The student loan debt crisis and the promise of income driven repayment reform

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This article analyzes the Saving on a Valuable Education (SAVE) student loan plan unveiled by the Biden administration in 2023. Author Max Wolf-Johnson describes the context of recent student loan policy and analyzes how well the SAVE plan addresses gaps in the current system. The article concludes by exploring policy recommendations for further improving income-driven repayment plans.

In August 2023, the Biden administration unveiled a new income driven repayment plan for federal student loan borrowers. The Saving on a Valuable Education (SAVE) plan will play a central role in the administration's agenda to address student loan debt, especially after its attempt to offer broad-based forgiveness was struck down by the Supreme Court in July 2023. This article will examine which student loan related outcomes most require attention from and trace recent conditions and policy choices that have contributed to producing the current loan repayment landscape. I examine the extent to which the SAVE plan may positively address key outcomes and where its potential for impact may fall short. I conclude by exploring several policy recommendations.

Background Framing Student Loan Repayment Reform

Student loan debt has become increasingly ubiquitous for college-going Americans, representing the second largest amount of household debt after mortgages.[1] Nearly half of all adults who go to college borrow to do so, with those aged twenty-five to thirty-four being the most likely to have taken out a student loan.[2] In total, federal borrowers owe $1.6 trillion in outstanding student loan debt.[3]

Today's students are also far more dependent upon loans to facilitate access to postsecondary opportunities than prior generations. Between 1990–91 and 2019–20, per-student borrowing nearly tripled. This increased reliance on loans has also created new pressures on a repayment system that does not adequately serve borrowers facing a wide range of socio-economic experiences.

For those who fall behind on their monthly payments, the loan repayment system can feel particularly predatory. Borrowers who fail to make a monthly payment for 360 days enter default, after which their entire outstanding debt becomes due. At that point, they may have their wages garnished, tax returns and federal benefits payments withheld, face collection fees, and experience steep reductions to their credit score.[4] They can also lose access to additional federal financial aid, which, for borrowers who did not complete their degree, can foreclose opportunities to increase their earnings so that they are better equipped to pay off their loans. Prior to the COVID-19 pandemic, roughly one million borrowers defaulted on their loans per year.[5]

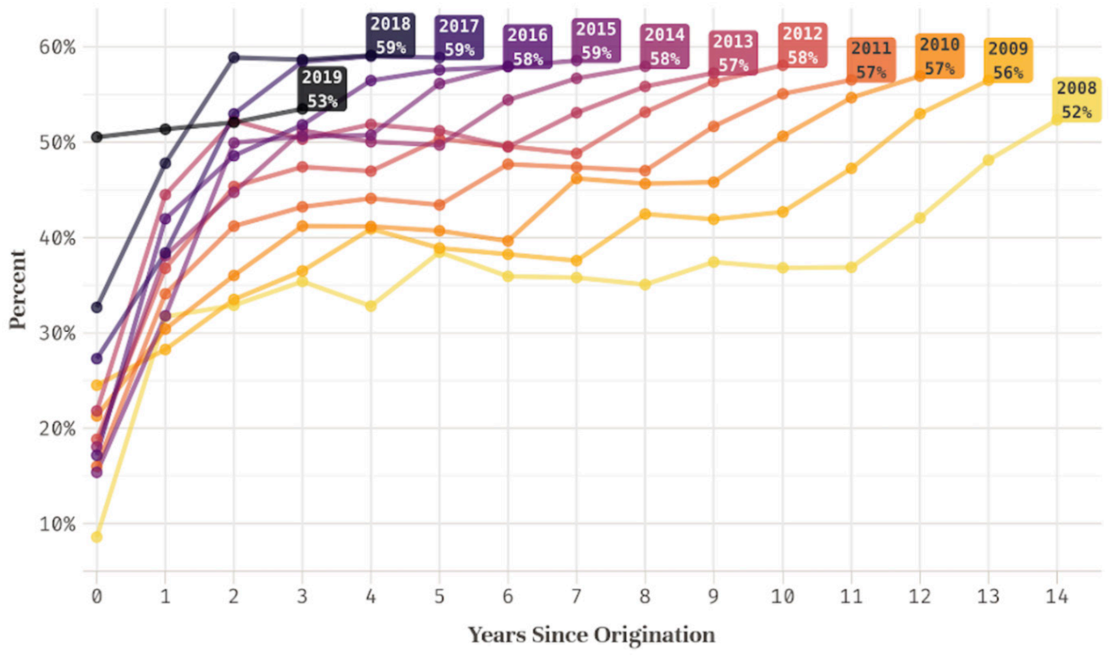
Efforts to reform loan repayment should strive to achieve two related goals: first, easing the short-term financial burdens associated with student loan repayment, and second, ensuring that borrowers have a reasonable path to fully escaping debt. Making progress on the first goal without meaningfully addressing the second risks compounding an underlying crisis of non-repayment.

Negative financial outcomes associated with student loans are distributed highly unevenly, with borrowers of color, those who are unable to complete their degree, and those who attended private, for-profit institutions among borrowers experiencing the greatest difficulty repaying, including falling into delinquency and default at the highest rates.[6] In particular, Black borrowers owe on average almost twice as much as their white counterparts four years after graduating and default at roughly five times the rate of white graduates within ten years of graduating.[7]

Similarly, for-profit attendees are more than twice as likely as those who attended a public non-profit institution to be behind on their student loan payments, and among borrowers under forty, first-generation students are roughly three times as likely as their peers to have fallen behind on payments.[8] By restructuring repayment to support lowest-income borrowers and provide greater

Tracking Non-repayment Trends of Student Loan Vintages Over Time

Each line represents student loans initiated in a particular year (vintage) and tracks the percent loans that currently hold a balance greater than the initial loan amount by years elapsed since the loan's year of origination.



protection against harms associated with delinquency and default, policymakers can help reduce such inequitable financial outcomes.

While policymakers should ease the short-term burdens placed on low-income borrowers, they must also ensure that this does not occur at the expense of enabling these borrowers to fully escape debt within a reasonable period. Lower monthly payment amounts can extend an individual's time to full repayment and increase the total amount they must repay over the life of the loan. This should be of concern to policymakers given that borrowers are taking increasingly longer to pay off their student loan debt.

In a study published in 2020 and updated in 2023, the Jain Family Institute (JFI) found that most borrowers with outstanding loans are not on track to repay within the standard ten-year amortization period and that, increasingly, borrowers from successive cohorts are failing to make progress on reducing their balances relative to when their loans originated.[9] In fact, JFI finds that half of all borrowers with outstanding debt in 2009 were still in repayment ten years later, and that of these borrowers half had a larger outstanding balance in 2019 than in 2009.[10] This "crisis of non-repayment" indicates a deeper, structural failing of the federal student loan system.

In general, students have experienced greater difficulty repaying over time. In comparing first time postsecondary students who began in 1995–96 and 2003–04, on average, a smaller share of the latter cohort was able to escape debt without defaulting within twelve years. Among the lowest-income quartiles, borrowers who entered college in 2003–04 were on average five percent less likely to exit debt within twelve years without experiencing default.

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Total time to repayment should also be of concern to policymakers because not all students benefit equally from their postsecondary education. After graduating, students face sharp disparities in labor market outcomes along racial and ethnic lines.[11,12] An inflexible and overly predatory repayment system can entrench inequality and inhibit mobility, in particular for low-income borrowers of color who must borrow more and face a harder time repaying than their peers.[13]

Ensuring that all borrowers are not only presented with repayment terms that appropriately estimate their ability to pay, but that they can also fully escape debt within a reasonable time frame can help produce more equitable economic outcomes.

Recent Reform of Income Driven Repayment and Lessons Learned

Between 2012 and 2015, the Department of Education stood up two new Income Driven Repayment (IDR) plans: Pay As You Earn (PAYE) and Revised Pay As You Earn (REPAYE). Both offered more generous terms to borrowers, including by capping monthly payments at ten percent of a borrower's discretionary income, and enabling borrowers to access forgiveness after twenty or twenty-five years of repayment.[14]

The creation of the PAYE and REPAYE plans helped address concerns regarding relatively high rates of delinquency and default and how these outcomes were distributed across populations. Yet roughly ten years later, it is evident that the current repayment scheme is still falling short by key measures. Average student loan debt has steadily increased over time along with cumulative default rates, and prior to the pandemic, nearly forty percent of borrowers were on pace to default on their student loans by 2023.[15] Moreover, a Pew Research Center survey found that roughly half of borrowers enrolled in an IDR plan reported that they still struggle to make their monthly loan payments. This suggests that the terms offered under prior plans insufficiently calculated borrowers' ability to pay based on their income.[16]

Current data on the provisions enabling borrowers to access full forgiveness are even more bleak; as of March 2021, only thirty-two borrowers had received cancellation through an IDR program while two million borrowers have been in repayment for more than twenty years and still owe federal undergraduate loans.[17]

Policymakers have learned important lessons from borrower experiences with PAYE and REPAYE. One of the greatest challenges inhibiting the efficacy of existing IDR plans has been administrative burden. Historically, borrowers have been required to manually recertify their income annually in order to remain enrolled in an IDR plan, which more than half of all borrowers struggle to do on time.[18] In response to this challenge, Congress passed the Fostering Undergraduate Talent by Unlocking Resources for Education Act (FUTURE Act) in 2019, which allows the Department of Education's Federal Student Aid (FSA) office access to the necessary Internal Revenue Service data to automate the recertification process.[19]

Student loans have succeeded in enabling a broader share of the American public to pursue higher education.[20] However, policymakers must increasingly contend with the question, "at what cost?" Broadly, past federal student loan policy has succeeded in expanding access but failed to produce conditions under which borrowers can consistently repay on time, and at worst, consolidated harms among populations already experiencing higher rates of poverty and economic insecurity. Moreover, need-based aid has failed to keep pace with the rising cost of college, contributing to soaring loan debt. SAVE represents another attempt at mitigating loan-related harms through IDR, which it seeks to achieve by simplifying borrower experiences and targeting relief.

Evaluating the SAVE Plan

The SAVE plan utilizes a revised formula to calculate eligible borrowers' loan payments. Those who enroll in the new IDR option pay no more than five percent of their discretionary income on a monthly basis, or half of what borrowers were required to pay under the most generous previous plans. [21] The SAVE plan also redefines "discretionary income" in favor of low-income borrowers by protecting a greater share of their adjusted gross income (225 percent of the federal poverty line as opposed to 150 percent under previous plans). Consequently, a single borrower earning up to $32,800 would qualify to make $0 monthly payments while remaining in good standing and accruing eligibility toward loan forgiveness. The Education Department estimates that over a million borrowers will qualify for $0 payments.[22]

The Biden administration has also created a new protection against negative amortization, which occurs when a borrower's accrued interest exceeds their monthly loan payment. In the past, such borrowers saw their balances grow while making payments on time and in full. Black borrowers in particular disproportionately experienced negative amortization prior to this reform.[23]

Lastly, the administration has created a new limited path to loan forgiveness for those who borrowed $12,000 or less and make ten years' worth of payments under SAVE. Some borrowers with greater initial loan sums are also eligible for the benefit, but for every $1,000 borrowed above $12,000, they must make an extra year of payments before qualifying.

The Biden administration projects that taken together these reforms will confer broad benefits to low-income borrowers, including that those "with the lowest projected lifetime earnings" will reduce payment per dollar borrowed by 83 percent, and that on average, Black, Latinx, and Native borrowers will experience a fifty percent reduction in their total lifetime payments.[24]

The SAVE plan and related reforms improve upon status quo policies in several important ways.

First, by significantly expanding the share of borrowers who will be required to make not only low dollar payments, but $0 payments, SAVE will effectively ensure that for a new subset of lowest income borrowers, it will become impossible to enter delinquency and default.

Second, by automatically enrolling those borrowers in SAVE who become delinquent while repaying under a different repayment plan, this policy framework will ensure that the most generous terms are available to a much larger share of those with the greatest need and at the highest risk of defaulting. A long-standing challenge of IDR plans has been compelling borrowers who struggle to repay to enroll in one of the more generous offerings.[25]

Third, enabling those who are actively in default to enroll in an IDR plan will enable borrowers to reenter good standing on their loans far quicker.

Fourth, the implementation of the FUTURE Act will help a greater percentage of those enrolled in SAVE stay enrolled, thereby improving the likelihood that more borrowers continue to experience the targeted benefits conferred under the new reforms.

Although the availability of SAVE will likely decrease defaults, a potential drawback of

the plan is that average time in repayment may increase as most borrowers make lower monthly payments over a longer window. This projection is supported by changes in repayment trends after the PAYE and REPAYE plans were enacted, which correlated with a reduction in the pace at which borrowers made progress on their outstanding loan debt.[26]

The federal loan framework was designed with specific references to a ten-year amortization period. Increased reliance on IDR plans has, crucially, improved conditions for low-income borrowers, but has obfuscated clear guideposts for when borrowers should expect to exit default. Under SAVE and other IDR plans, borrowers can hold out for full forgiveness after two decades of repayment, but for many, having prospective loan payments extend so far into the future can exact a serious psychological cost.[27]

Student loan debt has also been shown to delay or impact decisions regarding buying a home and contributing to retirement savings.[28] More generally, numerous studies have linked long-term experiences with debt to reductions in physical and mental wellbeing, including higher rates of suicidal thoughts and depression, which suggests that there may be a public-health cost of inadequately addressing the nonrepayment crisis.

While fewer borrowers are likely to default as a result of the availability of SAVE, it may become more challenging to accurately measure financial and psychological strain resulting from long-term indebtedness, even as short-term conditions become more bearable.

Notably, the SAVE plan does not offer a shorter window to full forgiveness to most borrowers than prior IDR plans, despite providing more generous terms in almost every other regard. The decision not to shorten the time borrowers must be enrolled in IDR to access loan forgiveness represents a missed opportunity to significantly reduce average time in repayment and correct one of the least effective policy elements of the PAYE and REPAYE plans.

There are likely significant positive externalities associated with conferring debt relief.[29] In particular, student loan borrowers who benefit from debt forgiveness have been shown to rapidly reduce other outstanding sources of debt and be less likely to enter default on other loans.[30]

Moreover, structurally, SAVE closely mirrors proceeding IDR plans. The design of the formula used to calculate borrowers' monthly payments remains the same, with different benchmarks, such as the percent of FPL used to calculate discretionary income, producing more generous terms for borrowers. Setting "discretionary income" at 225 percent of federal poverty guidelines reflects a conscious policy choice based on a determination that it provides an appropriate level of relief to borrowers struggling to repay under current conditions.

However, for some borrowers, the chosen share of income that is protected may still insufficiently estimate their expenses. For those residing in high cost-of-living areas, housing costs alone may account for upwards of seventy percent of protected "non-discretionary" income. Such borrowers may continue to struggle with student loan repayment in the short-term.

Policy Recommendations

Any conversation about student loans or loan relief is incomplete without acknowledging the trends that have produced historic levels of debt, namely rising costs and reductions in the purchasing power of need-based aid.

Consequently, in the long run, sustainable policy solutions must involve efforts to incentivize state investment in public systems of higher education and continued investments in the Pell grant program and similar forms of grant aid.

However, as long as loans remain essential for facilitating access to post-secondary opportunity, policymakers should consider several key reforms to improve borrowers' experiences. First, they should incorporate clearer benchmarks for how long borrowers, particularly those enrolled in an IDR plan, should expect to be repaying loans. This could be achieved by setting a more reasonable timeframe for accessing IDR forgiveness or expanding a version of the newly introduced benefit that enables those with smaller loan sums to have their debt forgiven after ten years of qualifying payments under SAVE. For example, this provision could be restructured such that all borrowers enrolled in IDR are eligible for full forgiveness after ten to fifteen years in repayment, with those who borrowed less qualifying earlier.

IDR forgiveness could also be structured to provide borrowers with periodic relief throughout their repayment timeline, rather than as all-or-nothing benefit at the end of it. During the Education Department's negotiated rulemaking process on Income Driven Repayment, negotiators for Legal Assistance organizations proposed annual cancellation of some level of debt based on a borrower's income.[31] Such a policy would help mitigate some of the psychological harms associated with long term indebtedness, especially for borrowers making low or zero-dollar payments, who do not see their balances decrease.

Second, policymakers should consider limiting the negative financial outcomes associated with default and provide maximum flexibility for borrowers to re-enter good standing on their loans when they do fall behind on payments. Even with more generous repayment terms, there are likely to be borrowers who experience difficulty repaying. It remains critical that loan default not further compound the financial hardship of low-income borrowers and further impair their ability to repay.

Lastly, policymakers should monitor borrower experiences under SAVE to assess whether the new plan appropriately sets payments at a level consistent with borrowers' ability to repay. For example, policymakers might consider further raising the threshold for calculating discretionary income under the plan to 250 percent of the federal poverty line if repayment trends under SAVE indicate that a significant share of low-income borrowers still struggle to make monthly payments on time.

Moving forward, policymakers must acknowledge that efforts to reform student loan repayment pertain to both how much borrowers are on the hook to repay and how long they should be in repayment.

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