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A Case For (and Against) Automated Income Driven Repayments for Student Loans

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The views expressed in this report are solely those of the author.

Imagine for a moment that you have taken up on a government program that provides funding for your college education. This program will allow you to take out a loan at a relatively low interest rate, which you agree to pay back after you leave college. Now, let's say that you can choose from three options to pay this loan back.

Plan 1: First, you can choose a “fixed” repayment plan. Here you pay what you borrowed plus any interest that accrues monthly over a fixed time horizon (let's say 10 years, or 120 payments). You owe the same amount each month, regardless of your income, and you write a check each month to a third-party servicer who collects it on behalf of the government. If you miss payments, your credit score is penalized and interest accrues. If you fail to make enough payments consecutively, your loan goes into default, at which point you may be referred to a debt collecting agency, or have your wages or benefits garnished. You can switch into the next plan (Plan 2, below) at any time unless you are in default, but you must contact your third-party loan servicer and file the necessary paperwork.

Plan 2: A second option is to pay through an income driven repayment plan (an IDR). Here your payments vary with your earnings. If you earn less than 150% of the poverty line after some standard deductions, you don't owe anything, but interest accrues. If your taxable earnings are above 150% of the poverty line, you owe 10% of your remaining earnings above that. While in this plan, you cannot default unless you fail to make payments when earnings are above the earnings threshold. In addition, you are also eligible for forgiveness after 20 years of eligible payments. To enroll in Plan 2, you must contact your loan servicer and fill out an Income-Driven Repayment Plan Request in which you provide information from your federal income tax return. You must repeat this process annually to recertify, if you have more than one servicer, you must repeat the process for each. If you do not, you will automatically revert to Plan 1 and may lose eligibility for forgiveness. In both Plan 1 and Plan 2, your third-party servicer may change at any time. You make payments directly to your servicer as in Plan 1.

Plan 3: A final option is the same as Plan 2 except payments are automatically deducted from your paycheck each month by the government, just as for your payroll taxes, Social Security, Medicare contributions, and any retirement savings plan. In this case, you are automatically enrolled, do not need to recertify, and have no loan servicer. If you lose your job, are not working, or have taxable income below 150% of the poverty line, no payments are due, though interest still accrues, as in Plan 2. You are still eligible for forgiveness after 20 years. You can also opt to “pre-pay” at any time to lower your balance should you choose.

My guess is that you are aware that Plans 1 and 2 already exist as part of the government's suite of repayment options, these are the Standard and REPAYE plans (see Table 1). Plan 3 does not, at least not in the U.S. You may also know that the majority of borrowers are in Plan 1, as are the majority of those who default. Many enroll in Plan 2, but many also fail to recertify and are defaulted back into Plan 1, which is what you are enrolled in if you do nothing at all, which is more common

than not. Plan 3 does not exist if you live in the U.S. While the Biden Administration has proposed changes to REPAYE that includes automatic enrollment in REPAYE for delinquent borrowers, it only applies to those who have provided approval for the IRS to share tax information, it retains the Standard plan as the default, does not mention automatic withholding, and retains the current third-party servicer model.

Much of the discussion about college has focused on how expensive it has become. While important, lowering college costs will not affect the millions of borrowers currently in repayment. Put simply, if we take as a starting point that borrowers are struggling to make payments in the current system, and that the government will neither forgive all student loan debt, nor will make college “free” to all students any time soon, it behooves us to find a practical solution for the more than 40 million Americans who hold student loan debt today, and the many who will do so in the future.

In the following I will make a case that Plan 3, an Automated Income Driven Repayment plan, in which every federal borrower is automatically enrolled and where payments are automatically made through withholding, is the most meaningful change we can make to aid borrowers, and is the best option for those borrowers and the taxpayer alike. I have made this case before,¹ as have others. Here, I will do this in a somewhat unorthodox manner. Rather than arguing directly for what I will call an automated IDR plan, I will instead lay out the case for Plans 1 and 2. If these are the current options, there must be some justification for them. I will also list arguments many make against Plan 3, to see if these hold water. Through this, I hope to show that while no plan is perfect, a single, automated, income driven repayment plan is not only feasible, but will also benefit borrowers and better support the sustainability of the student loan program.

Arguments for a “fixed” repayment plan (Plan 1) as opposed to any IDR plan at all (Plans 2 and 3)

1. People pay less in total under a fixed plan (Plan 1) as compared to IDR plans (Plans 2 and 3).

One argument for a fixed repayment plan is that people will pay off their debt more quickly because they accrue less interest (the actual name is the “Standard” Plan). This can be true, but it relies on two shaky pillars. First, this is true only if people can afford to make each payment. Because payments for income driven repayment plans vary with earnings, by definition, borrowers only repay faster under the Standard Plan because they’re making payments when, under IDR, we would say they earn too little to afford them. In fact, very high earners pay off faster under the IDR plan because payments are a percent of earnings. Hence, there is a faulty logic to this claim. Second, this calculus fails to take penalties for non-payment into account. Missing a payment hurts credit scores, fees can accrue, and interest accumulates regardless. This increases the cost of all future borrowing, for example credit card rates, auto financing, and mortgage loans. In short, if you think that borrowers are facing repayments that are too high, a fixed repayment plan is not the best solution.

2. If everyone is in an Automated IDR (Plan 3), forgiveness will be too generous, and too few will repay.

What if you’re concerned with the opposite? What if you think that by letting people pay less when they earn less, and by offering forgiveness, the government will not recoup enough money to make the loan system solvent for future borrowers? This is a good point, especially if we consider the administration’s proposed changes making IDR even more generous.

Under the Standard Plan, the government will eventually garnish wages, if you have any, and will even take from your Social Security benefits if it gets to that point. But it turns out that people repay more when they are in an IDR plan, at least in the short term. It isn’t simply who enrolls in these plans that causes this. A recent paper uses variation in which borrowers’ servicers called to encourage enrollment in IDR plans.² This created a mini-experiment facilitating a comparison of repayment rates under IDR to those under Standard. It turns out that those who were nudged into IDR by the calls paid back more and had lower outstanding balances, largely because they didn’t miss payments and were less likely to go into default. But this was just in the short run, this result doesn’t account for forgiveness.

It may be the case that under a universal and automated IDR (Plan 3) many borrowers make it to forgiveness, and that their residual balances are not entirely offset even with increased repayments. Proposed changes to IDR plans, as of writing, would

make any IDR significantly more generous to the point that future forgiveness could swamp the benefits of increased current repayments. These changes would raise the earnings threshold to 225% of the poverty line, up from 150%, lower payments to only 5% of earnings above that, down from 10%, and eliminate interest accrual under non-payment.³ This would virtually guarantee that borrowers pay less in aggregate under IDR.⁴ In fact, their own projections suggest that repayments per \$10,000 in borrowing will decrease from about \$11,000 on average to about \$7,000.⁵ The proposal suggests these changes will lead to a reduction of about \$147 billion in future repayments - a burden assumed by the taxpayer.⁶

This highlights an important tradeoff. Under Plan 1, the program is kept solvent by forcing borrowers to repay even when they can't afford to. To ease this concern, Plan 2 exists, which requires repayment from those who can afford it and offers forgiveness to those who cannot; but too few take it up due to complexity. Plan 3 is meant to remove that complexity. The success of Plan 3 then depends on striking the right balance of generosity and ensuring that the program is not regressive. Evidence suggests that putting everyone in an automated IDR plan would increase repayment rates in the short-term while easing burdens on those who cannot afford to pay. Given a sufficiently long horizon to repay, it might also lead to higher repayment rates in the long-term as well. But, if all borrowers are in an IDR plan that requires borrowers to repay only 7 of every 10 dollars borrowed on average, the program will become increasingly subsidized by the taxpayer, potentially in a regressive manner.⁷

3. People prefer the “commitment device” and simplicity of Plan 1

Another argument for the Plan 1 is that borrowers prefer the “commitment device.” This forces them to make higher payments at some times than they'd like, but the threat of missing payments keeps them “on track.” Some might even argue that IDR plans (plans 2 and 3) disincentivize work as they act as a tax on income. Finally, others say, “they can always switch to IDR” when they need it.

There is little evidence for any of these claims. Some borrowers may prefer commitment devices, but the fact that between ten and twenty percent of loans are in default at any time suggests the commitment device may have serious consequences, or not be working when people simply can't pay.⁸ There is also no good evidence of work disincentives from IDR, whether in the United States or in other countries who have implemented universal automated IDR programs.

While it is the case that borrowers can always switch to IDR (Plan 2) from Standard (Plan 3) if they need, it is hard to reconcile that benefit with incredibly high default rates. The fact of the matter is that the complexity of switching can be prohibitively high. Borrowers must contact their servicer to enroll. This requires filling out the Income-Driven Repayment Plan Request application in addition to providing evidence of past year's earnings from federal income tax returns. If borrowers have more than one servicer, which is common, they must repeat this process for each. To recertify, this process must be repeated each and every year for every servicer for 20 years to be eligible for forgiveness. Further, if your financial circumstances change, for example if your income decreases significantly, you must provide documentation such as a pay stub.

As a result of all this complexity, the same research that showed borrowers pay more back under IDR also showed that even though they benefitted from this, many failed to recertify after a year and started missing payments again followed by an increase in delinquency and defaults.

This is not lost on the current administration. The White House's announcement of proposed reforms to student loans makes clear that automated IDR plans are probably a better route to repayment, and that, “the existing versions of these plans are too complex and too limited. As a result, millions of borrowers who might benefit from them do not sign up...”⁹ Concerning easing complexity, while the NPRM includes the possibility of automatic IDR enrollment for borrowers 75 days delinquent or more, this is subject to the borrower having provided approval for the IRS to provide the necessary information. It does not consider automatic withholding, nor does the proposal provide for automatic enrollment or recertification other than to say it will “automate the application and recertification process wherever possible.”

Arguments for keeping IDR (Plan 2), but not making enrollment automatic (Plan 3)

Possibly you agree that IDR plans make more sense; you are not alone, the government and most experts agree. But, it is a complicated process, and the hurdles to enroll, and to stay enrolled, are high enough that the plans are underutilized, costly to administer by servicers, and many fail to stay in them. One solution is to automate repayments. Here the government would simply apply the current IDR rules (Plan 2), but rather than contract out to third-party loan servicers, it would simply deduct payments directly from paychecks. While other countries have this in place already, for example Australia, the UK and Germany, they have other differences too. Maybe we can't, or shouldn't, do this. Let's consider some of those arguments.

1. The government simply can't do that.

An automated repayment mechanism would require a few pieces of information. The government would need to know your loan balances and the interest rate on each, your current earnings, any deductions for determining your adjusted gross income (AGI)¹⁰, and the poverty rate for your location and family size. These are the key components in calculating an IDR payment.

When you are hired, you are required to fill out a W4 form for withholding. This includes your name and Social Security Number, your address, if you hold other jobs, if you have dependents or file taxes jointly, and any deductions or other withholding you make. An additional box could be added to ask if you have a student loan, though that would not even be necessary. The Department of Education (ED), who issues federal student loans, has this information. The IRS will know what you earn through standard reporting. These can be linked by SSN. Since you list location, dependents, and other deductions, AGI can be calculated. Putting these together would complete the picture. Is it simply the case that ED and Treasury can't link this data?

It doesn't seem to be. If you default on your loan, the entire balance becomes immediately due (this is called "acceleration"). This means if you can't make payments, they all come due. Then, to recoup this loan you can't pay, the government can withhold tax refunds and federal benefit payments such as Social Security (this is called "treasury offset"). Your wages may also be garnished, in which case your employer may be required to *withhold earnings and send them directly to the government*. If these or other steps do not resolve the loan, they can recommend that the Department of Education refer the case to the Department of Justice, which can then sue you to collect the loan, in which case you will pay the court, collection, and attorney fees.¹¹

In short, if Treasury and ED can withhold tax refunds and garnish your wages, and ED and Social Security can withhold those benefits, and both already do withholding through SSN's, it is not unreasonable to believe that they can take student loan payments before you are in default. This process can also be applied to self-employed workers. In fact, the government knows this all quite well. Treasury and ED have been collaborating on the *FUTURE Act*,¹² which will make precisely this possible. The Act modifies the Internal Revenue Code (IRC) to allow the IRS to send certain information to ED for the purposes of administering federal student aid, in particular for automating FAFSA applications and improving IDR certification and recertification, though this is simply meant to improve the process, not to do away with selective enrollment, annual recertification, or the role of servicers.

The role of these third-party servicers has led to difficulties in IDR administration, and has left the government absent good information about repayments. To demonstrate, a recent GAO report¹³ studied the incidence of forgiveness, as the first cohort of borrowers who are eligible are entering this process. In short, ED found that 11 percent of loans analyzed potentially qualified for forgiveness but did not receive it. In fact, of 70,300 loans that had been in repayment long enough to potentially qualify for forgiveness, only 157 had been forgiven (0.02%), while 89% had not made enough qualifying payments.

That's not all. The report further pointed out that ED can't determine why this 11% hasn't received forgiveness, but simply says "Education's data do not provide enough information to definitively determine why thousands of additional loans were not forgiven."¹⁴ In fact, the GAO and ED both make clear that servicers are likely applying payments toward forgiveness inconsistently, and that "[w]eaknesses in Education's procedures for tracking qualifying payments may lead to inaccurate

counts of borrowers' progress toward IDR forgiveness." Even worse, "Education lacks reasonable assurance that eligible loans receive timely IDR forgiveness." This all makes clear that (1) the government can do this, and (2) that the current system is not working well.

2. Students may want to pay more than the IDR amount.

One worry many have about Plan 3 is that borrowers who want to pay back more than 10% of earnings above AGI (or whatever the prevailing repayment formula is, for example 5% in the new proposal) won't be able to. Thus, we'd be forcing interest accrual on borrowers who can afford, and want to, to pay off even more quickly.¹⁵ This can easily be incorporated into Plan 3 (automated IDR) by adding a single question asking if you want additional funds withheld as "pre-payment," or it could simply be just another optional withholding you can request in the already existing space for that option.

3. What if high earners want to pay less?

In Plan 3 (an automatic IDR-only program), there is no option to switch back to plan 1 (the Standard Plan) under which high earners would pay more each month, but would pay back more quickly and likely less overall. While one can request to pay more through pre-payment, as above, there is no recourse to pay less. This is only relevant when earnings are high enough that an IDR repayment would be more than what a Standard repayment would be,¹⁶ keeping in mind that the former is never more than 10% of taxable earnings above 150% of the poverty line.

You may in fact prefer this, as it places a higher tax on high earners. But you might also note that those high earners may in fact pay less in total because they accrue less interest. Regardless, one drawback of an IDR-only system would be that borrowers have little flexibility. Given that so few borrowers switch back and forth among the current plans, one might argue that the loss of the ability to pay less for high earners is a worthwhile trade in return for the multitude of borrowers who default despite the fact that they could have enrolled in an IDR plan to avoid it.

Is there any evidence that this is feasible?

Yes. Not long ago, Matthew Chingos and Susan Dynarski undertook a decidedly unscientific yet entirely persuasive study of which country has the "best" system for handling student loan debt.¹⁷ They compared four countries (the U.S., Australia, Great Britain, and Sweden), and asked some experts on student loans which they thought was best in a NCAA playoff-style bracket. The U.S. lost in a landslide (defeated by Sweden in the first round, 11 experts to 0). Australia won the "tournament" handily, its closest call was an 8-3 victory over Great Britain. Why do the experts like the Australian model so much, and why was the U.S. the biggest "loser"?

The knock against the U.S. was its complexity. Despite having repayment options that look like other countries, for example IDR plans with forgiveness, borrowers can't navigate the system effectively. The two most popular plans, in Britain and Australia, have a lot in common. Both have automatic deductions, and relatively low earnings thresholds for repayment. In Australia, loans are indexed by Tax File Numbers (like our Social Security Numbers). When borrowers start working, they fill out a Tax Declaration Form (like our W4) and check a box that says they have a loan - the form itself is one page.¹⁸ Employers then withhold funds based on income, and borrowers see this on their paychecks, so they know what they're paying. The UK's system is even more simple. Here's how the Universities and Colleges Admissions Service (UCAS, the UK's admissions service for higher education) describes loan repayment to its borrowers:

"The important thing to remember is that the amount you'll repay will be based on how much you earn, not how much you borrow. Once you leave your course, you'll only repay when your income is above the repayment threshold. The current UK threshold is £27,295 a year, £2,274 a month, or £524 a week... If your income changes, the amount you repay will change too. *But don't worry—this happens automatically.* If you stop working, or start to earn below the repayment threshold, your repayments will stop until you earn over the threshold. You'll make a

repayment if you go over the weekly or monthly threshold at any point during the year, for example, if you get a bonus or work overtime. You can request a refund at the end of the tax year if your total income was below the annual repayment threshold.”¹⁹

Simple indeed. What put the Australians ahead in the voting was their higher earnings threshold for repayment (\$44,000 as compared with \$29,000 in the UK). The UK also collects payments for up to 30 years before forgiveness, though the typical borrower is in repayment for less than that. Australia collects as long as you’re working, but due to lower college costs, a typical borrower spends only 9 years in repayment.

This is all to say that moving to an automated IDR plan is eminently feasible. Implementing the Future Act is an essential first step. Transitioning to automatic enrollment would be the next step. As the panelists in that survey noted, the best system is one that is simple, where repayments are based on earnings, and where those payments are collected directly through the tax system. We have few excuses left for not having one.

Table 1: Repayment Plans

	Plan 1 - A "fixed" repayment plan	Plan 2 - An "IDR" plan	Plan 3 - An "auto-IDR" plan
What are my monthly payments?	Your total balance, plus interest, is divided into 120 monthly payment. You owe the same every month for 10 years.	You owe 10% of your income after deductions that is above 150% of the poverty line every month until principal plus interest is paid.	Same as Plan 2.
How do I enroll in this plan?	You don't have to do anything. You are automatically enrolled in this plan.	You must contact your loan servicer who will provide you with the Income-Driven Repayment Plan Request application (see How are earnings calculated below for this process). If you have more than one servicer for the loans, you must submit a separate request to each servicer.	You don't have to do anything. You are automatically enrolled in this plan.
How are earnings for repayments calculated?	It doesn't matter what you earn. Your payments are the same each month.	To provide Adjusted Gross Income (AGI) for the application process above, use the IRS's Data Retrieval Tool to transfer information from your federal income tax return. If using a paper application, provide a paper copy of your most recent federal income tax return. If you haven't filed a tax return in the past two years, or if your current income is significantly different from the income on your most recent tax return, e.g. if you lost your job, you must provide alternative documentation. If you currently receive pay, submit a paper Income-Driven Repayment Plan Request with alternative documentation of your income, such as a pay stub. If you don't have any income have only untaxed income, no further documentation is required. You may be placed in forbearance while your servicer verifies your income.	You don't have to do anything. Your payments are automatically calculated based on your current earnings, family size, and location based on information in your tax return.
Do I have to re-certify?	No.	Yes, every year via the above process for calculating earnings. If your income or family size change and you want to have payments recalculated, you can recertify at any time.	No.

Table 1: Repayment Plans (continued)

	Plan 1 - A “fixed” repayment plan	Plan 2 - An “IDR” plan	Plan 3 - An “auto-IDR” plan
How do I make payments?	This depends on your servicer(s). Most offer auto-debit from a bank account. You can also make one-time payments by mail, online, or by phone. Many servicers offer a mobile app.	Same as plan 1.	Payments automatically withheld from your paycheck.
When am I eligible for forgiveness?	Never.	After 20 years of qualifying payments (not including forbearance or deferment unless for economic hardship).	After 20 years.
Does this plan exist in real life?	Yes, this is the “Standard Plan.”	Yes. Above is based on the REPAYE Plan, but these factors largely apply to other IDR plans as well, with some variation.	Australia and the United Kingdom have this, though with different income thresholds, repayment rates, and forgiveness timelines.

ENDNOTES

- 1 See: Dynarski, S. & Kreisman, D. (2013). "Loans for Educational Opportunity: Making Borrowing Work for Today's Students." The Hamilton Project at the Brookings Institution." and Kreisman, D. (2021) "Unforced Errors: How One Simple Fix Could Improve Student Loan Repayment." The Third Way.
- 2 Herbst, D. (2021). The Impact of Income-Driven Repayment on Student Borrower Outcomes. American Economic Journal: Applied Economics.
- 3 <https://www2.ed.gov/policy/highered/reg/hearulemaking/2021/nprmidr.pdf>
- 4 For example, a typical \$26,000 loan under the Standard plan would lead to monthly payments of about \$216. One would have to earn \$82,000 to make a comparable monthly payment under IDR. Further, assuming 5% earnings growth (as the government does in projections) and that the poverty line increases by the same, under IDR that individual would pay off in about 7 years.
- 5 See table 3 of NPRM (<https://www2.ed.gov/policy/highered/reg/hearulemaking/2021/nprmidr.pdf>).
- 6 Through the 2032 cohorts. See Table 6 of NPRM (<https://www2.ed.gov/policy/highered/reg/hearulemaking/2021/nprmidr.pdf>).
- 7 One result of a universal IDR plan is that defaults should go to zero. While this is good, it would not allow the government to use cohort default rates to determine which schools retain access to financial aid. One solution, of many, is to use the ratio of debt-to-earnings, which has the benefit of not conflating the inability to make payments (which it measures) with students' defaulting because they are unaware of alternative programs available to them (which the current measure also captures).
- 8 <https://educationdata.org/student-loan-default-rate>
- 9 <https://www2.ed.gov/policy/highered/reg/hearulemaking/2021/nprmidr.pdf>
- 10 The IDR plans actually take 10% of AGI above 150% of the poverty line, not earnings. AGI is earnings minus allowable deductions.
- 11 <https://studentaid.gov/manage-loans/default>, and <https://studentaid.gov/manage-loans/default/collections>.
- 12 Fostering Undergraduate Talent by Unlocking Resources for Education.
- 13 GAO (2022). "Education Needs to Take Steps to Ensure Eligible Loans Receive Income Driven Repayment Forgiveness." GAO-22-103720.
- 14 GAO-22-103720, Page 10.
- 15 The current proposal will not charge unpaid monthly interest.
- 16 A typical \$26,000 loan would lead to about \$275 in monthly payments under the Standard Plan, or \$3,300 annually. For IDR to be more than that, using the national poverty line (\$12,880), anyone earning more than about \$52,500 would pay more in IDR than Standard, not taking deductions for AGI into account.
- 17 <https://www.nytimes.com/2018/04/02/upshot/an-international-final-four-which-country-handles-student-debt-best.html>
- 18 Question 10 asks if you have a student loan. Choose yes or no. That's it. See it here: https://www.ato.gov.au/uploadedFiles/Content/IND/Downloads/TFN_declaration_form_N3092.pdf
- 19 <https://www.ucas.com/student-finance-england/repaying-your-student-loan> . £524 is \$632 at time of writing. Italics my own.