

Lowering Monthly Payments for Borrowers in Income-Driven Repayment Could Have Unintended Consequences

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Reducing the share of income student loan borrowers are required to spend on loan repayment could create problems for both borrowers and taxpayers.

Currently, borrowers who opt in to income-driven repayment (IDR) pay 10 percent of their discretionary income, or income above 150 percent of the federal poverty level, before having their remaining debt forgiven after 20 years (or 25 years if they borrowed for graduate school). During his campaign, President Joe Biden proposed lowering the payments IDR plans require to 5 percent of discretionary income.¹

The motivation for this change is presumably that monthly payments put too much strain on borrowers' budgets. With these lower payments, however, more borrowers would see their balances increase as their monthly payments fail to cover interest charges. Borrowers on IDR would be in debt longer, and fewer borrowers would pay off their debt completely, shifting the burden to taxpayers. Though there are good reasons for policymakers to ease the burden of student debt, lowering the repayment rate for all borrowers on IDR is not the best solution.

Changing the Assessment Rate Does Not Help the Borrowers with the Lowest Incomes

The share of discretionary income that borrowers on IDR are required to pay (i.e., the assessment rate) is irrelevant for borrowers with no discretionary income. Single borrowers with incomes below \$19,320 (150 percent of the 2021 federal poverty level) make no payments, regardless of debt size.² Borrowers in three-person households make no payments until their incomes exceed \$32,940. For these borrowers, changes to the assessment rate will not affect their repayment experience.

¹ "The Biden Plan for Education beyond High School," JoeBiden.com, accessed March 1, 2021, <https://joebiden.com/beyondhs/>.

² "U.S. Federal Poverty Guidelines Used to Determine Financial Eligibility for Certain Federal Programs," US Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, January 15, 2021, <https://aspe.hhs.gov/poverty-guidelines>.

For Borrowers Who Do Make Payments, a Lower Assessment Rate Means More Years of Repayment and More Interest

IDR plans offer undergraduate borrowers forgiveness after 20 years, but many borrowers pay off their debts more quickly because their incomes are high enough to support the necessary payments. If borrowers paid a smaller share of their incomes, it would take longer for them to retire their debts. And because interest accrues as long as a loan is in repayment, the total amount paid increases as the time to repayment increases. It might be financially beneficial to stretch out payments if borrowers can earn a return exceeding the interest rate on the loans by investing the funds, but increasing the savings rate is not the program's goal or the likely outcome. For borrowers, having the debts hanging over their heads for 20 years when they could have eliminated them quickly may have psychological costs and may interfere with other forms of borrowing.

To understand how this plays out, consider how the typical graduate with student debt would fare under three versions of IDR:

1. the current plan, where borrowers pay 10 percent of discretionary income
2. Biden's proposed plan, where borrowers pay 5 percent of discretionary income
3. a combined plan, where borrowers pay 5 percent of the first \$10,000 in discretionary income but 10 percent on further income; this approach would ease the burden on borrowers repaying out of relatively low incomes

In the examples below, income increases 4 percent each year. The federal poverty level, and thus the payment threshold, rises 2 percent each year, along with inflation. The interest rate on loans is 4 percent (about the average charged on undergraduate student loans taken out over the past 10 years). Changing any of these assumptions would modify the dollar outcomes but not the pattern of the results.

A single borrower with a starting income of \$51,000 and a debt of \$30,000 (the median bachelor's degree recipient who borrowed for college³) would pay off his debt in 10 years under the 10 percent plan (with monthly payments beginning at \$256), 11 years under the combined plan (with monthly payments beginning at \$214), and 19 years under the 5 percent plan (with monthly payments beginning at \$128).⁴

A borrower with a starting income of \$36,000 and a debt of \$17,000 (the median associate degree recipient) would pay off his debt in 10 years under the 10 percent plan (with monthly payments beginning at \$131) and 13 years under the combined plan (with monthly payments starting at \$89).

³ "PINC-03. Educational Attainment—People 25 Years Old and Over, by Total Money Earnings, Work Experience, Age, Race, Hispanic Origin, and Sex," US Census Bureau, accessed March 1, 2021, <https://www.census.gov/data/tables/time-series/demo/income-poverty/cps-pinc/pinc-03.html>.

⁴ If the borrower married over the course of his repayment, the income threshold would rise, lowering the payments required based on his income, but his spouse's income would be considered.

Under the 5 percent plan (with monthly payments starting at \$65), he would be in repayment for 19 years.

Borrowers who leave college without a credential have the highest loan default rates. Many borrowers struggle because their earnings do not reflect a college wage premium. Median earnings for adults ages 25 to 34 with some college but no degree (a group that includes adults with certificates) are \$33,000. With this earnings level and the typical \$6,000 debt for this group,⁵ the repayment period would increase from six years to nine years if the assessment rate were cut in half. The total amount repaid would increase somewhat.

Who Will Repay Their Debt over 20 Years?

Assuming the length of time to forgiveness remains the same, lowering the IDR assessment rate would significantly raise the income levels required for borrowers to repay their loans before reaching the end of the 20-year repayment period.

Figure 1 shows the starting incomes required for borrowers to be likely to pay off their debts under each plan; table 1 shows the share of associate and bachelor's degree recipients ages 25 to 34 with incomes this high.

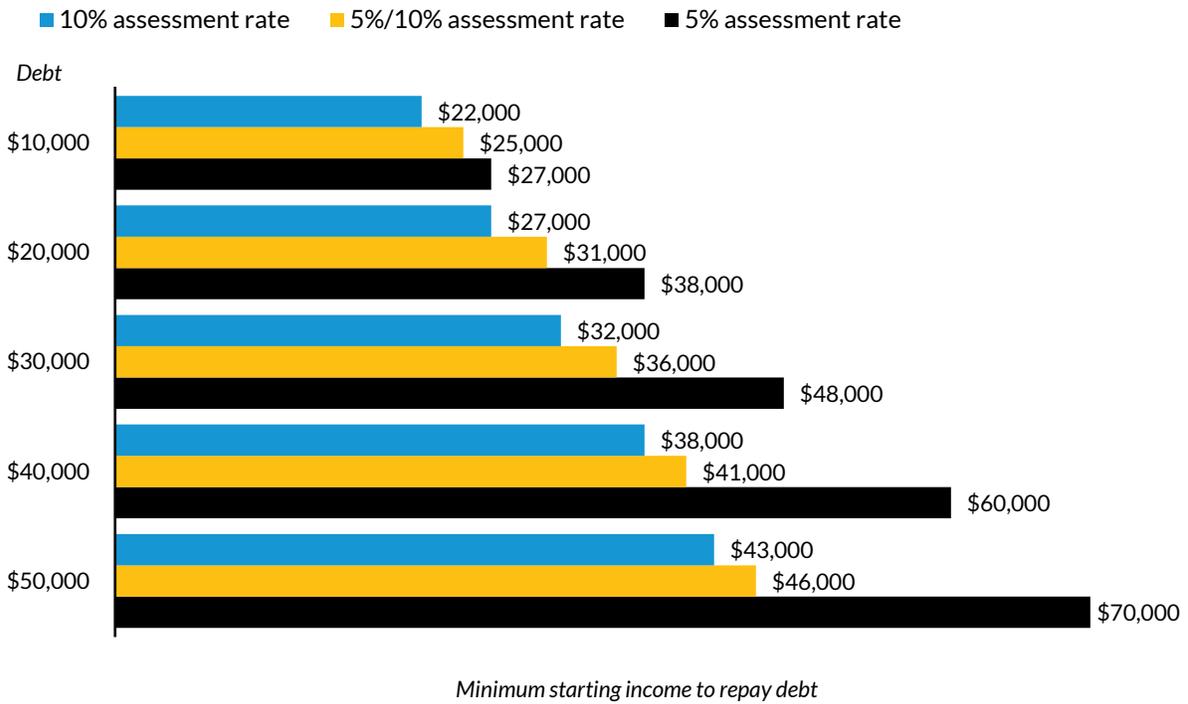
Under the current 10 percent plan, 67 percent of bachelor's degree recipients have early incomes high enough (\$32,000) to allow them to repay the typical \$30,000 debt load. Under the combined plan, the minimum required starting income would be \$36,000, and 64 percent of bachelor's degree recipients would pay off their debt. Under the 5 percent plan, this threshold would rise to \$48,000, and an estimated 49 percent of bachelor's degree recipients would fully repay. The other half would see balances forgiven after 20 years of payments. (Under current law, they would owe taxes on the amount forgiven.)

The share of associate degree recipients able to fully repay debts of \$20,000 (slightly more than the median debt for this group) would fall from 60 percent to 53 percent to 37 percent with the changes in assessment rates.

⁵ Data from the National Center for Education Statistics' Beginning Postsecondary Students Longitudinal Study 2012/17.

FIGURE 1

Minimum Starting Income Required to Fully Repay Debt within 20 Years



Source: Author's calculations.

TABLE 1

Share of Young Bachelor's Degree Recipients with Incomes High Enough to Pay Off Debt within 20 Years

	Assessment rate for bachelor's degree recipients ages 25 to 34 meeting income requirement			Assessment rate for associate degree recipients ages 25 to 34 meeting income requirement		
	10%	5%/10%	5%	10%	5%/10%	5%
\$10,000 debt	78%	76%	73%	68%	64%	60%
\$20,000 debt	73%	69%	61%	60%	53%	37%
\$30,000 debt	67%	64%	49%	50%	44%	28%
\$40,000 debt	61%	58%	35%	40%	37%	18%
\$50,000 debt	54%	52%	37%	33%	31%	10%

Source: Author's calculations.

Notes: Incomes are assumed to increase 4 percent each year, 2 percentage points beyond the assumed 2 percent inflation rate. A starting income of \$22,000 would rise to \$26,292 in year 10 and \$35,050 in year 20, after adjusting for inflation. A starting income of \$36,000 would rise to \$43,023 in year 10 and \$52,445 in year 20. A starting income of \$59,000 would rise to \$70,510 in year 10 and \$85,952 in year 20. The interest rate on loans is 4 percent.

A Lower Assessment Rate Benefits Borrowers with Larger Debts Most

In IDR, monthly payments are based on income, not on the amount of debt, so borrowers with the same income pay the same amount, regardless of loan size, if they pay all 20 years. Under the 5 percent plan, more borrowers would be required to make the same total payments as their peers who received larger loans. Borrowers with larger loans benefit most from the lower assessment rate. Those with smaller debts are more likely to have finished repaying before the end of 20 years with the higher rate. With the lower rate, they remain in repayment longer, paying more interest.

Imagine two borrowers, each with starting incomes of \$38,000 (table 2). One borrowed \$30,000, and the other borrowed \$50,000. Under the 10 percent plan, the borrower with the lower debt finishes paying in his 15th year. The borrower with the higher debt ends up getting forgiveness but has paid a larger amount because of the extra years in repayment. But under the 5 percent plan, even the borrower with a \$30,000 debt does not pay off his entire debt. He ends up making the same payments as the borrower who owed \$50,000 but has a lower balance forgiven. Cutting the assessment rate by 5 percent saves the \$30,000 borrower \$9,397 but saves the \$50,000 borrower \$24,080. It means the \$30,000 borrower made a poor choice working more or living more cheaply (or spending more of his parents' money) while in college to avoid borrowing more.

TABLE 2
Amount Repaid, by Total Debt

	\$30,000 debt	\$50,000 debt
Starting income	\$38,000	\$38,000
10% assessment rate		
Discounted value of total payments (3%)	\$33,477	\$48,160
Total forgiven or year loan is paid off	15th year	\$17,529
5% assessment rate		
Discounted value of total payments (3%)	\$24,080	\$24,080
Total forgiven or year loan is paid off	\$19,412	\$56,893
5%/10% assessment rate		
Discounted value of total payments (3%)	\$34,057	\$40,498
Total forgiven or year loan is paid off	18th year	\$31,475

Source: Author's calculations.

Note: Family size = one person.

Forgiving more for borrowers with larger loans tends to benefit students who stayed in school longer and earned higher degrees. This increases the burden on taxpayers while doing nothing to help the most vulnerable borrowers. Among students who completed degrees in 2015–16, 40 percent left school owing less than \$20,000.⁶ More than half of these graduates had earned certificates or associate degrees, and only 8 percent had earned advanced degrees. In contrast, among the 20 percent of degree

⁶ Data from the National Postsecondary Student Aid Study.

completers who left school owing more than \$50,000, two-thirds had earned advanced degrees, and only 7 percent had left with certificates or associate degrees.

Lowering the Share of Income Paid Would Also Come at a Heavy Cost to Taxpayers

The Congressional Budget Office estimates that lowering the assessment rate from 10 percent to 8 percent would increase the subsidy cost to the government of loans in income-driven plans by \$4.3 billion a year once the policy was fully implemented.⁷ Graduate loan borrowers would receive 81 percent of this new government subsidy, and undergraduate borrowers would receive 19 percent.

When borrowers do not totally retire their debts, the system forgives remaining balances—generally after 20 years for borrowers with only undergraduate debt. This unpaid debt adds to the federal debt, potentially creating trade-offs with other federal spending priorities.⁸ The system is designed to provide insurance to borrowers whose education does not pay off financially. It should prevent monthly payments from being unaffordable, allow borrowers to wait to repay the bulk of their debt until their incomes are high enough to support larger payments, and forgive debt for those whose incomes are too low over the long term to support repayment. It is not designed to turn the loans of most students into grants even if they could reasonably afford to pay them off.

Conclusion

Moving from a 10 percent to a 5 percent assessment rate would lower monthly payments but lead to fewer borrowers, even those who are successful financially, repaying their loans. The length of time over which borrowers must make payments would increase, and more borrowers would watch their balances grow even as they make the required payments. In addition, the share of students for whom greater borrowing is costless would rise, providing an incentive for students to accrue larger amounts of debt.

It is worth considering a more moderate change that would lower the assessment rate on the first dollars of income above the payment threshold—perhaps \$10,000—but maintain the 10 percent rate on income above that level. And one of the best federal policies for reducing the burden of student debt in the future would be to significantly increase the Pell grants that help low- and moderate-income students pay for college.

For more examples of the likely effects of a change in the assessment rate on borrowers in a range of different circumstances, see the Urban Institute’s loan simulator.⁹

⁷ Nadia Karamcheva, Jeffrey Perry, and Constantine Yannelis, *Income-Driven Repayment Plans for Student Loans: Budgetary Costs and Policy Options* (Washington, DC: Congressional Budget Office, 2020).

⁸ Sandy Baum and Donald Marron, “What Would Forgiving Student Debt Mean for the Federal Budget?” *Urban Wire* (blog), Urban Institute, December 22, 2020, <https://www.urban.org/urban-wire/what-would-forgiving-student-debt-mean-federal-budget>.

⁹ Kristin Blagg and Matthew M. Chingos, “Charting Student Loan Repayment,” Urban Institute, last updated October 9, 2018, <https://apps.urban.org/features/student-loan-repayment/>.

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