The US student loans crisis

Introduction

1,7 trillion dollars. That's the amount of student debt in the United States. Payment delays and defaults on these loans could have repercussions for many sectors of the economy.

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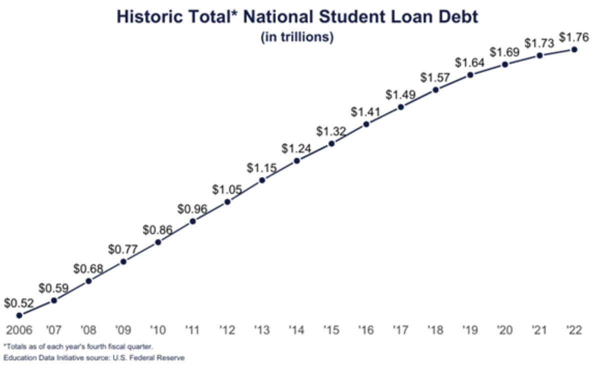
Historical context

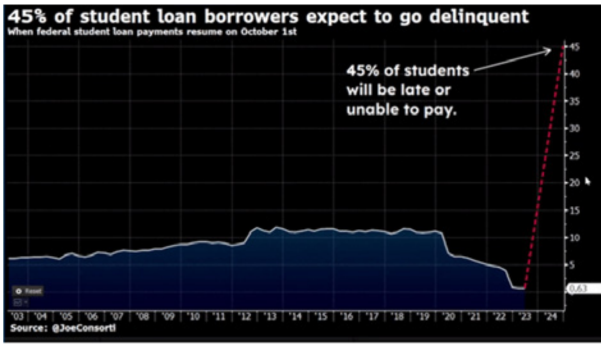
The story of the U.S. student loan crisis began just after the end of World War II. At that time, America experienced a surge in college enrollment, thanks in large part to the 1944 GI Bill. This landmark legislation provided tuition assistance to veterans, marking the federal government's first foray into funding higher education. Over the decades, the college degree became synonymous with the American dream, stimulating a growing demand for higher education. However, this growth has been accompanied by a number of challenges. Starting in the 1980s, tuition fees began to rise exponentially, regularly exceeding the rate of inflation. This trend was exacerbated by the decline in public funding for higher education institutions, shifting the financial burden onto students. The official creation of the federal student loan system can be attributed to the Higher Education Act of 1965. What began as a noble endeavor to guarantee access to higher education for students from all economic backgrounds quickly turned into a complex situation of financial obligation. The 1990s saw the introduction of unsubsidised loans, leading to increased borrowing limits and sowing the seeds of the crisis facing the U.S. today. The subprime mortgage crisis of 2008, rooted in lax mortgage lending practices and a belief in perpetually rising house prices, bears striking similarities to the student loan issue. In both cases, a system based on optimistic premises was confronted with the harsh realities of economic dynamics.

Current state of the crisis

The monumental figure of $1,700 billion, which has increased by 66% over the last decade, is not just a number, but represents the aspirations and difficulties of over 44 million borrowers.



While the amount of debt is alarming, the trajectory of this crisis has seen some fluctuations. Initiatives such as the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and subsequent executive orders have brought temporary relief to borrowers throughout 2021. These measures, while laudable, are akin to putting a band-aid on a deep wound. They have reduced the proportion of borrowers in arrears, but without tackling the root causes or proposing long-term solutions. Private institutions and federal loans play distinct roles in this story. Billions of dollars worth of student loans are being bundled and sold as Student Loan Asset-Backed Securities (SLABS) to large investors. This securitisation process, designed to spread and reduce the risk of default, comes with its own set of challenges and concerns. Experts have drawn parallels between SLABS and the subprime mortgage-backed securities of the 2008 crisis, highlighting the potential systemic risks they pose to the US economy, particularly if a significant number of borrowers simultaneously default. According to Bloomberg, 45% of students believe they will not be able to pay their student loans on time or at all.



Economic consequences

The burden of student loans has an immediate and visible impact on the housing market, making home ownership out of reach for many indebted students. A large proportion of potential first-time buyers with student-related debt find themselves postponing home ownership or foregoing it altogether. According to Investopedia, a 10% increase in student debt between 1997 and 2010 led to a 1 to 2 percentage point drop in home ownership for borrowers in the first five years after graduation. This delay in home ownership not only affects individual financial trajectories, but also has wider implications for the housing market and associated industries. In addition, the resumption of student loan repayments is expected to lead borrowers to cut other expenses, which could amount to more than $100 billion a year, as reported by the Washington Post. Such a significant reduction in discretionary spending could impact and weaken economic growth. In fact, some estimates suggest that U.S. GDP could fall by 0.1% due to the resumption of student loan repayments.

Financial personal decisions

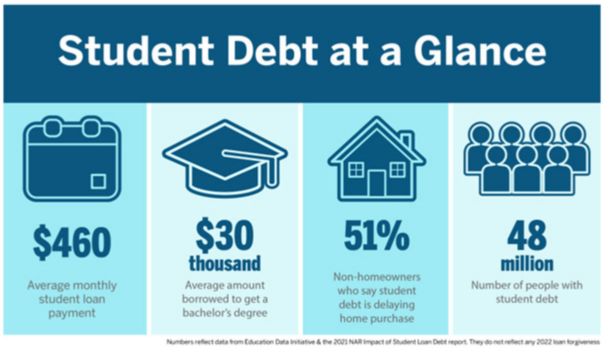
For many, the burden of repaying these loans shapes life goals, often leading to delays or changes in traditional career paths. For many borrowers, their student debt affects their ability to achieve their financial and personal goals. According to a CNBC survey, 81% of respondents have postponed major financial milestones because of their student debt. This translated into delays in investing (40%), saving for retirement (38%), buying a home (33%), as well as delays in personal decisions such as starting a family (16%) or getting married (14%). Beyond the financial results, the psychological burden of student debt is significant. The constant pressure of payments and the challenges of managing expenses create stress and anxiety. 54% of adults with student loans regret and feel their loans aren't worth it, especially those earning less than $50,000 a year, underlining the disproportionate pressure on low-income earners.

Answers and political solutions

The student loan crisis in the United States has captured the attention of policymakers, prompting a variety of responses and proposals over the years. These initiatives, though varied, underline the urgent need for structural change. Among them, the Coronavirus Relief, Assistance and Economic Security Act (CARES Act) is one of the major recent policy responses. This response, enacted in response to the economic challenges posed by the COVID-19 pandemic, provided temporary relief to federal student loan borrowers by suspending payments and setting interest rates at zero. The issue of student loan forgiveness is being debated at the national level, ranging from partial proposals to more ambitious debt forgiveness plans. While the idea has found support, it has also attracted criticism, particularly regarding its potential impact on high-income earners and government tax implications. Reducing interest rates on student loans is one proposed solution. This would lighten borrowers' overall debt burden, making it easier to manage repayments. Some also suggest capping interest rates to keep them below a specified threshold. Income-based repayment plans, adjusting monthly payments according to the borrower's income, are gaining in popularity as a potential solution. Although they may seem unfair in penalising success and its challenges, some believe that tying repayments to income will relieve the financial pressure on low-income borrowers. In addition, a consensus is emerging in favour of systemic reforms to higher education funding, including increasing public funding for public institutions, expanding financial aid programs, and exploring alternative financing models to reduce dependence on loans.

Perspectives

The long-term trajectory and consequences of the crisis depend on a number of factors, from political decisions to economic trends. The immediate concern is the resumption of student loan repayments, with millions of borrowers facing this daunting prospect as temporary relief measures expire. The increased risk of defaults, especially in times of economic uncertainty, could have widespread repercussions, not only for individual borrowers, but also for the financial system due to the securitisation of student loans into SLABS. On the political front, the debate over student loan forgiveness is likely to intensify despite strong support. However, implementation is complex, with fiscal implications and moral risks to consider. The crucial role of educational institutions in resolving the crisis calls for a reassessment of the value of higher education, potentially incentivising innovation through alternative funding models, private partnerships, or a transition to more online and modular educational offerings. From an economic point of view, the relationship between the student loan crisis and broader economic trends will be crucial. Factors such as wage growth, employment opportunities and housing market dynamics influence borrowers' ability to manage and repay their debts. In addition, the potential systemic risks posed by SLABS will be closely monitored by financial experts and regulators.



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