Special Commentary — April 17, 2024

School Me Once: Student Loan Cancelation Revisited

Summary

New proposals from the Biden administration have brought student loan relief and its implications back into the macro discussion. In this report we (I) offer some context for student loans in the overarching category of household debt, (II) recap some of the high-level developments that have impacted the category in recent years and (III) offer a rough assessment of the latest proposals and weigh the impact on the consumer. In a nutshell: student loans are a fast-growing category of household debt, there has been a lot of tinkering with repayment in recent years and the latest developments will not make or break aggregate consumer spending even if the proposal overcomes the expected political and legal challenges.

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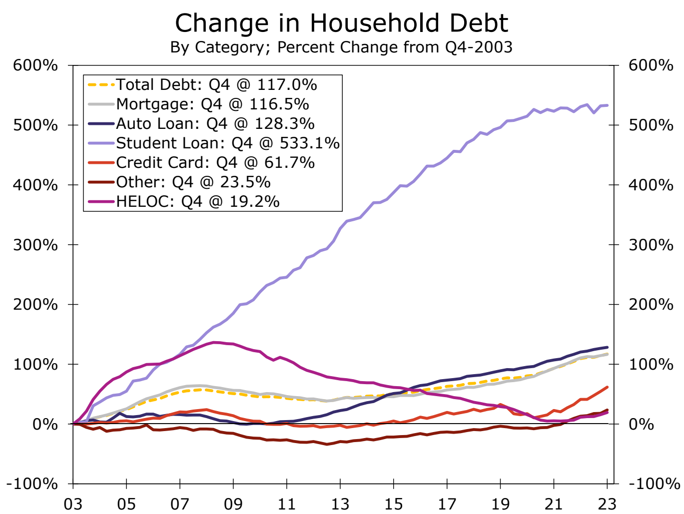
Figure 1



Source: Federal Reserve Bank of New York and Wells Fargo Economics

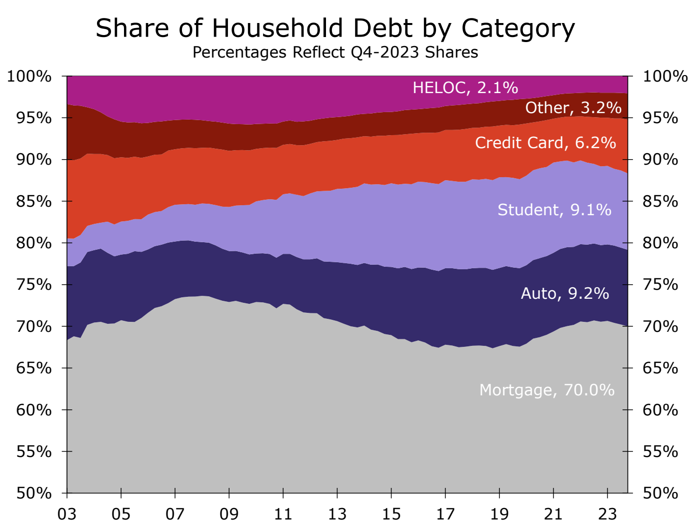
Part I: Fastest Growing Debt Category of the Past 20 Years

Student loans have been the fastest growing category of household debt over the past 20 years, having risen during that time from the smallest category of household liabilities to the third largest through the fourth quarter of 2023, the latest available data (Figure 2).

Primary mortgage debt at $12.3 trillion is far and away the largest liability for households. Second place is closely contested. On an aggregate basis, U.S. households owe $1.601 trillion in student loan debt (Figure 3) which roughly matches the $1.607 trillion in auto debt. Still, households owe more on student loans than they do on credit cards or secondary lines of credit secured by home equity (HELOC). This is how the approach to student loan payments can become a consideration in the outlook for consumer spending.

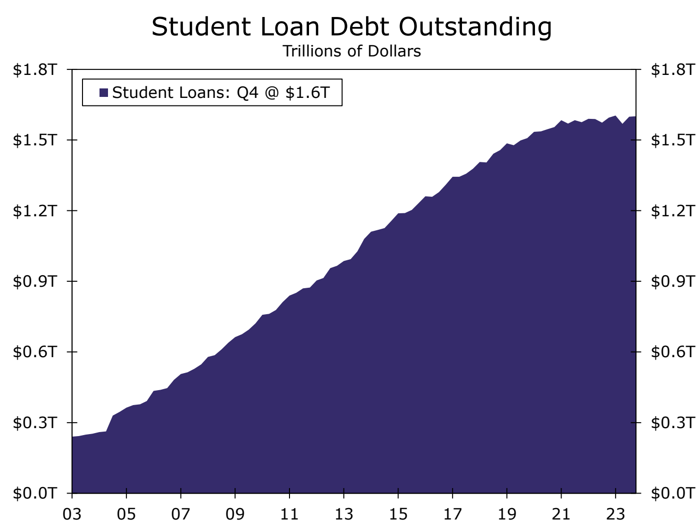
It bears noting that all this student loan debt is a relatively recent development in the long history of economic cycles. To say that student loan debt is growing is an understatement, as it has grown *four times* faster than any other category over the past two decades. Twenty years ago (Q4-2003), student loans added up to only $253 million, making it the *smallest* category of household debt. In the intervening years as seen back in Figure 1, total household debt roughly doubled, whereas student loan debt grew more than fivefold (+533.1%). The second fastest growth category was auto loans which increased "just" 128.3%. While young people tend to be saddled with more of this debt than others, aggregate data show that *all* age groups (even the very oldest ones) are burdened with student loans. Little surprise then to see policymakers and elected officials paying so much attention to the issue in recent years.

Figure 2



Source: Federal Reserve Bank of New York and Wells Fargo Economics

Figure 3



Source: Federal Reserve Bank of New York and Wells Fargo Economics

Part II: Recap, Words that Sound the Same but Mean Different Things

Forbearance. Debt forgiveness. Payment holiday. Canceled debt. These words and phrases sound similar but can mean different things. A recap of recent developments is the cleanest way we can think of to offer some disambiguation on these similar-sounding terms.

Public Service Loan Forgiveness (PSLF) is a program dating back to the George W. Bush administration which provides indebted workers a way out of their federal student loan debt by working full-time in public service. Restrictions apply, but as a rule-of-thumb, 10 years of uninterrupted payments along with service to the government or a non-profit will do the trick. The PSLF generally enjoys bipartisan support, as does canceling debt for the disabled. In August 2021, the Biden administration announced it would use executive action to cancel $5.8 billion in student loans held by people who are permanently disabled. This was an expansion of measures taken by the Trump administration that also granted cancellation of student debt for permanently disabled veterans in 2019.

Starting in March 2020, federal student loan borrowers received *payment suspensions* which offered temporary reprieve from making student loan payments during the COVID pandemic. Not only did the U.S. Department of Education not require households to make payments, *interest waivers* meant that those loans would not accrue interest. This payment holiday proved immensely popular. According to repayment data from the Department of Education, in December 2021, just 1.2% of borrowers continued to pay down their loans during the years of optional deferment. No surprise then that this relief was subsequently extended multiple times across multiple administrations and didn't come to an end until September 2023, more than three years after its initial enactment.

In the summer of 2022, the Biden administration announced a plan to provide relief to millions of borrowers with outstanding federal student loans, although legal challenges and bureaucratic hurdles impacted implementation. The proposal called for up to $10,000 (double that for Pell Grant recipients) of loan forgiveness for individuals making less than $125,000 a year (couples making $250,000 or less). In June 2023, the U.S. Supreme Court ruled that President Biden overstepped his authority in his plan to forgive federal student loans. The forgiveness did not come to pass.

Earlier this month, on April 8, the Biden administration proposed a similar, yet new, initiative to slash student debt. This plan too will likely face legislative pushback and legal challenges. The White House estimates that 40 million borrowers would have benefited from its 2022 proposals. The new, slightly more modest plan would help 30 million borrowers, they say, in combination with previous efforts to forgive debt.[1]

Part III: Assessment of the Latest Proposal

The crux of the new program is to cancel up to $20,000 in debt for borrowers whose balances have grown as a result of unpaid interest. This plan is different from the previous proposal in that this plan specifically targets those whose outstanding balances are *larger* than the amount initially borrowed.

The eligibility is limited to those who earn $120,000 or less (couples making $240,000 or less) and have been making payments toward undergraduate debt for at least 20 years or graduate-level debt for 25 years or more. Inaddition, there are other targeted parts of the proposal aimed at reducing the debt burden for borrowers who attended “low-financial-value programs” or those experiencing financial hardship. The administration estimates that this plan would fully wipe out accrued interest for 23 million borrowers, would eliminate the full outstanding student loan balance for over 4 million borrowers and provide over 10 million borrowers with at least $5,000 in relief.

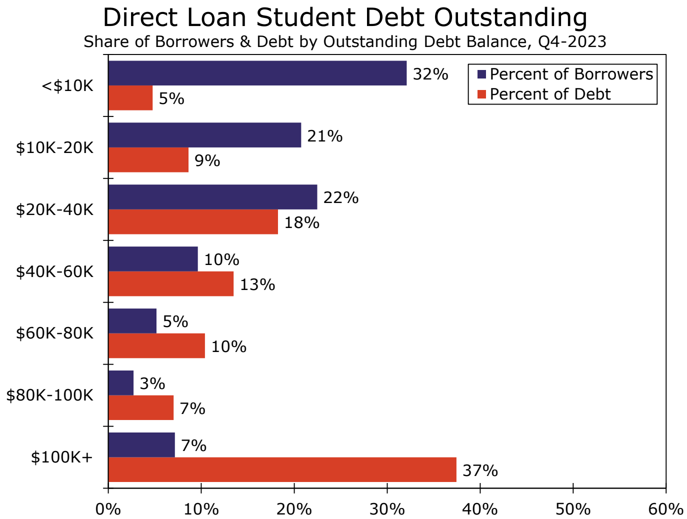
Backing into a precise macroeconomic impact is limited by the lack of detailed student-loan data necessary to calculate how much debt per borrower would be canceled under the package. But our initial read on this proposal is that while it can have drastic benefits for individual borrowers, the macro impact will likely be more modest.

Just consider the recent resumption of student loan payments. As the three-plus year loan moratorium came to a close, payments resumed for some 26 million borrowers, yet overall consumer spending continued to plow ahead.[2] Real personal spending rose at a 3.3% annualized rate in the fourth quarter, marking the second-fastest quarterly rate since coming out of the pandemic. We've estimated that the resumption of student loan payments could reduce the *aggregate* amount of real consumer spending by only 0.4% to 0.6% on an annual basis.[3] The distribution of debt offers some clarity as to why the repayment impact was manageable.

Relatively large outstanding loan balances are concentrated in a small number of households. More than half of all borrowers, as of the fourth quarter, had comparatively manageable loans totaling $20K or less (Figure 4). The enormous student loan debts, in which borrowers owe $100K or more in debt, comprise only 7% of student loan borrowers, which is equivalent to fewer than three million people, or less than 1% of the total U.S. population.

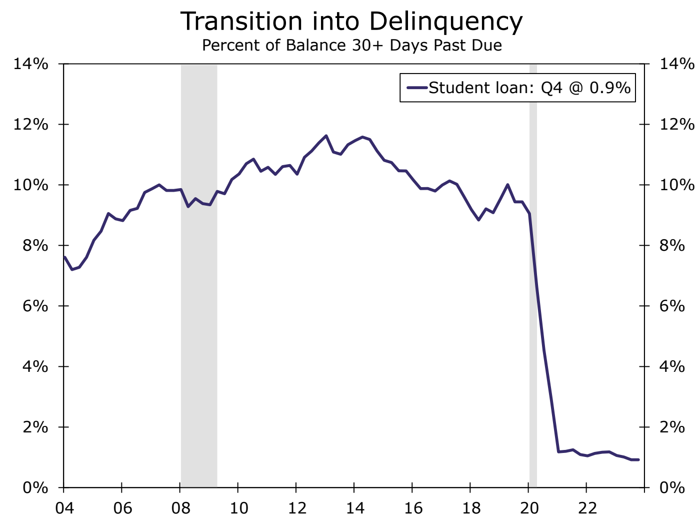
Still, there's evidence to suggest those who hold student loans are struggling. A total of 29% of borrowers were in deferment, forbearance or default as of the fourth quarter of 2023, but that's compared to 33% just before the moratorium went into effect in Q2-2020. It's ultimately challenging to get a clean read on how big of a burden this is today due to the Department of Education instituting what it deemed a 12-month “on ramp” following the resumption of student loan payments in September 2023. The policy states that borrowers who miss monthly payments from October 2023 through September 2024 will not be considered delinquent or be reported to credit bureaus. This delay creates a household delinquency data lag, as missed payments will not show up in household delinquency data until Q4-2024, which is holding the delinquency rate artificially low (Figure 5). The Q4-2024 edition of the New York Fed's Household Debt and Credit report will not be released until around February 2025, meaning a clear read on student loan borrower distress may be close to a year out.[4]

Figure 4



Source: U.S. Department of Education and Wells Fargo Economics

Figure 5



Source: Federal Reserve Bank of New York and Wells Fargo Economics

So what would the impact of this proposal look like on a macro level? There is so much uncertainty with respect to who will actually see the relief, not to mention the legal wrangling expected to slow if not stop its progress. In an attempt to identify the very-top end of the range in terms of measurable impact, we can do some basic arithmetic. If we assume that all the 30 million Americans the administration estimates could be affected receive the full $20,000 in relief, that would amount to around $600 billion of student loans being canceled. Through Q4-2023, student debt outstanding amounted to over $1.6 trillion, and a $600 billion reduction would bring the total down to near $1 trillion, a level last seen over a decade ago. Remarkably even this back-of-the-envelope tally of a $600 billion reduction would reduce total household liabilities by only 3%, translating to just a 0.4% increase in aggregate household net worth. Overall, the macroeconomic impact looks to be muted for the policy, even if the impact could be significant for individually-impacted households.

Endnotes

1 – "President Joe Biden Outlines New Plans to Deliver Student Debt Relief to Over 30 Million Americans Under the Biden-Harris Administration." The White House. April 2024. (Return)

2 – The student loan moratorium that was in place from March 2020 through September 2023 paused payments and interest accrual on student loans held by the federal government, or what is designated as "direct loans" by the U.S. Department of Education. By our estimates, that covers roughly 37 million of the 43 million student loan borrowers. But due to the 12-month grace period where collection efforts won't occur and borrowers aren't penalized for nonpayment in the first 12 months of resumption (though interest will accrue during this period), according to the U.S. Department of Education Federal Student Aid Office only about 26 million borrowers have resumed payment since the end of the payment pause in October 2023. (Return)

3 – Seery, S. Quinlan, T. and Kohl, J. "Don't Make a Mountain Out of a Loan Bill." Wells Fargo Economics. October 2023. (Return)

4 – The Federal Reserve Bank of New York similarly remarked in the Q4-2023 release of the Household Debt and Credit report, saying "less than 1% of aggregate student debt was reported 90+ days delinquent or in default in 2023Q4 and will remain low until at least 2024Q4." (Return)

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