38% graduated with debt. In the for-profit sector of two-year degrees, over 90% have debt. The average debt load at a public two-year institution is $7,000.

One community college, Henry Ford Community College in Dearborn, Mich., is offering a one-time student debt amnesty program that will allow students who owed a balance prior to or including the winter 2012 semester to afford to return to the college. The program “offers the opportunity for students to pay 50% of what is owed on their account to settle their debt with the College.” Will this become a norm within the two-year degree space as more and more debt is accumulated?

The Cost of Debt

Of this $1.2 trillion in student debt, about $1 trillion is in federal student loans. This figure does not tell the full story, however, as the $1.2 trillion does not include funds students must divert away from retirement savings, parent borrowing, or credit card debt. President Obama is expected to sign the bipartisan Senate bill to tie federal student loan interest rates to the market this week. On one side, this will reverse the interest rate hike that went into effect on July 1, lowering the current rates for undergraduate students from 6.8 to 3.8%. As the market climbs, however, these rates will climb until they reach a cap of 8.25%. By TICAS calculation, this may cost families $715 million more over the next 10 years.

What does 3.8% interest translate to for students? If we go back to that average figure of $26,600, compounding for interest year over year using the 10-year-payback plan that is the standard, the total cost of your $26,600 loan is about $38,600. Break that down by monthly payments and you are looking at about $320 per month going toward student loan payments. "Debt costs you time in savings, pushes back when and whether you can buy a home, start a family, open a small business or access capital," says Asher. Not to mention the opportunity cost of the education itself at almost $40,000.

Dealing with the Problem

What can we do? With more and more emphasis being placed on college education for all, raising costs of an already expensive degree, and underemployment of college graduates running rampant, student loan debt is a problem that will cripple economic possibilities and success to come. In its recent report, Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Succes, TICAS is calling for simplification and better access to information regarding student loan debt, including information on consolidating debt, and increasing students' information to both school's default and graduation rates.

While many have been calling for debt forgiveness to help settle this score, others have a problem with burdening the taxpayer with the responsibility to pay back loans that they are neither responsible for, nor benefit directly from. While a more educated populous has positive externalities, debt forgiveness sets a bad precedent for the financial world. Ohio University developmental economist Julia Paxton says:

> “ One of the problems of debt forgiveness is that it sets a precedent that similar loans in the future will also be forgiven. Although the loans are allocated toward education, money is fungible and will have the net impact of increasing the spending ability of students in other areas of their lives. As the expectation of repayment obligation falls, borrowers may enter into a situation where they take on higher levels of debt and take more risks. This will lead to a weakened ability to repay, creating a vicious cycle that hurts the financial sector and the credit ratings of the borrowers.

I have seen firsthand the effects of this phenomenon that economists call moral hazard. One friend explained to me in my sophomore year that because his student loan money finally came through he was able to put the finishing touches on his beer pong table.

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