Income-Driven Repayment of Student Loans

Options for Reform

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The 1993 legislation creating Income-Contingent Repayment, the first program to allow student loan borrowers to repay their loans as a share of income, included a provision for the Internal Revenue Service (IRS) to provide information necessary to compute required payments annually, but that provision was never implemented. The federal government now offers a multitude of complicated income-driven repayment (IDR) plans that are difficult to understand, enroll in, and stay in. Many students who would benefit from IDR do not enroll, and others will have large amounts of debt forgiven despite earning high wages.

The current problems with IDR are not an indictment of the basic approach, and IDR can be an important safety net for students whose earnings do not match the investment they made in their education. But the current version of IDR has problematic design details and implementation failures. Here, we offer solutions to some of the biggest problems with IDR, drawing on our longer report, which provides details on each of these solutions.

Enrolling and Staying in IDR

Problem

It is difficult for borrowers to understand, enroll in, and stay in IDR. The IDR system is too complicated, with multiple plans and a dizzying array of details.

Solutions

- Create one income-driven federal student loan repayment plan into which borrowers are automatically enrolled, with clear options for making larger payments if borrowers choose. Maintain the current option of an alternative plan for borrowers who have special circumstances with a simple appeal process.
- Implement automatic IRS income verification to ensure the system keeps income information up to date with minimal effort on the part of borrowers.
- Work toward an efficient system of payroll withholding to facilitate monthly payments so that required payments will adjust automatically to changes in earnings. Such a system would reduce delinquency and default.

Setting Payment Levels

Problem

Payments might still be unaffordable for some borrowers who use the program, but general reductions in payment levels over time mean typical borrowers will not fully repay their loans, leading to extensive loan forgiveness at taxpayer expense.

Solutions

- Lower payments for the lowest-income borrowers, while leaving repayment rates the same for those with higher incomes.
- Raise the income threshold at which borrowers must make payments. Median earnings of high school graduates ages 25 to 34 are about 200 percent of the federal poverty level, an argument for raising the income threshold at which borrowers must make payments to this level from the current 150 percent of the federal poverty level.
- Lowering the assessment rate on the first $10,000 of income above the threshold, or on income between 200 and 300 percent of the federal poverty level, would reduce payments significantly for low-income borrowers without providing disproportionate relief to higher-income borrowers. Across-the-board assessment rate decreases, however, benefit high-income borrowers more than they benefit low-income borrowers.

- Allowing borrowers to easily suspend payments for a few months without penalty if they feel the need to do so could mitigate short-term problems.

Ballooning Balances

Problem

Many borrowers see their balances increase even as they remain in good standing in IDR because their payments are too small to cover interest charges.

Solutions

- Forgive a set amount of unpaid interest each month, up to, say, $50 (equivalent to the monthly interest on a $20,000 loan with 3 percent interest). The alternative, forgiving a set percentage of the unpaid interest, would skew the benefit toward borrowers with larger debts.
- Implement a graduated interest rate for loans enrolled in IDR. This design would charge 0 percent on the first $10,000 of debt and gradually raise the rate on higher levels of debt, preventing ballooning balances for low-income borrowers who have small debts without generating outsize subsidies for graduate borrowers. Forgiving interest for borrowers with $0 payments would create an unacceptable cliff, with interest accruing for borrowers with small payments.

Time to Loan Forgiveness

Problem

Borrowers with low initial balances and persistently low incomes must remain in repayment for 20 or 25 years before having their debts forgiven and make the same payments as those with similar income paths who borrowed larger amounts.

Solutions

- Modify the system to forgive remaining balances for borrowers with small debts more quickly and require those with larger debts to pay longer before having their balances forgiven. A possible structure would be to forgive the balances of borrowers with $6,000 of debt after five years and add one month for each $200 of debt. Borrowers with $30,000 of debt would have their balances forgiven after 15 years.

Graduate School Debt

Problem

Loans from graduate study account for about two-thirds of the debt enrolled in IDR, and about four-fifths of projected debt forgiveness will be for graduate school debt.

Solutions

- Limit the amount of debt graduate or undergraduate borrowers can enroll in IDR.
- Implement longer repayment periods for higher debt levels to increase the payments of many graduate students but avoid creating loan forgiveness terms based solely on the type of degree borrowers pursued.

Conclusion

If policymakers are concerned about borrowers struggling to repay, they should make IDR widely and easily available to all borrowers. If keeping program costs under control is a goal, most borrowers should ultimately repay their loans, with grant programs continuing to be the primary source of subsidies to college students.

Constructive reform of the loan repayment system requires carefully considering the interaction of the system's components, including the amount of debt eligible for IDR, the threshold for payments, the assessment rate, interest rates, and time to forgiveness. The system's long-term sustainability, the distribution of subsidies provided, and the relationship between those subsidies and need-based grant aid that is the foundation of the programs supporting college access and success must all be central to a better-designed system.

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For more information on this project, see Sandy Baum and Jason Delisle, *Income-Driven Repayment of Student Loans: Logic, History, and the Need for Reform* (Washington, DC: Urban Institute, 2022).

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