Irrational Behaviors in the Student Loans Market

University

Data

Student loans promote equitable access to post-secondary education. There are two major types of student' loans, and they include federal and private student loans. The federal government funds the federal students' loan program, whereas banks, credit unions, and other financial institutions offer private loans. The federal student' loan is more flexible as compared to the private loans since they do not require assurance for creditworthiness (Lochner & Monge-Naranjo, 2016). Students appling for the federal loans have to fill out the application forms, commonly known as the FAFSA forms, which are reviewed by the U.S. Department of Education. The majority of students applying for loans with a high school diploma are eligible for the loan. Every year, the federal government sets the interest rates for federal student' loans through Congress proposals.

Private loans are offered by financial institutions looking forward to making a fortune from the student loans market. Students applying for private loans have to provide security or assurance that they can repay the loan. Banks and other financial institutions require the student's parents, guardian, or any other person to co-sign to prove their creditworthiness (Lochner & Monge-Naranjo, 2016). The cosigner should be liable for loan repayment in case the student defaults to pay their debt. Notably, graduate students can apply for refinancing loans to advance and further their studies in banks, credit unions, or any other financial institution offering such loans.

Key Indicators

Approximately 60% of students joining colleges and universities in the U.S. apply for a student loan to pay for higher education. Statistics reveal that the students' loan debt is increasing at an alarming rate. More than 44.5 million individuals across all demographics have borrowed loans amounting to $1.5 trillion in student loan debt (Friedman, 2018). Approximately 92% of the student loans are federal loans, whereas private loans account for a minute fraction of the total debt. The rising debt in the student loan market has become an issue of concern for the government, financial institutions, and society at large. With the increasing cost of tuition fees in both public and private institutions of higher learning, more students have started borrowing student loans to further their studies. Over time, the student loan debt has become arduous for the borrowers and the nation's economy. Research reveals that student loan debt is the second-highest consumer debt after mortgage loans. Student loans have even surpassed automobile and credit card debts.

Students are often advised to borrow responsibly and apply for loans they can manage to repay. Most students borrow the loan hoping that they will secure employment and repay their loans through the income-based repayment scheme. Research reveals that most graduates are still struggling to repay their student loans. In 2016, the average student loan debt was estimated to be $ 37,102, whereas the average monthly payment was roughly $393 (Friedman, 2018). Surprisingly, approximately 62.5% of the student loan defaulters are above 30 years of age. This reveals that the number of older Americans with student loans has quadrupled in the last decade. The delinquency rates are also alarming and raise a question on the available repayment plans.

Demographics of student loan defaulters reveal that the majority of the people disproportionally affected are from minority ethnic groups. More than three-quarters of black students will apply for federal student loans to advance their post-secondary education. Women are also adversely affected by the student loan crisis since they take longer to repay their loans. The disparity between male and female defaulters is attributable to the gender pay gap. Defaulters from the middle and low socioeconomic strata often experience challenges securing a job (Nica & Mirica, 2017). Graduates have to settle for low paying jobs so that they can commence paying their loans. In the long run, this places a huge financial burden during a period in which someone should focus on personal growth and actualization of the set goals. Some graduates have to survive colossal pay cuts and deductions to finance their student loans.

Student's Loan Debt and Defaulting

The rising student debt has creeping threats to the economy of the nation. Experts suggest that student debt will have an adverse impact on the state of the economy. The figure in appendix 1 reveals that the outstanding student loan debt, expressed as a share of the national income, doubled between 2006 and 2019 (Ingraham, 2019). There is a growing fear that a further upsurge in the student loan may cause an economic crisis. Banks, credit unions, and other financial institutions have become more stringent in their borrowing and repayment policies. Lenders are afraid of the delinquency behavior of loan borrowers. The interest rates provided by lenders are dissuading students from applying for the loan. Nowadays, lenders have to weigh the creditworthiness of an applicant before approving a loan applicant. In a nutshell, new borrowers are experiencing challenges to secure private loans from financial institutions.

The struggle to pay the student loan debt has a far-reached effect on the realization of set goals. Research reveals that loan defaulters have a higher likelihood of delaying to marry or even start a family. Most graduates spend most of their time and hard-earned income trying to settle their student loans (Elliott & Nam, 2013). Most of the young entrepreneurs and starters are graduates who look forward to employing themselves and provide job opportunities for others. Student loans hamper the start of new business ventures due to financial insecurity. Defaulters often have the challenge of purchasing a house since most of them cannot qualify for a mortgage due to student loan arrears. Loan defaulters may find it challenging to save for retirement.

References

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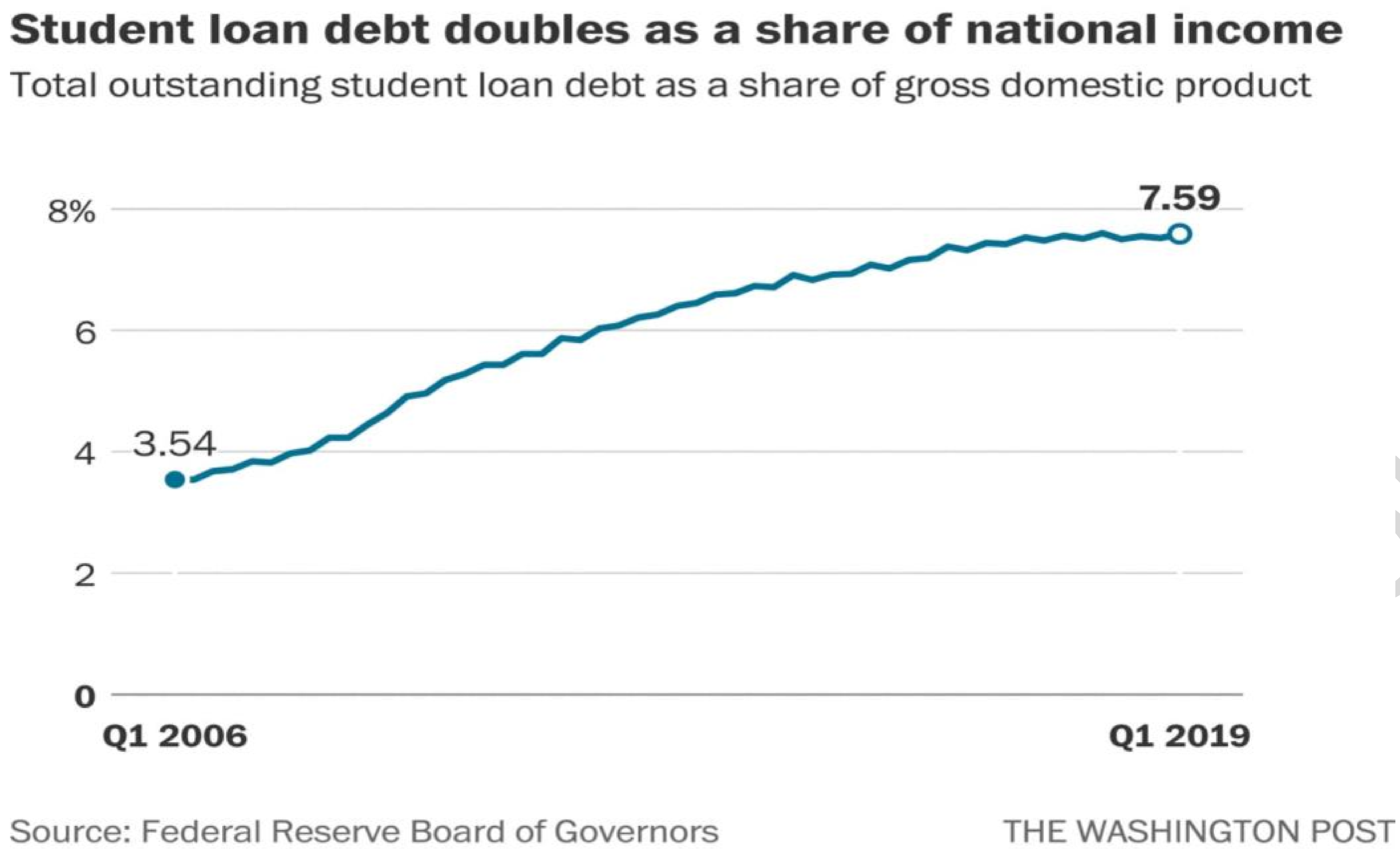
Appendix 1


Student loan debt doubles as a share of national income
Total outstanding student loan debt as a share of gross domestic product
8%
6
4
2
0
3.54
7.59
Q1 2006
Q1 2019
Source: Federal Reserve Board of Governors
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