

The End of the Student Loan Repayment Moratorium

Borrowers didn't have to make payments for three and a half years. How will they — and the economy — weather a rapidly changing student loan landscape?

“College is an investment.” It’s a common line in dinner table conversations about higher education. The conventional wisdom is that college will set graduates on a trajectory where they are likely to earn far more than they would have otherwise. Indeed, research from the New York Fed suggests that recent college graduates on average earn substantially more — upward of \$24,000 per year more — than workers in the same age group with only a high school degree. And this wage premium for college graduates only increases over time, as it goes from about 27 percent at age 25 to 60 percent by age 55, according to Harvard University economist David Deming. Clearly, there are substantial short- and long-term financial benefits to graduating from college.

At the same time, while the price tag on higher education options can vary, the costs of attending college or graduate school have increased dramatically. As a result, student loans currently are the third-largest source of household debt, behind mortgages and car loans. Some 43.2 million Americans hold a total of \$1.6 trillion in student loans — a figure nearly three times what it was around 15 years ago — with an average monthly payment of between \$200 and \$300. About 4.3 million of those borrowers live within the Fifth District.

When economic activity ground to a halt with the onset of the COVID-19 pandemic in March 2020, those monthly payments became difficult for many borrowers to make. To ease the strain, the CARES Act — a massive economic stimulus package signed into law by President Trump that same month — contained a moratorium on the repayment of government-held student loans, as well as on interest accrual. Payments were originally paused until September of that year, but forbearance was extended repeatedly under the Trump and Biden administrations. The moratorium was finally lifted a little more than three years later, in June 2023, as part of the debt ceiling deal negotiated between the Biden administration and the Republican majority in the House of Representatives; payments and interest accrual resumed later that fall.

EFFECTS OF THE MORATORIUM

The New York Fed has reported that about \$260 billion in total loan payments were paused during the moratorium. Instead of this money going back to the government, it remained in borrowers’ pockets, altering their spending and consumption habits.

In a May 2023 working paper, economists at the University of Chicago characterized the moratorium as a large economic stimulus where borrowers substituted “increased private debt for paused public debt.” Specifically, they found that rather than using the money to pay down other debt, eligible borrowers (that is, those with government-held loans) spent those funds on other things, expanding their balances on credit cards, mortgages, and auto loans by an average of 3 percent, or about \$1,200, compared to borrowers with private loans that did not qualify for forbearance.

Who were the borrowers taking advantage of the moratorium? As it turns out, only 18 percent of federal loan borrowers continued to pay down their loan balances during that period. All borrowers with government-held loans — regardless of loan amount, income, or family size — were granted relief. But according to a 2023 report by economists at the Federal Reserve Board and the Department of the Treasury, families with children were most likely to benefit, as more than half of families with eligible student loans had children.

Further, based on their income, families that were eligible for relief were more well off than those that were not, “likely at least partly driven by the fact that families with student loan debt tend to have more education than those without.” Perhaps most notably, the economists discovered blanket forbearance was highly regressive, allowing higher-income families to save more relative to lower-income borrowers, as they tend to have higher monthly payments, “due partly to having more debt and partly to reduced eligibility for IDR [income-driven repayment] programs.” (IDR plans base monthly payments on income and family size.)

These findings underscore the significant variation that exists when it comes to how much individual borrowers owe and what educational programs they pursue with

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Demonstrators in Brooklyn, N.Y., at an April 2021 rally for the cancellation of student loan debt.

those loans. The median amount of a borrower's outstanding student debt in 2022 was between \$20,000 and \$24,999 (that is, half of borrowers owed less, while half owed more) — but the mean, or average, balance was just over \$37,000 at the end of 2023, according to the Department of Education. This difference can be attributed in part to the fact that borrowing is skewed by a minority of borrowers who take on outsized loans: In 2021, 7 percent of borrowers owed over \$100,000 and 16 percent owed over \$60,000. As the findings above suggest, borrowers with hefty loan balances are likely those who pursue graduate or professional degrees (for example, J.D.s, M.D.s, and MBAs), and those additional degrees generally translate into higher incomes. For example, the American Bar Association and Bureau of Labor Statistics report the average education debt for a law school graduate is \$130,000 and the average salary is just over \$148,000.

IS TROUBLE BREWING FOR BORROWERS?

Prior to the pandemic, the delinquency rate among student loan borrowers (that is, those who missed at least one payment) was about 23 percent, according to economists at the New York Fed. One question coming out of the moratorium was what effect it would have on this number: Would borrowers who benefited from three and a half years of forbearance, and those who finished school during the pandemic and moratorium, adjust to the new reality of having to make potentially substantial monthly payments? In August 2023, the New York Fed's Household Spending Survey asked borrowers this question.

Borrowers generally expected to make their payments at the same rate as they did prior to the pandemic, but that does not mean that all borrowers expressed the same level of confidence. Indeed, the Household Spending Survey

showed significant variation across different demographic groups. Female borrowers, for example, reported a 28.9 percent probability of missing a payment, more than twice the 12.5 percent probability reported by men. Borrowers with household incomes of less than \$60,000 per year reported an average probability of 39 percent of missing a payment, while those in households making above that threshold had an average probability of only 14.3 percent.

Rajashri Chakrabarti is one of the New York Fed economists who conducted the survey. She notes that while women are more likely than men to miss a student loan payment, they also expect to miss non-student debt payments at a lower rate. "That may be because women first try to pay down the other kinds of debt and then student debt, whereas the men do the opposite way," she says.

Missing a payment in the current environment, however, does not carry the same consequence that it might have previously: Recent guidance from the Department of Education directs its loan servicers not to report missed payments to credit bureaus.

Further softening the blow for many borrowers, the Department of Education unveiled the SAVE (Saving on a Valuable Education) plan in the summer of 2023. Like previous IDR plans, such as REPAYE, monthly payments are based on the borrower's income and family size. But SAVE increases the income exemption from 150 percent of the poverty line — the exemption under REPAYE — to 225 percent. This change means that a single borrower who earns less than \$32,805 a year, or \$67,500 for a family of four, will not have to make any monthly payments. The Department of Education estimates that under SAVE, more than 1 million additional low-income borrowers will qualify for a \$0 payment, including 400,000 borrowers who were previously enrolled in REPAYE and were automatically transferred to SAVE.

As for the borrowers who make over 225 percent of the poverty line, the Department of Education anticipates that they will still save at least \$1,000 per year compared to what they paid under the REPAYE plan. Additionally, if borrowers make a full scheduled payment each month, they'll avoid the situation of some borrowers in prior programs whose loan balances actually grew over time as a result of interest charges. In the SAVE plan, a loan balance won't grow because of unpaid interest from the previous month. For example, if \$50 in interest accrues each month and you have a \$30 monthly payment, the remaining \$20 would not be charged if you make your monthly payment on time. Data from the Household Spending Survey indicate the SAVE plan has widespread popularity with borrowers, as overall enrollment in an IDR plan went from 36.7 percent before the moratorium to 57.9 percent of borrowers expressing interest in enrolling after the pause.

In terms of the effect of the moratorium's end on the wider economy, the Household Spending Survey found that lifting the moratorium will likely have a small impact

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on consumption, perhaps about 0.1 percentage points lower than aggregate levels as of August 2023, right before payments restarted. This estimate is far less than initial forecasts. When it became clear the moratorium would be lifted in the spring and early summer of 2023, interest rates had gotten relatively high and the economy had slowed, leading observers to suggest the economy might experience a 0.8 percentage point drop in consumption. These concerns dissipated somewhat over time, however, as strong spending and growth continued, especially in the third quarter of 2023, when GDP growth was 5.2 percent and spending growth was 3.6 percent.

AFTER THE MORATORIUM: CANCELING DEBT

During the 2020 election, then-candidate Biden campaigned on canceling \$10,000 in student debt per borrower. Travis Hornsby is a student loan consultant whose firm, Student Loan Planner, helps borrowers navigate the world of student loan repayment. He suggests that the combination of the pandemic-induced moratorium and Biden's victory led many borrowers to believe their days of loan repayment had ended, saying many were thinking, "Oh, wow! Biden won! I'm never going to have to pay these loans again!"

President Biden attempted to follow through on that campaign pledge in 2022, announcing his intention to cancel \$10,000 for borrowers making under \$125,000 per year (\$250,000 for married couples), while Pell Grant recipients making under that same amount would have \$20,000 in debt canceled. The plan would have wiped clean the debt of about 20 million people — about half of all federal loan borrowers — and the Congressional Budget Office estimated at the time it would have amounted to about \$400 billion over the next 30 years that would not be going back into government coffers. This is money the federal government would have to fund otherwise, most likely by borrowing, thereby increasing the level of debt for all Americans. The U.S. Supreme Court, however, ruled in June 2023 that the administration lacked the authority to grant such broad relief, leaving borrowers to plan on resuming payments.

Unlike the blanket moratorium, the administration's cancellation plan would have granted forgiveness to those borrowers earning under a specified income cap. Such an idea may address one of the criticisms of universal loan forgiveness — that it is too regressive, disproportionately benefiting the high-income earners who might not need relief, and, at the same time, needlessly costing the government billions in lost revenue. In studying the idea of income-based eligibility, economists at the New York Fed found means testing loan forgiveness reduces costs and "drastically changes the distribution of benefits" by helping those who have the hardest time making their payments. Specifically, they showed that by forgiving \$10,000 in loans to borrowers earning under \$75,000 — half of the income in the Biden administration's 2022 proposal — the overall

cost of such a policy would drop by almost 45 percent. But at the same time, the share of forgiven dollars going to low-income neighborhoods would go from 25 percent to 35 percent and the share going to those with delinquent loans would rise from 34 percent to 60 percent. (The Department of Education argues that even under the plan proposed in 2022, "90 percent of relief dollars [would] go to those earning less than \$75,000 a year.")

Against the backdrop of the adverse ruling by the Supreme Court, President Biden has used his executive authority to cancel student debt for smaller numbers of borrowers, up to just under 4 million so far who have had about \$143.6 billion in loans forgiven. Some 513,000 borrowers with a total or permanent disability have had their debt canceled, as have 1.3 million borrowers who attended colleges or universities (many for-profit) deemed to have defrauded them by misrepresenting their graduates' employment prospects. An additional 793,000 borrowers enrolled in the Public Service Loan Forgiveness program also had their loans forgiven. This program grants forgiveness to borrowers working in the public sector and nonprofits after a decade, but the program suffered from poor recordkeeping and loan servicing, as well as misinformation, which resulted in these borrowers not getting the forgiveness to which they were entitled after making that decade's worth of payments. Bureaucratic failures also kept 930,500 borrowers who had been in IDR plans that predate SAVE from receiving the relief they had earned after making payments for over 20 years, which was the original expected duration. Most recently, in February 2024, the administration announced that borrowers who originally took out \$12,000 or less in loans would have the balance forgiven after as few as 10 years, impacting 153,000 borrowers holding a total of \$1.2 billion.

If President Biden's 2022 loan forgiveness plan had not been struck down by the court, it would likely have carried measurable economic consequences. Thomas Lubik and Aubrey George of the Richmond Fed conducted what Lubik calls a "thought experiment" in 2022 with a set of assumptions about the plan's implementation that allowed them to assess its potential effects. They found it was likely to be inflationary, shifting the debt burden — somewhere between \$330 billion and \$519 billion — from borrowers to the government, adding roughly 1 percent to the existing federal debt, which at the time was \$30.6 trillion. This additional burden would have to be covered by future revenues, namely higher taxation or a reduction in future spending; unless those revenues were found elsewhere, the gap would have to be covered by a reduction in the value of outstanding nominal debt. Lubik and George calculated this as a one-time price jump that translated into a monthly inflation spike as high as 1.7 percent.

Lubik says that with forgiveness now being granted to smaller groups of borrowers and spread over time, accounting for its inflationary effects is difficult to

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measure. “We imagined that student loan forgiveness is a gigantic piece of additional government expenditure that has to be financed because it shows up in the budget,” says Lubik. “What we’re seeing now is that it’s slowly phased in and the numbers are much smaller, and that would be really hard to measure.”

IS LOAN FORGIVENESS THE FUTURE?

The administration has also announced additional initiatives intended to ease borrowers’ debt burden. For example, for most borrowers in the SAVE plan who make over 225 percent of the poverty line, monthly payments on undergraduate loans are currently set at 10 percent of their monthly income; in July 2024, that will be reduced to 5 percent, essentially cutting monthly payments in half. Also, the American Rescue Plan Act, another COVID-19-era stimulus package passed and signed into law in 2021, exempted student loan forgiveness from being counted as taxable income, including the debt forgiven through IDR plans like the SAVE plan. That provision is set to expire at the end of 2025, but President Biden’s proposed 2025 budget would make it permanent, allowing any future forgiveness to also be tax exempt.

Student loan forgiveness carries its share of controversy. For individuals who get relief, the benefits are obvious: They can focus on building a life unburdened by potentially vast amounts of debt. While previous generations were able to access middle-class American life by graduating from college — thus justifying the debt incurred to do so — skyrocketing tuition costs and no guarantee of a meaningful wage bump (even for those with some graduate degrees) have created burdens that prevent many of today’s graduates from doing the same. Making monthly payments has simply made buying a home, saving for retirement, or even putting money away for their own children’s education too difficult. There is data to back these claims, as research from economists at the New York Fed, the University of California, Berkeley, Ohio State University, and Cornerstone Research in 2021 suggests that increasing tuition and student debt has contributed to declining homeownership rates among younger adults, as well as weaker future spending and wealth accumulation.

At the same time, however, opponents maintain freeing

individuals from these debts raises issues of fairness.

Taxpayers who chose not to spend as much money on their education — or pursue higher education at all — are, in effect, required to subsidize those who did. Similarly, it might be said to punish after the fact those who continued to pay down their debt during the moratorium only to see that it ultimately would have been forgiven.

Critics also note that continued forgiveness creates a series of distortions that affect the incentives of actors and institutions in the future, and, if anything, it may make it even harder to solve the broader problem of how to bring down the costs of higher education. Forgiveness can lead to higher loan amounts, as borrowers may believe that there is no reason to not borrow the maximum amount if it will be forgiven down the line. This, in turn, could translate into higher tuition rates, as colleges and universities are said to lack any incentive to keep costs down if they continue to receive government money — although research by Grey Gordon of the Richmond Fed and Aaron Hedlund of Purdue University casts doubt on whether this hypothesis is correct.

Targeted programs like the Public Service Loan Forgiveness program seem to have more broad support, although they, too, raise questions about fairness and what degrees and jobs society values. To complicate it further, careers in medicine, business, or law carry high earning potential and are respected by much of society, but workers in those fields carry the bulk of the country’s student debt. If policymakers provide relief to any group, should it be to those professionals or to others who provide a valuable service but struggle to make ends meet? And if policymakers elect to pursue blanket forgiveness of student loans, why not forgive other forms of debt as well?

As the economy regains its footing and continues to grow, the question remains whether new borrowers will also benefit from future loan forgiveness initiatives and all the consequences — both positive and negative — that result.

“From an economic point of view, investment in human capital is beneficial because it increases future productive potential,” says Lubik. “Based on that, you can make the argument that you want to subsidize higher education, whatever the form. The question is whether student loans are the best way to do this.” **EF**

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