SKETCHING A NEW CONSERVATIVE EDUCATION AGENDA

Replace the Federal Student Loan System with an Income Share Agreement Program

By Beth Akers

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Key Points

- The higher education narrative has been dominated by the student loan crisis as of late. While the magnitude of this problem is often oversold, borrowers do sometimes need help.
- However, debt forgiveness plans, such as those proposed by Sens. Bernie Sanders (I-VT) and Elizabeth Warren (D-MA), deliver the biggest benefits to those who need it least.
- A better solution would be a government-sponsored income share agreement, in which the amount due each month depends only on how much the borrower is earning, and a simplified IRS-managed income withholding repayment system.

We hear a lot about how student loans are unaffordable for borrowers. That notion was central in the 2020 Democratic primary race, with Sens. Bernie Sanders (I-VT) and Elizabeth Warren (D-MA) proposing to wipe away massive amounts of debt. Student loans—an oft-forgotten policy issue in days past—were addressed in the first COVID-19 relief bill, even though many other more pressing areas of the economy were left untouched.

The problem with generous debt forgiveness plans like Sanders' and Warren's is that they deliver the biggest benefit to those who need it least.[1] College typically pays huge dividends during a career. Even with a student loan payment, people with college and graduate degrees are among the more well-off in the economy.

But sometimes college doesn't pay off,[2] and borrowers do need help. We've tried to fix this problem with a system for loan repayment[3] that relieves borrowers from having to make unaffordable monthly payments. Unfortunately, that system doesn't work well, because over time it has become a cobbled-together safety net of different programs with different terms and rules for eligibility. The result is that people who are underwater on their investment in college sometimes end up defaulting on their loans and paying an unnecessary price.

We need to replace this patchwork of programs with a simple, universal program in which all borrowers repay their federal student debt through a single plan: a government-sponsored income share agreement (ISA). While quietly embraced by conservatives for several years, the idea of using an ISA program to replace the federal lending program was formally proposed[4] for the first time as part of Jeb Bush's campaign for the Republican nomination for president in 2016. It is described in detail by its architect, Jason Delisle of the American Enterprise Institute, in a recent Manhattan Institute report.[5]

The benefit of an ISA is that the amount due each month depends only on how much borrowers are earning, meaning they pay only what they can afford. That way, people who do not experience a big return on their investment in college do not have to pay back as much as those who win big with high-paying jobs do.

A related concern is that the current system of student loan servicing is confusing, which often means people cannot fully take advantage of the benefits available to them. To simplify, we should replace the current overly complex system of student loan servicing with IRS-managed income withholding. Eliminating third-party servicers would both lower costs for taxpayers and improve the Department of Education's ability to effectively manage repayment. Unlike the current system, borrowers won't need to actively manage their repayment, either by choosing and enrolling in alternative repayment plans or by having to track and communicate with their servicer.

Together, these changes would help borrowers who find themselves struggling to make ends meet after college not be on the hook to make payments they cannot afford. They would simplify the safety net, which means more struggling borrowers would receive the benefits they need. In addition, aspiring students who are concerned about borrowing would be better able to understand the safety nets available to them. This could encourage more disadvantaged students to enroll in college, as they are the most likely to be concerned about unaffordable debt after graduation.

That said, the safety net implicit in this system does introduce a moral hazard: Borrowers will have less incentive to earn money if they can get off the hook for repayment. That might encourage some to take cushy jobs or even opt out of working altogether, which imposes a real cost. This is an unfortunate but necessary evil when designing safety nets, but it doesn't mean they shouldn't exist.

Additionally, if program parameters are set appropriately, they could actually reduce moral hazard relative to the current policy regime, which sometimes creates circumstances in which certain borrowers can knowingly take on additional debt without increasing the amount they'll have to repay.[6]

It's not wrong for students to have to borrow for college. But it is wrong to have a safety net for borrowers that doesn't work or to implement universal loan forgiveness that benefits those who need it least. We need a system of higher education finance that not only allows students to borrow to invest in themselves but also provides a safety net that ensures unaffordable loans don't hamstring young people for life.

About the Author

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Notes

1. Adam Looney, David Wessel, and Kadija Yilla, "Who Owes All That Student Debt? And Who'd Benefit If It Were Forgiven?," Brookings Institution, January 28, 2020, https://www.brookings.edu/policy2020/votervital/who-owes-all-that-student-debt-and-whod-benefit-if-it-were-forgiven/.
2. Douglas Webber, "Is College Worth It? Going Beyond Averages," Third Way, September 18, 2018, https://www.thirdway.org/report/is-college-worth-it-going-beyond-averages.
3. US Department of Education, Federal Student Aid, "If Your Federal Student Loan Payments Are High Compared to Your Income, You May Want to Repay Your Loans Under an Income-Driven Repayment Plan," https://studentaid.gov/manage-loans/repayment/plans/income-driven.

4. Michael Stratford, "Bush Pushes Loan Overhaul," *Inside Higher Ed*, January 20, 2016, https://www.insidehighered.com/news/2016/01/20/jeb-bush-unveils-higher-education-plan-focus-federal-loan-overhaul.

5. Jason D. Delisle, "How to Make Student Debt Affordable and Equitable," Manhattan Institute, July 23, 2019, https://www.manhattan-institute.org/replacing-federal-student-loan-program.

6. Jason D. Delisle and Alexander Holt, *Zero Marginal Cost*, New America, August 6, 2014, https://www.newamerica.org/education-policy/policy-papers/zero-marginal-cost/.