**To:** The Honorable Governor Carey Nupf, Governor

**From:** Grace Sam, Policy Analyst

**Date:** September 14, 2024

**Subj:** Alleviating short and long-term burden cause by college debt

Many working-age adults living in the state reported difficulty in making payments due to high college debt relative to income. After making payments towards education loan, rent, food, utilities, medicines, and other necessary expenses, residents are left with very little residual income every month. The limited means to spend affects the quality of life. More importantly they are unable to save and invest which limits their ability to build generational wealth. The limited spending also has an impact on the state’s economy. Lower debt would boost consumption, has positive effects on employment choices, mental health, financial security, and allows wealth building through homeownership and entrepreneiurship.3

Defining the problem

The problem can be understood as high proportion of monthly income spent on college debt repayment - ratio of debt repayment amount/monthly income being high. Another related yet alternate definition would be low levels of monthly residual income - income left after making monthly payments is too low. The memo uses the latter to define and scope the problem as residual income is a broader definition since it takes into account other living expenses in addition to college debt being too high and income being too low, and thus allows a more comprehensive view of the issue affecting the residents

Figure 1 illustrates the causal pathways influencing the issue. Low incomes, high cost of college, high living expenses (boxes in bold) could be considered as the proximate causes leading to difficulty in meeting expenses and low residual income levels. The end nodes could be considered as the root causes.

While high and increasing tuitions are the primary cause, associated factors like lack of targeted debt alleviation programs, or lack of awareness and under-utilization of these programs, and low levels of family income worsen the issue. Low savings, and lack of need-based or monthly-debt-burden focused programs also aggravate the debt burden.

Low income makes meeting expenses, including college debt payment difficult, and leaves individuals with low residual income, affecting their ability to save and invest. Both supply side factors like too many working-age adults, low education levels, skill to job mismatch wherein individuals are forced to accept jobs below their skill-level, and demand side factors like not enough job opportunities, and recession negatively affect income.

High cost of living is another factor that determines realized potential of earned income. High living expenses – rent, food, utilities, medicines – and necessary expenses like taxes result in lower residual income. High prices combined with low homeownership, and low levels of family wealth make saving and investing harder and perpetuates income and racial inequality, since its often people-of-color, Black and Hispanic families and individuals that have lower generational wealth.

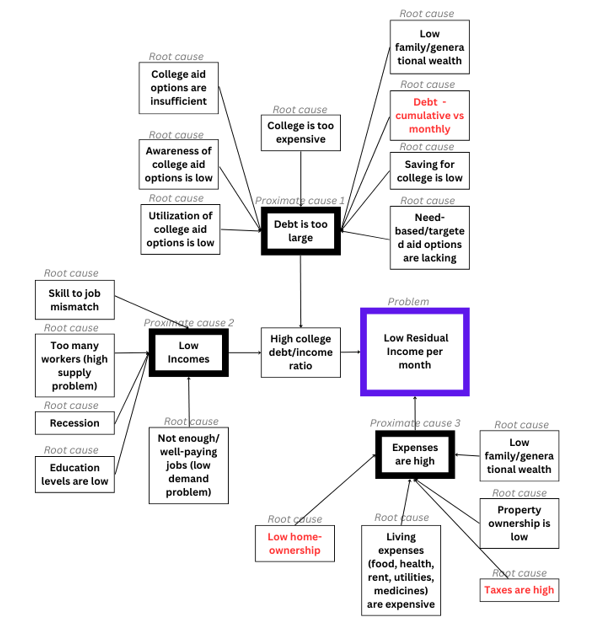


Figure 1 – Causal model for high college debt burden - Proximate causes (boxes in bold) and Root causes (end nodes). Boxes in red are those through which the memorandum considers addressing the issue in the following sections.

Policy Options

The following section will consider three policy options and their potential impact in alleviating the expense burden for individuals.

1. Lowering state-tax burden

Under this program every dollar spent towards college debt repayment, up to 10% of income, will reduce the income tax base by an equivalent amount, lowering the tax liabilities for individuals.

i.e. if, *current\_tax\_liability = income \* state tax rate*

then, under the program,

*new\_tax\_liability = (income – college debt repayment amount) \* state tax rate*

*Tax\_deduction = (current\_tax\_liability - new\_tax\_liability)*

The ‘income’ here represents net taxable income with all existent deductions in place.

Program implementation would be through collecting ‘amount paid towards college debt repayment’ at the time of income tax filing, by adding this line in the income tax form.

The program aims to reduce the tax burden on individuals caused by high college debt, and aims to increase the residual income available with them. While this will reduce revenue base for the state, the reduction would be by proportion (= *college debt repayment amount \* state tax rate*), while debt repayment (= *college debt repayment amount*)will be by equivalent dollar amount. Overall, the money flow in the economy should gain by this incentive.

|  |  |  |  |
| --- | --- | --- | --- |
| **Income** | **Loan Amount Paid** | **Tax rate** | **Tax deduction** |
| $15,000 | $500 | 3% | $15 |
| $50,000 | $500 | 3% | $15 |
| $15,000 | $1,500 | 3% | $45 |
| $50,000 | $1,500 | 3% | $45 |

Table 1 - Tax deduction = college debt repayment amount \* state tax rate

An unintended impact of this program, as the table above illustrates, is that the benefit amount, the reduction in tax liability, will be equivalent across incomes if payment amount is the same. Individuals with 15k and 50k income, get a tax deduction of $45 when they pay $1500 towards loan repayment. The same benefit amount ($45) and repayment amount ($1500) have different valuation at different income levels. It is more demanding to pay $1500 with 15k income relative to 50k income. Similarly, the value of $45 tax relief would be higher at lower incomes. To account for this, the reduction in tax liability can also take into account debt repayment amount relative to income, i.e.

*Tax\_deduction = (current\_tax\_liability - new\_tax\_liability) \* (1 + college debt repayment amount/income)*

|  |  |  |  |
| --- | --- | --- | --- |
| **Income** | **Loan Amount Paid** | **Tax rate** | **Tax deduction** |
| $15,000 | $500 | 3% | $15.5 |
| $50,000 | $500 | 3% | $15.15 |
| $15,000 | $1,500 | 3% | $49.5 |
| $50,000 | $1,500 | 3% | $46.35 |

Table 2 - Tax deduction = college debt repayment amount \* state tax rate\* (1 + college debt repayment amount/income)

As the table above illustrates, this tax relief program lowers the tax burden for individuals, and thereby alleviates the difficulty residents reported in low residual income. And it does so proportionally, benefit is higher for lower incomes for same amount of debt repayment.

Depending on budget allocation, deductions can be increased or decreased, by tailoring the factor (*1 + college debt repayment amount/income* in above table) to income levels. As an example, in the table below the factor used is (*10 + college debt repayment amount/income*) for 15k income and (*5 + college debt repayment amount/income*) for 50k income.

|  |  |  |  |
| --- | --- | --- | --- |
| **Income** | **Loan Amount Paid** | **Tax rate** | **Tax deduction** |
| $15,000 | $500 | 3% | $150.5 |
| $50,000 | $500 | 3% | $75.15 |
| $15,000 | $1,500 | 3% | $454.5 |
| $50,000 | $1,500 | 3% | $226.35 |

Table 3 - Tax deduction = college debt repayment amount \* state tax rate\* (10 + college debt repayment amount/income) for 15k income. And Tax deduction = college debt repayment amount \* state tax rate\* (5 + college debt repayment amount/income) for 50k income.

The choice of the factor and corresponding deduction would determine the extent of tax relief individuals get from the program. If the tax benefit is too high, the program might incentivize debt repayment over other needs, which in the short run might come at the expense of education, nutrition, and health, and would have unintended long-term effect on well-being; too low and the program might not be effective in easing the expense burden and increasing residual income.

1. Income Based Repayment4,6

Loan assistance programs that aim at loan forgiveness alleviate ‘cumulative’ high debt burden over individual’s lifetime. As the residents reported low income and high expenses that make monthly debt repayment difficult, aid assistance program that address ‘monthly debt burden’ would be more effective here. Income based repayment plans can ensure that payments towards college debt aren’t a strain on the household resources and needs.

Residual income (or discretionary income) is part of the income that is left after necessary payments have been made (rent, utilities, food, health, medicine, transport, loans). Income based repayment plans can alleviate the stress caused by high college debt by allowing month repayments to be flexible and adjusted to discretionary income available.

The Federal Poverty Line (FPL) is the minimum income that a family requires for food, clothing, transportation, shelter, and other necessities.8,7 The table below shows FPL defined

|  |  |  |
| --- | --- | --- |
| **Family size** | **2024 FPL Income** | **200% FPL** |
| For individuals | $15,060 | $30,120 |
| For a family of 2 | $20,440 | $40,880 |
| For a family of 3 | $25,820 | $51,640 |
| For a family of 4 | $31,200 | $62,400 |
| For a family of 5 | $36,580 | $73,160 |
| For a family of 6 | $41,960 | $83,920 |
| For a family of 7 | $47,340 | $94,680 |
| For a family of 8 | $52,720 | $105,440 |

Table 4 – Federal poverty line per household size

basis household size. The following section uses ‘households’ and ‘individuals’ interchangeably.

Under the Income Based Repayment (IBR) program, households with income above 200% of FPL, can choose monthly repayment amounts which are over 5% of their income. The proportion is up to household’s discretion, and is fixed at the start of the program. The proportion can be increased or decreased anytime upon request. Households for whom the repayment period is over 35 years with the current monthly payment plan would be considered separately to identify room to increase monthly payment, and a stricter repayment criterion to qualify for loan forgiveness at the end of 35 years. All residents of the state are eligible to participate in the program, though loans outside the state will have to be reconsolidated with the state. Residency would be defined in terms of those working in the state. Also eligible are those who had taken state-loans to finance their education.

Households with income below 200% FPL would have $0 repayment requirement every month. If at any point, income falls below 200% FPL, individuals can report the change, and no payment would be due, and no penalty would be incurred. Households have 18 grace-months of $0 monthly-payment-due over their lifetime. Households in this sub-group who are either making $0 payments towards debt repayment, or their monthly payment is such that repayment would be over 35 years are required to participate in trainings to identify pathways to improve their income. A portal would be developed that would maintain the repository of education and employment experience of recipients of the program. The portal would match skills to new and better job opportunities. Individuals are required to accept if it improves income to above 200% FPL. Rejecting jobs with higher incomes would be considered on a case-by-case basis.

The program alleviates the difficulty in making repayments towards college debt by requiring repayment from those with income above 200% FPL, and giving individuals the flexibility to decide the monthly repayment amount. An unintended impact of the program could be that people with income just slightly above 200% FPL, would have incentive to earn below 200% FPL to reduce their liability by at least 5% of their income. While the program sets a limit of 18 months to $0 payment-due months, the potential to save this money during a crisis can affect the repayment schedule. This could be misused by those close to their 35-year mark, as this group can use the 18-month grace period and then ask for loan forgiveness, which would be a waste of state’s resources.

1. Assisting home ownership5

Debt-to-income (DTI) ratio is a crucial factor that determines the ability to get a mortgage, and also the interest rate at which individuals can get it. Given the high debt to income ratio, and low residual income that residents are left with, it directly affects their ability to own a home.

Under this program, residents can get loans from state housing finance agencies that calculate DTI ratios excluding the monthly payment towards student debt, and thus accept higher DTI ratios. Individuals and households earning above 200% FPL and who have consistently made payments towards their student debt over the last 3 years are eligible to participate in this program. The program also gives a $15,000 downpayment assistance for first-time home-buyers.

The program prevents student debt from affecting residents’ ability to become home-owners. An unintended impact of the program could be that it would incentivize households to split if credit history and home-ownership of a partner limits them from benefitting from the program.

Conclusion

Residents in the state are burdened by high student debt, high expenses, and low income which leaves them with low residual income. The policies considered here can alleviate the debt burden by lowering tax due. Giving the option of income-based-payment plans gives residents the flexibility to allocate their discretionary income basis need. The state financed home ownership assistance prevents student debt from limiting households’ ability to build wealth. These programs alleviate both short and long-term burden causes by having student debt, and incentivize repayment.

*Resources*

1. [*https://studentaid.gov/manage-loans/forgiveness-cancellation/public-service*](https://studentaid.gov/manage-loans/forgiveness-cancellation/public-service)
2. [*https://crsreports.congress.gov/product/pdf/R/R45389/3*](https://crsreports.congress.gov/product/pdf/R/R45389/3)
3. [*https://www.whitehouse.gov/cea/written-materials/2024/04/08/the-economics-of-administration-action-on-student-debt/*](https://www.whitehouse.gov/cea/written-materials/2024/04/08/the-economics-of-administration-action-on-student-debt/)
4. [*https://studentaid.gov/manage-loans/repayment/plans/income-driven*](https://studentaid.gov/manage-loans/repayment/plans/income-driven)
5. [*https://files.eric.ed.gov/fulltext/ED606374.pdf*](https://files.eric.ed.gov/fulltext/ED606374.pdf)
6. [*https://studentaid.gov/help-center/answers/article/discretionary-income*](https://studentaid.gov/help-center/answers/article/discretionary-income)
7. [*https://www.healthcare.gov/glossary/federal-poverty-level-fpl/*](https://www.healthcare.gov/glossary/federal-poverty-level-fpl/)
8. [*https://www.investopedia.com/terms/f/fpl.asp#:~:text=The%20FPL%20is%20the%20minimum,such%20conditions%20in%20the%20U.S*](https://www.investopedia.com/terms/f/fpl.asp#:~:text=The%20FPL%20is%20the%20minimum,such%20conditions%20in%20the%20U.S)*.*
9. [*https://www.brookings.edu/articles/bidens-income-driven-repayment-plan-would-turn-student-loans-into-untargeted-grants/*](https://www.brookings.edu/articles/bidens-income-driven-repayment-plan-would-turn-student-loans-into-untargeted-grants/)