ECONOMIC FINDING

The Distributional Effects of Student Loan Forgiveness

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A more responsive and generous income-driven repayment plan, which links payments to income and forgives debt after a period of time, is the least expensive and most progressive policy option.

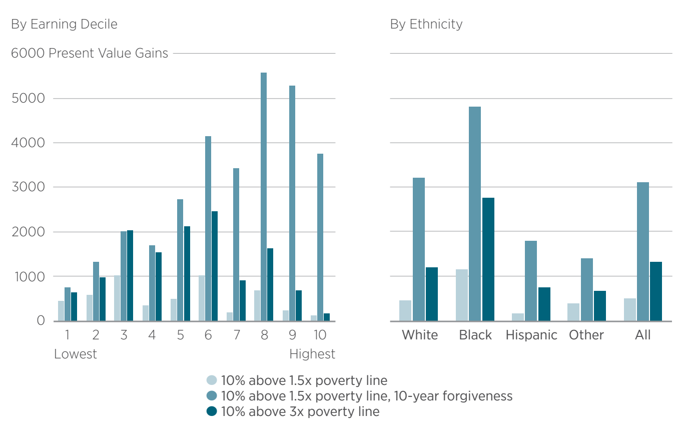
US student loan debt reached $1.6 trillion in 2020, with calls for debt relief growing in strength as that number rises. However, not all debt forgiveness plans are created equal, and the impacts vary depending on the relative income of borrowers. For example, debt forgiveness can be universal, capped at a certain amount, or targeted to specific borrowers. Importantly, while much recent media and policy attention has focused on universal forgiveness, many may not realize that some student borrowers are already granted relief through an Income-Driven Repayment (IDR) plan, which links payments to income and which forgives remaining debt after, say, 20 or 25 years, depending on the plan. This means that low-income earners can receive substantial loan forgiveness over time.

To analyze policy options, the authors used the 2019 Survey of Consumer Finances (SFC) to estimate the present value of each student loan, and to forecast future payments and the evolution of a loan's balance until it reaches zero or is forgiven. Regarding universal plans (forgiving all loans) or capped (forgiving loans to a certain amount), the authors find that these policies disproportionately accrue to high-income households. For example, individuals in the bottom half of the earnings distribution would receive 25% of the dollars forgiven. Households in the top 30% of the earnings distribution receive almost half of all dollars forgiven.

Next, the authors examined who would benefit from a more generous IDR plan that raised the threshold above which borrowers must pay a portion of their income, and which accelerated loan forgiveness. In contrast to universal forgiveness, expanding IDR leads to substantial forgiveness for the middle of the earnings distribution. Under a policy enrolling all borrowers who would benefit from IDR, individuals in the bottom half of the earnings distribution would receive two-thirds of dollars forgiven, and borrowers in the top 30% of the earnings distribution receive one-fifth of dollars in forgiveness. Raising the threshold above which borrowers pay a portion of their income and earlier loan forgiveness both lead to a large increase in forgiveness. However, under accelerating loan forgiveness, these benefits accrue to the top of the earnings distribution, while increasing the repayment threshold leads to large benefits for middle-income borrowers.

In sum, the authors find that universal and capped forgiveness policies are highly regressive, with the vast majority of benefits accruing to high-income individuals. On the other hand, IDR plans that link repayment to earnings lead to forgiveness for borrowers in the middle of the income distribution.

Figure 1 · Targeted Enrollment in IDR



Notes: This figure displays the average present value gains from targeted policies of automatic enrollment in income- driven repayment, by within-cohort earnings decile and ethnic group, including households without student loans. First, we consider the case in which households would pay 10% of their discretionary earnings, in line with current IDR rules. We also consider (i) a variation of this policy in which loans are forgiven 10 years after the first repayment and (ii) a variation in which households pay 10% of their earnings only above three times the poverty line. In all cases, payments are capped by the default fixed payment. We assume that these policies are targeted towards households for which they generate present value gains.

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