RESEARCH BRIEF • MAY 2023

Debt Moratoria: Evidence from Student Loan Forbearance

Based on BFI Working Paper 2023-62, "Debt Moratoria: Evidence from Student Loan Forbearance," by Ching-Tse Chen, Chicago Booth, Michael Dinerstein, University of Chicago's Kenneth C. Griffin Deptartment of Economics; and Constantine Yannelis, Chicago Booth

Relative to borrowers who had to continue paying their loans, borrowers allowed to pause their payments sharply increased mortgage, auto, and credit card borrowing, with little effect on loan delinquencies.

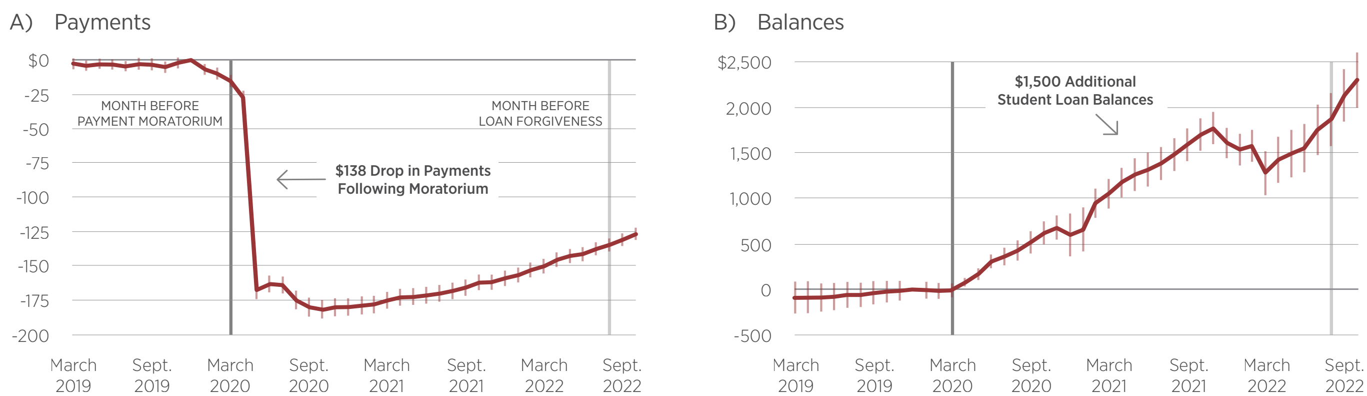
Debt moratoria, or delays in debt or obligation payments, are one of a series of options for policymakers seeking to stimulate growth during times of economic distress. One feature of debt moratoria is that they immediately inject liquidity into an economy without large long-term fiscal costs for the government. In this paper, the authors study the effects of debt moratoria on borrowing, consumption, and loan repayment by analyzing the 2020 student loan payment freeze in the United States that led to a complete stoppage of student loan payments for most borrowers.

Student loans were the second largest source of household debt in the United States in 2020, with an approximate $1.7 trillion outstanding.

As part of relief during the 2020 coronavirus pandemic, the federal government ordered a temporary pause—extended through June 30, 2023—in student loan payments, aimed at relieving households from debt burdens. Owing to the particular status of loans, a subset of borrowers did not participate in the program, giving the authors an opportunity to compare effects across borrowers. They find the following:

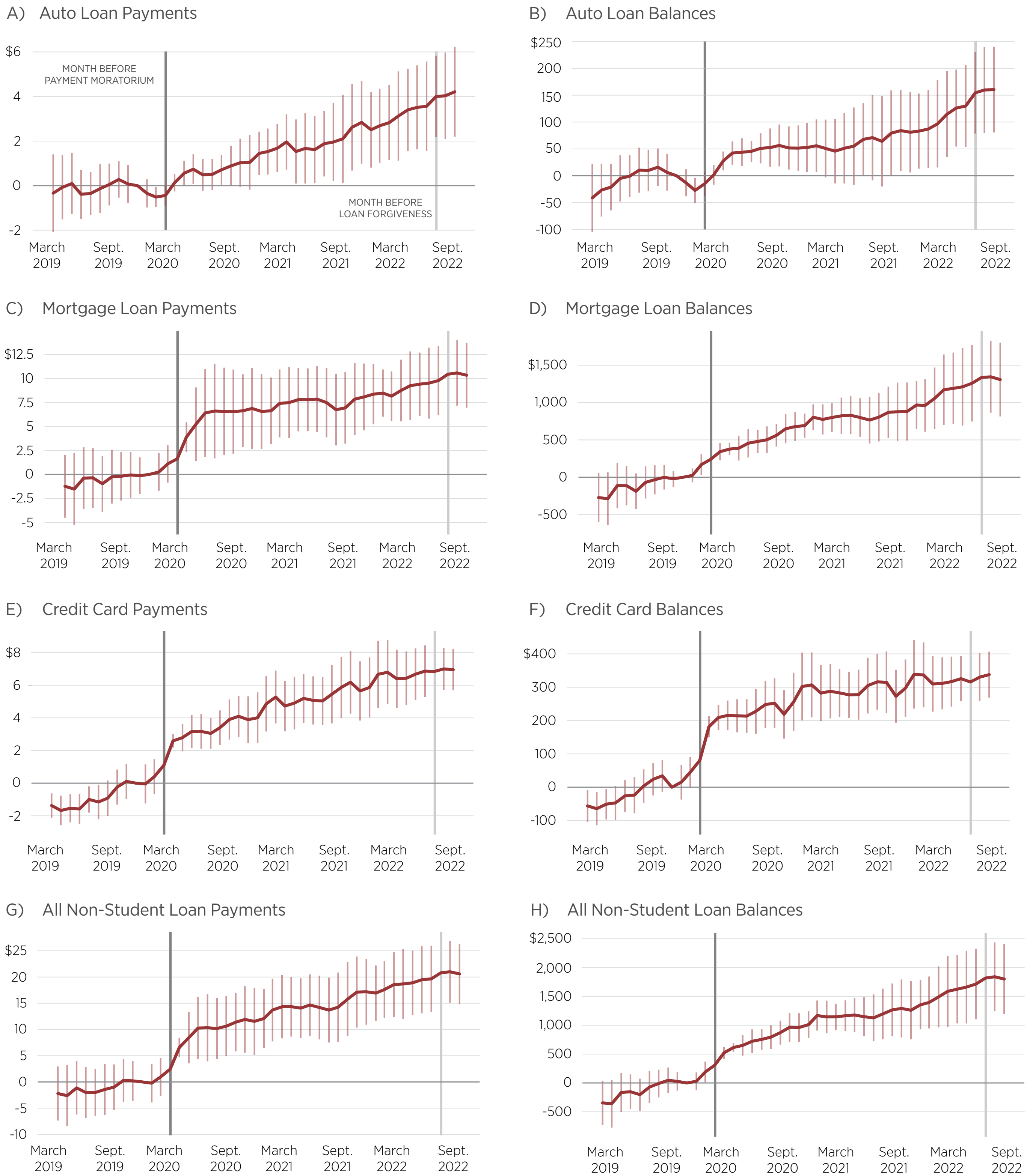
- Borrowers subject to the payment pause ("paused borrowers") sharply reduce payments, leading to a spike in loan balances. By the end of 2021, these paused borrowers had an additional $1,500 in outstanding student loan balances relative to those that did not see a payment stoppage.

Figure 1 • Student Loan Balances and Payments



Note: This Figure shows the drop in payments and evolution of loan balances post-moratorium, with a pointwise 95% confidence interval. Consistent with the policy, there is a $138 drop in payments following the payment moratorium for DL borrowers, which leads to an approximate $1,500 in additional student loan balances in the following year, as the payment pause continued. The solid line shows the month before the payment moratorium announcement, while the light solid line shows the month before the forgiveness announcement.

Figure 2 • Balances and Payments Following the Student Loan Payment Pause



Note: This Figure shows auto, mortgage, credit card, and total loan payments and balances following the student loan payment pause. For all types of credit, payments and balances increase. By the end of the sample period, individuals with a student loan payment pause owe an additional $1,800 in other debt, and pay an additional $20 monthly. Most of the increase in debt is driven by mortgage payments, which tend to be longer maturity, and revolving debt. The solid line shows the month before the payment moratorium announcement, while the dashed line shows the month before the forgiveness announcement.
Source: TransUnion

- Paused borrowers were also 0.8 percentage points less likely to be delinquent on their student loans, and have significantly higher credit scores, with little effect on delinquencies for non-student loans.
- Paused borrowers do not use their additional liquidity to pay down other debt. Rather, household leverage rises as borrowers make higher payments on other loans, and mortgage, auto, and credit card debt rise. Overall, excluding student loans, household leverage increases by $1,200 (3%) for households subject to the pause. Student loan balances increase by a similar amount. This suggests that the payment pause led to higher durable and non-durable consumption in the short term, but higher overall leverage.
- This increased use of credit suggests that the demand for credit increased as paused borrowers attained more liquidity. Changes in credit supply do not lead to increased borrowing.
- Finally, the authors estimate the effects of the Biden Administration's August 2022 executive order to cancel between $10,000 and $20,000 in student loan debt, to show no likely impact on affected borrowers' use of credit.

These findings have policy implications relative to the ongoing debate over how to provide relief to student loan borrowers, with proposals ranging from full forgiveness to more modest capped proposals. Much of the debate involves the question of how student debt affects people's finances. On the one hand, those with student debt may have short-term liquidity needs; in such a case, policies effectively extending maturity terms, such as Income-Driven Repayment, can alleviate burdens. On the other hand, if the issue is a longer-term structural inability to pay, then discharging debt, a costlier option from a fiscal perspective, may be important. The results in this work are consistent with decreased liquidity as the key constraint on student loan borrowers, meaning that less costly debt policies may still be effective.

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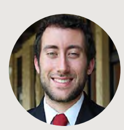

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