Student Aid Policy Analysis Papers

Policy Options for Student Loan Forgiveness

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With more than $1.7 trillion in federal and private student loan debt outstanding,[1] second only to mortgage debt, borrowers and policymakers have been calling for widespread student loan forgiveness.

Many stakeholders have put forward plans to address the student loan crisis. It has been suggested by well-meaning and thoughtful policy-makers that all student loan borrowers should have up to $50,000 of their debt forgiven. However, in a time when a $1 trillion loan forgiveness package may be difficult to achieve, there are other options that can result in substantial relief targeted to cohorts that may be *most* in need of forgiveness.

Forgiving $10,000 Makes A Meaningful Difference

Providing up to $10,000 in student loan forgiveness for borrowers who owe $10,000 or less will completely eliminate federal student loan debt for a third of all borrowers. More than 15 million borrowers will have their federal student loan debt completely wiped out, including[2] the majority of borrowers who are in default on their federal student loans.[3] These borrowers were struggling to repay their federal student loans even before the pandemic. Most of them had dropped out of college, leaving them with debt but not a degree that can help them repay the debt.[4]

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[1] Consumer Credit Outstanding (Levels), G.19 Report, Federal Reserve Board, as of 2020 Q3. https://www.federalreserve.gov/releases/g19/HIST/cc_hist_memo_levels.html

[2] Based on an analysis of data from the U.S. Department of Education's Enterprise Data Warehouse, 33.6% of borrowers, or 15.3 million borrowers, owe $10,000 or less in federal student loans as of Q4 of FY2020. Data includes all federal education loans from the Federal Direct Loan, Federal Family Education Loan and Federal Perkins Loan programs.

[3] Based on an analysis of data from the 2012 follow-up to the 2003-04 Beginning Postsecondary Students longitudinal study (BPS:04/09), 60% of borrowers in default owed less than $10,000 in 2009, 86% owed less than $20,000 and almost all borrowers owed less than $50,000. The average amount owed was $11,145 and the median debt was $7,798. Note that this data is for just one cohort of borrowers who borrowed their federal student loans more than a decade ago. However, an analysis of the 2017 follow-up to the 2011-12 Beginning Postsecondary Students longitudinal study (BPS:12/17) yields a similar result. The average federal student loan for borrowers in default in the Direct Loan program was $21,930 as of Q1 of FY2020 (12/31/2019). This data includes all borrowers who are currently in default, including borrowers who defaulted decades ago.

[4] Based on an analysis of data from the 2009 follow-up to the 2003-04 Beginning Postsecondary Students longitudinal study (BPS:04/09), only 0.1% of students who graduated with a Bachelor's degree and 1.1% of students who graduated with an Associate's degree defaulted on their federal student loans. Overall, 7.8% of undergraduate borrowers who dropped out of college defaulted on their federal student loans, compared with 2.1% of borrowers who graduated. College dropouts are 3.7 times more likely to default on their federal student loans and represent 72% of the defaults. College dropouts represent 97% of defaults in Bachelor's degree programs, 93% of defaults in Associate's degree programs and 47% of defaults in Certificate programs. Of borrowers in default on their federal student loans, 71.8% did not attain a college degree, 24.7% attained a Certificate, 2.4% attained an Associate's degree and 1.1% attained a Bachelor's degree. About three-quarters (74%) of the defaults among borrowers who attained a Certificate were by borrowers who graduated from a for-profit college.

A third of borrowers who owe $10,000 or less in federal student loans attended community colleges and a quarter attended public 4-year colleges and universities.[5]

While eliminating debt for all borrowers with $10,000 in student loans or less affects fewer borrowers in total than with other proposals, it will positively impact the borrowers who are least likely to repay their loans.

Table 1 shows the impact of limiting student loan forgiveness to borrowers who owe less than a specified amount of federal student loan debt. This eligibility restriction doubles the amount of student loan debt that can be forgiven per borrower.

Table 1

Debt Size	% of Dollars	% of Borrowers	Total Dollars (Billions)	Total Borrowers (Millions)
Less than $5,000	1.3%	17.4%	$21	7.9
Less than $10,000	4.8%	33.6%	$75	15.3
Less than $20,000	13.3%	53.8%	$208	24.5
Less than $30,000	22.0%	64.4%	$345	29.3
Less than $40,000	30.7%	74.9%	$481	34.1
Less than $50,000	37.2%	79.6%	$584	36.2
Less than $60,000	43.8%	84.2%	$687	38.3
Less than $70,000	49.5%	87.0%	$775	39.6
Less than $80,000	55.1%	89.9%	$864	40.9
Less than $90,000	59.0%	91.4%	$925	41.6
Less than $100,000	63.0%	93.0%	$987	42.3
Less than $200,000	83.2%	98.0%	$1,304	44.6
Total	100.0%	100.0%	$1,567	45.5

Additional Options for Student Loan Forgiveness

There are several additional options for student loan forgiveness that can be targeted at borrowers who are experiencing severe financial challenges.

A 2014 GAO report found that "borrowers age 65 and older hold defaulted federal student loans at a much higher rate, which can leave some retirees with income below the poverty threshold" due to the offset of their Social Security disability and retirement benefits.[6] Almost a third of borrowers age 65 and

[5] Based on an analysis of data from the 2009 follow-up to the 2003-04 Beginning Postsecondary Students longitudinal study (BPS:04/09), 33.9% of borrowers who owe less than $10,000 attended community colleges and 25.5% attended public 4-year colleges and universities. Similar statistics apply to more recent college graduates. Based on an analysis of data from the 2015-2016 National Postsecondary Student Aid Study (NPSAS:16), 33.6% of borrowers who owe less than $10,000 attended community colleges and 30.6% attended public 4-year colleges and universities.

[6] *OLDER AMERICANS: Inability to Repay Student Loans May Affect Financial Security of a Small Percentage of Retirees*, GAO-14-866T, September 10, 2014. https://www.gao.gov/products/GAO-14-866T Based on data in this report, 27% of borrowers age 65-74 and 54% of borrowers age 75 and older are in default, compared with 10% of borrowers under age 65.

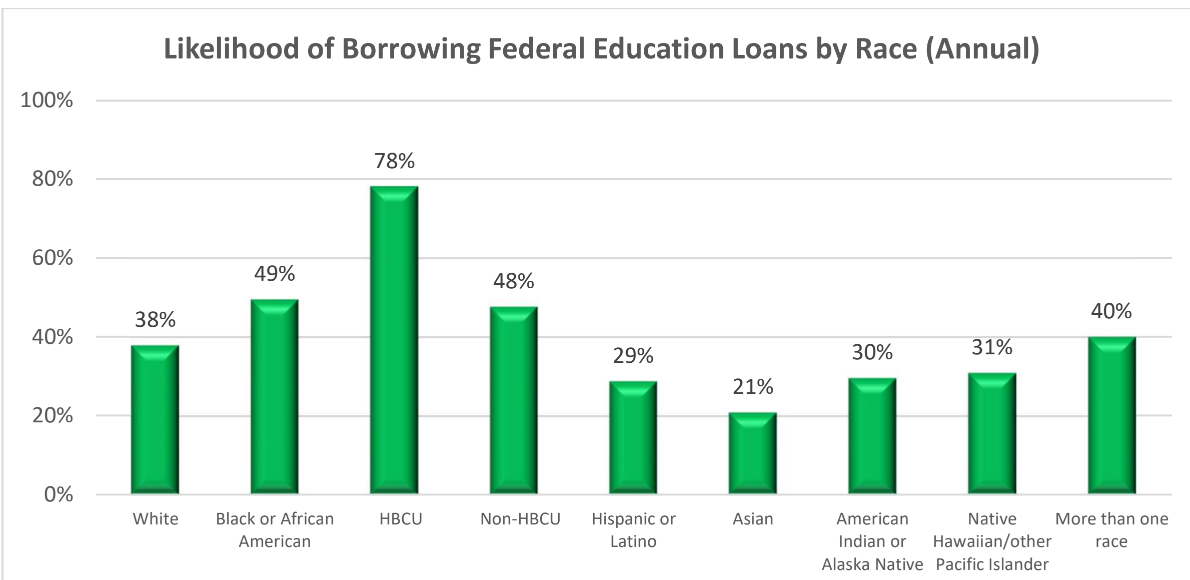
older are in default on their federal student loans, including more than half of borrowers age 75 and older.

Forgiving the federal student loans of borrowers age 65 and older would cost $59 billion, and affect more than 2 million borrowers.[7]

Borrowers who attended Historically Black Colleges and Universities (HBCUs) are more likely to graduate with student loan debt and they graduate with disproportionately greater amounts of student loan debt. Half of Black or African-American[8] students borrow federal student and parent loans each year, compared with 38% of White students. At HBCUs, 78% of Black or African-American students borrow federal education loans each year. Among college graduates, 77% of Black or African-American students graduate with student loan debt, including 88% of students who graduate from HBCUs, compared with 61% of White students.

Forgiving all federal education loans for students who attended an HBCU would cost about $30 billion, while forgiving all federal education loans for Black or African-American students would cost about $300 billion.

Chart 1



Forgiving the federal student loan debt of social workers would cost about $18 billion.

Forgiving the federal student loan debt of teachers would cost about $117 billion.

Forgiving the federal student loan debt of all doctors and nurses would cost about $248 billion. Limiting the student loan forgiveness to borrowers who work in the front lines of the pandemic would reduce the cost.

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[7] Based on an analysis of the Federal Reserve Board's 2019 Survey of Consumer Finances (SCF), households with borrowers age 65 and older represent 3.9% of student loan borrowers and owe 3.5% of student loan debt outstanding, an average of $35,636 per borrower.

[8] See note ii.

Means-Testing Student Loan Forgiveness Solutions

Broad student loan forgiveness invariably results in forgiving loans for borrowers who have the ability to repay their loans.

Limiting student loan forgiveness based on borrower income will provide more financial relief to more borrowers who are experiencing economic distress while reducing the cost of the loan forgiveness.

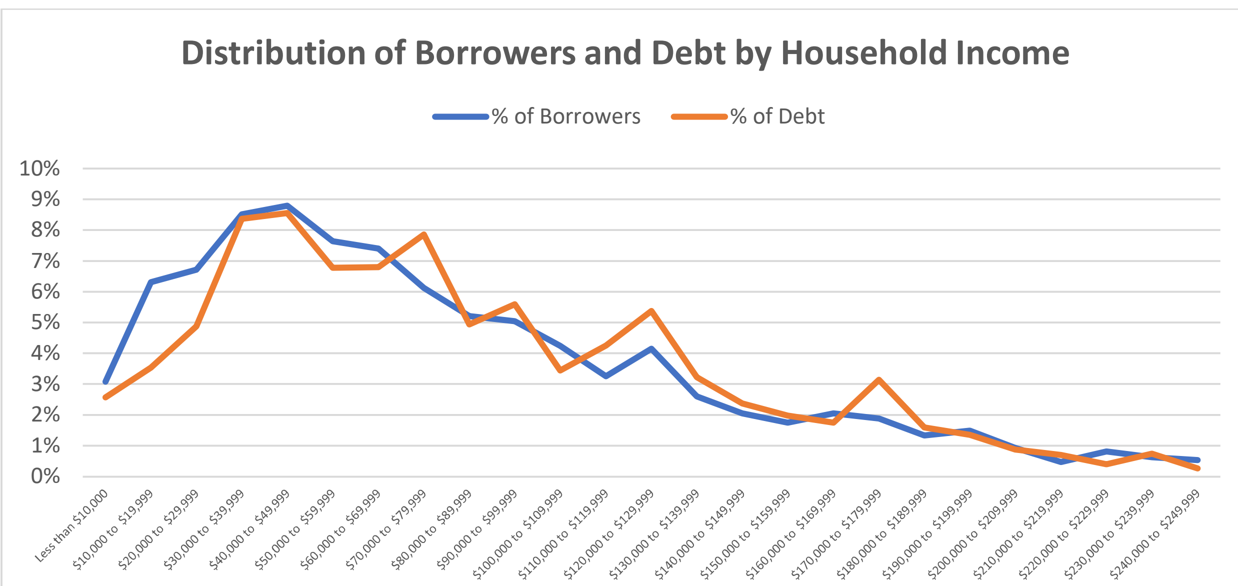
As shown in Table 2, about a third of student loan borrowers are low-income, about a third are middle-income and about a third are high-income.[9] The average student loan debt-to-income ratio is 1.2 for low-income borrowers, 0.6 for middle-income borrowers and 0.2 for high-income borrowers.[10] If the debt-to-income ratio is less than 1.0, the borrower should be able to repay their student loans in 10 years or less. Otherwise, they will need extended repayment or income-driven repayment to afford the monthly student loan payments, and they will pay more interest over the life of the loans.

Table 2

Household Income	% of Student Loan Borrowers	% of Student Loan Debt
Less than $50,000	33%	28%
$50,000 to $99,999	31%	32%
$100,000 or more	35%	40%

Chart 2 shows the distribution of student loan borrowers and debt by household income.[11]

Chart 2



[9] Based on an analysis of the Federal Reserve Board's 2019 Survey of Consumer Finances (SCF).

[10] Low-income borrowers are defined as borrowers with income less than $50,000. Middle-income borrowers are defined as borrowers with income of $50,000 to $99,999. High-income borrowers are defined as borrowers with income of $100,000 or more.

[11] This chart does not show borrowers with income of $250,000 or more, who represent 9% of the student loan debt and 7% of the borrowers.

If student loan forgiveness is limited not just by the amount owed, but also by the borrower's income, it can further reduce the cost of student loan forgiveness, while targeting the benefit to those who are unable to pay off their loans. Table 3 shows the cost of forgiving federal student loans owed by borrowers who owe less than the specified amount of debt, limited by income.

Table 3

Total Amount Forgiven	Maximum Income				
Maximum Forgiveness and Maximum Debt	$25,000	$50,000	$75,000	$100,000	$125,000
$10,000	$8 billion	$19 billion	$32 billion	$40 billion	$46 billion
$20,000	$25 billion	$56 billion	$91 billion	$113 billion	$127 billion
$30,000	$48 billion	$107 billion	$161 billion	$193 billion	$219 billion
$40,000	$60 billion	$154 billion	$226 billion	$274 billion	$312 billion
$50,000	$65 billion	$184 billion	$281 billion	$345 billion	$392 billion
$60,000	$74 billion	$222 billion	$334 billion	$410 billion	$470 billion
$70,000	$85 billion	$254 billion	$385 billion	$475 billion	$539 billion
$80,000	$96 billion	$285 billion	$429 billion	$534 billion	$602 billion
$90,000	$96 billion	$297 billion	$448 billion	$563 billion	$634 billion
$100,000	$99 billion	$316 billion	$479 billion	$611 billion	$702 billion

Table 4 shows the percentage of borrowers receiving student loan forgiveness limited by income, if eligibility is limited to borrowers who owe less than the specified amount of federal student loan debt.

Table 4

% of Borrowers	Maximum Income				
Maximum Debt	$25,000	$50,000	$75,000	$100,000	$125,000
$10,000	4.6%	10.3%	16.3%	20.5%	23.5%
$20,000	7.4%	16.6%	26.2%	32.6%	37.0%
$30,000	9.5%	21.6%	33.1%	40.6%	46.1%
$40,000	10.4%	24.8%	37.7%	46.2%	52.6%
$50,000	10.7%	26.5%	40.7%	50.2%	57.1%
$60,000	11.0%	28.3%	43.1%	53.1%	60.6%
$70,000	11.5%	29.5%	45.1%	55.6%	63.3%
$80,000	11.9%	30.6%	46.6%	57.7%	65.5%
$90,000	11.9%	30.9%	47.2%	58.5%	66.4%
$100,000	12.0%	31.4%	48.0%	59.8%	68.3%

Regardless of the amount of forgiveness per borrower, student loan forgiveness represents a greater share of income for low-income borrowers than for middle-income borrowers and a greater share of income for middle-income borrowers than for high-income borrowers. So, student loan forgiveness will have a proportionately greater impact on the budgets of low-income borrowers.

Assuming a fixed amount of money available for student loan forgiveness, there is a tradeoff between the number of borrowers receiving forgiveness and the amount of forgiveness per borrower.

Means-testing the student loan forgiveness will reduce the number of borrowers receiving student loan forgiveness, but allow a greater amount of student loan forgiveness per eligible borrower. For example, providing $50,000 in student loan forgiveness per borrower for all borrowers has the same cost as forgiving all student loan debt of borrowers who earn less than $100,000 per year. Forgiving $10,000 per borrower for all borrowers has the same cost as forgiving $20,000 per borrower for borrowers who earn less than $100,000 and $80,000 per borrower for borrowers who earn less than $50,000. A third of borrowers earn up to $50,000 and two-thirds earn up to $100,000.

Simplifying Income-Driven Repayment

Income-driven repayment plans target student loan forgiveness based on income, but they are too complicated. There are currently four income-driven repayment plans when there should be just one. The monthly student loan payment is based not just on the borrower's income, but also a multiple of the poverty line, which can vary depending on the borrower's family size and geographic location. This makes it more difficult to have a simple lookup table for the monthly student loan payment.

President Biden's proposal for a new income-driven repayment plan is simpler. It bases the monthly payment on 5% of discretionary income, which is defined as the amount by which adjusted gross income exceeds $25,000, with tax-free forgiveness of the remaining debt after 20 years in repayment. Since discretionary income will no longer be based on the poverty line, the new income-driven repayment plan can be adapted to generate a simple lookup table for the monthly student loan payment, such as Table 5.

Table 5

Income	Monthly Loan Payment
$25,000	$0.00
$50,000	$104.17
$75,000	$208.33
$100,000	$312.50
$125,000	$416.67

The new income-driven repayment plan could be made even simpler by basing it on a percentage of income as opposed to a percentage of discretionary income. Thus, the monthly payment could be based on 5% of monthly income minus $100 per month, with no payment due for borrowers who earn less than $25,000 per year. This formula yields a similar monthly student loan payment, but is easier to understand.

Another problem is the length of the repayment term. Requiring borrowers to make student loan payments for 20 years – half of the typical work-life – is much too long. Many borrowers will still be repaying their own student loans when their children enroll in college.

A possible solution is to double the monthly loan payments, but for half the time. Monthly student loan payments would be based on 10% of income minus $200 for 10 years instead of 5% of income minus $100 for 20 years. The monthly loan payments would still be affordable, similar to the payments under the Pay-As-You-Earn (PAYE) repayment plan. The monthly loan payments would be less than 5% of income for borrowers earning less than $50,000 a year, fulfilling the Biden campaign promise. Table 6 compares this alternative with the repayment plan shown in Table 5, showing similar total payments.

Table 6

	5% of (AGI - $25,000)/12 for 20 Years		(10% of AGI)/12 minus $200 for 10 Years	
Income	**Monthly Loan Payment**	**Total Payments**	**Monthly Loan Payment**	**Total Payments**
$25,000	$0.00	$0.00	$8.33	$1,000.00
$50,000	$104.17	$25,000.00	$216.67	$26,000.00
$75,000	$208.33	$50,000.00	$425.00	$51,000.00
$100,000	$312.50	$75,000.00	$633.33	$76,000.00
$125,000	$416.67	$100,000.00	$841.67	$101,000.00

With a 10-year repayment term, there would no longer be a need for standard repayment, except perhaps as a cap on the monthly student loan payments under income-driven repayment. Federal student loans could then have just one repayment plan, instead of a dozen different repayment plans.

Such simplification would make the income-driven repayment plan easier to explain to borrowers. It should also be coupled with one-time authorization of the transfer of the borrower's income data from the IRS (or Social Security Administration) to the loan servicer for the duration of the repayment plan, instead of requiring an annual certification. (Annual certification will no longer be required to report family size, since the income-driven repayment plan will no longer be based on the poverty line.)

Another potential enhancement is to base student loan payments under an income-driven repayment plan on the borrower's *earnings* instead of the borrower's *adjusted gross income*. This would enable mandatory employer withholding of student loan payments, without the need for an annual reconciliation process based on the difference between earned income and adjusted gross income.

But, what about wealthy borrowers who receive most of their income through unearned income as opposed to earned income, such as through dividends and capital gains? This loophole could be addressed by requiring borrowers whose adjusted gross income exceeds a high threshold, such as $250,000, to base their loan payments (or a reconciliation process) on adjusted gross income instead of earned income. The threshold should be set high enough that a reconciliation process would not be required of most borrowers.

Conclusion

All of the stakeholders in the student loan debate are driving to address an urgent public policy need. The data included in this analysis is offered with that recognition, but also that the solution costs can and often do act as a constraint. Obviously, public policy need not be a zero-sum game and the data above is offered to illustrate how other options may impact those struggling to pay off their federal student loans.