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Student debt domino effect?

BY ROHIT CHOPRA

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On May 8th, we released a report discussing comments we received in response to a request for information and outlining options policymakers and market participants should consider to help student borrowers manage their debt.

While a college degree can be a key to the American dream, for many Americans, unmanageable student debt has turned into a nightmare. There appears to be growing consensus that unmanageable debt burdens are not just a problem for individual borrowers but for all of us.

While many in Washington are focused on what loans look like for future borrowers, there may be a domino effect on the broader economy if we ignore borrowers currently stuck with high student loan payments.

Since the Consumer Financial Protection Bureau highlighted a year ago that student debt had surpassed the $1 trillion threshold, others have warned about the impact on the broader economy. Last year, the Treasury Department's Office of Financial Research described how student debt might impact demand for mortgage credit. The Federal Reserve Board's open market committee discussed whether student debt is impacting household spending. And just a few weeks ago, the Financial Stability Oversight Council discussion of student debt in its annual report added to the chorus.

In February, we asked the public to tell us about potential policy options to tackle the problem of unmanageable student debt — particularly private student loans, a market that boomed in the years leading to the financial crisis. We received more than 28,000 submissions from experts and individuals. We heard that high student debt levels might impact everything from homeownership to health care.

First, we heard that unmanageable student debt impacts homeownership and household formation. The National Association of Home Builders wrote to the CFPB about the relatively low share of first-time home buyers in the market compared with historical levels, and that student debt can "impair the ability of recent college graduates to qualify for a loan." When monthly student loan payments are a high portion of income, applicants may be less qualified candidates for a mortgage.

The National Association of Realtors wrote in its submission that first-time home buyers typically rely heavily on savings to fund down payments. When young workers are putting big chunks of their income toward student loan payments, they're less able to stash extra cash for that first down payment.

Other submissions cited research that showed three-quarters of the overall shortfall in household formation can be attributed to reductions among younger adults ages 18 to 34. In 2011, 2 million more Americans in this age group lived with their parents than in 2007. Moody's Analytics estimates that each new household formed leads to $145,000 of economic impact.

If student debt is holding back just a third of those 2 million young Americans from living on their own, that adds up to a $100 billion loss or delay in economic activity.

Second, student debt diminishes entrepreneurship and small-business growth. In submissions by coalitions of small businesses and start-ups, they cited a number of factors about the threats from student debt. For many young entrepreneurs, it's critical to invest capital to develop ideas, market products and hire employees. High student debt burdens require these individuals to take more cash out of their business so they can make monthly student loan payments. Others note that unmanageable student debt limits their ability to access small-business credit; some report being denied a small-business loan because of student loan debt.

Third, student debt is a risk to retirement security. In its submission, AARP raised concerns about families headed by an American ages 50-64, noting that "increasing debt threatens their ability to save for retirement or accumulate other assets, and may end up requiring them to delay retirement." Student debt also can delay participation in employer-sponsored retirement plans, leading to less growth in critical early years of a career.

But it's not just an economic issue. The American Medical Association wrote that high debt burdens can impact the career choice of new doctors, leading some to abandon caring for the elderly or children for more lucrative specialties. Aspiring primary-care doctors with heavy debt burdens may be less able to secure a mortgage or a loan to start a new practice. This can have a particularly acute impact on rural America, where rental housing is limited and solo practitioners are a key part of the health care system.

Classroom teachers submitted letters detailing the impact of private student loans, which usually don't offer forgiveness programs and income-based repayment options. One school district official noted that programs to make student debt more manageable could lead to higher retention of quality teachers.

Although there are signs that housing is recovering, we cannot forget that all of us were impacted by the recent meltdown — whether we personally took on a subprime mortgage or not. While student debt may not pose the same sort of systemic risk to the financial system, it could be a drag on the recovery if borrowers can't afford their payments.

As we figure out solutions to foster affordable student loans, it would be a mistake to ignore these warning signs. We should address not only the next generation of students but also those struggling with debt today.

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