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SHOULD ALL STUDENT LOAN PAYMENTS BE INCOME-DRIVEN?

Trade-Offs and Challenges

REPAYMENT DEBT-TO-INCOME PASSIVE REPAYMENT
COLLEGE
BORROWERS
DEBT-TO-INCOME REPAYMENT SIMPLIFY
PAYE MANDATORY SUCCESS DEBT PAYE
ENROLLMENT
LOANS IBR
MANDATORY CHOICE \$\$\$
PAYE
INCOME-DRIVEN REPAYMENT

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The Institute for College Access & Success (TICAS) is an independent, nonprofit organization that works to make higher education more available and affordable for people of all backgrounds. TICAS is home to the Project on Student Debt, which seeks to increase public understanding of rising student debt and the implications for our families, economy, and society. For more about TICAS, see www.ticas.org.

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TRADE-OFFS AND CHALLENGES

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
CONTEXT AND APPROACH	3
COMPARATIVE PERSPECTIVE: INCOME-DRIVEN REPAYMENT IN AUSTRALIA AND THE UNITED KINGDOM	6
TRADE-OFFS AND CHALLENGES OF MANDATORY INCOME-DRIVEN REPAYMENT	10
WHY PROGRAM DESIGN MATTERS	19
TRADE-OFFS AND CHALLENGES OF PASSIVE STUDENT LOAN REPAYMENT	28
HUMAN CAPITAL CONTRACTS: DEBT BY ANOTHER NAME	31
NEED FOR MORE RESEARCH AND DATA	33
OTHER APPROACHES TO STUDENT LOAN REPAYMENT REFORM	34
CONCLUSION	35
APPENDIX A: CITATION LIST FOR FIGURE 2: “KEY COMPARISONS OF IDR SYSTEMS AND CONTEXT: U.S., U.K., AND AUSTRALIA”	36
APPENDIX B: BORROWER EXAMPLE DETAILS	38

EXECUTIVE SUMMARY

As concerns about rising college costs and student debt have intensified in recent years, so has attention to the way student loans are repaid, the manageability of loan payments, and the consequences when students cannot repay. In the United States, federal student loan borrowers currently have a mix of repayment options, including multiple “income-driven repayment” (IDR) plans. IDR plans base monthly payments on a share of the borrower’s income rather than the amount that she owes. In several other countries, IDR is the only way to repay student loans. Some have proposed that the U.S. take a similar approach, either requiring all borrowers to repay through an IDR plan, or automatically enrolling borrowers in IDR but letting them opt out (making IDR the “default” option). Some proposals would also encourage or require the use of passive repayment systems, such as paycheck withholding. This paper focuses on the potential for such proposals to improve or reduce college access, success, and affordability in the U.S., particularly for lower income students.

We found that the complex federal student loan repayment system in the U.S. is clearly ripe for streamlining and improvement, but requiring IDR for everyone could have unintended consequences, and it is certainly not the only way to help more borrowers keep up with their loan payments and avoid default. The vision of all borrowers seamlessly making affordable payments and staying out of default must be tempered with the reality of our country’s broader financial aid and higher education systems, as well as the risk of unintended consequences for lower income students. However, no matter how optimally designed or how widely used, IDR alone cannot solve the larger problems of rising college costs and student debt.

Here is a summary of our main findings:

Program design and context matter

- Whether an IDR plan is the only or default repayment option, how it is designed has implications for borrowers and taxpayers.
 - Key design factors include: how monthly payments are calculated, how accrued interest is treated, whether very low-income borrowers are required to make payments, and if payments are time-limited or can last a lifetime.
- The context in which IDR operates and its goal also matter. Models from Australia and the U.K. are instructive, but the lessons are not easily applicable to the U.S.
 - Key contextual differences include: how college tuition is set, the higher education system’s diversity and centralization, student loan interest rate policies, and the social safety net.
 - The Australian and U.K. systems were not created to increase college access, success, or affordability, but rather to generate revenue for and expand the higher education system.

Trade-offs and challenges of mandatory IDR

- Mandatory IDR would eliminate confusion in selecting a repayment plan but also eliminate consumer choice.
- IDR plans can help make monthly payments manageable, and more widespread use could thus reduce – but not eliminate – student loan defaults.

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- Borrowers could end up paying more over the life of the loan under IDR than in a traditional repayment plan.
 - IDR can increase the amount of time that borrowers have outstanding debt, which might reduce access to other forms of credit and borrowers' willingness to buy a home, start a family, start a small business, or save for retirement.
 - Without reforms to current accountability systems for colleges, such as sanctions based on cohort default rates, mandatory IDR could inadvertently create a safe haven for schools that fail to serve students well.
 - Mandatory IDR could also reduce pressure on governments and colleges to make higher education more affordable.

Trade-offs and challenges of passive student loan repayment

- Federal student loan borrowers already have access to passive repayment. More than two million borrowers with Direct Loans have elected to have their banks automatically make payments to their loan servicers each month. A 0.25% interest rate reduction applies to payments made this way.
- Paycheck withholding is another form of passive repayment, which is used for Australian and U.K. student loans. Whether it simplifies or complicates student loan repayment depends on factors such as borrowers' financial and tax-filing status, whether they are employees or contractors, have one job or multiple jobs, and if their employers are well equipped to administer such withholdings.

Research and data gaps

- The many gaps in currently available research and data prevent more thorough assessments of how mandatory or default IDR, as well as passive repayment, would likely affect college access, success, and affordability. Examples include: the prevalence of loan aversion, how borrowers who do and do not opt in to current IDR plans differ, and how many student loan borrowers are self-employed or contract workers.
- More information is needed to ensure that such proposals would not lead to additional process burdens and costs for the neediest students.

Other approaches to student loan repayment reform

- Simplify and improve student loan repayment options: provide one well-designed IDR plan that targets benefits to borrowers who need help the most, and a limited menu of traditional plans with incrementally longer repayment periods available to those with larger balances.
- Make it easier for borrowers in IDR to keep their income information up to date.
- Do not treat debt discharged through IDR as taxable income.
- Automatically enroll severely delinquent borrowers in IDR.
- Improve loan counseling, servicing, and outreach, and direct distressed borrowers to IDR.

CONTEXT AND APPROACH

Because college costs have risen faster than family incomes and available grant aid, student loans have become a fact of life for more Americans than ever before. Less than half of four-year college graduates had loans in 1993.¹ By 2012, 71% had loans, and those who borrowed owed an average of \$29,400 at graduation.² Among undergraduates at all types of schools, federal Pell Grant recipients – who typically have family incomes under \$40,000 – were more than twice as likely as other students to take out a loan in 2012.³

As awareness of these trends has grown, so have concerns among policymakers, colleges, the media, and the general public about the burden of student debt. Students and families have real fears about high debt, unmanageable payments, and the consequences of delinquency and default. Students worried about having to borrow may avoid college altogether or try to limit debt in ways that also reduce their odds of success, such as delaying enrollment, attending part time, working long hours, or dropping out. For example, research shows that students working 15 or more hours a week are more likely to drop out of college than those working fewer hours.⁴

To help contain both the real and perceived risks of borrowing, TICAS' Project on Student Debt developed the policy framework and led the advocacy campaign for a federal loan repayment plan called Income-Based Repayment (referred to in this paper as "Classic IBR"), which Congress created in 2007.⁵ At the time, safeguards for borrowers with high debt relative to their income were grossly inadequate. We found that students, schools, lenders, and legislators from both sides of the aisle supported the goals of affordable loan payments based on income and family size, and a light at the end of the tunnel with any remaining debt discharged after a certain period of responsible payments.⁶

Classic IBR became available to all federal loan borrowers in July 2009.⁷ In 2010, Congress passed President Obama's proposal to lower monthly payments further and shorten the repayment period for new borrowers starting in July 2014 (referred to in this paper as "2014 IBR").⁸ In 2012, the Administration created the Pay As You Earn (PAYE) plan to extend these benefits to many current students and recent graduates.⁹ PAYE builds on a pre-existing but little-

¹ Calculations by TICAS using data from the U.S. Department of Education, 1993 National Postsecondary Student Aid Study (NPSAS). Figures reflect the cumulative student loan borrowing of undergraduates who were citizens or permanent residents, attended colleges in the 50 states or the District of Columbia, and were expected to graduate with a bachelor's degree during the academic year.

² TICAS. 2013. *Student Debt and the Class of 2012*. <http://projectonstudentdebt.org/files/pub/classof2012.pdf>.

³ Calculations by TICAS using data from the U.S. Department of Education, 2012 National Postsecondary Student Aid Study (NPSAS). Figures reflect the annual borrowing of undergraduates who were citizens or permanent residents and attended colleges in the 50 states or the District of Columbia.

⁴ CALPIRG. 2009. *Working Too Hard to Make the Grade: How Fewer Work Hours and More Financial Aid Can Help California Community College Students Succeed*. <http://www.uspirg.org/sites/pirg/files/reports/workingtoohard.pdf>. American Council on Education. 2002. *Crucial Choices: How Students' Financial Decisions Affect Their Academic Success*. <http://armasineducation.com/documents/crucialchoices.pdf>. Orszag, Jonathan M., Peter R. Orszag, and Diane M. Whitmore, commissioned by UPromise, Inc. 2001. *Learning and Earning: Working in College*. <http://www.brockport.edu/career01/upromise>.

⁵ Classic IBR was created as part of the College Cost Reduction and Access Act of 2007: <http://1.usa.gov/UQfQy7>. For information about the policy framework and advocacy campaign, see "Petition for Rulemaking to Amend Title 34, Sections 682.210, 685.204, and 685.209 of the Code of Federal Regulations." 2006. Signed by American Student Assistance, the College Board, College Parents of America, the Council for Opportunity in Education, Great Lakes Higher Education and Affiliates, The Howard Center for Family, Religion and Society, TICAS' Project on Student Debt, State Public Interest Research Groups, and the United States Student Association. http://projectonstudentdebt.org/files/File/Petition_to_ED_5.2.06.pdf. See also TICAS. 2006. *Addressing Student Loan Repayment Burdens: Strengths and Weaknesses of the Current System*. http://ticas.org/pub_view.php?idx=103.

⁶ For more information about the Plan for Fair Loan Payments and support for its goals, see <http://bit.ly/VLVLbj>.

⁷ TICAS. June 30, 2009. Press release. "New Federal Income-Based Repayment Plan Goes Into Effect July 1." http://ticas.org/files/pub/July_1_IBR_Alert.pdf. Classic IBR covers federal loans made through both the Direct and FFEL programs, as long as they are not in default.

⁸ The White House. 2010. "Ensuring That Student Loans are Affordable." <http://1.usa.gov/d32TEd>.

⁹ The White House. October 25, 2011. Press release. "We Can't Wait: Obama Administration to Lower Student Loan Payments for Millions of Borrowers." <http://1.usa.gov/t63akG>. See also TICAS. December 20, 2012. Blog post. "Pay As You Earn Now Available to Help New College Grads." <http://views.ticas.org/?p=956>.

used plan called Income-Contingent Repayment (ICR), which is still available but in most cases provides less relief than Classic IBR, 2014 IBR, and PAYE.¹⁰ As of December 2013, an estimated 1.9 million Direct Loan borrowers had enrolled in an IDR plan.¹¹ See Figure 1 for a summary of the existing IDR options.

FIGURE 1: SUMMARY OF EXISTING IDR OPTIONS IN THE U.S.¹²

	Available	Eligibility	Monthly Payment Cap	Discharge After
Income-Based Repayment (Classic IBR)	Since 2009	All borrowers with federal student loans (Direct or FFEL), new or old, with a partial financial hardship (PFH). ^a	15% of discretionary income ^b	25 years
Income-Based Repayment (2014 IBR)	Starting July 2014	Borrowers who take out their first loan on or after July 1, 2014, ^c and have a PFH.	10% of discretionary income	20 years
Pay As You Earn (PAYE)	Since late 2012	Direct Loan borrowers who took out their first loan after September 30, 2007 and at least one after September 30, 2011, and have a PFH.	10% of discretionary income	20 years
Income-Contingent Repayment (ICR)	Since 1994	Borrowers with Direct Loans, new or old; no PFH requirement.	The lesser of: 20% of discretionary income and 12-yr repayment amount x income percentage factor	25 years

^a Borrowers have a “partial financial hardship” (PFH) if their calculated payment based on income and family size is less than what they would pay under the 10-year standard repayment plan.

^b For Classic IBR, 2014 IBR, and PAYE, discretionary income is defined as the amount of adjusted gross income (AGI) above 150% of the poverty level for the borrower’s household size. For ICR, discretionary income is defined as the amount of AGI above 100% of the poverty level for the borrower’s household size.

^c Borrowers can also become eligible for this plan if they had loans before July 1, 2014 but paid them off before borrowing again on or after July 1, 2014. Note that no new FFEL Program loans have been made since June 30, 2010, so only Direct Loans will be eligible for repayment under 2014 IBR.

The IDR plans described above can help federal loan borrowers manage their debt by capping loan payments at a modest share of income and limiting how long they must repay. Access to affordable, income-driven payments and a light at the end of the tunnel are critical safeguards for borrowers in an era of rising college costs and student debt.

However, it is important to recognize that no matter how optimally designed or widely used, IDR alone cannot solve the larger problems of college costs and debt. Repayment policy is just one aspect of our federal loan program, which also includes interest rates, loan limits, and other factors that can affect the cost and amount of student debt. Borrowers’ monthly and total payment amounts are shaped by how much they owe as well as the terms and conditions of their loans, including repayment options. Federal and state investment in grant aid for needy students and state investment in public colleges are key determinants of how much students need to borrow. However, deep cuts in public funding for higher education have significantly shifted the costs of higher education to individual students and their families over the past

¹⁰ For more information about ICR, see <http://studentaid.ed.gov/repay-loans/understand/plans/income-contingent>.

¹¹ U.S. Department of Education, Federal Student Aid (FSA). “Federal Student Loan Portfolio,” “Direct Loan Portfolio by Repayment Plan,” as of Dec. 31, 2013. <http://studentaid.ed.gov/about/data-center/student/portfolio>. This figure includes enrollment by Direct Loan borrowers in Classic IBR, PAYE, and ICR. 2014 IBR is not yet available to borrowers. The figure does not include FFEL borrowers who are enrolled in Classic IBR.

¹² These plans are only available for federal student loans that are not in default. Parent PLUS loans are not covered. For more information about these repayment plans, see U.S. Department of Education, “Repayment Plans,” <http://1.usa.gov/1eBS1i8>.

generation,¹³ and the maximum federal Pell Grant currently covers the smallest share of attending a public, four-year college since the program started.¹⁴ Although a well-designed IDR plan could be expected to solve some repayment problems for borrowers, more comprehensive reforms to student aid and higher education policy will be necessary to slow or reverse the growth in college costs and student debt levels, and narrow the sizeable income gaps in enrollment and completion.

The current repayment system is far from perfect

Current federal student loan repayment policies and practices are clearly in need of improvement.¹⁵ The number of repayment options and the variation in eligibility requirements, costs, and benefits can be overwhelming. When considering improvements to the current system, it is important to distinguish challenges that stem from inadequate information and outreach from substantive process and design issues, such as having four different IDR plans. Some seemingly insurmountable problems could be solved by improving information and communication, or by technical, administrative, regulatory, or legislative fixes, rather than creating a whole new repayment system.

TICAS has identified several ways to simplify and improve federal loan repayment options to help borrowers manage their debt, and to reduce the financial distress and defaults that undermine the goals of increased enrollment and completion. These proposals are detailed in a 2013 report¹⁶ and summarized in the “Other Approaches to Student Loan Repayment Reform” section.

Our approach to evaluating student loan repayment options

It is in the broader context described above that we consider the question of how a shift to mandatory income-driven repayment of federal student loans might affect college access, success, and affordability, particularly for low-income students. This white paper focuses primarily on the trade-offs and challenges of mandatory or default enrollment in an income-driven plan, rather than how such a plan should be designed.¹⁷ Unless otherwise noted, we use “mandatory IDR” to refer to a loan repayment system in which all borrowers would be required to make income-driven payments. We also consider what lessons can be drawn from other countries’ student loan repayment systems, the use of passive repayment for student loans, and alternative approaches to reducing the burden of student debt.

In assessing potential changes to loan repayment options and other aspects of student aid policy, TICAS considers whether and how those changes are likely to increase access, success, and affordability, particularly for low-income students and their families. We define student success as completing a quality credential without burdensome debt. Borrowers’ perceptions of burden may vary, but one way to define “burdensome” debt is whether it forces borrowers to choose between making their loan payments and meeting basic needs for themselves and their families.

¹³ See, for example: Center on Budget and Policy Priorities (CBPP). 2013. *Recent Deep State Higher Education Cuts May Harm Students and the Economy for Years to Come*. <http://www.cbpp.org/files/3-19-13sfp.pdf>. State Higher Education Executive Officers (SHEEO). 2013. *State Higher Education Finance: FY 2012*. <http://bit.ly/MOCqAK>. Delta Cost Project at American Institute for Research (AIR). 2012. *Spending, Subsidies, and Tuition: Why Are Prices Going Up? What are Tuitions Going to Pay For?*

¹⁴ TICAS. 2014. “Pell Grants Help Keep College Affordable for Millions of Americans.” http://www.ticas.org/files/pub//Overall_Pell_one-pager.pdf.

¹⁵ TICAS. 2013. *Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success*. http://www.ticas.org/pub_view.php?id=873.

¹⁶ Ibid.

¹⁷ For more information on the implications of program design, see “Why Program Design Matters.”

We also consider the interests of different stakeholders, in this case primarily students, borrowers in repayment, families of students and borrowers, and taxpayers. It is important to note that federal loans need not be entirely self-financing to align with taxpayers' interests. Rather, we believe that federal loans should be a form of financial aid and merit taxpayer support. In contrast, federal student loans are currently designed such that they generate profits for the government.

There are a number of problems that mandatory IDR and passive repayment policies might seek to address. Emphasis on particular goals will affect both the program's design and its likely effects on access, success, and affordability. For example, the primary goal could be to increase simplicity and ease of use for borrowers, to reduce student loan default and delinquency, to contain costs for borrowers, or to contain costs or generate revenue for taxpayers.

Our analysis of mandatory IDR and passive repayment focused on:

- The likely effects on college access, success, and affordability for financially needy students.
- What evidence is available to support anticipated outcomes.
- What unintended consequences can be anticipated, and whom would they affect.
- How changes could be implemented within, and interact with, other aspects of our current higher education system, tax system, or social and economic conditions.
- Whether other solutions should also be considered.

We believe that federal loans should be a form of financial aid and merit taxpayer support.

COMPARATIVE PERSPECTIVE: INCOME-DRIVEN REPAYMENT IN AUSTRALIA AND THE UNITED KINGDOM

Several countries have implemented some form of a mandatory income-driven repayment (IDR) system for student loans. Here, we briefly consider the structure and relevance of existing mandatory IDR models in two countries: Australia, the first country to implement an IDR-based student loan system, in 1989; and the United Kingdom (U.K.), which introduced its system in 1998.

Their experiences with mandatory IDR are instructive, but no one model can be easily transferred from one country to another. Ultimately, significant differences in the size, heterogeneity, and tuition-setting mechanisms of each country's higher education system, as well as in their social welfare policies and other factors, mean that any international lessons must be applied with great care.

Differences in reasons for adopting IDR

The United States shares with Australia and the U.K. many similar underlying concerns about the rising cost of higher education for taxpayers, students, and families, as well as the need to produce more degrees, but the context and conditions in the U.S. are markedly different.

First, Australia and the U.K. implemented mandatory IDR to introduce cost-sharing in an environment where students were paying no tuition, and many received funds to help cover

books, housing, food, and other costs.¹⁸ Because introducing or increasing tuition in systems that were entirely publicly-funded sparked student and other stakeholder concerns, mandatory IDR was a more politically viable approach to introducing fees for students. It limited both the visibility and burden of increased cost by deferring repayment until after the student graduated and was earning a certain amount of money, and by basing monthly payments on a limited percentage of income.¹⁹ In contrast, the U.S. has long relied on students and families to make significant contributions toward tuition, fees, and the other costs of being in school, and, for many, to take on loans to finance higher education. In the U.S., mandatory IDR is typically presented as a way to help ease the burden of students whose loan payments are unmanageably high.

Second, in Australia and the U.K., the primary goal of mandatory IDR was to generate additional revenue for universities to expand student slots and increase institutional quality.²⁰ It was also argued in Australia that using taxpayer funds to support relatively privileged university students was regressive.²¹ While neither country wanted mandatory IDR to decrease the enrollment of any group of students, increasing diversity or addressing equity concerns was not an explicit goal. In the U.S., on the other hand, narrowing participation and completion gaps between lower and higher income students is a widely shared goal. There are open questions about how mandatory IDR might affect low-income students' enrollment or success in the U.S.

Differences in diversity, scale, and centralization of higher education

Major differences in these countries' higher education systems also make comparisons challenging. As shown in Figure 2 below, Australia has 140 higher education institutions and 200 vocational institutions, about 1.3 million students, and A\$26 billion (US\$23.1b)²² in outstanding student loan debt. The U.K. has 160 universities,²³ around 2.5 million students, and £47 billion (US\$76.6b) in outstanding student loan debt. In contrast, the U.S. higher education system is far larger and more complex, with more than 7,400 institutions (degree-granting and non-degree granting), 21 million students, and more than \$1 trillion in outstanding student loan debt.

Maximum tuition is set centrally by the national government in the U.K. and Australia, where almost all universities are public. In the U.S. there is no national cap on tuition, and tuition-setting authority and policy differ among public, private nonprofit, and private for-profit institutions and across states. The U.S. does have annual and aggregate federal loan limits (set by Congress), but these do not act as de facto caps on tuition, which varies widely by school, state, and sector.

¹⁸ For information about the Australian system, see Chapman, Bruce and Jane Nicholls. 2013. *Higher Education Contribution Scheme (HECS)*. Crawford School Asia and the Pacific Policy Studies Research Paper No. 02/2013. <http://ssrn.com/abstract=2307733>. Parliament of Australia. 2000. *Higher Education Funding Policy*. <http://bit.ly/MrZQPk>. For information about the U.K. system, see Higher Education Funding Council for England (HEFCE). "Recent history of higher education in England." <http://www.hefce.ac.uk/about/intro/abouthighereducationinengland/historyoftheinengland/>. Student Loans Company (U.K.). "Student Loan Repayment: Income Contingent Loans." <http://bit.ly/LwfQPu>.

¹⁹ Johnstone, Bruce. 2009. "Conventional fixed-schedule versus income contingent loan obligations: Is there a best loan scheme?" *Higher Education in Europe* 34(2): 189-199. <http://bit.ly/letlZVV>.

²⁰ Johnstone 2009. The National Committee of Inquiry into Higher Education, chaired by Lord Dearing. 1997. *Report of the National Committee*. <http://www.leeds.ac.uk/educol/ncihe/>.

²¹ Chapman and Nicholls 2013.

²² All conversions to U.S. dollars use the exchange rate from February 4, 2014 (1 British Pound Sterling equals 1.63 U.S. Dollar; 1 Australian Dollar equals 0.89 U.S. Dollar).

²³ Figures for students and institutions in the U.K. may not include students eligible for government financial aid due to enrollment in "designated courses" at more than 300 providers other than higher education institutions. Due to data limitations, it is difficult to quantify total enrollment in these courses. See Student Finance England. 2014. "Full list of designated courses." <http://www.practitioners.slc.co.uk/policy-information/designated-courses/full-list.aspx>.

Other key differences

Beyond higher education, differences in other national policies could lead to unintended consequences for mandatory IDR. For instance, Australia and the U.K. have universal public health care, while the U.S. does not.²⁴ Unexpected and high medical costs could render otherwise modest loan payments unaffordable in ways that have nothing to do with the borrower's income per se.²⁵ It is notable that in the U.S., the majority of bankruptcies are due to medical bills, and 70% of those with medical bankruptcies had health insurance.²⁶ While the recently enacted Affordable Care Act has introduced subsidies for lower income households to help pay for health insurance, the cost of health insurance and health care itself remains very high in the U.S.²⁷

Additionally, differences in tax structures and employment characteristics may create unique complications around implementing mandatory IDR. In the U.S., married spouses can file their taxes jointly, and the vast majority of married filers do,²⁸ which means that their taxes are based on a single household income figure. In contrast, there is only individual taxation in Australia and the U.K., regardless of marital status.²⁹ Among other things, such differences affect how easily income-driven payments for married borrowers can be determined and/or collected via the tax system.³⁰ Differences in the share of the workforce that is contingent or self-employed may also complicate the implementation and administration of mandatory IDR and passive repayment for both borrowers and governments.

Figure 2 on the following page highlights some of the key comparison points between mandatory IDR in Australia and the U.K. and the opt-in IDR plans that exist in the U.S. today.

²⁴ New York State Department of Health. 2011. "Foreign Countries with Universal Health Care." http://www.health.ny.gov/regulations/hcra/univ_hlth_care.htm.

²⁵ The strength of the social safety net also has consequences for certain types of passive repayment. See "Trade-offs and Challenges of Passive Student Loan Repayment" for more information.

²⁶ Himmelstein, David U., Deborah Thorne, Elizabeth Warren, and Steffie Woolhandler. 2009. "Medical Bankruptcy in the United States, 2007: Results of a National Study." *The American Journal of Medicine* 122 (8): 741-746. [http://www.amjmed.com/article/S0002-9343\(09\)00404-5/abstract](http://www.amjmed.com/article/S0002-9343(09)00404-5/abstract).

²⁷ The Commonwealth Fund. November 13, 2013. News release. "New 11-Country Health Care Survey: U.S. Adults Spend Most; Forgo Care Due to Costs, Struggle to Pay Medical Bills, and Contend with Insurance Complexity at Highest Rates." <http://bit.ly/1inMXkt>.

²⁸ Calculations by TICAS using data from the U.S. Internal Revenue Service (IRS). Table 1.2: "All Returns: Adjusted Gross Income, Exemptions, Deductions, and Tax Items," tax year 2011. http://www.irs.gov/file_source/pub/irs-soi/11in12ms.xls.

²⁹ Organisation for Economic Co-operation and Development (OECD). 2005. *Taxing Working Families: A Distributional Analysis*. Table 1.2.3: "Tax unit, 2002." <http://books.google.com/books?id=EGUdRXWZTUwC>.

³⁰ One example of the potential difficulty can be found in the IRS Data Retrieval Tool, which helps simplify the federal student aid application process and makes it easier for borrowers to enroll in IDR plans in the U.S. and annually update their income information once enrolled. Married borrowers who file separately are blocked from using this tool, while those who file jointly can easily transfer required income information electronically from the IRS to the Education Department, which sends it to the relevant loan servicer. See <http://1.usa.gov/1iEPcPV>.

**FIGURE 2: KEY COMPARISONS OF IDR SYSTEMS AND CONTEXT:
U.S., U.K., AND AUSTRALIA³¹**

	Australia (Mandatory IDR)	U.K. (Mandatory IDR)	U.S. (Voluntary IDR)^a
Unit of Income Taxation	Individual (regardless of marital status)	Individual (regardless of marital status)	Individual or joint (married can file jointly, and most do)
Universal Healthcare	Y	Y	N
Total # Institutions	340	160	7,400
Total # Students Enrolled	1.3m	2.5m	21m
Government Price Control	Y	Y	N
Outstanding Student Loan Debt	\$23.1b (A\$26b)	\$76.6b (£47b)	\$1.05t ^b
Interest Rate Formula	Loan balance indexed to inflation	Inflation (RPI) + 3.00%	10-Year T Note +2.05% Undergraduate (up to 8.25%); +3.60%, Graduate (up to 9.50%); +4.60%, PLUS (up to 10.50%) ^c
2013 Interest Rates	2.00%	6.30%	3.86%, Undergraduate; 5.41%, Graduate; 6.41%, PLUS ^c
Payment Initiated By	Employer	Employer ^d	Borrower
Repayment Threshold	\$45,665 (A\$51,309, not adjusted for family size)	\$34,230 (£21,000, not adjusted for family size)	\$17,505 (adjusted for family size) ^e
Repayment Amount (if > \$0)	4-8% (progressive) of total taxable income	9% of gross income above threshold	10% (PAYE and 2014 IBR) or 15% (Classic IBR) of adjusted gross income above threshold
Discharge of Remaining Debt	At Death	30 Years	20 Years (PAYE and 2014 IBR) or 25 Years (Classic IBR)
Pre-pay Loans w/o Penalty	Y	Y	Y
Access to Loan Balance Information	Anytime from tax office	1x per year from SLC	Anytime from servicer or online federal database

^a Chart reflects current policy for Classic IBR, 2014 IBR, and Pay As You Earn (PAYE).

^b Figure for the U.S. includes federal loans for both students and parents, as of December 31, 2013.

^c Interest rate policy in the U.S. currently treats Graduate Stafford Loans differently than Graduate and Parent PLUS Loans. See <http://studentaid.ed.gov/types/loans> for more information about the different types of federal loans.

^d Due to the significant lag time between employer reporting of withheld payments to the U.K. Student Loan Company (SLC) via the Tax Office, students are recommended to switch to sending payments directly to the SLC from their bank accounts for the final 23 months of payment, to avoid overpaying and having to apply for a refund.

^e 150% of the federal poverty guideline for the borrower's household size. Figure reported in table is the 2014 amount for a single person living in the continental U.S.

³¹ Figure 2 reflects current policy for new loans. Complete sources for this figure are provided in Appendix A.

Results and revisions in Australia and the U.K.

In general, the increased cost borne by Australian students due to the implementation of IDR has not measurably altered their demand for higher education or their return on investment.³² Thus, it is unsurprising that the government has responded to economic pressures and competing policy priorities by tinkering with the IDR system and repeatedly shifting burdens further toward students. In the U.K., this same shift has been even more rapid, culminating in the tripling of tuition charges in 2012 alone.³³ It is too early to assess the impact of this change on college access and success, but the consequences should be closely monitored.

Today, both countries continue to grapple over questions about the costs and benefits of their student loan systems,³⁴ and both are considering additional changes, including controversial proposals to sell each country's student loan portfolio to banks to generate revenues for the government.³⁵ These continuing changes in both Australia and the U.K., which increasingly shift costs from the public to the student, are important to consider when evaluating those models.

TRADE-OFFS AND CHALLENGES OF MANDATORY INCOME-DRIVEN REPAYMENT

While setting income-driven repayment (IDR) as the default or only repayment plan would certainly simplify the repayment plan selection process and would be expected to reduce defaults by helping make monthly payments more manageable, there are important trade-offs for borrowers and other stakeholders that must be considered. Borrowers in IDR may end up paying more in total over the life of their loans than under other repayment plans, and carrying outstanding debt over a longer period of time may reduce their ability or willingness to buy a home or make other financial commitments. Implementing mandatory or default IDR would also raise a number of structural, logistical, and equity issues. Additionally, greatly expanded participation in IDR would intensify the already pressing need to rethink how we hold colleges accountable for serving their students well.

IDR helps make monthly payments manageable, and more widespread use could reduce defaults

By basing monthly payments on borrowers' income rather than the size of their loan debt, IDR helps make those payments more manageable. Currently, the majority of federal Direct Loan borrowers are enrolled in 10-year standard repayment,³⁶ the "default" plan that borrowers are placed in if they do not actively select a different one. Under 10-year standard repayment, monthly payments are fixed amounts based on the size of the borrower's debt. The relatively short repayment period minimizes the total cost of the loan for borrowers who can afford the monthly payments. However, for those who borrowed a large amount, are struggling to find a

³² Chapman and Nicholls 2013.

³³ *London Evening Standard*. August 9, 2012. "University applications drop as tuition fees triple." <http://www.standard.co.uk/news/education/university-applications-drop-as-tuition-fees-triple-8026177.html>.

³⁴ Jump, Paul. March 7, 2013. "Australia's academy faces day of reckoning over student loans." *Times Higher Education*. <http://bit.ly/1ePwFMR>. Coughlan, Sean. November 28, 2013. "Student loan repayment needs tighter control, say MPs." *BBC*. <http://www.bbc.co.uk/news/education-25121145>.

³⁵ *BBC*. November 25, 2013. "Ageing student loans sold to debt firms." <http://www.bbc.co.uk/news/business-25084744>. Jump, Paul. November 7, 2013. "Opposition mounts to Oz plans for student loan sell-off." *Times Higher Education*. <http://www.timeshighereducation.co.uk/news/opposition-mounts-to-oz-plans-for-student-loan-sell-off/2008781.article>.

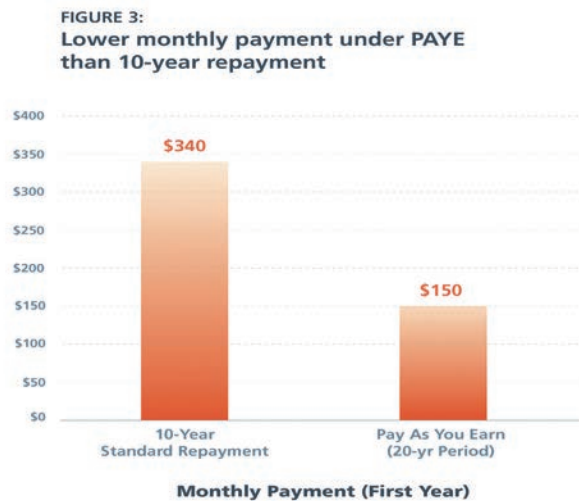
³⁶ U.S. Department of Education, Federal Student Aid (FSA). "Federal Student Loan Portfolio," "Direct Loan Portfolio by Repayment Plan," as of Dec. 31, 2013. <http://studentaid.ed.gov/about/data-center/student/portfolio>.

Lowering borrowers' monthly payments under IDR can reduce their likelihood of default, which is currently defined as not making any loan payments for at least 270 days.

well-paying job, and/or have other substantial financial obligations, the 10-year payments may be unaffordable.

To illustrate how IDR can reduce monthly payment amounts, consider Borrower A, a single borrower with \$29,400 in federal loans.³⁷ She earns \$35,000 in adjusted gross income (AGI) in her first year at work, and her income increases 4% a year.³⁸ The average interest rate on her loans is 6.8%.

Figure 3 shows the borrower's monthly payment amounts during her first year of repayment.³⁹ This borrower's monthly payments under Pay As You Earn (PAYE) would be less than half the size of her monthly payments under the 10-year standard repayment plan: \$150, compared to \$340. As mentioned earlier, PAYE sets monthly payments at 10% of discretionary income and discharges remaining balances after 20 years of qualifying payments.



Lowering borrowers' federal loan monthly payments in this way can reduce their likelihood of default, which is currently defined as not making any loan payments for at least 270 days. It is important to note, however, that it is still possible for borrowers to default while enrolled in an IDR plan, if they are unable or unwilling to make the required income-driven payments for a specified period of time. No formula is perfect, and borrowers may have substantial expenses (e.g., health care and private education loans) that are not factored into the monthly payment calculation. Specific program design, such as the income exclusion, can also affect how affordable borrowers' monthly payments would be under IDR.⁴⁰

Default reduction should be a major benefit of IDR, whether opt-in or mandatory, because the consequences of defaulting on a federal student loan are so severe. Borrowers who default face ruined credit scores and high fees that significantly increase the cost of the loan. They can have their wages garnished, see their tax refunds claimed, and even lose part of their Social Security payments. They also lose eligibility for federal student aid that could otherwise help them

³⁷ \$29,400 was the average total student loan debt (including both federal and private loans) for borrowers who graduated with bachelor's degrees in academic year 2011-12. 71% of bachelor's degree recipients that year had student debt. See TICAS. 2013. *Student Debt and the Class of 2012*. <http://projectonstudentdebt.org/files/pub/classof2012.pdf>.

³⁸ For more details about this borrower scenario, see Appendix B.

³⁹ Both monthly payments and total costs are affected by a multitude of factors specific to the borrower, including his or her debt amount, household size, and income trajectory over the repayment period.

⁴⁰ See "Why Program Design Matters" for more information.

complete their education or train for a better paying job. In addition, student loans are much more difficult to discharge in bankruptcy than other types of debt.

Participation in the existing IDR plans is currently relatively low, with only 11% of Direct Loan borrowers in repayment enrolled in Classic Income-Based Repayment (IBR), Pay As You Earn (PAYE), or ICR.⁴¹ If an IDR plan were the default or only repayment option, more borrowers would receive the protections it provides, including, in many cases, lower monthly payments. There are clearly more borrowers who could benefit from IDR, given rising default rates and millions of borrowers behind on their student loan payments.⁴² However, there are practical ways to reduce delinquency and default while still letting borrowers opt in to IDR. As noted in “Other Approaches to Student Loan Repayment Reform,” streamlined and improved repayment options, improved loan counseling, targeted outreach, and more consumer-friendly processes could go a long way in helping more borrowers who stand to benefit enroll in an IDR plan, or a more traditional plan with a repayment term appropriate to their level of debt.

Borrowers may end up paying more under IDR

One potential trade-off for lower monthly payments is that borrowers may end up paying more in total under IDR plans than other repayment plans. Making lower payments over a longer period of time can cost borrowers more in total due to accrued interest, especially if repayment periods are long or unlimited. In fact, the Department of Education cautions borrowers considering IDR plans about the risk of paying “more total interest over the life of the loan than you would under other repayment plans.”⁴³ The current IDR plans in the U.S. have repayment periods of up to 25 years. Others have also raised concerns about the cost of additional accrued interest.⁴⁴

As shown in Figure 4, Borrower A (with \$29,400 debt and a \$35,000 starting AGI) would end up paying more in total under PAYE than under 10-year standard repayment, even after adjusting for inflation. In fact, total payments under PAYE would be 46% higher in current dollars, and 26% higher in constant dollars, than total payments under a 10-year standard repayment plan.⁴⁵

⁴¹ Calculations by TICAS using data from the U.S. Department of Education, Federal Student Aid (FSA). “Federal Student Loan Portfolio,” “Direct Loan Portfolio by Repayment Plan,” as of Dec. 31, 2013. <http://studentaid.ed.gov/about/data-center/student/portfolio>. 2014 IBR is not yet available to borrowers.

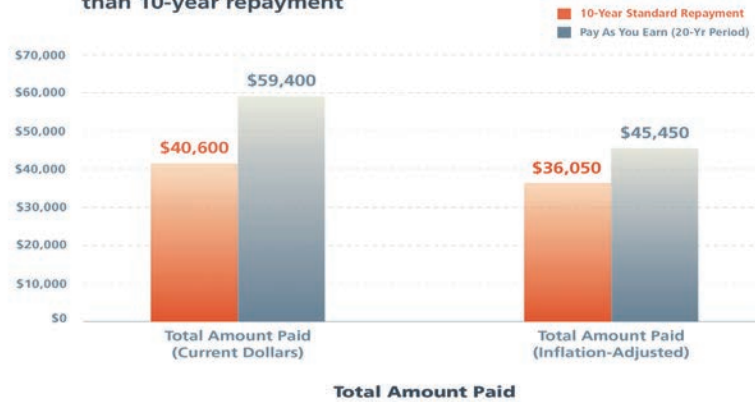
⁴² Almost seven million borrowers have at least one education loan past due, including parent and student loans, both federal and private. Lee, Donghoon. Federal Reserve Bank of New York. 2013. Presentation for Press Briefing. “Household Debt and Credit: Student Debt.” <http://www.newyorkfed.org/newsevents/mediaadvisory/2013/Lee022813.pdf>.

⁴³ See, for example, the Department of Education’s webpages on the Income-Based Repayment Plan (<http://studentaid.ed.gov/repay-loans/understand/plans/income-based>) and the Pay As You Earn Repayment Plan (<http://studentaid.ed.gov/repay-loans/understand/plans/pay-as-you-earn>).

⁴⁴ See, for example, Delisle, Jason. New America Foundation. “Keeping College Within Reach: Examining Opportunities to Strengthen Federal Student Loan Programs.” Testimony before the U.S. House of Representatives Committee on Education and the Workforce. Delivered on March 13, 2013. http://edworkforce.house.gov/uploadedfiles/delisle_written_testimony_.pdf.

⁴⁵ This figure illustrates total amounts paid in current dollars and then discounted at a 2.4% annual rate, the projected average annual increase in the Consumer Price Index over the next 20 years. This calculation does not apply a discount rate above inflation, which will depend on external factors such as federal interest rates and the borrower’s personal preferences for having more money now or in the future. Note that economists and government agencies vary in the discount rates they apply in their calculations and may apply different discount rates for different years.

FIGURE 4:
Borrower pays more in total under PAYE than 10-year repayment



Note that total costs to borrowers, as well as taxpayers, are affected by the details of how the loan program is structured, in addition to the amount originally borrowed. For example, the length of the repayment period, interest rate, and formula for calculating monthly payment amounts can affect how much borrowers end up paying. For further discussion see the “Why Program Design Matters” section.

Although paying more in accrued interest is an inherent risk of making reduced monthly payments over a longer period of time, there are ways to help manage that risk within an IDR program, whether it is opt-in, automatic, or mandatory. For example, capping interest accrual or capitalization, discharging remaining debt after a certain number of qualifying payments, and not treating discharged loan balances as taxable income would help reduce total repayment burdens for borrowers in IDR.

Given the risk of higher total payments, any IDR program should encourage and make it easy for borrowers to make higher-than-scheduled payments if they can, so they accrue less interest. There should never be a penalty for prepayment, and lenders or servicers should clearly communicate to borrowers the potential benefits of prepayment. Analysis of a recent policy change indicates that given the information and opportunity, consumers may well take steps to contain total costs by making higher payments. A 2009 law and its regulations require credit card statements to include this warning: “If you make only the minimum payment each period, you will pay more in interest and it will take you longer to pay off your balance.” Statements must also provide estimates of repayment period length and total amounts paid if borrowers made the minimum payment versus a higher amount, and monthly payments, total costs, and savings if they were to pay off the bill in three years. The share of consumers making only the minimum payment declined after these disclosure changes occurred, according to initial findings reported by the Consumer Financial Protection Bureau.⁴⁶

Borrowers in IDR plans may end up paying for a longer time

Although current monthly payment amounts may be more salient to many borrowers than future payments or total costs, there are other real benefits to paying off a loan over a shorter period of time. Carrying outstanding student debt may affect borrowers’ ability and willingness

⁴⁶ Consumer Financial Protection Bureau (CFPB). 2013. *CARD Act Report: A review of the impact of the CARD act on the consumer credit card market*. http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf.

to make other financial commitments, such as buying a home or a car, enrolling in graduate school, opening a small business, saving for their children's education, or saving for their own retirement.⁴⁷ Student loan payments are included in debt-to-income ratios that can limit borrowers' access to other credit, and the need to set aside money for student loan payments ties up funds that could have been used in other ways.⁴⁸ Another trade-off of longer repayment periods is that borrowers may find themselves with more inflexible obligations as they get older, such as a mortgage and childcare expenses. Although they may enter repayment during their lowest earning years, their student loan payments may end up being or feeling more burdensome later in life.

Mandatory IDR simplifies the repayment selection process, but there are risks to eliminating all choice

The current repayment plan selection process for federal student loans is far too complex. The number of repayment options and the variation in eligibility requirements, costs, and benefits can be overwhelming, even for otherwise sophisticated borrowers. With so many choices and variables, comparisons can become unwieldy and confusing, and borrowers may end up in plans that do not fit their needs or goals.

Under the existing system, federal student loan borrowers are faced with the following repayment options:⁴⁹

- 10-year standard repayment, where payments are “fixed” at the same amount each month. This is the “default” plan that borrowers are placed in if they do not actively select another plan.
- 10-year graduated repayment, where payment amounts are lower at first and then increase.
- Extended repayment, with repayment periods lasting up to 30 years.⁵⁰ Monthly payments may be either fixed or graduated. Borrowers can qualify if their federal loan debt is sufficiently high.
- Several IDR plans, with varying benefits and eligibility requirements. For more detail, see Figure 1 on p. 4.
 - Income-Based Repayment (Classic IBR) for borrowers who took out loans before July 2014: monthly payment amounts are 15% of discretionary income, and remaining balances are discharged after 25 years of qualifying payments.
 - Income-Based Repayment (2014 IBR) for borrowers who first took out loans on or after July 1, 2014: monthly payments are 10% of discretionary income, and remaining balances are discharged after 20 years of qualifying payments.

Carrying outstanding student debt may affect borrowers' ability and willingness to make other financial commitments.

⁴⁷ Consumer Financial Protection Bureau (CFPB). 2013. *Student Loan Affordability: Analysis of Public Input on Impact and Solutions*. http://files.consumerfinance.gov/f/201305_cfpb_rfi-report_student-loans.pdf. Federal Reserve Bank of New York. April 17, 2013. “Young Student Loan Borrowers Retreat from Housing and Auto Markets.” <http://bit.ly/lizd1Jw>. Kim, Dongbin and Therese S. Eyermann. 2006. “Undergraduate Borrowing and Its Effects on Plans to Attend Graduate School Prior to and After the 1992 Higher Education Act Amendments,” *Journal of Student Financial Aid* 36(2): Article 1. <http://publications.nasfaa.org/jsfa/vol36/iss2/1>.

⁴⁸ Lee, Donghoon. Federal Reserve Bank of New York. 2013. Presentation for Press Briefing. “Household Debt and Credit: Student Debt.” <http://www.newyorkfed.org/newsevents/mediaadvisory/2013/Lee022813.pdf>. National Association of Realtors. June 18, 2012. Blog post. “Impact of Student Debt on Future Housing Demand.” <http://economistsoutlook.blogs.realtor.org/2012/06/18/impact-of-student-debt-on-future-housing-demand/>. Young Invincibles. 2012. *Denied? The Impact of Student Debt on the Ability to Buy a House*. <http://bit.ly/KhNurg>.

⁴⁹ See <http://studentaid.ed.gov/repay-loans/understand/plans> for more information about these options.

⁵⁰ In this paper, the term “extended repayment” refers to repayment plans of longer than 10 years. For more information, see U.S. Department of Education, “Extended Plan,” <http://studentaid.ed.gov/repay-loans/understand/plans/extended>, and “Standard Plan – Monthly Payments for Consolidation Loans,” <http://studentaid.ed.gov/repay-loans/understand/plans/standard>.

Before imposing a single repayment plan on all federal loan borrowers, in all situations, it is crucial to understand how eliminating choice might affect borrowers.

- Pay As You Earn (PAYE): monthly payments are 10% of discretionary income, and remaining balances are discharged after 20 years of qualifying payments. Only Direct Loans are covered and borrowers must have taken out loans after a certain time period to qualify.
- Income-Contingent Repayment (ICR): monthly payments are the lesser of 20% of discretionary income or the 12-year repayment amount multiplied by an “income percentage factor,” and remaining balances are discharged after 25 years of qualifying payments.

Researchers have found that having too many choices can reduce the odds of an optimal outcome.⁵¹ Consumers (in this case, borrowers) faced with a large set of choices may experience cognitive overload, particularly if the options seem similar. As a result, they may make a suboptimal choice or not make any decision at all.

Mandatory IDR would eliminate the need to understand, compare, and choose to enroll in a specific plan. However, removing all choice has risks as well, such as the potential for borrowers to pay much more over the life of their loans, as described above; and eliminating the borrower’s ability to prioritize minimizing monthly payment amounts, minimizing total time to repayment, and/or minimizing the total cost of the loan based on personal preferences and circumstances.

Before imposing a single repayment plan on all federal loan borrowers, in all situations, it is crucial to understand how eliminating choice might affect borrowers. Only a limited amount of data on enrollment by repayment plan is currently available,⁵² and many issues are still unknown. For example:

- How do borrowers choose repayment plans? How often do they switch? What information affects their decisions, and how?
- What are the characteristics of borrowers in different repayment plans (e.g., debt amounts, incomes, household sizes, length of time in repayment, type of program/school attended, ages, race/ethnicity)?
- How are borrowing decisions affected by different aspects of the student loan system, such as the interest rate, monthly payment amounts, total payment amounts, likelihood of delinquency or default, potential for negative amortization, and availability of loan forgiveness?
- What share of borrowers is expected to pay more in total under an existing IDR plan than under standard 10-year repayment? How much more, and for which groups of borrowers?
- What is the repayment status of borrowers in IDR plans compared to those in other plans? What share of borrowers in each plan is making scheduled payments (not 90 or more days delinquent), in forbearance, in deferment, 90 or more days delinquent, or in default? What share of borrowers in delinquency or default is enrolled in each repayment plan?

⁵¹ For more information about the behavioral economics research on consumer choices, see the paper in this series from Angela Boatman, Brent Evans, and Adela Soliz. See also Cronqvist, Henrik and Richard H. Thaler. 2004. “Design Choices in Privatized Social-Security Systems: Learning from the Swedish Experience.” *American Economic Review* 94 (2): 424-428. <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.174.3079&rep=rep1&type=pdf>. Iyengar, Sheena S. and Mark R. Lepper. 2000. “When Choice is Demotivating: Can One Desire Too Much of a Good Thing?” *Journal of Personality and Social Psychology* 79 (6): 995-1006. http://www.columbia.edu/~ss957/articles/Choice_is_Demotivating.pdf.

⁵² See U.S. Department of Education, Federal Student Aid. “Federal Student Loan Portfolio.” <http://studentaid.ed.gov/about/data-center/student/portfolio>.

- When do borrowers default? How often do they re-default after rehabilitation? What are the characteristics of borrowers who default?

Income documentation challenges

Making IDR the default or only repayment plan also poses a number of implementation challenges that would need to be addressed.

To automatically enroll borrowers in IDR and automatically adjust their payments in response to changes in annual income, the Department of Education would need access to their tax records or other income information for the life of the loan. One potential mechanism would involve requiring borrowers to provide such access via the promissory note, as a condition of the loan. Borrowers' permissions could last for the entire repayment period or a smaller number of years,⁵³ but what would happen to borrowers who decline or forget to renew their permissions? Access for just the first year of repayment would facilitate automatic enrollment but not address the need to update income information at least annually. However, a proposal to require all federal student loan borrowers to provide pre-emptive, indefinite access to their tax information would likely generate significant political and policy concerns.

Regardless of whether enrollment in IDR is by default, mandate, or opt-in as it is today in the U.S., the process for capturing borrowers' income information needs to be improved and simplified. For example, we have recommended that borrowers have the option of giving the Department of Education access to multiple years of tax data to mitigate the current need for annual income certification.⁵⁴ Several limitations of the current system, described below, could hinder attempts to streamline the process if not addressed.

Currently, U.S. borrowers have to provide their income information to apply for IDR plans. Those already making income-driven payments are required to provide updated income documentation every year to continue making such payments; otherwise the monthly payment is increased to a 10-year standard payment.⁵⁵ Some borrowers can electronically transfer their tax information into an online form via the IRS' Data Retrieval Tool (DRT), which has greatly streamlined the application and income recertification process.⁵⁶ However, borrowers who recently filed a 1040 form may have to wait from two to 11 weeks to be able to use the DRT, depending on whether they filed electronically or by mail.⁵⁷ Additionally, certain types of borrowers cannot use the DRT due to their tax filing status.⁵⁸ Others cannot use the tool because they earn too little to

⁵³ For example, Direct Loan borrowers were formerly able to authorize the Internal Revenue Service (IRS) to disclose certain tax return information to the Department and its contractors, for a period of five years. This form (OMB No. 1845-0017) is no longer in use. See U.S. Department of Education, "William D. Ford Federal Direct Loan Program Income Contingent Repayment Plan & Income-Based Repayment Plan Consent to Disclosure of Tax Information," <http://loanconsolidation.ed.gov/forms/icr.pdf>.

⁵⁴ TICAS. 2013. *Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success*. http://www.ticas.org/pub_view.php?id=873. P. 63.

⁵⁵ If borrowers do not provide the required income documentation, their monthly payments will be based on their debt when they entered Classic IBR, 2014 IBR, or PAYE. Additionally, any unpaid accrued interest will capitalize, which may increase the total cost of the loan. Borrowers can remain in Classic IBR, 2014 IBR, or PAYE and return to making income-based payments if they eventually provide the required documentation.

⁵⁶ For more information about how the IRS Data Retrieval Tool can be used with the electronic IBR/PAYE/ICR application, see <http://1.usa.gov/LF9WfQ>. The IRS Data Retrieval Tool can also be used to provide information for the FAFSA (Free Application for Federal Student Aid).

⁵⁷ U.S. Department of Education. "Filling Out the FAFSA: When will my tax return information be available using the IRS DRT?" <http://studentaid.ed.gov/afsa/filling-out#when-irs-drt>.

⁵⁸ Borrowers cannot use the IRS Data Retrieval Tool if they file taxes as "Married Filing Separately" or "Head of Household;" file an amended tax return, a Puerto Rican tax return, or a foreign tax return; or changed marital status since December 31 of the prior year. For more about the limitations, see <https://fafsa.ed.gov/help/irshlp10.htm>. These limitations apply to the tool's use for FAFSA completion and for IDR application and annual income confirmation.

Mandatory IDR must not inadvertently create a safe haven for colleges that fail to serve their students well, or reduce pressures on governments and colleges to make college more affordable.

owe federal income tax; the DRT is not designed to pull earnings data from W-2 or 1099 forms. Borrowers who are blocked from using the DRT must provide a paper copy of their tax form or a tax return transcript. Those who don't file a 1040 or need to provide more recent income information than their latest tax return reflects must use a more burdensome "alternative documentation of income" process.⁵⁹

Default or mandatory IDR should not create additional burdens or present additional obstacles for those with the fewest resources. Any system for gathering income information would have to be designed to account for different types of borrowers and employment, and ensure appropriate payment amounts. See "Trade-offs and Challenges of Passive Student Loan Repayment" for a discussion of the implementation issues related to the potential use of paycheck withholding within IDR.

Implications for college accountability and costs

Mandatory IDR could also have larger implications for college accountability and costs. For the sake of both students and taxpayers, mandatory IDR must not inadvertently create a safe haven for colleges that fail to serve their students well, or reduce pressures on governments and colleges to make college more affordable.

Accountability

Currently, the federal government uses "cohort default rates," or CDRs, as one key factor to assess colleges' eligibility to participate in federal grant and loan programs. CDRs measure the share of a school's federal loan borrowers who default within the first few years of repayment. CDRs are currently the primary way colleges are held accountable for student outcomes. Colleges where many borrowers default are considered too great a risk for further federal investment and lose their eligibility for federal aid.

As discussed above, lowering borrowers' monthly payments should help reduce their likelihood of default. This is a major benefit of IDR, whether voluntary or mandatory, because the consequences of defaulting on a federal student loan are so severe. With individual borrowers less likely to default, expanded or mandatory participation in IDR would in turn be expected to reduce college CDRs. However, this college-level change would occur *for reasons unrelated to how well any college is serving its students*. Therefore, a move to mandatory participation in IDR would require reforms in our current accountability systems to ensure that colleges that receive taxpayer subsidies meet meaningful standards. Such reforms could include:

- Lowering the threshold for sanctions based on CDRs. Under current rules, colleges do not lose access to federal aid unless their three-year CDRs are 30% or greater for three consecutive years, or unless their CDR is greater than 40% in one year.⁶⁰
- Developing a more robust accountability system to assess borrowers' repayment "wellness" rather than just their most severe distress, in the form of default. Additional measures could include loan repayment rates and/or data on forbearance, delinquency, and economic deferments.

⁵⁹ U.S. Department of Education. 2012. Presentation at Federal Student Aid Conference. "Income-Driven Repayment Plans & Public Service Loan Forgiveness." <http://1.usa.gov/1b3Ecwl>.

⁶⁰ U.S. Department of Education, Federal Student Aid. 2013. "Cohort Default Rate Guide." <http://ifap.ed.gov/DefaultManagement/guide/attachments/CDRMasterFile.pdf>. Colleges with very low borrowing rates are not subject to sanctions, and there are other specific circumstances under which colleges can file challenges, adjustments, and appeals to their CDRs.

- Lengthening the window of time during which default rates are measured, for either disclosure or accountability purposes.

Costs

Additionally, IDR's promise of more manageable payments after college must not relieve pressure on colleges, states, or the federal government to keep prices down and provide upfront grant aid to lower income students. The past decade has seen an increasing concentration of the costs of higher education on individual students and their families due to cuts in public support.^{61,62} In fact, net tuition revenue as a share of total educational costs at public colleges increased from 30% in FY2002 to almost half (47%) in FY2012.⁶³ Since the assurance of manageable payments could draw attention away from the costs students are asked to cover, mandatory IDR could make it easier for states and public colleges to continue shifting a growing share of their costs onto individual students and families. For example, a recent proposal in the Washington legislature would replace the state's need-based grant program with a financial obligation requiring income-driven payments for 21 years or until the tuition the student would have incurred is paid off, whichever comes first.⁶⁴ See "Human Capital Contracts: Debt by Another Name" for more about such risks.

The best way to support access, success, and affordability for low-income students is to reduce the price of college, either directly or indirectly through grant aid. As mentioned in "Comparative Perspective: Income-Driven Repayment in Australia and the United Kingdom," the U.K. and Australia did not implement their universal IDR systems with access or success as the goal, and there were no resulting increases in low-income enrollment. In contrast, studies have found that grants are more effective than loans in increasing enrollment and completion,⁶⁵ and that need-based grant aid in particular increases college enrollment among low- and moderate-income students and reduces their likelihood of dropping out.⁶⁶

⁶¹ See, for example: Center on Budget and Policy Priorities (CBPP). 2013. *Recent Deep State Higher Education Cuts May Harm Students and the Economy for Years to Come*. <http://www.cbpp.org/files/3-19-13sfp.pdf>. State Higher Education Executive Officers (SHEEO). 2013. *State Higher Education Finance: FY 2012*. <http://bit.ly/M0CqAK>. Delta Cost Project at American Institute for Research (AIR). 2012. *Spending, Subsidies, and Tuition: Why Are Prices Going Up? What are Tuitions Going to Pay For?*

⁶² Although a recent survey found a small increase in state spending for higher education between FY2013 and FY2014, allocated state support still remains below pre-recession levels and the change in spending varies considerably by state. See Grapevine, Illinois State University with SHEEO. 2014. "Grapevine - Summary Tables, Fiscal Year (FY) 2013-14." <http://grapevine.illinoisstate.edu/tables/index.htm>. Table 1.

⁶³ State Higher Education Executive Officers (SHEEO). 2013. *State Higher Education Finance: FY 2012*. <http://bit.ly/M0CqAK>. Figure 4.

⁶⁴ See bill text and bill digest of Washington State Legislature, House Bill 2619. <http://apps.leg.wa.gov/billinfo/summary.aspx?bill=2619&year=2013>.

⁶⁵ Li, Dai. 2008. "Degree Attainment of Undergraduate Student Borrowers in Four-Year Institutions: A Multilevel Analysis." *Journal of Student Financial Aid*. Vol. 37, No. 3. <http://bit.ly/14HbrxP>. Moore, Robert L., A.H. Stuenkel, and Thomas Slobko. 1991. "The Effect of the Financial Aid Package on the Choice of a Selective College." *Economics of Education Review*. Vol. 10, No. 4.

⁶⁶ Castleman, Benjamin and Bridget Terry Long. 2013. "Looking Beyond Enrollment: The Causal Effect of Need-Based Grants on College Access, Persistence, and Graduation." National Bureau of Economic Research Working Paper 19306. <http://www.nber.org/papers/w19306.pdf>. Goldrick-Rab, Sara, Douglas N. Harris, Robert Kelchen, and James Benson. 2012. "Need-Based Financial Aid and College Persistence: Experimental Evidence from Wisconsin." <http://bit.ly/12iY97R>. Bettinger, Eric. 2010. "Need-Based Aid and Student Outcomes: The Effect of the Ohio College Opportunity Grant." <http://www.sesp.northwestern.edu/docs/need-based-aid-why.pdf>. Chen, Rong and Stephen L. DesJardins. 2008. "Exploring the Effects of Financial Aid on the Gap in Student Dropout Risks by Income Level." *Research in Higher Education* 49 (1): 1-18. Bettinger, Eric. 2004. "How Financial Aid Affects Persistence." National Bureau of Economic Research Working Paper 10242. Heller, Donald. 2003. "Informing Public Policy: Financial Aid and Student Persistence." WICHE. <http://www.wiche.edu/info/publications/InformingPublicPolicy.pdf>. Kane, Thomas J.. 2003. "A Quasi-Experimental Estimate of the Impact of Financial Aid on College-Going." National Bureau of Economic Research Working Paper 9703. Seftor, Neil S. and Sarah E. Turner. 2002. "Back to School: Federal Student Aid Policy and Adult College Enrollment." *The Journal of Human Resources* 37 (2): 336-352. Heller, Donald E.. 1997. "Student Price Response in Higher Education: An Update to Leslie and Brinkman." *The Journal of Higher Education* 68 (6): 624-659.

WHY PROGRAM DESIGN MATTERS

This paper focuses on the broad implications of mandatory income-driven repayment (IDR) and/or passive repayment of federal student loans. While there are many trade-offs and challenges to consider at the conceptual level, the impact on borrowers, taxpayers, and college affordability also depends on key aspects of how such programs and related systems are designed.⁶⁷

For example, the consequences of making IDR the default or only repayment option are shaped by how much students and families can or need to borrow in the first place, as well as characteristics of the loans themselves. The interest rate on student loans can affect borrowers' monthly and total payments in IDR plans, as well as the importance of the length of the repayment period and availability of loan forgiveness.⁶⁸

To illustrate the effect of interest rates on total payments, consider Borrower A, a single borrower with \$29,400 in federal loans.⁶⁹ She earns \$35,000 in adjusted gross income (AGI) in her first year of work, and her income increases 4% a year.⁷⁰ Unless otherwise noted, this example is used throughout this section. For more detail about the borrower examples, see Appendix B.

As shown in Figure 5, if the average interest rate on this borrower's loans were 6.80% rather than 3.86%, this borrower would end up paying 14% (\$5,100) more under the 10-year standard repayment plan, and 46% (\$18,850) more under the Pay As You Earn (PAYE) plan.⁷¹ The borrower would also spend four and a half more years in repayment under PAYE if her loans had the higher interest rate (20 years vs. 15 years and 5 months).



⁶⁷ For more information about TICAS' comprehensive proposals for student aid reform, including specific proposals around federal loans and repayment, see TICAS. 2013. *Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success*. http://www.ticas.org/pub_view.php?id=873.

⁶⁸ For example, if there is no interest charged above inflation, the length of the repayment period has less of an effect on how much borrowers end up paying.

⁶⁹ \$29,400 was the average total student loan debt (including both federal and private loans) for borrowers who graduated with bachelor's degrees in academic year 2011-12. 71% of bachelor's degree recipients that year had student debt. See TICAS. 2013. *Student Debt and the Class of 2012*. <http://projectonstudentdebt.org/files/pub/classof2012.pdf>.

⁷⁰ Note that both monthly payments and total costs are affected by a multitude of factors specific to the borrower, including his or her debt amount, household size, and income trajectory over the repayment period.

⁷¹ 6.80% was the interest rate on new unsubsidized Stafford loans taken out during the 2012-13 year. 3.86% is the interest rate on new subsidized and unsubsidized undergraduate Stafford loans taken out during the 2013-14 year.

It is also necessary to carefully consider the design features of an IDR plan, and how they would likely affect outcomes for borrowers and other stakeholders. These elements differ across currently available IDR plans in the U.S., as well as IDR programs in other countries. See Figure 1 in the “Context and Approach” section and Figure 2 in the “Comparative Perspective: Income-Driven Repayment in Australia and the United Kingdom” section for more information. Important features include:

- 1. Which borrowers and which loans are eligible for repayment under the plan.** For example, the Pay As You Earn (PAYE) plan in the U.S. is only available to borrowers with loans disbursed during a certain time period who also have relatively high debt compared to their income. In addition, PAYE only covers certain types of loans.
- 2. How interest accrues, and whether and when interest capitalizes** (i.e., is added to the principal balance). For example, under Classic Income-Based Repayment (IBR), 2014 IBR, and PAYE, unpaid accrued interest capitalizes when borrowers no longer qualify to make income-based payments due to increases in income or decreases in family size.⁷²
- 3. How the monthly payment is calculated:** the percentage of income (flat or sliding scale), how income is defined (gross income, adjusted gross income/AGI, discretionary income, or another measure), and whether there is a minimum (non-zero) or maximum monthly payment amount. For example, monthly payments under PAYE are calculated as 10% of discretionary income (defined as AGI minus 150% of the poverty level), capped at the 10-year standard payment amount. The minimum payment is \$0.
- 4. Whether there is an income threshold below which borrowers are not required to make payments, what that threshold is, and whether it adjusts for household size.** For example, in Classic IBR, 2014 IBR, and PAYE, borrowers do not have to make payments until their AGI exceeds 150% of the federal poverty guideline for their family size. That amount of income is also excluded from the calculation of monthly payment amounts. Australia uses a higher income threshold before borrowers have to make payments, but it does not adjust for family size.
- 5. How easy it is for borrowers to prepay their loans if they are able to, and how prepayments are treated.** For example, in Classic IBR, 2014 IBR, and PAYE there is no penalty for prepayment. Any excess payments are first applied to accrued interest, then outstanding fees, then principal.
- 6. Whether remaining loan balances are discharged after a certain number or years of qualifying payments, how many years or payments are required, and which payments qualify** (e.g., calculated \$0 monthly payments or payments made before consolidation). For example, remaining loan balances are discharged after 20 years of qualifying payments under PAYE. In contrast, there is no maximum repayment period in the Australian IDR system, so borrowers have to continue making payments until their loan is entirely paid off or until they die.

⁷² In this situation, borrowers' monthly payments will be the amount they would have paid under the 10-year standard repayment plan at the time they entered Classic IBR, 2014 IBR, or PAYE, also called the “permanent standard” amount. Borrowers can remain in Classic IBR, 2014 IBR, or PAYE and return to making income-based payments if their income drops or family size increases.

7. **Whether discharged amounts are treated as taxable income.** For example, amounts discharged under IDR plans in the U.S. are treated as taxable income, though amounts discharged under the Public Service Loan Forgiveness program are not.
8. **Whether the benefits of the program are targeted to borrowers who need help the most.** For example, the Australian IDR system sets monthly payments using a sliding scale for borrowers with incomes above the repayment threshold. Higher earners pay a larger percentage of their total taxable income (up to 8%). There is also a sliding scale in Classic IBR, 2014 IBR, and PAYE in the U.S., due to the income exclusion and calculation of discretionary income, but those plans cap payments in ways that can leave high-income borrowers paying a lower percentage of their total taxable income than other borrowers. See pp. 25-28 for a description of TICAS’ proposal to better target IDR benefits.

The following examples illustrate how much these features of an IDR plan can affect costs for borrowers.

Calculation of monthly payment as certain percentages of income

Figures 6 and 7 illustrate the differences in monthly and total payment amounts between an IDR plan that calculates monthly payments as 15% of discretionary income and a plan that calculates monthly payments as 10% of discretionary income. “Discretionary income” is defined here as the amount of adjusted gross income (AGI) above 150% of the poverty level for the borrower’s household size.⁷³ This example assumes both plans have a 20-year repayment period,⁷⁴ though in both cases the borrower ends up paying off her loans in less than 20 years. Again, Borrower A has \$29,400 debt and a \$35,000 starting AGI, increasing 4% a year. The average interest rate on her loans is 6.8%.

This borrower’s monthly payment would be 47% (\$70) higher if it were 15% of her discretionary income rather than 10%. However, she would end up paying less in total under the 15% plan.



⁷³ This is the definition of “discretionary income” used by the Classic IBR, 2014 IBR, and PAYE plans. Classic IBR (for borrowers who took out loans before July 1, 2014) sets monthly payments as 15% of discretionary income, while PAYE and 2014 IBR set monthly payments as 10% of discretionary income.

⁷⁴ Note that the actual IBR plan available to those who started borrowing before July 2014 (Classic IBR) has a 25-year repayment period.

FIGURE 7:
**Borrower pays less in total under
 15% plan than 10% plan⁷⁵**



Income threshold for payments

Currently, Classic IBR, 2014 IBR, and PAYE include an “income exclusion” that is used to calculate discretionary income and also serves as a threshold below which borrowers are not required to make payments (i.e., the calculated monthly payment is \$0). For all three programs, the income exclusion is 150% of the poverty level for the borrower’s household size.

People with incomes below 150% of poverty (e.g., \$17,505 for a single person in 2014)⁷⁶ are unlikely to be able to afford to make any student loan payments, because they have little or no income after paying for necessities such as housing, food, and transportation. Lowering the amount of income protected would increase the monthly payment amount for most borrowers, and could lead to unaffordable payments for borrowers with low incomes.⁷⁷ Borrowers with very high incomes, however, have so much discretionary income that the income exclusion is unnecessary. Removing or changing the income exclusion can also affect how much borrowers end up paying over the life of the loan.

Additionally, the income exclusion in Classic IBR, 2014 IBR, and PAYE allows monthly payments to rise gradually with a borrower’s income. This prevents the “cliff effect” that occurs in systems where there is a repayment threshold, but income below the threshold is not excluded from the calculation of IDR payments. Under such systems, borrowers just above the repayment threshold may be abruptly required to repay a sizeable share of their total income.

⁷⁵ This figure illustrates total amounts paid in current dollars and then discounted at a 2.4% annual rate, the projected average annual increase in the Consumer Price Index over the next 20 years. This calculation does not apply a discount rate above inflation, which will depend on external factors such as federal interest rates and the borrower’s personal preferences for having more money now or in the future. Note that economists and government agencies vary in the discount rates they apply in their calculations and may apply different discount rates for different years.

⁷⁶ Calculations by TICAS using data from the U.S. Department of Health and Human Services. “2014 Poverty Guidelines.” <http://aspe.hhs.gov/poverty/14poverty.cfm>.

⁷⁷ For a recent example of a mandatory IDR proposal with no income threshold or exclusion, see Dynarski, Susan and Daniel Kreisman. 2013. *Loans for Educational Opportunity: Making Borrowing Work for Today’s Students*. The Hamilton Project, The Brookings Institution. http://www.hamiltonproject.org/files/downloads_and_links/THP_DynarskiDiscPaper_Final.pdf.

The examples below are based on Borrower A, who has \$29,400 debt and a \$35,000 starting AGI, increasing 4% a year. As shown in Figure 8, this borrower's monthly payments would be almost twice as high under Pay As You Earn (PAYE) without the income exclusion. If she could actually afford the much larger monthly payments, this particular borrower would end up paying thousands less over the life of the loan, as illustrated in Figure 9.

FIGURE 8:
Borrower pays much more per month under PAYE without the income exclusion

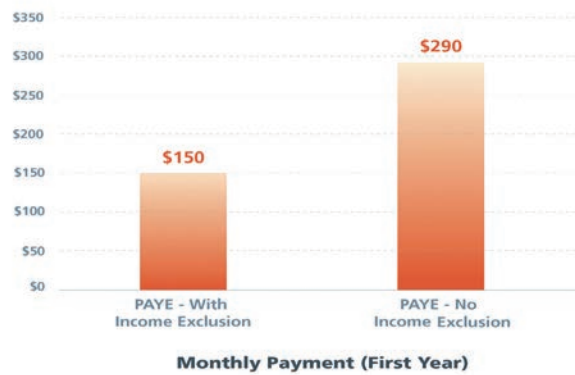
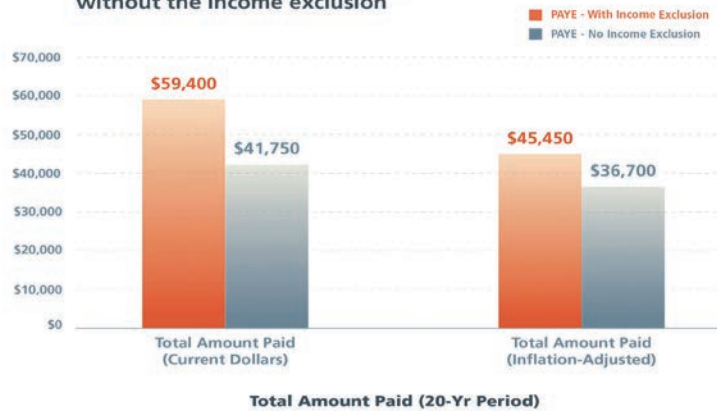


FIGURE 9:
Borrower pays less in total under PAYE without the income exclusion



Length of the repayment period

Beyond the calculation of monthly payment amounts, how long borrowers are required to make such payments can greatly affect their total cost, as well as their ability and willingness to make other financial and personal commitments, as discussed in "Trade-offs and Challenges of Mandatory Income-Driven Repayment." Classic IBR, 2014 IBR, and PAYE all include a "light at the end of the tunnel:" a maximum repayment period after which remaining debt, if any, is discharged. As discussed earlier, a trade-off of making lower payments over a longer period of

time is that accrued interest leads to higher total costs, especially if repayment periods are very long or unlimited.⁷⁸

In the example below, Borrower B is a single borrower who has \$29,400 in federal debt, earns \$30,000 AGI in the first year with increases of 4% a year, and has an average interest rate of 6.8% on his loans. His monthly payments are set at 10% of discretionary income.

As shown in Figure 10, Borrower B would pay \$20,000 (44%) more in current dollars under this 10% plan if the repayment period were 25 years rather than 20 years. After adjusting for inflation, the borrower would pay more than \$11,000 more.⁷⁹



Taxation of discharged amounts

As discussed above, discharging remaining debt after a certain number of qualifying payments helps contain the actual and perceived risk of accruing more interest over the life of the loan under IDR than under other repayment plans. However, this benefit is severely undermined if discharged loan balances are treated as taxable income.

Under current law, debt discharged under the existing IDR plans is taxable, while debt discharged under the Public Service Loan Forgiveness program is not.⁸⁰ Borrowers who have low incomes at the end of their repayment period and have remaining debt discharged may face unaffordable tax penalties. For example, consider Borrower C, a single borrower with \$29,400 in federal debt, earning \$25,000 AGI in the first year with income increases of 4% a year.⁸¹

⁷⁸ Total costs can be even higher if unpaid accrued interest capitalizes during the course of repayment. This occurs under Classic IBR, 2014 IBR, and PAYE if borrowers have unpaid accrued interest and no longer qualify to make income-based payments due to increases in income or decreases in family size. Borrowers with lower incomes for a longer period of time are more likely to have large amounts of outstanding interest, so interest capitalization would greatly increase the size of their loan balance and the length of time it would take them to repay it in full. As such, limiting the IDR repayment period helps to contain the risk of making higher total payments for those borrowers.

⁷⁹ This calculation does not apply a discount rate above inflation, which will depend on external factors such as federal interest rates and the borrower's personal preferences for having more money now or in the future. Note that economists and government agencies vary in the discount rates they apply in their calculations and may apply different discount rates for different years.

⁸⁰ Recent proposals by the Obama Administration and a bipartisan group of representatives would prevent debt discharged under IDR plans from being considered taxable income. For more information, see U.S. Department of the Treasury, 2014, *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals*, <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf>, p. 149, and H.R. 2492, <http://beta.congress.gov/bill/111th/house-bill/2492>.

⁸¹ For more information about this borrower, see Appendix B.

He is enrolled in PAYE and his loans have an average interest rate of 6.8%. After 20 years of responsible payments, his remaining loan balance of \$38,550 (current dollars) is discharged.⁸² His federal tax liability on that discharged amount would be an estimated \$9,650, more than doubling his overall tax bill.⁸³ Borrowers who are unable to pay their full tax liability in one year face additional costs due to IRS penalties and interest that accrues on the unpaid amount.⁸⁴ The engineer of Australia's IDR system believes that the taxation of discharged debt undermines the policy goal of managing borrowers' risk through IDR, that it "actually can increase the burden of risk on borrowers when ICL [income-contingent loan repayment] is supposed to do the opposite."⁸⁵

Targeting of benefits

The particular design of an IDR plan affects how differently situated borrowers may benefit. For example, while PAYE (as currently designed) can substantially reduce monthly payment amounts for low-income borrowers, it can also allow some high-debt, high-income borrowers to pay a smaller share of their incomes than other borrowers and receive substantial loan forgiveness when they could have afforded to pay more.

To better target IDR benefits in the U.S., we have proposed:⁸⁶

- 1. Gradually phasing out the income exclusion for higher income borrowers.** Borrowers with very high incomes can spend a larger share of total income on loan payments and still have sufficient funds to cover basic necessities, such as food and housing. The income exclusion would remain 150% of the poverty level, accounting for household size, up to an AGI of \$100,000. At an AGI of \$101,000, the percentage of poverty used to calculate the income exclusion would decrease by 1 percentage point and continue decreasing by 1 percentage point for each \$1,000 of AGI above \$100,000 until it reaches 0% at an AGI of \$250,000. For example, at an AGI of \$101,000, the income exclusion would be 149% of poverty; at an AGI of \$102,000, the income exclusion would be 148% of poverty; and so forth. The AGI level at which the income exclusion phase-out begins would be indexed to inflation.
- 2. Removing the standard payment cap on monthly payment amounts.** The way monthly payments are capped in Classic IBR, 2014 IBR, and PAYE results in some high-income borrowers paying a smaller share of their income than lower income borrowers.⁸⁷ We propose capping monthly payments at 10% of discretionary income (calculated with the phase-out described above) rather than at the "permanent standard" payment amount. The Administration and others have also proposed eliminating the standard payment cap so that borrowers in IDR plans are always making

⁸² The borrower's AGI when remaining debt is discharged (year 21) is \$54,800 in current dollars (\$34,400 in 2014 dollars). His total payments made under PAYE are less than under 10-year standard repayment: \$30,800 compared to \$40,600 in current dollars.

⁸³ Calculations by the Tax Policy Center. The borrower's federal tax liability would increase from an estimated \$7,050 to \$16,700 due to the discharged debt. All figures are in current dollars, rounded to the nearest \$50.

⁸⁴ While borrowers may be able to repay unmanageable tax obligations through a six-year installment plan, they will still incur penalties and fees as well as interest, and face the new risk of defaulting on debt owed to the IRS. See <http://www.irs.gov/Individuals/Payment-Plans,-Installment-Agreements> for more information.

⁸⁵ Bruce Chapman, email correspondence with the authors, January 26, 2014. Cited with the author's permission.

⁸⁶ TICAS. 2013. "TICAS Proposal to Create One Improved Income-Driven Repayment Plan." http://www.ticas.org/pub_view.php?id=906.

⁸⁷ Under current law, the monthly payment amount for Classic IBR, 2014 IBR, and PAYE is calculated as a proportion of the borrower's discretionary income, up to but not exceeding the "permanent standard" amount – the monthly amount the borrower would have had to pay had she entered a 10-year standard repayment plan when she entered Classic IBR, 2014 IBR, or PAYE. Borrowers whose incomes rise above the point where they must start paying the permanent standard amount are, by definition, paying a smaller share of their discretionary income than borrowers making income-based payments.

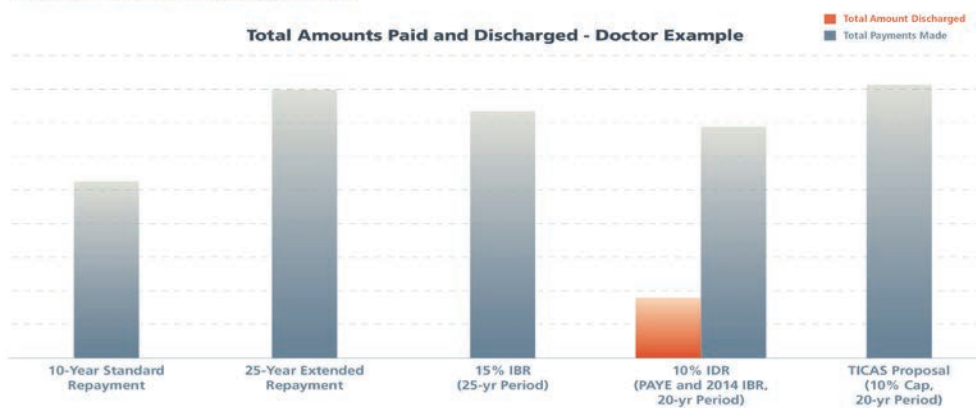
payments based on their income.⁸⁸ By having borrowers with high incomes make larger monthly payments, it better targets benefits and prevents high-debt, high-income borrowers from receiving substantial loan forgiveness when they could have afforded to pay more.

Figures 11-14 illustrate how these targeting proposals would affect certain borrowers. For more detail about these borrowers, including the dollar amounts for monthly payments, total payments, and amounts discharged, see Appendix B.

Borrower D: OB/GYN, married with two children, has \$192,000 in federal loans, earns \$45,000 during 4-year residency and then \$190,000 in private practice, increasing 4% a year. Her household size decreases in years 10 and 15 as children leave home.

As shown in Figure 11, this borrower would repay her loan in full under Classic (15%) IBR. She would pay less in total under PAYE and 2014 IBR and receive more than \$81,000 in loan forgiveness. Under TICAS' targeting proposal, she would pay more in total than under Classic IBR, PAYE, or 2014 IBR, and receive no loan forgiveness. However, she would pay about the same amount, in current dollars, under our targeting proposal as under the 25-year extended repayment plan with fixed payments based only on her loan amount.

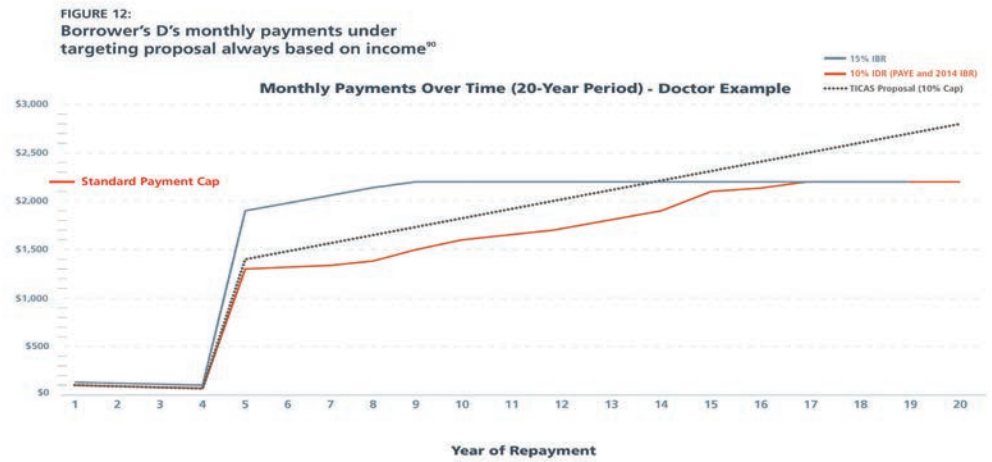
FIGURE 11:
Borrower D pays more and receives no forgiveness under targeting proposal⁸⁹



⁸⁸ For example, see U.S. Department of Education. 2014. *Student Loans Overview: Fiscal Year 2015 Budget Proposal*. <http://www2.ed.gov/about/overview/budget/budget15/justifications/s-loansoverview.pdf>. See also HCM Strategists, IHEP, NASFAA, New America Foundation, and Young Invincibles. 2014. *Automatic for the Borrower: How Repayment Based on Income Can Reduce Loan Defaults and Manage Risk*. <http://bit.ly/1fLB1OK>.

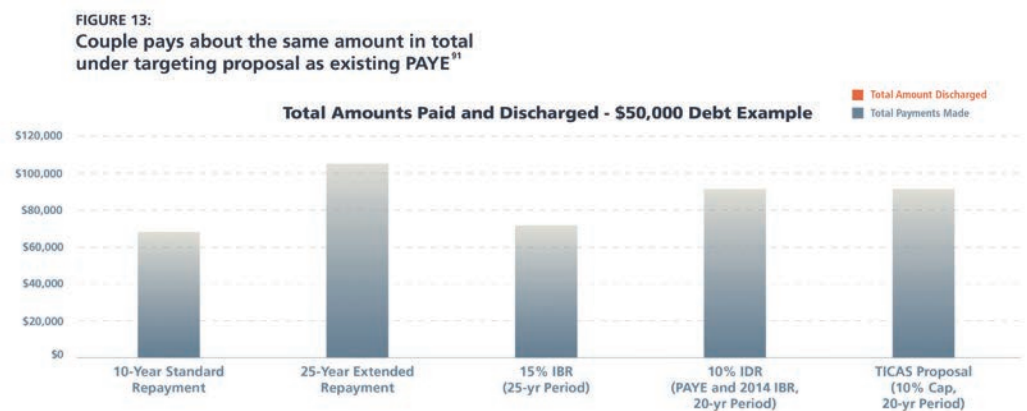
⁸⁹ All figures in this chart are in current dollars. For more detail about this borrower, including inflation-adjusted values for total payments and amounts discharged, see Appendix B.

Figure 12 illustrates how the targeting changes would affect the borrower's monthly payment amounts. The red "standard payment cap" mark at \$2,210 illustrates this borrower's monthly payment amount under the 10-year standard repayment plan, which is the maximum monthly payment under Classic IBR, 2014 IBR, and PAYE. The grey dotted line represents our targeting proposal. It continues rising above the standard-payment cap through the end of the repayment period, though the payments never exceed 10% of the borrower's taxable income.



Borrower E: Married couple, has a child in year 8, \$50,000 in combined federal loans, earns \$60,000 in first year, income increases 4% a year.

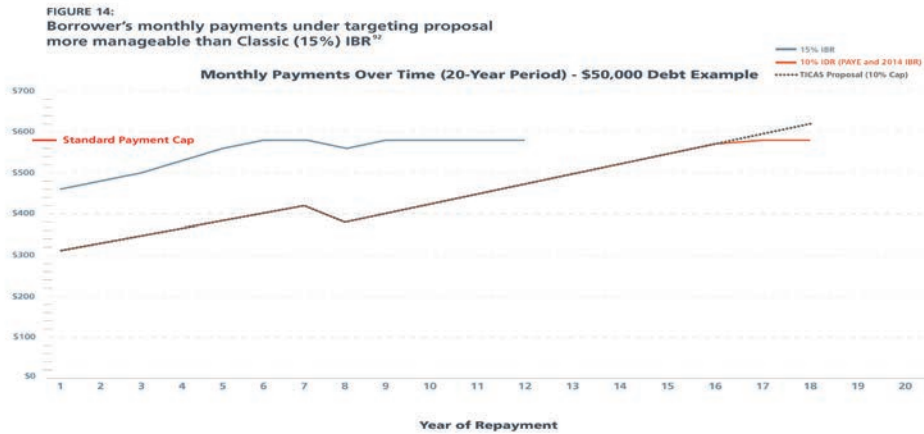
This couple pays *more* in total under PAYE, 2014 IBR, and the TICAS proposal than under Classic IBR, but their monthly payments are more manageable. They repay in full under all plans, as shown in Figure 13.



⁹⁰ The line graph displays the monthly payment amount at the beginning of each year. Generally, the borrower pays the same monthly payment amount for the entire year, unless the loan is repaid during that year.

⁹¹ All figures in this chart are in current dollars. For more detail about this borrower, including inflation-adjusted values for total payments and amounts discharged, see Appendix B.

Figure 14 shows that Borrower E's monthly payment amounts under our targeting proposal are the same as under PAYE and 2014 IBR, except for the last two years of repayment, when the borrower would otherwise have hit the standard payment cap. In all cases, the monthly payment is more manageable than Classic IBR.



TRADE-OFFS AND CHALLENGES OF PASSIVE STUDENT LOAN REPAYMENT

To streamline the process of making student loan payments and to reduce delinquency and default, some have proposed passive repayment systems in which borrowers would not have to initiate payments each month. Often discussed in conjunction with income-driven repayment (IDR), passive repayment can be applied to any type of loan payment. A passive repayment system can also take various forms, from how borrowers get enrolled to how the actual payments are made.

Although passive repayment can simplify the repayment process and help borrowers stay on top of their loan payments in many circumstances, it can also bring risks and complications in others. Here we briefly explore some of the trade-offs and challenges with two different approaches to passive repayment: electronic debit and paycheck withholding.

Electronic debit

In the U.S., borrowers in any federal student loan repayment plan can choose to make automatic payments from their bank accounts to their loan servicers through an “electronic debit account.” Borrowers receive a 0.25% interest-rate reduction while making payments this way.⁹³ In fall 2013, more than two million (about one in five) Direct Loan borrowers were making automatic electronic payments.⁹⁴

⁹² The line graph displays the monthly payment amount at the beginning of each year. Generally, the borrower pays the same monthly payment amount for the entire year, unless the loan is repaid during that year. The line stops at the year when the borrower pays off his/her loan.

⁹³ U.S. Department of Education, Federal Student Aid. “Direct Loans - While You’re in Repayment.” <http://www.direct.ed.gov/inrepayment.htm>. See also “Understanding Repayment,” <http://studentaid.ed.gov/repay-loans/understand>, and “Parents,” <http://www.direct.ed.gov/parentrepay.html>.

⁹⁴ U.S. Department of Education, email correspondence with TICAS, December 19, 2013.

Making paycheck withholding the default or only way to remit student debt payments would pose particular risks to borrowers with little financial cushion.

Borrowers who choose electronic debit do not have to remember to send monthly loan payments. They also retain the flexibility to adjust their payment amounts as needed, whether making a larger-than-scheduled payment after a financial windfall or freezing payments during a deferment or forbearance. Borrowers receive information about how to sign up when they get their first bill and then must take the initiative to set up the recurring debit. For passive repayment through electronic debit to be effective, borrowers must have a bank account and sufficient funds to cover their loan payments each month.

Paycheck withholding

Some proposals for making IDR the only or default repayment plan include passive repayment through paycheck withholding by the borrower's employer, with the goal of simplifying the repayment process and/or reducing defaults.⁹⁵ One existing model is Australia's universal IDR system for student loans, which relies primarily on payments that are withheld from a borrower's paycheck and remitted to the national tax authority, where they are ultimately applied to the borrower's annual student loan obligation.⁹⁶ Paycheck withholding for student loan payments operates similarly in the U.K.⁹⁷

Making paycheck withholding the default or only way to remit student debt payments would pose particular risks to borrowers with little financial cushion. The forced prioritization of student debt over other expenses reduces the flexibility to respond to changing circumstances. For example, unexpected medical costs, unpaid sick days, or a car breakdown might require a reallocation of funds that are earmarked for student loan payments; a rate increase on a private student loan or a rent hike could alter a borrower's financial situation for months or years. Even if enrolled in an IDR plan, borrowers might not always be able to cover their loan payments because of costs that cannot be perfectly factored into a repayment formula. The risks are greater in countries where the social safety net is relatively thin, as it is in the U.S. compared to Australia or the U.K.

The benefits and risks of paycheck-based passive repayment will vary based on conditions such as the borrower's financial, employment, and tax-filing status.⁹⁸ The extent to which employer withholding streamlines or complicates the repayment process depends on whether borrowers are working full-time or part-time, all year or part of the year, and one job or multiple jobs. In the U.K. and Australia, self-employed student-loan borrowers must do their own withholding. The way borrowers file taxes can also create complications for passive repayment, as well as whether they have enough money on hand to cover "lumpy" costs like those discussed above.

Figure 15 illustrates two types of borrower circumstances: some well-suited to paycheck withholding as a way to pay student loans, and others in which requiring paycheck withholding would likely add risk and complexity.

⁹⁵ See, for example, HCM Strategists, IHEP, NASFAA, New America Foundation, and Young Invincibles. 2014. *Automatic for the Borrower: How Repayment Based on Income Can Reduce Loan Defaults and Manage Risk*. <http://bit.ly/1fLBIQK>. The Earnings Contingent Education Loans (ExCEL) Act of 2013. Introduced April 24, 2013. <http://beta.congress.gov/bill/113th-congress/house-bill/1716>. NASFAA. 2013. *Reimagining Financial Aid to Improve Student Access and Outcomes*. http://www.nasfaa.org/advocacy/RADD/RADD_Full_Report.aspx. The Hamilton Project. 2013. *Loans for Educational Opportunity: Making Borrowing Work for Today's Students*. <http://bit.ly/1nQLnFe>.

⁹⁶ See "Comparative Perspective: Income-Driven Repayment in Australia and the United Kingdom" for more information.

⁹⁷ Student Loans Company (U.K.). "Student loan repayment: How repayments are made." <http://bit.ly/1kaWILp>.

⁹⁸ There are additional challenges to implementing an automatic passive repayment system where IDR is the default or only repayment option. See "Trade-offs and Challenges of Mandatory Income-Driven Repayment" for more information.

FIGURE 15: SIMPLICITY OF PAYCHECK WITHHOLDING DEPENDS ON BORROWER CIRCUMSTANCES

Paycheck-based passive repayment might simplify the process for borrowers in these circumstances...	But might be complicated for borrowers in circumstances like these.
<ul style="list-style-type: none"> • Employed full time • Has only one employer • Works year round • Files taxes as single or married filing separately • Has money on hand to cover “lumpy” costs (e.g., car repair, rent deposit, hospital bill) 	<ul style="list-style-type: none"> • Employed part time • Works multiple jobs in a year • Works at a seasonal job • Self-employed • Files taxes jointly • Not enough left after monthly bills to cover “lumpy” costs

Requiring employers to be middlemen in the student loan repayment process also creates layers of paperwork and potential for error. Borrowers would have to depend on their employers to make the correct loan payment and change or defer payments when needed. In the U.S., federal loan borrowers must already rely on loan servicers to track and adjust their payments, with uneven results.⁹⁹ Adding employers to the mix would add more uncertainty for borrowers, especially given the variation in the size, type, sophistication, and capacity of employers to handle employees’ student loan issues. Employers would likely face new burdens as well.

Concerns and issues to consider include:

- How would employers be assisted with and held accountable for sending the correct payment, on time?
- How would borrowers be able to correct and protect their payment records and credit reports if a withheld payment were dropped, late, or incorrect?
- Would deferments or forbearances be available to borrowers in certain circumstances, as they currently are for borrowers in IDR plans in the U.S.? If so, how easy would deferments and forbearances be for borrowers to request and employers to implement?
- How would borrowers raise defenses against their debt? Automatic withholdings assume that people actually owe an outstanding debt and the right debt amount, but this will not always be the case.

There are also a number of logistical challenges that would have to be addressed in implementing loan repayment through paycheck withholding. These concerns are not insurmountable, but any passive repayment system must be designed carefully to ensure that it works well for different types of borrowers and employers, as well as for taxpayers.

The logistical challenges of paycheck withholding for student loan payments include:

- How to accommodate the self-employed, seasonally employed, those with multiple jobs, etc.
- How to accommodate joint tax filers.

⁹⁹ See, for example, Runcie, Jim. U.S. Department of Education, Federal Student Aid. December 9, 2013. Letter to Senator Elizabeth Warren. <http://1.usa.gov/18owwTG>. Consumer Financial Protection Bureau. December 3, 2013. Press release. “CFPB to Oversee Nonbank Student Loan Servicers.” <http://1.usa.gov/1dQ143a>. Nasiripour, Shahien. October 22, 2013. “Student Loan Servicing Beset By Problems Faces Calls for Overhaul.” *The Huffington Post*. http://www.huffingtonpost.com/2013/10/22/student-loan-servicing_n_4144760.html. Wang, Marian. April 23, 2012. “Student Loan Borrowers Dazed and Confused by Servicer Shuffle.” *ProPublica*. <http://www.propublica.org/article/student-loan-borrowers-dazed-and-confused-by-servicer-shuffle>.

- How to reconcile overpayments and underpayments, and what penalties are appropriate for underpayments.
- How to collect payments from borrowers who are out of the country for prolonged periods.
- Whether to continue to include student loans in credit reports, and if so, who would report the loan payments.

Addressing the challenges listed above would likely require exceptions and adjustments that undermine the goal of simplification. For example, in the U.K., efforts to avoid overpayments increase the system's complexity as borrowers approach the end of their repayment period. Due to the significant lag time between employer reporting of withheld payments to the U.K. Student Loan Company (SLC) via the Tax Office, students are recommended to switch to sending payments directly to the SLC from their bank accounts for the final 23 months of payment, to avoid overpaying and having to apply for a refund.¹⁰⁰

It is also worth noting that there is a high bar for the types of expenses that can be forcibly withheld from Americans' paychecks, including unpaid child support, back taxes, and *defaulted* federal student loans. The question of whether routine student loan payments should effectively become wage garnishments must be addressed in any discussion of paycheck withholding as the automatic or only form of student loan repayment.

HUMAN CAPITAL CONTRACTS: DEBT BY ANOTHER NAME

While this paper focuses on approaches to repaying federal student loans, another type of financing that uses income-driven payments has recently become part of the public debate about student debt and college affordability. Human capital contracts (HCCs) are financing mechanisms that require payments based on a percentage of the recipient's income for a fixed period of time, but the amount originally financed is not technically a loan because there is no principal or interest to pay down. Since early 2012, proposals to use taxpayer-backed HCCs to help finance public colleges and universities – instead of requiring students to pay tuition up front – have garnered considerable public attention.¹⁰¹ Some businesses have also generated buzz by presenting HCCs as a private-market alternative to student loans.¹⁰²

With the rapid rise in public college tuition and growing concerns about student loan debt, both student and policymaker interest in alternative financing models is not surprising, especially when packaged as a “debt-free degree” with “no up-front costs” for students.¹⁰³ In 2013, the state of Oregon passed a bill to study the feasibility of piloting HCCs for financing public college tuition.¹⁰⁴ In a nod to its roots in a 2012 concept paper from a Washington state think tank,¹⁰⁵ the

¹⁰⁰ Student Loans Company (U.K.). September 20, 2011. “Graduates are being reminded of two options available when they are coming to the end of their loan repayments.” <http://bit.ly/1goodZK>.

¹⁰¹ Abramson, Larry. February 7, 2012. “UC Students Propose Alternative To Tuition Increase.” *NPR*. <http://www.npr.org/2012/02/07/146479925/uc-students-propose-alternative-to-tuition-increases>. Perez-Pena, Richard. July 3, 2013. “Oregon Looks at Way to Attend College Now and Repay State Later.” *The New York Times*. <http://www.nytimes.com/2013/07/04/education/in-oregon-a-plan-to-eliminate-tuition-and-loans-at-state-colleges.html>.

¹⁰² *The Economist*. June 15, 2013. “Start Me Up: Helping Youngsters to Sell Stakes in their Future.” <http://www.economist.com/news/finance-and-economics/21579490-helping-youngsters-sell-stakes-their-future-start-me-up>.

¹⁰³ See, for example: Economic Opportunity Institute. 2013. *Pay It Forward: Debt-Free Access to Higher Education*. <http://www.eoionline.org/education/higher-education/pay-it-forward-debt-free-access-to-higher-education-2/>. See also Fix UC. 2012. *UC Student Investment Proposal*. <http://www.fixuc.org/proposal/>.

¹⁰⁴ See bill text and summary documents for Oregon State Legislature, House Bill 3472. <https://olis.leg.state.or.us/liz/2013R1/Measures/Overview/HB3472>.

¹⁰⁵ Economic Opportunity Institute (EOI). 2012. *Pay It Forward: Refinancing Higher Education to Restore the American Dream*. This report is no longer available on the EOI website but can be found here: http://www.alicelaw.org/uploads/asset/asset_file/1318/EOI_Pay_It_Forward.pdf.

bill's sponsors and supporters called their proposal "Pay It Forward, Pay It Back." Legislation with a Pay-It-Forward theme has since been introduced in several other state legislatures as well as the U.S. House and Senate.¹⁰⁶

Although well intentioned, financing higher education via HCCs does not lead to "debt-free" degrees or eliminate tuition, as often claimed.¹⁰⁷ It simply defers the cost of tuition until the student is no longer in school and finances it with a future financial obligation that is called something other than a loan. This proposed approach could result in higher costs for students and lead states to further reduce their investment in public higher education without the countervailing public pressure that comes in response to tuition hikes.

Key differences between Pay-It-Forward-style HCCs and IDR

Because both HCCs and income-driven repayment (IDR) plans rely on payments tied to a percentage of income, they are sometimes conflated and presented as having the same potential benefits and risks. While there is some overlap, there are also important differences.

Both IDR and HCC payments would be determined by the student's income after leaving school. Unlike IDR, however, HCCs do not involve a fixed amount owed, so the debt obligation cannot be retired before the end of the repayment period (typically 20 years or more). HCCs used for public college tuition also differ from IDR in that they are a higher education funding mechanism and not just a student payment mechanism, and would further erode the shared responsibility between students and taxpayers. After an initial investment from the state, revenues from HCC payments would be relied on to comprise a significant portion of the funding base for public higher education going forward, accelerating the shift from public higher education being financed by a combination of taxpayers across the generations, students, and students' families, to being financed primarily by students themselves. In fact, the initial Pay It Forward proposal called for converting pre-existing state grants for lower income students to HCC contracts.¹⁰⁸

These differences mean that Pay-It-Forward-style HCCs are likely to lead to even higher costs for public college students, especially those who currently depend on state grant aid. The use of HCCs for public college tuition could also have other unintended consequences, including relieving pressure on states to keep tuition down (since institutional budgets would be determined by post-graduate incomes and HCC contract terms, not tuition), and distorting the range of programs that universities offer (to maximize graduates' earnings and thus university revenues).

HCCs also present distinct logistical and actuarial challenges, such as: large up-front program costs before revenues start coming in; coordination with federal aid programs and federal loan repayment plans (for those students with both an HCC for tuition and federal loans to help cover the other costs of being in college, such as books and housing); how to design sound actuarial models that take into account potentially wide fluctuations in students' future earnings; and how to set payment levels that are both manageable for students and large enough to cover unknown future tuition costs.

¹⁰⁶ Pay-It-Forward themed legislation has been introduced in more than 15 states so far, and federal legislation has been introduced in the House and Senate by members of Oregon's delegation, Senator Merkley and Representative Bonamici. Some examples of state bills that have been introduced include SB 192 in Vermont, H 4414 in South Carolina, SB 2001 in Oklahoma, AB 8218 in New York, HB 3631 in Massachusetts, SB 667 in Maine, and AB 1456 in California.

¹⁰⁷ See, for example Dalbey, Beth. March 19, 2014. "'Free' College? Yes, Under Michigan's Pay-It-Forward Tuition Proposal." *Dearborn Patch*. <http://bit.ly/1h3zv5X>. Economic Opportunity Institute. 2014. *Pay It Forward: Debt-Free Access to Higher Education*. <http://bit.ly/OHdv6N>. Oregon Working Families Party. "Debt-Free Higher Education: Pay It Forward." <http://oregonwfp.org/issues/debt-free-higher-education/>. Kim, Susanna. July 5, 2013. "Oregon Lawmakers Pioneer Tuition-Free 'Pay it Forward, Pay it Back' College Plan." *ABC News*. <http://abcnews.com/1pu9LjO>.

¹⁰⁸ A bill recently introduced in Washington to create a "state need pay it forward program" takes a similar approach; it would replace state need-based grants with a hybrid HCC-loan. See bill text and bill digest of Washington State Legislature, House Bill 2619. <http://apps.leg.wa.gov/billinfo/summary.aspx?bill=2619&year=2013>.

NEED FOR MORE RESEARCH AND DATA

Currently available research and data have many gaps that prevent a more thorough and precise assessment of how default or mandatory income-driven repayment (IDR) and/or passive repayment would advance or undermine the goals of college access, success, and affordability. For example, it is crucial to understand more about loan aversion, how borrowers make decisions about student loan repayment plans, and the results of those choices. To ensure that repayment system changes do not impose additional burdens on the neediest populations, we also need more data to inform analyses of how student loan policies might affect borrowers in different circumstances (e.g., demographic and household characteristics, debt amounts, income levels, and types of employment).

Questions for further exploration and research include:¹⁰⁹

- How do perceptions and fears about borrowing affect college-going choices, especially for lower income students? How much do those perceptions have to do with the size of the loan balance, the size of the monthly payment amount, and/or the amount of time it would take to pay off the loan?
- How are borrowing decisions affected by different aspects of the student loan system, such as the interest rate, monthly payment amounts, total payment amounts, likelihood and consequences of delinquency or default, potential for negative amortization, and availability of loan forgiveness?
- How do borrowers choose repayment plans? How often do they switch? What information affects their decisions, and how?
- What are the characteristics of borrowers in different repayment plans (e.g., debt amounts, incomes, household sizes, length of time in repayment, type of program/school attended, ages, race/ethnicity)?
- What share of borrowers is expected to pay more in total under an existing IDR plan than under standard 10-year repayment? How much more, and for which groups of borrowers?
- What is the repayment status of borrowers in IDR plans compared to those in other plans? What share of borrowers in delinquency or default is enrolled in each repayment plan?
- When do borrowers default? How often do they re-default after reentering repayment?
- What are the characteristics of borrowers who default?
- During repayment, what is the relative effect of the size of the monthly loan payment, the size of the loan balance (particularly if negative amortization occurs), and the length of time it takes to repay the loan on borrowers' other financial and personal decisions? What are the psychological and behavioral effects of carrying student debt for a long period of time?
- What is the likelihood of borrowers facing large, unexpected costs (e.g., health care expenses or private loan payments) that are not included in the IDR monthly payment formulas?
- Which borrowers are more likely to opt-in to passive repayment via "electronic debit?" What kinds of communications and/or processes could encourage more borrowers to do so?
- What are the employment characteristics and tax filing statuses of borrowers (e.g., what share is in contingent employment and what share files taxes jointly)?¹¹⁰

¹⁰⁹ These questions include but are not limited to those on pp. 15-16.

¹¹⁰ See Figure 15 on p. 30 for more information on the types of borrower circumstances that are more or less well-suited to paycheck withholding as a way to pay student loans.

OTHER APPROACHES TO STUDENT LOAN REPAYMENT REFORM

TICAS has developed a comprehensive package of federal student loan reforms to reduce complexity, improve targeting, contain debt burdens, support wise borrowing decisions, and encourage college completion. These proposals include several practical recommendations for streamlining and improving repayment options that do not rely on income-driven repayment (IDR) for all borrowers, or on passive repayment through paycheck withholding. Summarized below are several changes that would give borrowers access to better options, information, and processes.

Let borrowers choose between one well-designed IDR plan and a limited menu of traditional plans.

One new and improved IDR plan. One IDR plan would replace today's four: Income-Based Repayment (Classic IBR) as currently available, IBR for new borrowers starting July 2014 (2014 IBR), Pay As You Earn (PAYE), and Income-Contingent Repayment (ICR). Borrowers already enrolled in these plans could stay in them or switch to the new plan. The new IDR plan would:

- Be available to all federal loan borrowers, regardless of their debt or income level, whether their loans are Direct or FFEL, or when they borrowed;
- Ensure payments never exceed 10% of taxable income;
- Discharge any remaining debt after 20 years of payments;
- Provide \$0 monthly payments for borrowers with incomes at or below 150% of the poverty guideline for their family size;
- Better target benefits to those who need help the most;
- Make it easy for borrowers to keep their income information up to date; and
- Not tax discharged debt as income.

Traditional plans. Borrowers could also choose from a limited menu of traditional plans with incrementally longer repayment periods available to those with larger balances when they enroll.

Improve the timing, content, and effectiveness of student loan counseling to help students borrow wisely and pick a repayment plan that works for them. For example, exit counseling should guide borrowers who want to reduce their debt's overall cost and can afford to pay it down faster to a shorter-term repayment plan. It should guide borrowers who want assurance that their monthly payments will remain affordable to the new and improved IDR plan.

Better prevent student loan defaults by automatically enrolling severely delinquent borrowers who have not made a payment in six months in the IDR plan; targeting outreach to borrowers showing signs of financial distress;¹¹¹ and providing loan discharges when students are defrauded by their college, paid for by the school.

These recommendations, along with more comprehensive proposals for reforming student loans and other aspects of federal student aid policy, are detailed in a 2013 report: [Aligning the Means and the Ends: How to Improve Federal Student Aid and Increase College Access and Success](#), which is available at www.ticas.org.

¹¹¹ For example, see U.S. Department of Education. November 4, 2013. Press release. "U.S. Department of Education Announces Additional Efforts to Inform Student Borrowers of Repayment Options." <http://1.usa.gov/OG0Q0ys>.

CONCLUSION

The complex federal student loan repayment system is clearly ripe for streamlining and improvement, but requiring income-driven repayment (IDR) for everyone could have unintended consequences, and it is certainly not the only way to help more borrowers keep up with their loan payments and avoid default. The vision of all borrowers seamlessly making affordable payments and staying out of default must be tempered with the reality of our country's broader financial aid and higher education systems, as well as the risk of unintended consequences, particularly for lower income students.

The models from other countries, while appealing in many ways, are not as simple or easily transferrable to the U.S. context as they may first appear, and they are still in flux. The potential for higher costs and other consequences for students, the importance of strengthened college accountability policies, and the gaps in available data and research all point to the need to proceed with caution in considering proposals for mandatory or default IDR and/or passive repayment. Meanwhile, there are improvements that policymakers can and should make without delay to help ensure that borrowers have access to better information, clearer choices, and well-designed processes that help keep their payments manageable and reduce defaults.

APPENDIX A: CITATION LIST FOR FIGURE 2: “KEY COMPARISONS OF IDR SYSTEMS AND CONTEXT: U.S., U.K., AND AUSTRALIA”

This appendix provides descriptions and source citations for the information included in Figure 2 in the “Comparative Perspective: Income-Driven Repayment in Australia and the United Kingdom” section of this paper.

How many institutions (degree- or non-degree-granting) are eligible to participate in the country’s national student loan programs?

- Australian Government. Study Assist website. “Providers that offer Commonwealth Assistance.” <http://bit.ly/1ellAah>.
- U.K. Higher Education Statistics Agency. 2013. “Students in Higher Education Institutions, 2011/12.” Table 1: “All students by HE institution, level of study, mode of study, and domicile.” <http://bit.ly/1igau68>.
- U.S. Department of Education, National Center for Education Statistics. 2013. *Postsecondary Institutions and Cost of Attendance in 2012-13; Degrees and Other Awards Conferred, 2011-12; and 12-Month Enrollment, 2011-12: First Look (Provisional Data)*. <http://nces.ed.gov/pubs2013/2013289rev.pdf>. Note: These figures represent all institutions of higher education in the U.S. and its territories receiving federal Title IV funds in 2012-13.

How many students are enrolled in any kind of higher education?

- Organisation for Economic Co-operation and Development (OECD). StatExtracts: “Students enrolled by type of institution.” <http://stats.oecd.org/Index.aspx?DatasetCode=RENRL>. Figures include students enrolled in all types of tertiary education in 2011.

How much do all students, past and present, currently owe in federal educational loans?

- Grattan Institute (A.U.). 2013. “Reform HECS, but don’t sell off the debt.” <http://bit.ly/1kHHrdi>.
- Library of the House of Commons (U.K.). 2014. Student Loan Statistics. <http://bit.ly/MqM4fR>. Note that the figure does not include previous portfolio of outstanding student debt sold to banks (valued at £1.25 billion at the end of 2003-04).
- U.S. Department of Education, Federal Student Aid (FSA). “Federal Student Aid Portfolio Summary.” <http://studentaid.ed.gov/sites/default/files/fsawg/datacenter/library/PortfolioSummary.xls>. Figure includes federal loans for both students and parents, as of December 31, 2013.

Does the national government cap how high tuition can be?

- Morgan, John. March 11, 2013. “Tuition fee cap frozen again.” Times Higher Education. <http://www.timeshighereducation.co.uk/news/tuition-fee-cap-frozen-again/2002422.article>.
- Australian Government. Study Assist website. “Student contribution amounts.” <http://bit.ly/1ioGUMz>.

How are interest rates for student loans calculated in each country and what were the interest rates in 2013?

- Student Loans Company (U.K.). “Student Loan Repayment: Interest Rates.” <http://bit.ly/1n7YCnH>.
- Australian Government. Study Assist website. “Interest and Indexation.” <http://bit.ly/1j8IRPY>.
- Australian Taxation Office. “HELP indexation rates.” <http://www.ato.gov.au/Rates/HELP-indexation-rates/>.

- U.S. Department of Education, Federal Student Aid. "Interest Rates and Fees." <http://studentaid.ed.gov/types/loans/interest-rates>.
- Public Law 113-28: "Bipartisan Student Loan Certainty Act of 2013." 127 Stat. 506. Date: August 9, 2013. <http://www.gpo.gov/fdsys/pkg/PLAW-113publ28/pdf/PLAW-113publ28.pdf>.

Who initiates monthly student loan payments: Employers or borrowers themselves?

- Australian Taxation Office. "Repaying your HELP debt, 2013-14." <http://bit.ly/1nQD4za>.
- Student Loans Company (U.K.). "Loan repayment: Repaying through PAYE." <http://bit.ly/1lzmGnS>.
- U.S. Department of Education, Federal Student Aid. "Making Payments." <http://studentaid.ed.gov/repay-loans#making-payments>.

At what income level do borrowers start repaying their debt, how much do they pay if above the threshold, and is there a time limit beyond which remaining debt is discharged?

- Australian Government. Study Assist website. "Loan repayment." <http://bit.ly/1bleyxw>.
- U.K. Government. "Student Finance: Repayments." <https://www.gov.uk/student-finance/repayments>.
- Student Loans Company (U.K.). "Student Loan Repayment: Frequently Asked Questions." <http://bit.ly/1fpVReB>.
- U.S. Department of Education, Federal Student Aid. "Repayment Plans." <http://studentaid.ed.gov/repay-loans/understand/plans>.
- U.S. Department of Health and Human Services. "2014 Poverty Guidelines." <http://aspe.hhs.gov/poverty/14poverty.cfm>.

Can borrowers prepay their loan balance without being subject to penalties?

- Australian Taxation Office. "Voluntary Payments." <http://bit.ly/1ioAwVs>.
- U.K. Government. "Student Finance: Repayments." <https://www.gov.uk/student-finance/repayments>.
- U.S. Department of Education, Federal Student Aid. 2010. *Your Federal Student Loans: Learn the Basics and Manage Your Debt*. https://studentaid.ed.gov/sites/default/files/your-federal-student-loans_1.pdf.

How can borrowers access their updated loan balance information?

- Northern Ireland Government (U.K.). "Finding Out Your Student Loan Balance." <http://www.nidirect.gov.uk/finding-out-your-student-loan-balance>.
- Australian Government. Study Assist website. "Paying back my loan." <http://studyassist.gov.au/sites/studyassist/payingbackmyloan>.
- U.S. Department of Education, National Student Loan Data System (NSLDS). http://www.nsls.ed.gov/nsls_SA/. In addition to using NSLDS, federal loan borrowers in the U.S. can check their balances at any time with their loan servicer. Loan servicers will have the most up-to-date information on borrowers' student loan balances.

APPENDIX B: BORROWER EXAMPLE DETAILS

The following tables cover five example borrowers:

- **Borrower A:** Single borrower with \$29,400 in federal loans and earning \$35,000 adjusted gross income (AGI).
- **Borrower B:** Single borrower with \$29,400 in federal loans and earning \$30,000 AGI.
- **Borrower C:** Single borrower with \$29,400 in federal loans and earning \$25,000 AGI.
- **Borrower D:** OB/GYN, married with two children, with \$192,000 in federal loans. She earns \$45,000 AGI during a four-year residency and then \$190,000 in private practice.
- **Borrower E:** Married couple who have a child in year eight of repayment, with \$50,000 in combined federal loans and earning \$60,000 AGI.

The tables illustrate monthly payments, total payments, and number of years in repayment under some or all of the following repayment plans:¹¹²

- 10-year standard repayment, the current “default” plan¹¹³
- 25-year extended repayment¹¹⁴
- Classic (15%) Income-Based Repayment (IBR)
- 10% IDR (2014 IBR and Pay As You Earn, or PAYE)¹¹⁵

Unless otherwise noted, the calculations for the example borrowers in this paper are based on the following assumptions:

- The borrower is single, does not have anyone else in the household, and lives in one of the 48 contiguous states.
- The borrower’s AGI increases 4% a year.
- The average interest rate on his or her loans is 6.80%.
- The income exclusion is 150% of the poverty level for the borrower’s household size, as under current rules for Classic IBR, 2014 IBR, and PAYE.
- Calculations are based on 2014 poverty levels and assume that the poverty level increases annually at the rate of inflation.
- Total amounts paid are illustrated in current dollars and then discounted at a 2.4% annual rate, the projected average annual increase in the Consumer Price Index over the next 20 years.¹¹⁶
- Monthly payments are rounded to the nearest \$10, total payments to the nearest \$50.

Note that both monthly payments and total costs are affected by a multitude of factors specific to the borrower, including his or her debt amount, household size, and income trajectory over the repayment period. Additionally, as discussed in “Why Program Design Matters,” the specific features of the loans and the IDR plan will also affect costs for borrowers.

¹¹² For more information about the IDR plans, see Figure 1 on p. 4.

¹¹³ For more information about the 10-year standard repayment plan for federal student loans, see U.S. Department of Education, “Standard Plan,” <http://studentaid.ed.gov/repay-loans/understand/plans/standard>.

¹¹⁴ For more information about the 25-year extended repayment plan for federal student loans, see U.S. Department of Education, “Extended Plan,” <http://studentaid.ed.gov/repay-loans/understand/plans/extended>.

¹¹⁵ These example borrowers end up having the same monthly payment amounts, total amounts paid, and total amounts forgiven in both PAYE and 2014 IBR, though other borrowers may end up paying less in total under PAYE because of its cap on interest capitalization. Additionally, there are other procedural and eligibility differences between PAYE and 2014 IBR.

¹¹⁶ These calculations do not apply a discount rate above inflation, which will depend on external factors such as federal interest rates and the borrower’s personal preferences for having more money now or in the future. Note that economists and government agencies vary in the discount rates they apply in their calculations and may apply different discount rates for different years.

TABLE 1: BORROWER A (\$29,400 DEBT, \$35,000 AGI, INCREASING 4% A YEAR) WITH A 6.80% INTEREST RATE

	10-year standard repayment	15% IBR (25-yr period)	10% IDR (PAYE and 2014 IBR, 20-yr period)
Monthly payment amount in first year	\$340	\$220	\$150
Total payments made	\$40,600	\$46,000	\$59,400
Total payments made, adjusted for inflation	\$36,050	\$39,000	\$45,450
Total amount discharged	\$0	\$0	\$500
Total amount discharged, in 2014 dollars	\$0	\$0	\$300
Years in repayment	10.0	13.0	20.0

This table provides more information for Figures 3, 4, 5, 6, 7, 8, and 9.

TABLE 2: BORROWER A (\$29,400 DEBT, \$35,000 AGI, INCREASING 4% A YEAR) WITH A 3.86% INTEREST RATE

	10-year standard repayment	15% IBR (25-yr period)	10% IDR (PAYE and 2014 IBR, 20-yr period)
Monthly payment amount in first year	\$300	\$220	\$150
Total payments made	\$35,500	\$36,650	\$40,550
Total payments made, adjusted for inflation	\$31,500	\$31,900	\$33,100
Total amount discharged	\$0	\$0	\$0
Total amount discharged, in 2014 dollars	\$0	\$0	\$0
Years in repayment	10.0	11.3	15.4

This table provides more information for Figure 5.

TABLE 3: BORROWER A (\$29,400 DEBT, \$35,000 AGI, INCREASING 4% A YEAR) WITH A 6.80% INTEREST RATE AND NO INCOME EXCLUSION*

	10-year standard repayment	15% IBR (25-yr period)	10% IDR (PAYE and 2014 IBR, 20-yr period)
Monthly payment amount in first year	\$340	n/a	\$290
Total payments made	\$40,600	n/a	\$41,750
Total payments made, adjusted for inflation	\$36,050	n/a	\$36,700
Total amount discharged	\$0	n/a	\$0
Total amount discharged, in 2014 dollars	\$0	n/a	\$0
Years in repayment	10.0	n/a	10.7

* Note: Without the income exclusion, this borrower no longer qualifies for Classic (15%) IBR.

This table provides more information for Figures 8 and 9.

TABLE 4: BORROWER B (\$29,400 DEBT, \$30,000 AGI, INCREASING 4% A YEAR) WITH A 6.80% INTEREST RATE

	10-year standard repayment	15% IBR (25-yr period)	10% IDR (20-yr period)	10% IDR (25-yr period)*
Monthly payment amount in first year	\$340	\$160	\$100	\$100
Total payments made	\$40,600	\$55,400	\$45,700	\$65,700
Total payments made, adjusted for inflation	\$36,050	\$43,700	\$34,750	\$46,400
Total amount discharged	\$0	\$0	\$22,850	\$8,400
Total amount discharged, in 2014 dollars	\$0	\$0	\$14,350	\$4,700
Years in repayment	10.0	17.9	20.0	25.0

*This is a hypothetical plan for the purposes of illustration only, not an existing IDR plan in the U.S.

This table provides more information for Figure 10.

TABLE 5: BORROWER C (\$29,400 DEBT, \$25,000 AGI, INCREASING 4% A YEAR) WITH A 6.80% INTEREST RATE

	10-year standard repayment	15% IBR (25-yr period)	10% IDR (PAYE and 2014 IBR, 20-yr period)
Monthly payment amount in first year	\$340	\$90	\$60
Total payments made	\$40,600	\$66,550	\$30,800
Total payments made, adjusted for inflation	\$36,050	\$46,750	\$23,300
Total amount discharged	\$0	\$7,200	\$38,550
Total amount discharged, in 2014 dollars	\$0	\$4,050	\$24,200
Years in repayment	10.0	25.0	20.0

This table provides more information for the scenario described on p. 24-25.

TABLE 6: BORROWER D (OB/GYN, MARRIED WITH TWO CHILDREN, \$192,000 DEBT WITH A 6.80% INTEREST RATE, \$45,000 AGI DURING 4-YEAR RESIDENCY, THEN \$190,000 IN PRIVATE PRACTICE, INCREASING 4% A YEAR). HER HOUSEHOLD SIZE DECREASES FROM FOUR IN YEAR 1 TO THREE IN YEAR 10, THEN TWO IN YEAR 15, DUE TO HER CHILDREN LEAVING HOME.

	10-year standard repayment	25-year extended repayment	15% IBR (25-yr period)	10% IDR (PAYE and 2014 IBR, 20-yr period)	TICAS Proposal: PAYE w/income exclusion phase-out, no standard payment cap
Monthly payments	\$2,210	\$1,330	\$120 to \$2,210	\$80 to \$2,210	\$80 to \$2,850
Total payments made	\$265,150	\$399,800	\$372,150	\$349,000	\$405,550
Total payments made, adjusted for inflation	\$235,500	\$300,400	\$286,250	\$258,350	\$299,500
Total amount discharged	\$0	\$0	\$0	\$81,350	\$0
Total amount discharged, in 2014 dollars	\$0	\$0	\$0	\$51,050	\$0
Years in repayment	10.0	25.0	18.3	20.0	20.0

This table provides more information for Figures 11 and 12.

TABLE 7: BORROWER E (MARRIED COUPLE, HAVE CHILD IN YEAR 8, \$50,000 DEBT WITH A 6.80% INTEREST RATE, \$60,000 AGI, INCREASING 4% A YEAR)

	10-year standard repayment	25-year extended repayment	15% IBR (25-yr period)	10% IDR (PAYE and 2014 IBR, 20-yr period)	TICAS Proposal: PAYE w/income exclusion phase-out, no standard payment cap
Monthly payments	\$580	\$350	\$460 to \$580	\$300 to \$580	\$300 to \$610
Total payments made	\$69,050	\$104,100	\$72,550	\$92,550	\$92,550
Total payments made, adjusted for inflation	\$61,350	\$78,250	\$63,250	\$73,400	\$73,400
Total amount discharged	\$0	\$0	\$0	\$0	\$0
Total amount discharged, in 2014 dollars	\$0	\$0	\$0	\$0	\$0
Years in repayment	10.0	25.0	11.2	18.0	17.9

This table provides more information for Figures 13 and 14.

the institute for
college
access & success

405 14th Street, Suite 1100
Oakland, CA 94612
510.318.7900

1111 16th Street, NW Suite 310
Washington, D.C. 20036
202.223.6060

info@ticas.org
www.ticas.org