

# INSURANCE VERSUS MORAL HAZARD IN INCOME-CONTINGENT STUDENT LOAN REPAYMENT

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Disclaimer: The results of these studies are based, in part, on Australian Business Registrar (ABR) data supplied by the Registrar to the ABS under A New Tax System (Australian Business Number) Act 1999 and tax data supplied by the ATO to the ABS under the Taxation Administration Act 1953. These require that such data is only used for the purpose of carrying out functions of the ABS. No individual information collected under the Census and Statistics Act 1905 is provided back to the Registrar or ATO for administrative or regulatory purposes. Any discussion of data limitations or weaknesses is in the context of using the data for statistical purposes, and is not related to the ability of the data to support the ABR or ATO's core operational requirements. Legislative requirements to ensure privacy and secrecy of these data have been followed. Source data are de-identified and so data about specific individuals or firms has not been viewed in conducting this analysis. In accordance with the Census and Statistics Act 1905, results have been treated where necessary to ensure that they are not likely to enable identification of a particular person or organisation.

## GOVERNMENT-FINANCED HIGHER EDUCATION

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  - Student loans = \$1.6 trillion in US and 10% of household debt in US and UK

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<b>Debt</b>	<b>Income-Contingent Loan</b>	<b>Equity</b>
<ul style="list-style-type: none"><li>• Standard contract in US</li><li>• Hard to discharge</li></ul>	<ul style="list-style-type: none"><li>• Used in US, UK, Australia, Canada</li></ul>	<ul style="list-style-type: none"><li>• Share of earnings</li><li>• Limited successful examples</li></ul>

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**This Paper:** Insurance vs. Moral Hazard

Conditional on ex-ante choices, how does income-contingent repayment affect **labor supply** and welfare?

- ① **Setting:** Australian government's income-contingent student loan program
  - **Variation:** discontinuities in repayment rates + policy change to these rates
  - **Identification:** limited room for selection and ex-ante responses
- ② **Research design:** bunching at discontinuities before and after policy change
  - **Data:** universe of income tax returns + student debt balances

Conditional on ex-ante choices, how does income-contingent repayment affect labor supply and **welfare**?

- ① Setting: Australian government's income-contingent student loan program
- ② Research design: bunching at discontinuities before and after policy change
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  - **Positive**: translate responses into estimates of preference parameters
  - **Normative**: characterize optimal amount and form of income-contingent repayment

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  - **Caveat**: compute optimal contracts taking ex-ante choices as given  $\approx$  **restructuring**

# MAIN RESULTS

- ① **Empirics:** borrowers reduce labor supply to ↓ income-contingent repayments
  - Larger responses in occupations with more hourly flexibility
  - Responses increase with liquidity constraints and decrease with  $P(\text{repayment})$
- ② **Structural estimation:** labor supply elasticity of **0.11** + adjustment frictions
- ③ **Contract design:** moral hazard reduces optimal amount of insurance
  - Fixed repayment → optimal income-contingent loan  $\Rightarrow \uparrow 1.3\%$  lifetime consumption
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**Takeaway:** income-contingent repayment creates **moral hazard** that affects contract design, but **too small** to justify fixed repayment

# OUTLINE

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# STUDENT LOANS IN AUSTRALIA: HELP

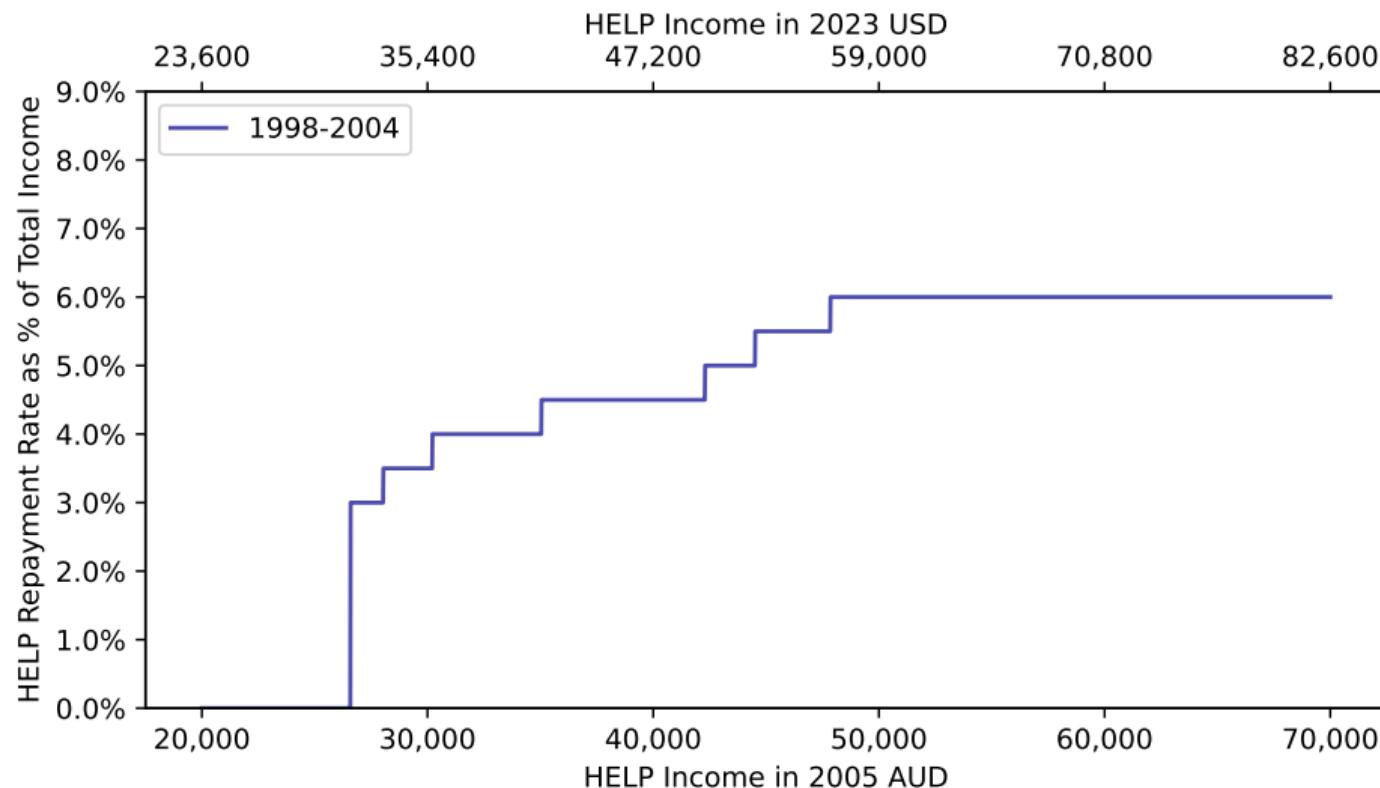
- Australian citizens eligible for government-provided student loans through **HELP**
- **Initial debt** = tuition – government contribution – upfront payment (avg.  $\approx \$20K$  USD)
- Debt grows at CPI net of **income-contingent repayments**:

$$\text{Repayment}_{it} = \text{HELP Rate}_t (\text{HELP Income}_{it}) \times \text{HELP Income}_{it}$$

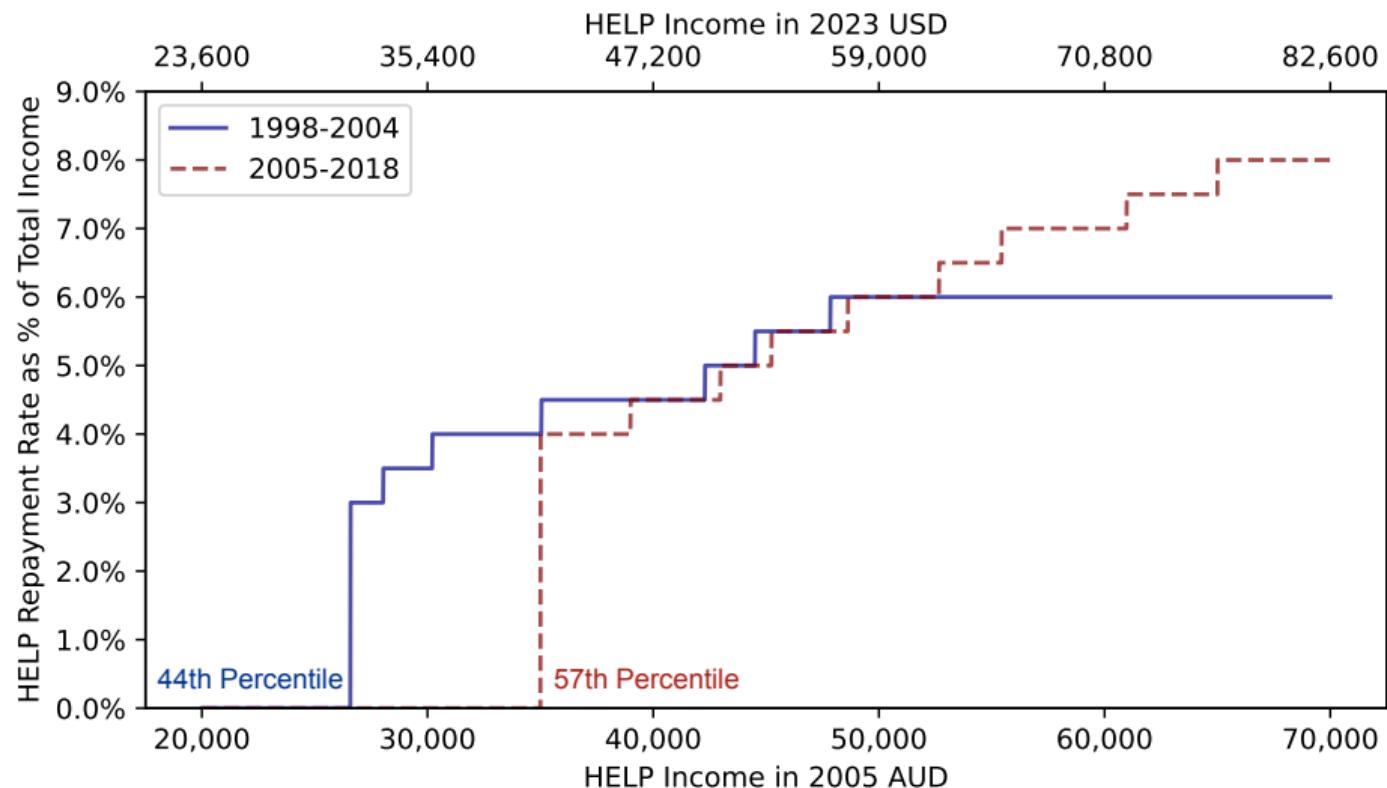
$$\text{HELP Income}_{it} = \text{Labor Income}_{it} + \text{Capital Income}_{it} - \text{Deductions}_{it}$$

- Repayments continue until remaining debt balance equals zero or death
  - ✗ Cannot be cancelled or discharged in bankruptcy

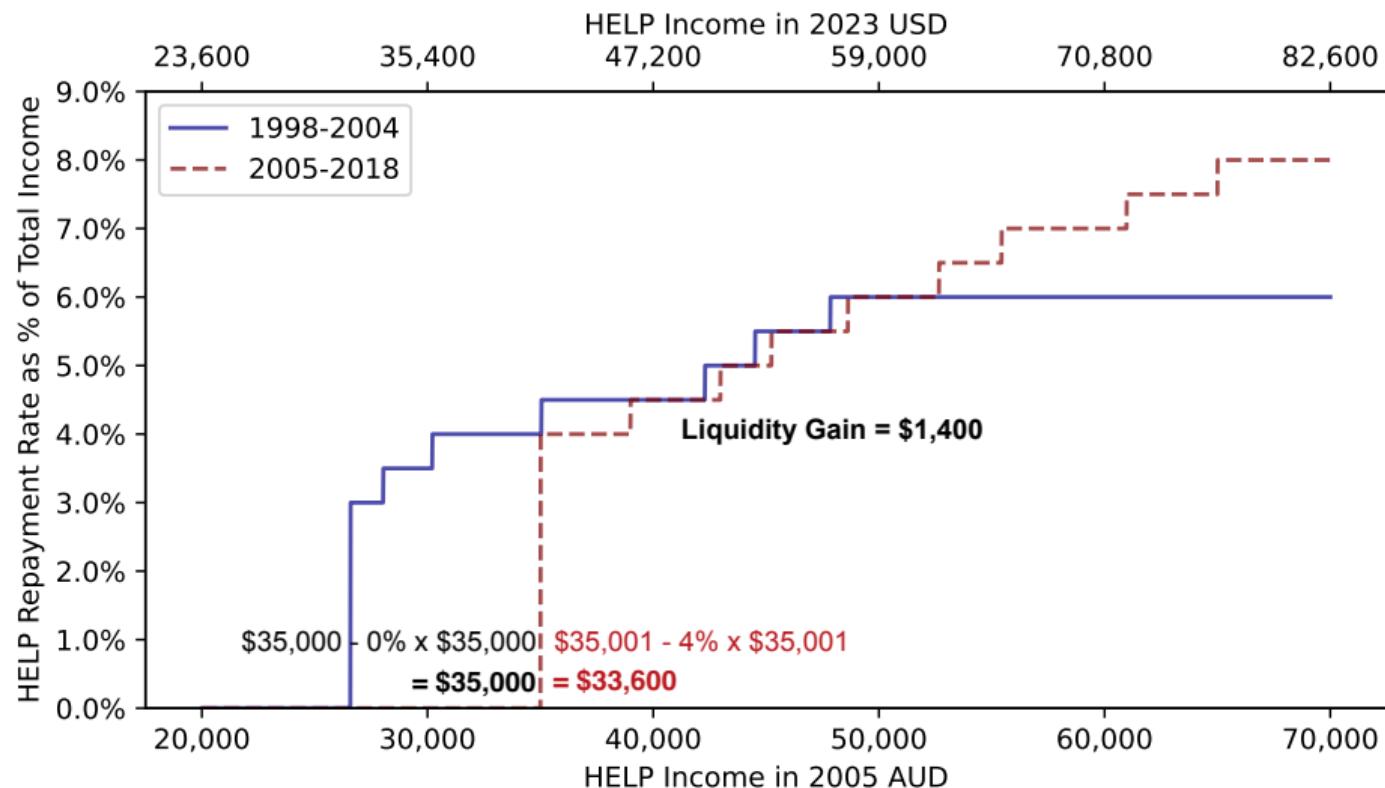
# IDENTIFYING VARIATION: DISCONTINUITIES IN REPAYMENT RATES



# IDENTIFYING VARIATION: POLICY CHANGE TO REPAYMENT RATES



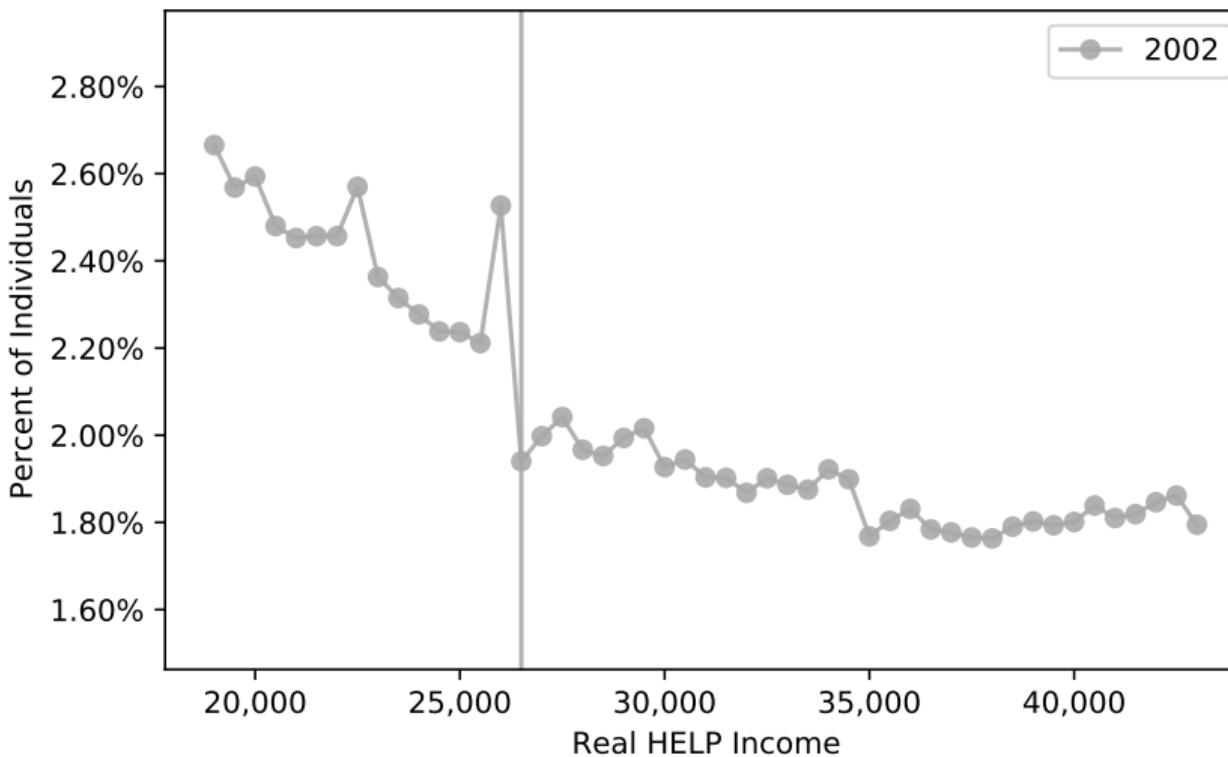
# REPAYMENT THRESHOLD INCREASES AVERAGE REPAYMENT RATE



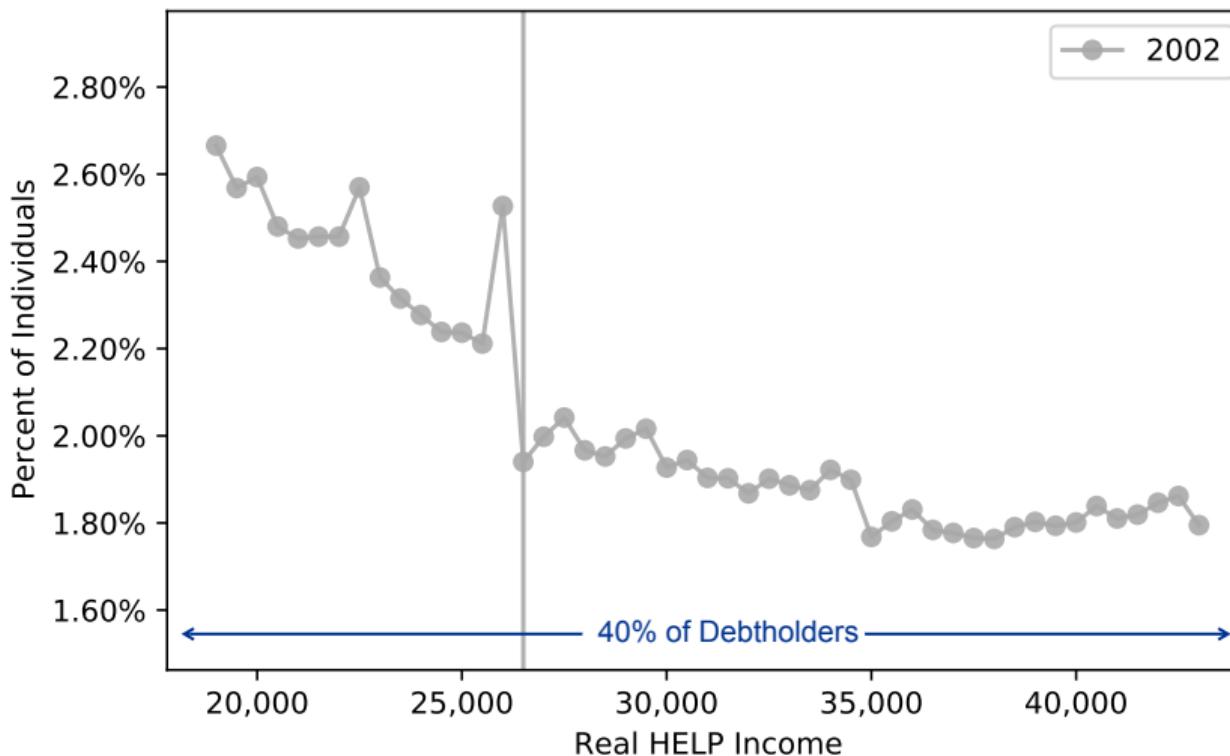
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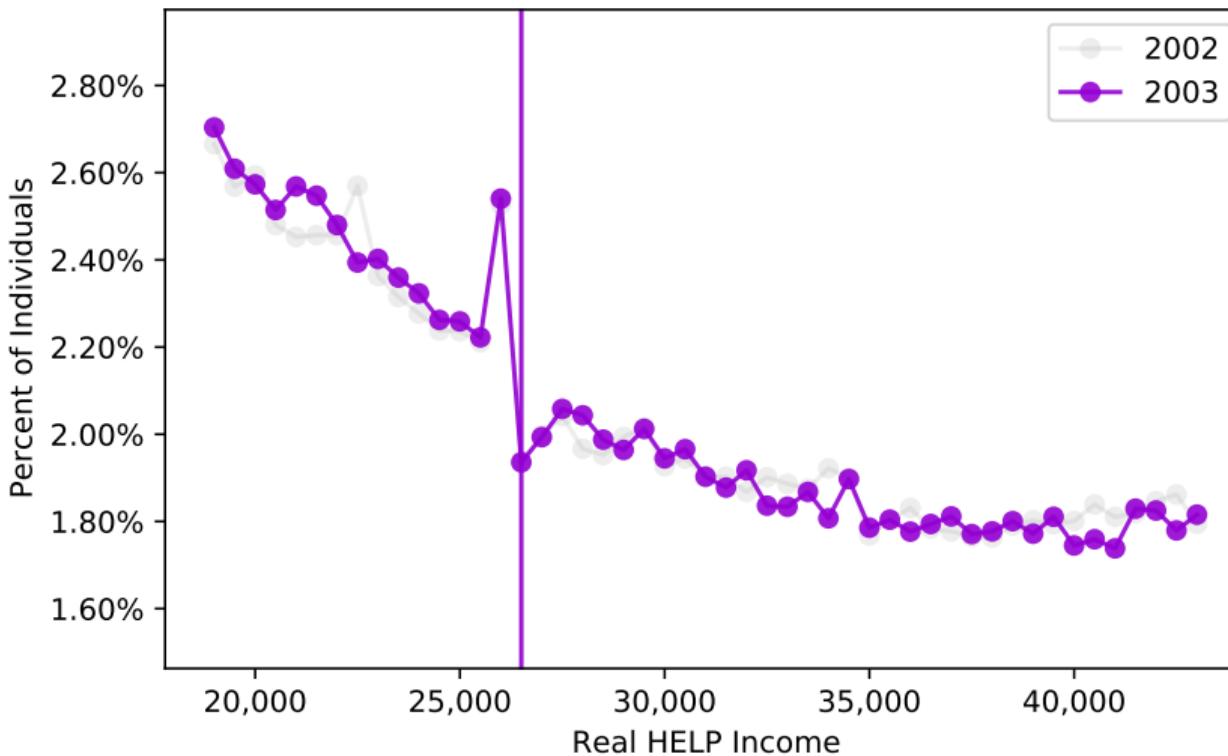
## BORROWERS ADJUST INCOME TO REDUCE REPAYMENTS



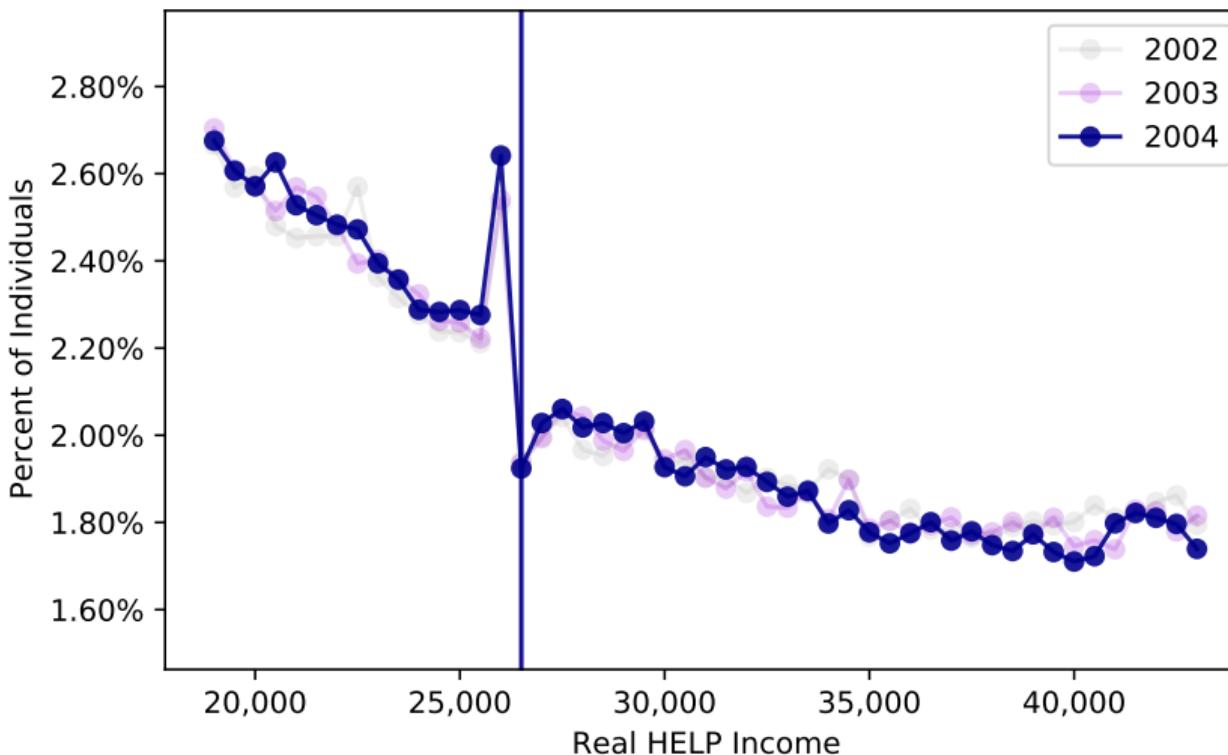
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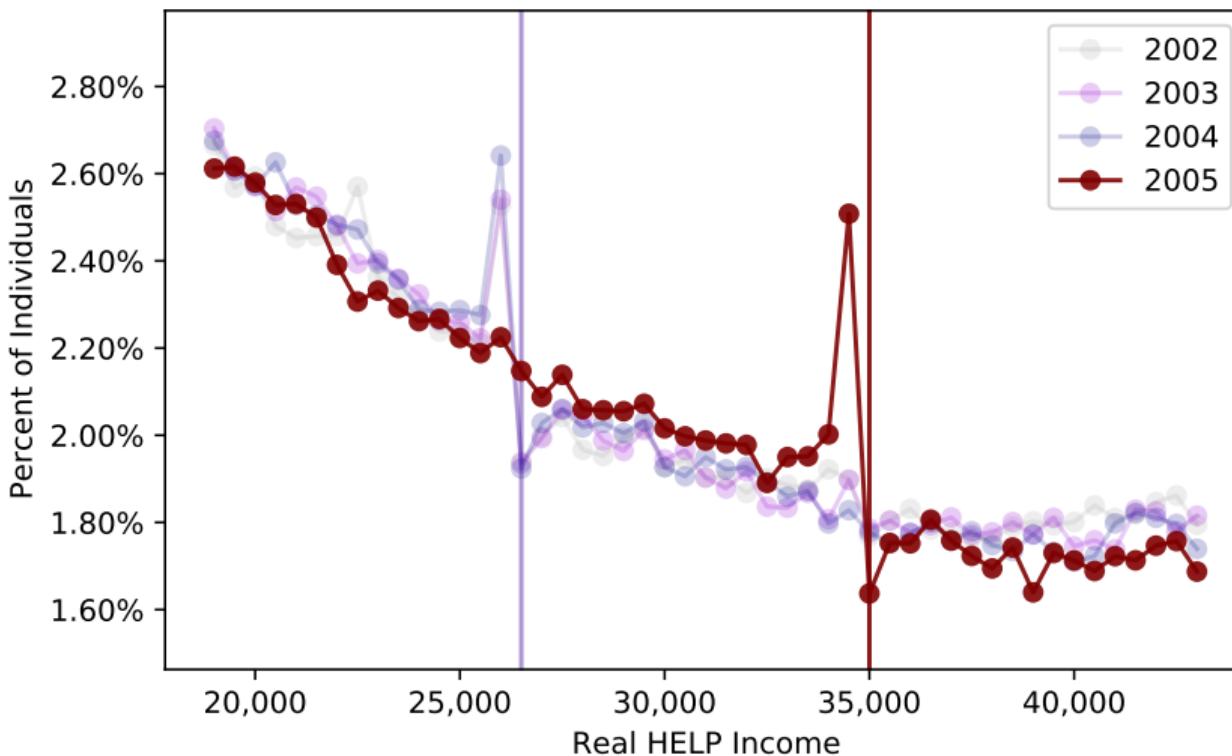
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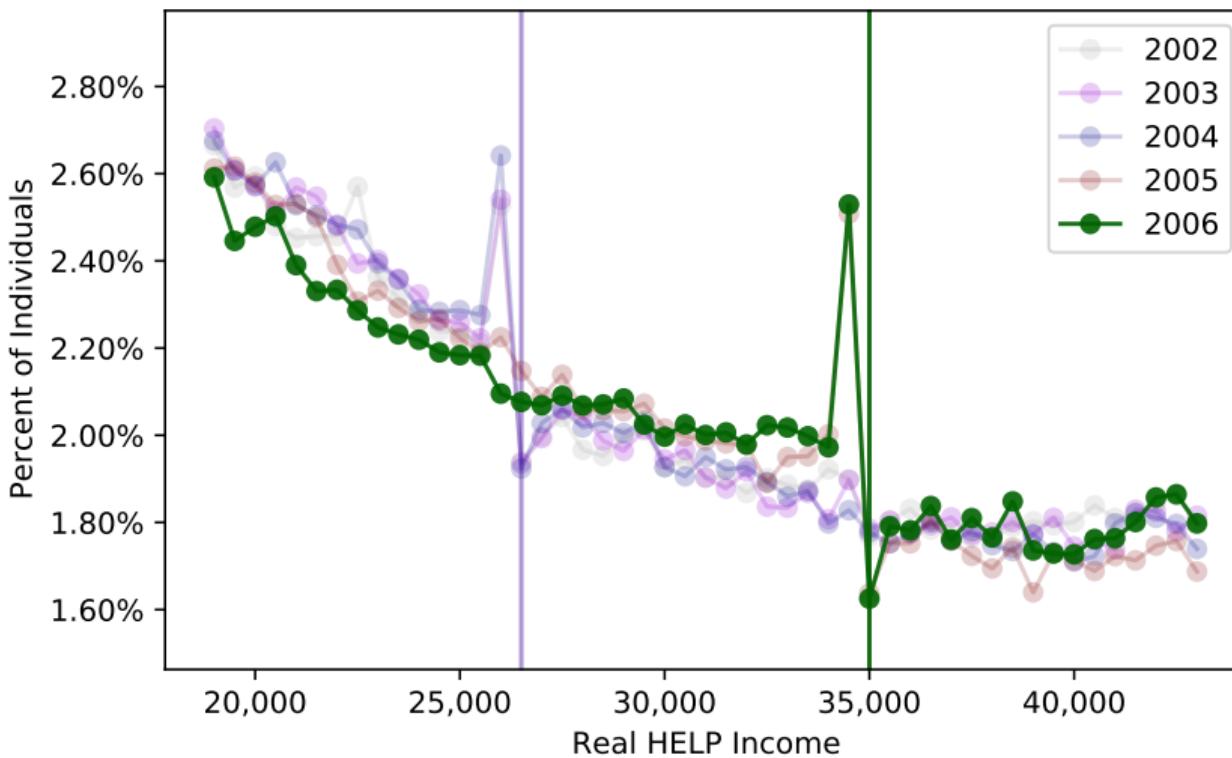
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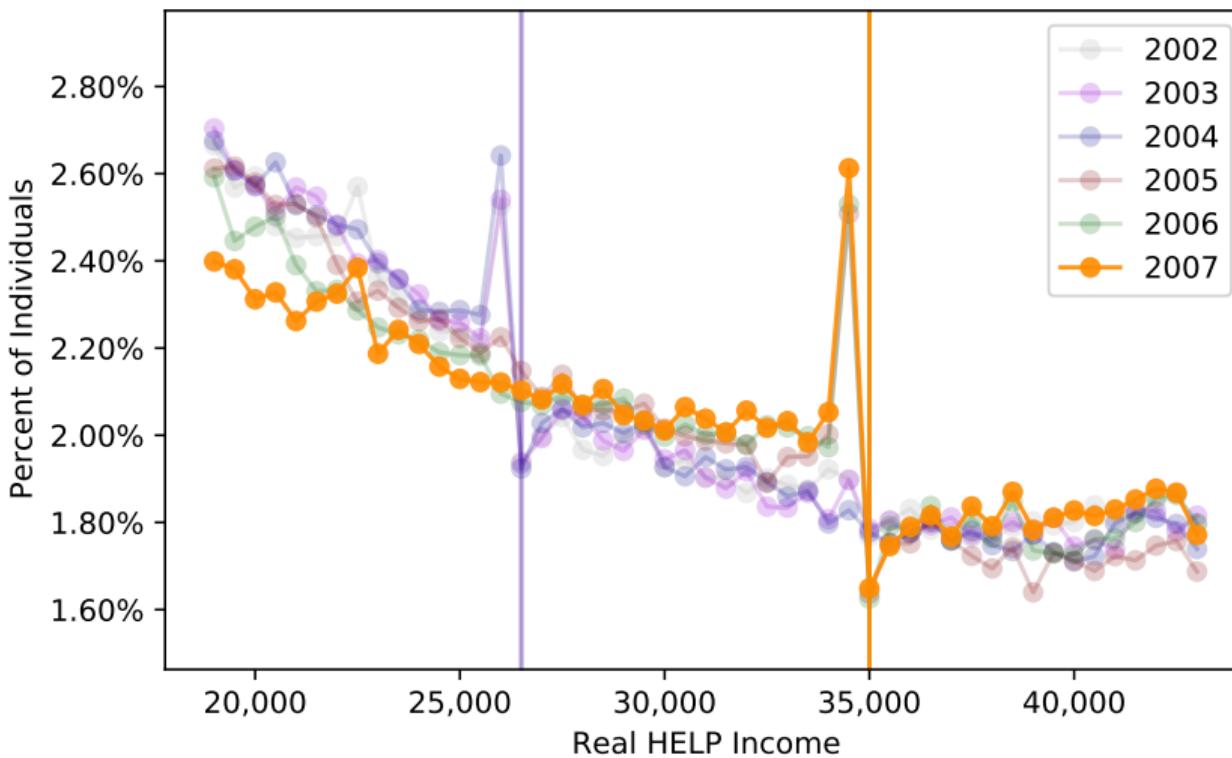
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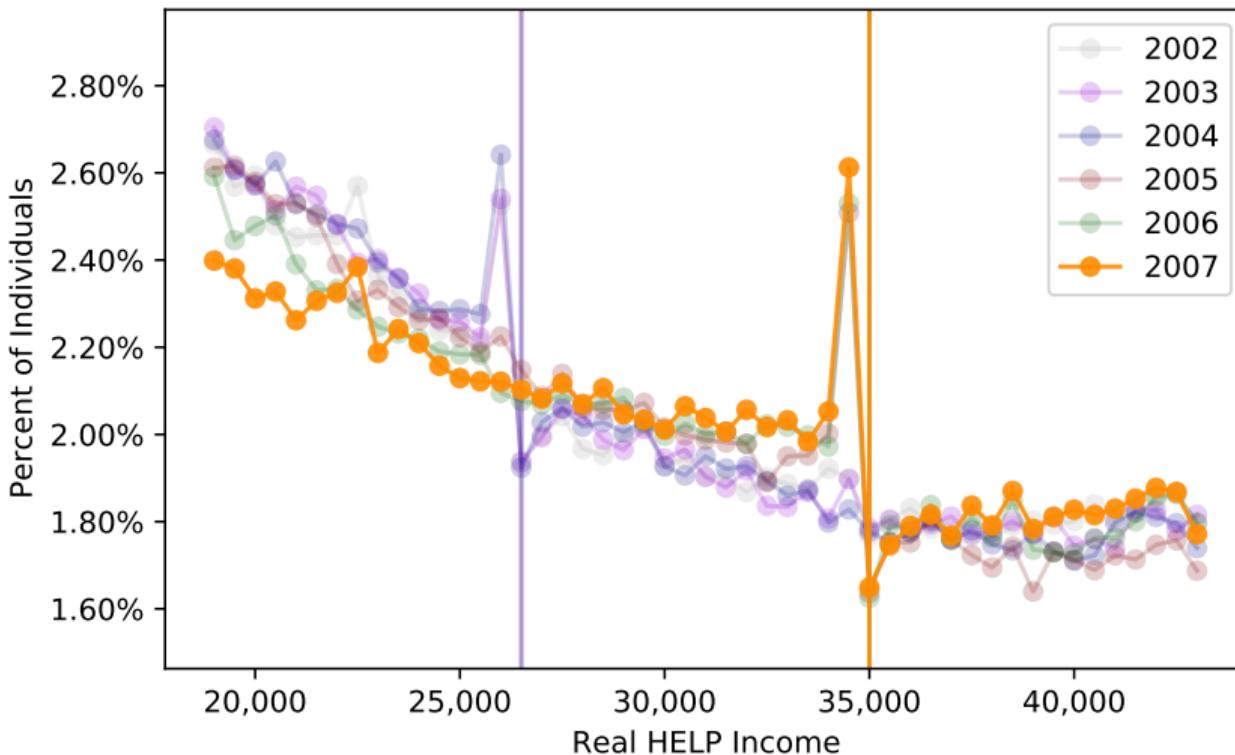
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- Next: does bunching reflect labor supply or evasion?

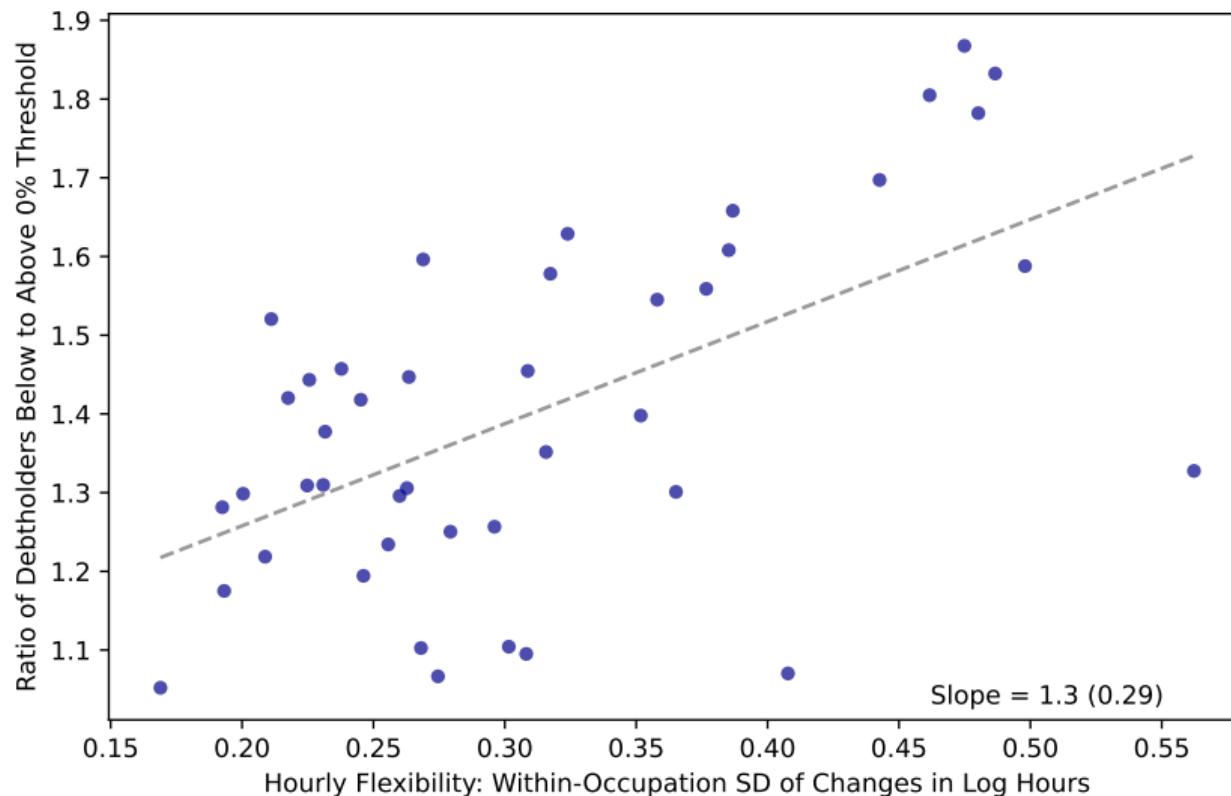
▶ Source

▶ Non-Debt

▶ Labor

▶ vs Tax

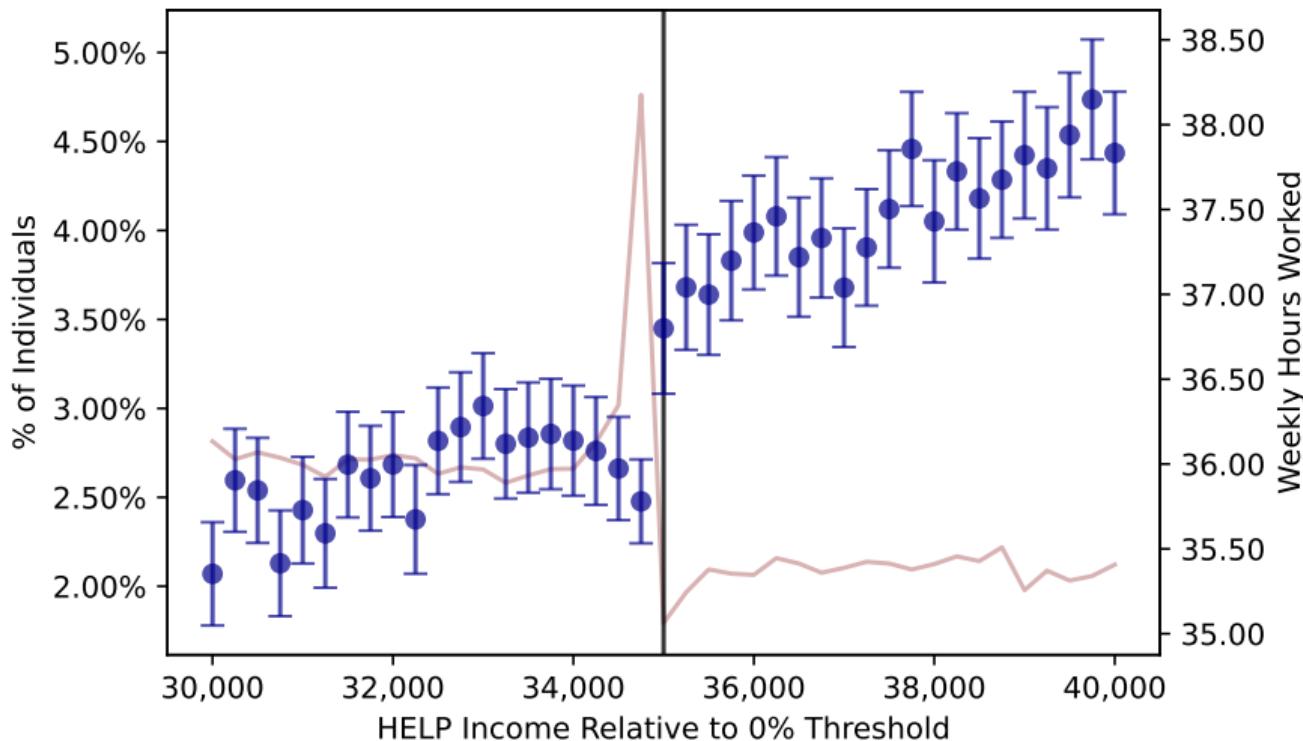
# MORE BUNCHING IN OCCUPATIONS WITH GREATER HOURLY FLEXIBILITY



Sample: all wage-earners between 2005-2018

▶ Alt. Measure ▶ Evasion ▶ Table ▶ Profiles ▶ Additional Results

# BORROWERS BELOW REPAYMENT THRESHOLD WORK FEWER HOURS



- In 2016, reduction is around **1** hour/week = 1.4 fewer weeks per year

## Empirical facts:

► Additional Results

- ① Borrowers reduce income in response to income-contingent repayment
  - Reflects labor supply: “bunchers” work fewer hours and in more flexible occupations
- ② Size of responses depends on
  - **P(repayment)**: increases with debt, decreases with wage growth and peak 
  - **Liquidity**: increases with liquidity demands, decreases with retirement wealth 

## Empirical facts:

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## Questions for model:

- ① How large are these labor supply responses quantitatively?
- ② Do they imply the costs of income-contingent repayment exceed the benefits?

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Life cycle model with debt + incomplete markets + endogenous labor supply  
  ⇒ demand for insurance                              ⇒ moral hazard

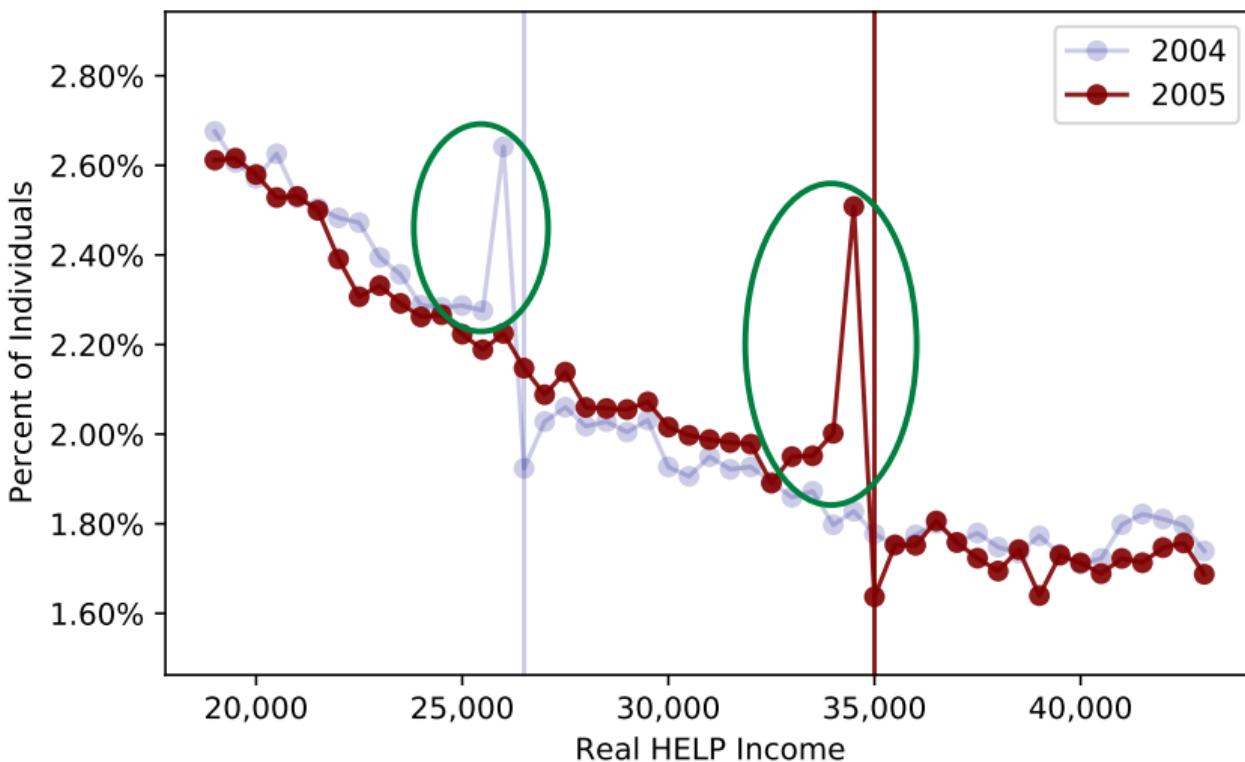
Life cycle model with debt + incomplete markets + endogenous labor supply

- Overlapping generations born at 22 with heterogeneous assets, wage, and debt
- From 22 to 64, individuals choose consumption,  $c_a$ , and labor supply,  $\ell_a$ 
  - Wage rate subject to idiosyncratic shocks (no aggregate risk, partial equilibrium)
  - Shocks are **uninsurable**: borrowing allowed up to age-dependent limit with interest
- After age 64, individuals retire and choose consumption  $c_a$

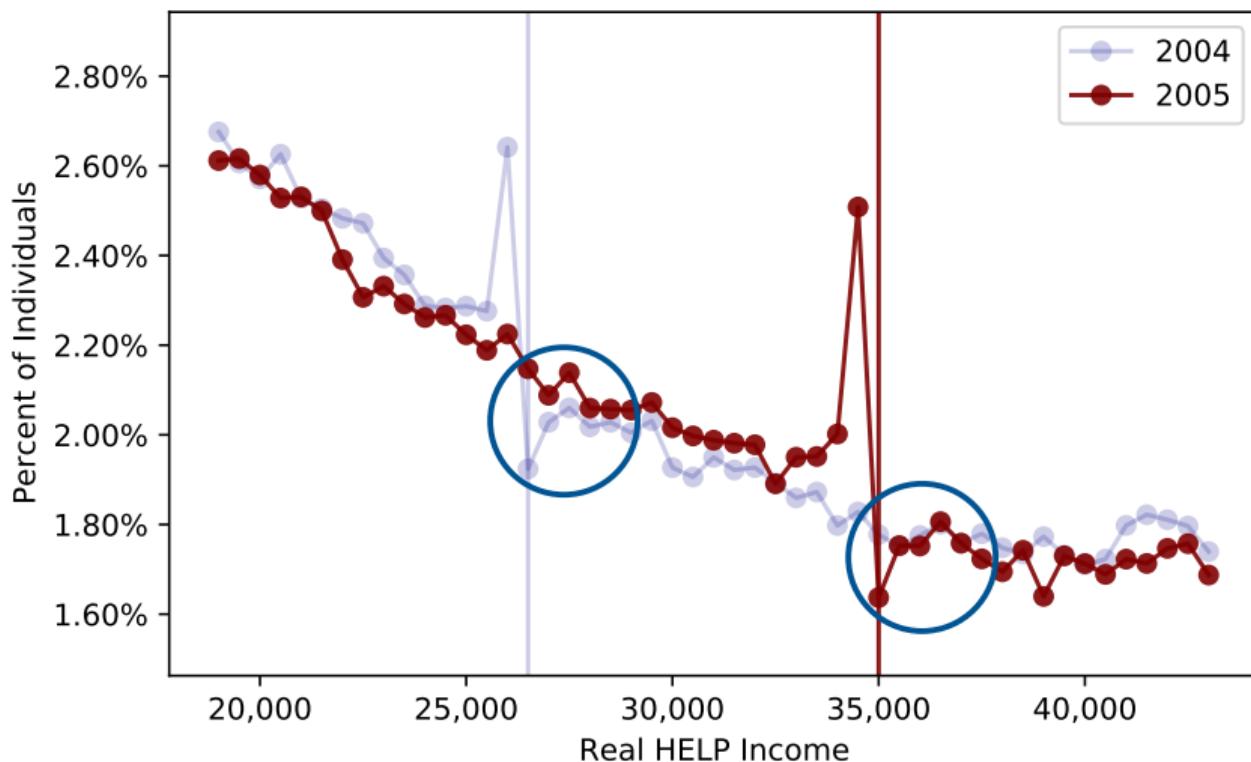
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- After age 64, individuals retire and choose consumption  $c_a$
- **Government**
  - Revenues: progressive income taxes, debt repayments
  - Expenses: means-tested unemployment benefits & retirement pension, initial debt

# BUNCHING CONSISTENT WITH POSITIVE LABOR SUPPLY ELASTICITY



# MASS ABOVE THRESHOLD INCONSISTENT WITH FRICTIONLESS MODEL



- Moving above to below threshold  $\Rightarrow$  more leisure **and** \$1400 more cash-on-hand

# LABOR SUPPLY OPTIMIZATION FRICTIONS

- Choice of  $\ell_a$  subject to two **optimization frictions** to give mass above threshold
    - Similar to models of pricing Nakamura-Steinsson 2010 and refinancing Andersen et al. 2020
- ① Canonical model of **time**-dependent adjustment (Calvo):
    - Fraction  $\lambda$  hit by shock and adjust  $\ell_a$ , other  $1 - \lambda$  set  $\ell_a = \ell_{a-1}$
    - E.g., inattention, arrival of opportunities to change hours/jobs
  - ② Canonical model of **state**-dependent adjustment ( $sS$ ):
    - Individuals hit by **Calvo shock** incur utility cost  $f$ , if they choose  $\ell_a \neq \ell_{a-1}$
    - E.g., real or psychological costs of changing hours/jobs

## SIMULATED METHOD OF MOMENTS

$$\text{Parameters} = \left( \begin{array}{c} \dots \\ \dots \end{array} \right)$$

- **Estimation** via SMM with 47 moments + 14 parameters
    - Find parameters that minimize % difference between data & model moments
  - **Simulated policy change:** unanticipated change in HELP formula at  $t = 2005$

## SIMULATED METHOD OF MOMENTS: IDENTIFICATION

$$\text{Parameters} = \left( \begin{array}{c} \overbrace{\phi \ f \ \lambda}^{\text{labor supply}} \\ \end{array} \right)$$

- **Labor supply elasticity:** identified by bunching below repayment threshold
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- Separate identification of frictions
  - **Intuition:** with  $f = 0$ , decision to bunch depends on Calvo shock not incentives
  - Moments: heterogeneity in bunching with **debt**, bunching at **0.5%** threshold

# SIMULATED METHOD OF MOMENTS: IDENTIFICATION

$$\text{Parameters} = \left( \underbrace{\phi \ f \ \lambda}_{\text{preferences}} \ \underbrace{\kappa \ \beta}_{\text{labor supply}} \ \underbrace{\delta_0 \ \delta_1 \ \delta_2}_{\text{wage profile}} \ \underbrace{\delta_0^E \ \delta_1^E}_{\text{wage risk}} \ \underbrace{\rho \ \sigma_\nu \ \sigma_\epsilon \ \sigma_i}_{\text{wage risk}} \right)$$

- Labor supply elasticity: identified by bunching below repayment threshold
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- Separate identification of frictions
  - **Intuition:** with  $f = 0$ , decision to bunch depends on Calvo shock not incentives
  - Moments: heterogeneity in bunching with **debt**, bunching at **0.5%** threshold
- No panel data on **hours**  $\Rightarrow$  wage profile & wage risk estimated **jointly**

# ESTIMATION RESULTS

Parameter	Estimation	
		Baseline
Labor supply elasticity	$\phi$	0.114
Fixed adjustment cost	$f$	\$377
Calvo parameter	$\lambda$	0.183
Time discount factor	$\beta$	0.973
Labor supply scaling parameter	$\kappa$	0.560
Wage profile parameters	$\delta_0$	8.922
	$\delta_1$	0.073
	$\delta_2$	-0.001
	$\delta_0^E$	-0.487
	$\delta_1^E$	0.020
Persistence of permanent shock	$\rho$	0.930
Standard deviation of permanent shock	$\sigma_\nu$	0.236
Standard deviation of transitory shock	$\sigma_\epsilon$	0.130
Standard deviation of individual FE	$\sigma_i$	0.599

► Comparison with Literature

► All Results with SE

# ESTIMATION RESULTS

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		Baseline	No Frictions
Labor supply elasticity	$\phi$	0.114	0.005
Fixed adjustment cost	$f$	\$377	.
Calvo parameter	$\lambda$	0.183	.
Time discount factor	$\beta$	0.973	0.996
Labor supply scaling parameter	$\kappa$	0.560	0.030
Wage profile parameters	$\delta_0$	8.922	9.862
	$\delta_1$	0.073	0.111
	$\delta_2$	-0.001	-0.002
	$\delta_0^E$	-0.487	-0.294
	$\delta_1^E$	0.020	0.032
Persistence of permanent shock	$\rho$	0.930	0.914
Standard deviation of permanent shock	$\sigma_\nu$	0.236	0.076
Standard deviation of transitory shock	$\sigma_\epsilon$	0.130	0.504
Standard deviation of individual FE	$\sigma_i$	0.599	0.101

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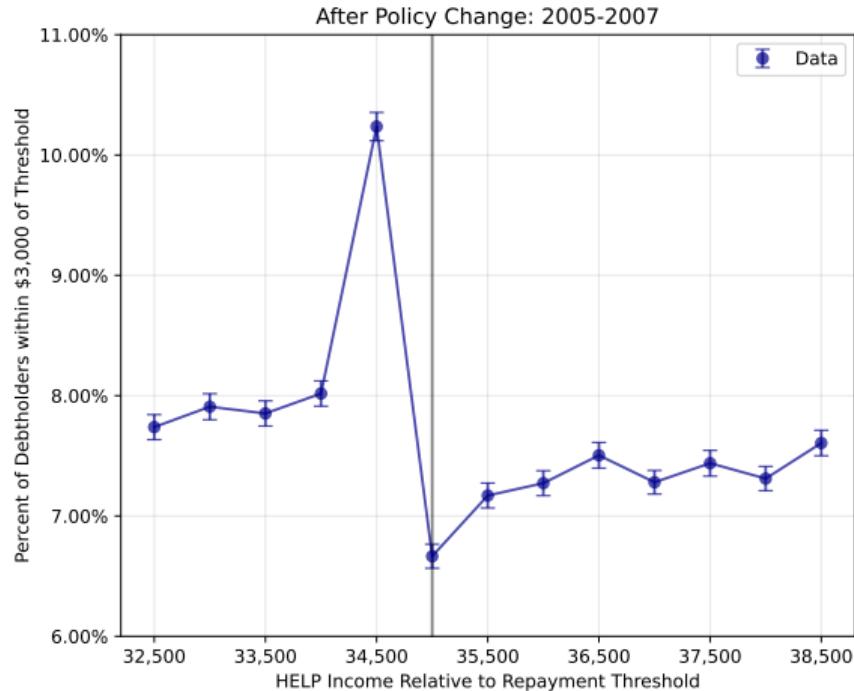
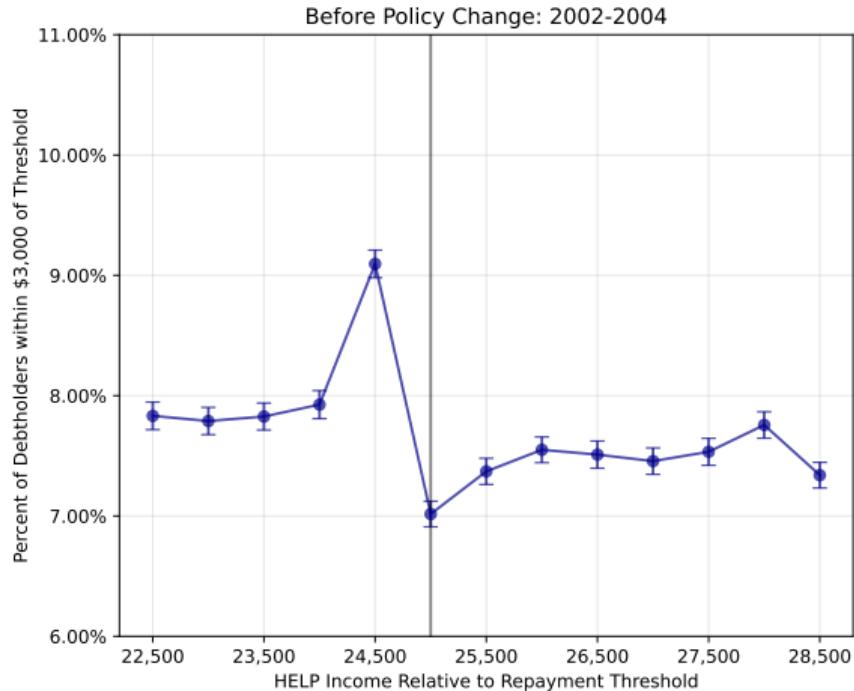
# ESTIMATION RESULTS

Parameter		Estimation		
		Baseline	No Frictions	LBD
Labor supply elasticity	$\phi$	0.114	0.005	0.082
Fixed adjustment cost	$f$	\$377	.	\$762
Calvo parameter	$\lambda$	0.183	.	0.346
Time discount factor	$\beta$	0.973	0.996	0.951
Labor supply scaling parameter	$\kappa$	0.560	0.030	1.242
Wage profile parameters	$\delta_0$	8.922	9.862	9.197
	$\delta_1$	0.073	0.111	0.070
	$\delta_2$	-0.001	-0.002	-0.001
	$\delta_0^E$	-0.487	-0.294	-0.480
	$\delta_1^E$	0.020	0.032	0.018
Persistence of permanent shock	$\rho$	0.930	0.914	0.889
Standard deviation of permanent shock	$\sigma_\nu$	0.236	0.076	0.288
Standard deviation of transitory shock	$\sigma_\epsilon$	0.130	0.504	0.064
Standard deviation of individual FE	$\sigma_i$	0.599	0.101	0.625

► Comparison with Literature

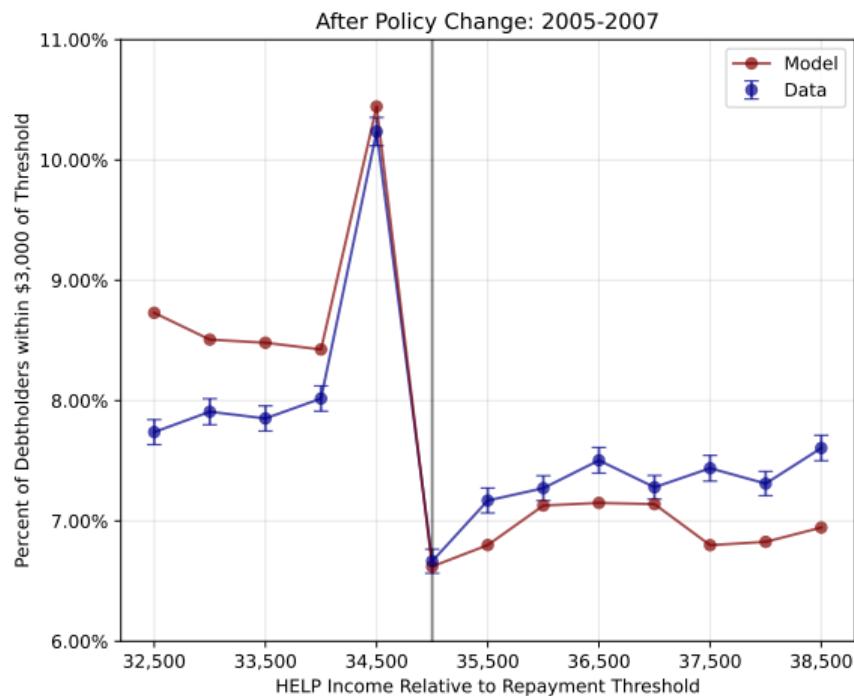
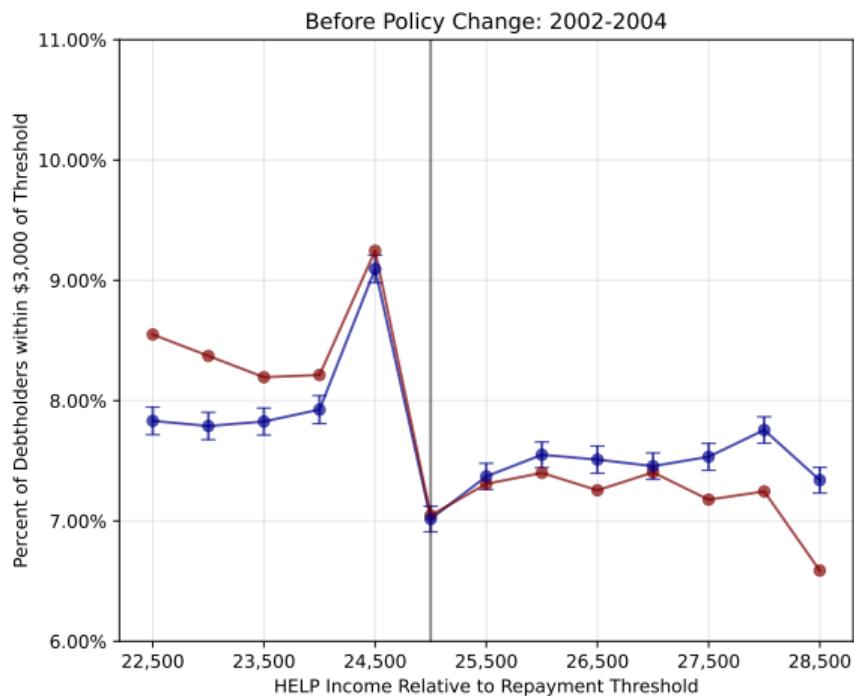
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# MODEL FIT: BUNCHING BEFORE AND AFTER POLICY CHANGE



► Model Fit: Heterogeneity   ► Model Fit: Other Moments   ► Additional Results

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► Model Fit: Heterogeneity

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Conditional on government subsidy for higher education, what repayment contract best balances **insurance** with **moral hazard**?

- **Perspective:** social planner that maximizes borrower welfare with **one** contract
  - Contract is subsidized with zero interest rate, prices held fixed
  - **Caveat:** borrowing and education choices held fixed  $\approx$  debt **restructuring**

Conditional on government subsidy for higher education, what repayment contract best balances **insurance** with **moral hazard**?

- **Approach:** solve constrained-planner's problem:

$$\max \mathbf{E}_0 \left( V_{a_0}^{1-\gamma} \right)^{\frac{1}{1-\gamma}} \quad (\text{behind the "veil-of-ignorance"})$$

(2)

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$$\max_{\psi, K} \mathbf{E}_0 \left( V_{a_0}^{1-\gamma} \right)^{\frac{1}{1-\gamma}}$$

**subject to:** (à la Ramsey, not Mirrlees)

$$\text{Repayments}_a = \psi * \max \{y_a - K, 0\} \quad (\text{US/UK}) \quad (1)$$

(2)

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subject to:

$$\text{Repayments}_a = \min \left\{ \psi * \max \{y_a - K, 0\}, D_a \right\} \quad (1)$$

(2)

# NORMATIVE ANALYSIS

Conditional on government subsidy for higher education, what repayment contract best balances **insurance** with **moral hazard**?

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subject to:

$$\text{Repayments}_a = \min \left\{ \psi * \max \{y_a - K, 0\}, D_a \right\} \quad (1)$$

$$G \equiv \mathbf{E}_0 \sum_{a=a_0}^{a_T} \frac{\text{Repayments}_a + \text{Taxes}_a - \text{Transfers}_a}{R_a} \quad (2)$$

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- **Approach:** solve constrained-planner's problem:

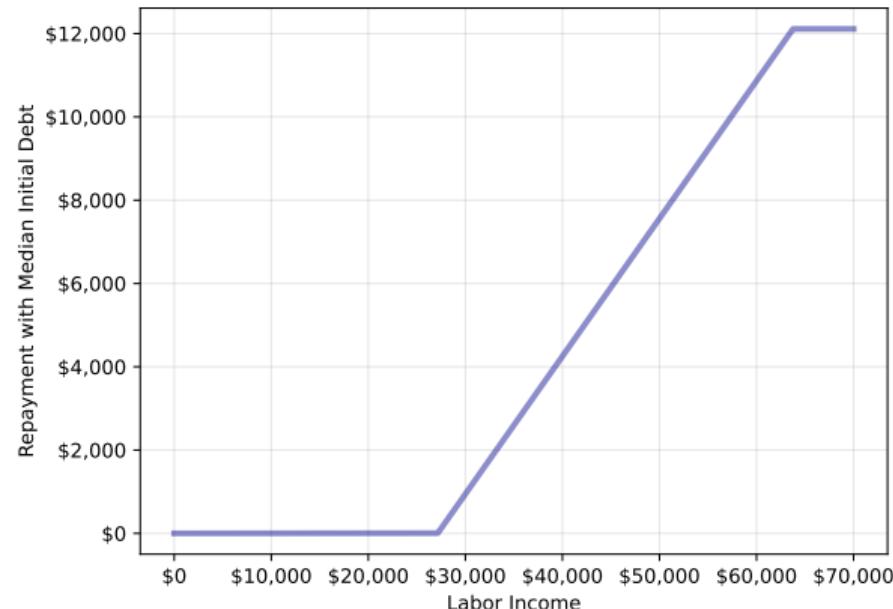
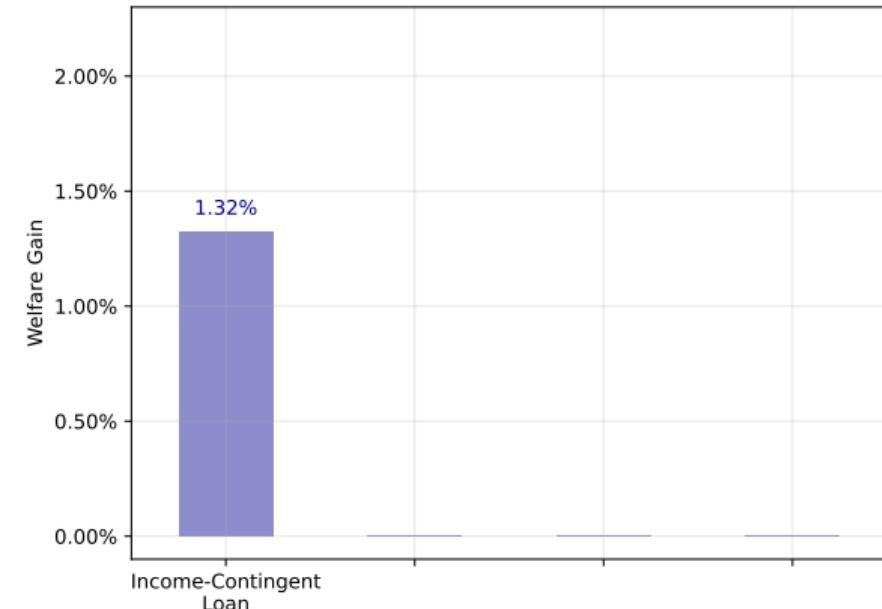
$$\max_{\psi, K} \mathbf{E}_0 \left( V_{a_0}^{1-\gamma} \right)^{\frac{1}{1-\gamma}}$$

subject to:

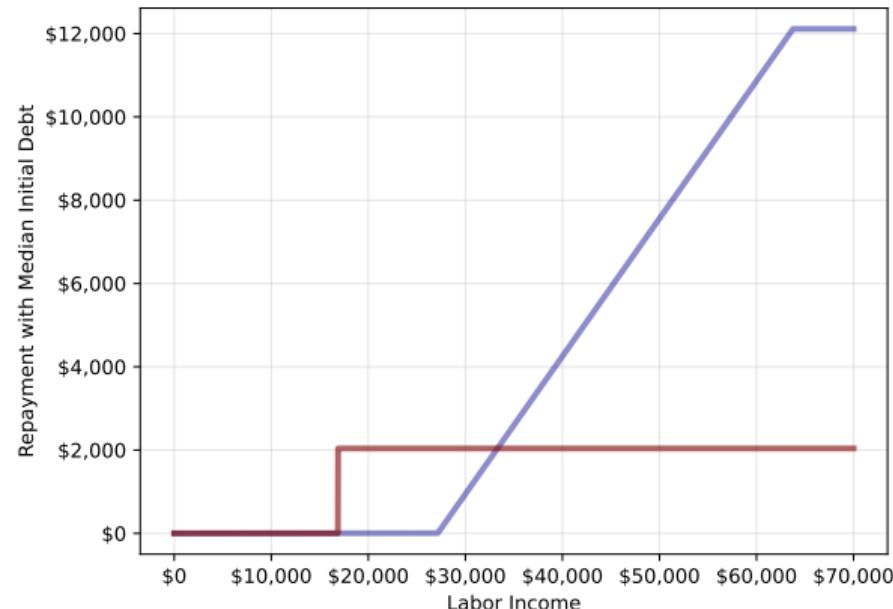
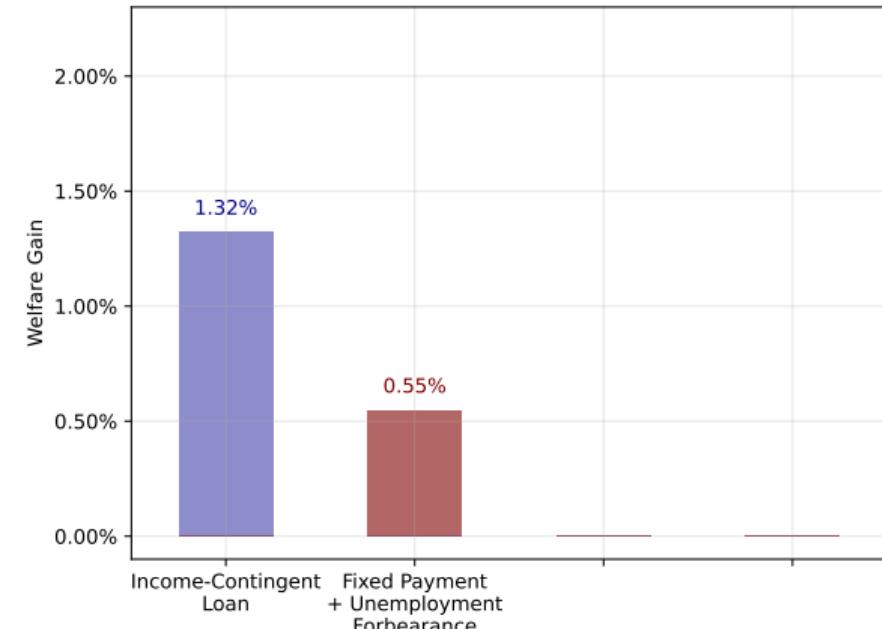
$$\text{Repayments}_a = \min \left\{ \psi * \max \{y_a - K, 0\}, D_a \right\} \quad (1)$$

$$\mathcal{G} \equiv \mathbf{E}_0 \sum_{a=a_0}^{a_T} \frac{\text{Repayments}_a + \text{Taxes}_a - \text{Transfers}_a}{R_a} \geq \mathcal{G}_{25\text{-Year Fixed}} \quad (2)$$

# INCOME-CONTINGENT LOANS OUTPERFORM FIXED REPAYMENT

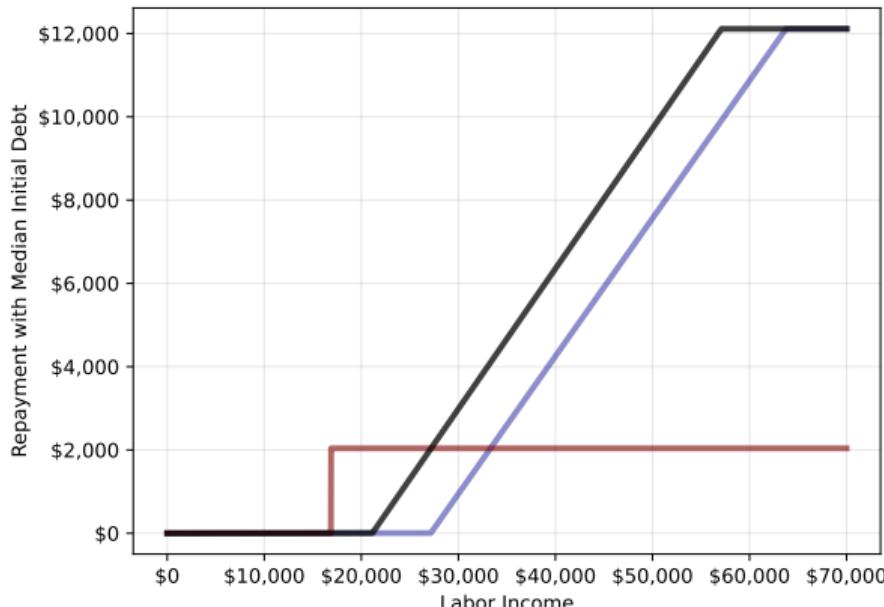
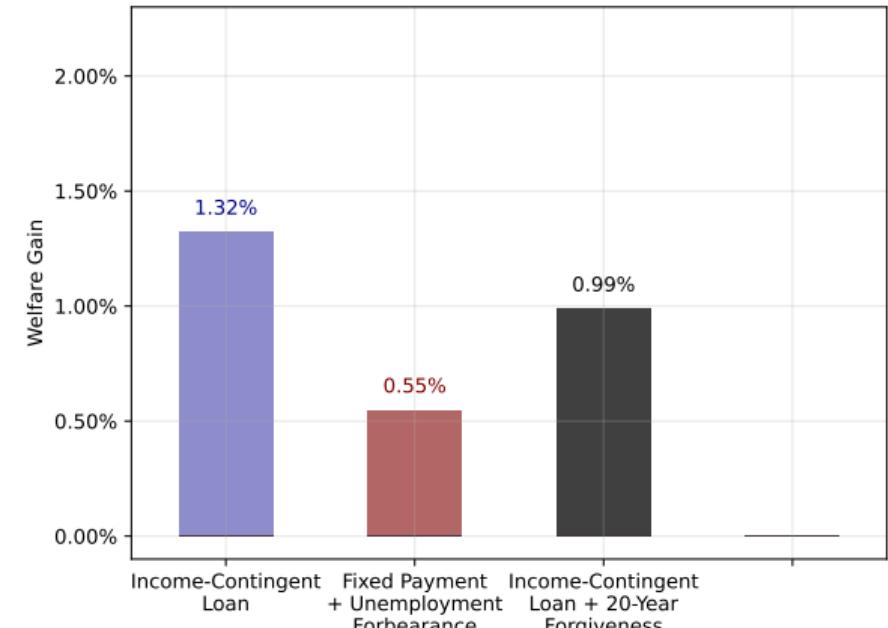


# JUST PROVIDING FORBEARANCE GIVES SMALLER GAINS



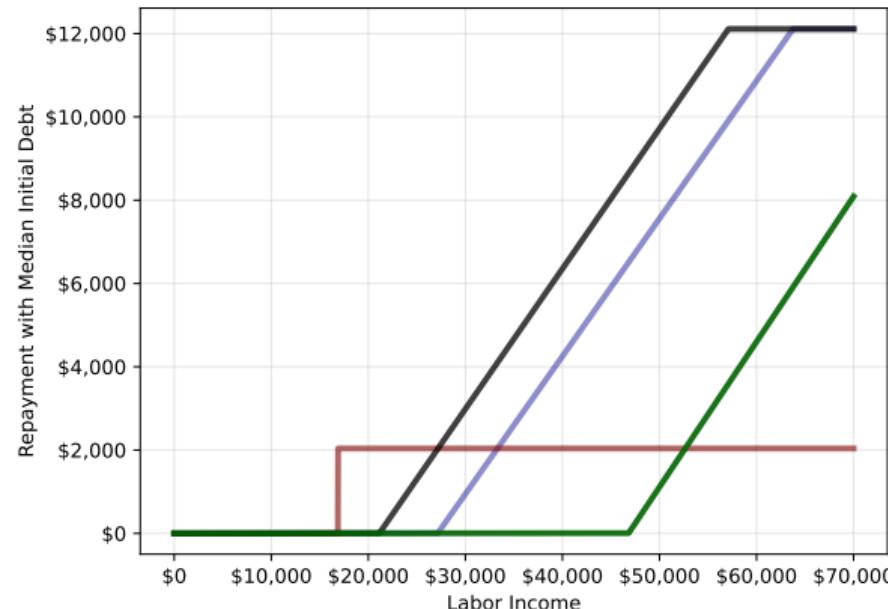
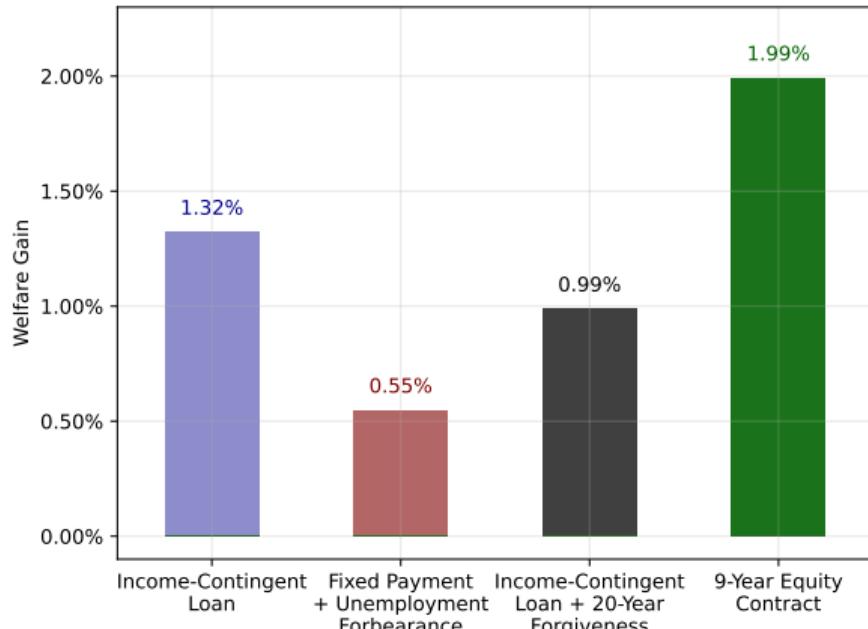
- **Benefit** of income-contingent loan: accelerate payments from high-income

# ADDING FORGIVENESS REDUCES WELFARE GAINS



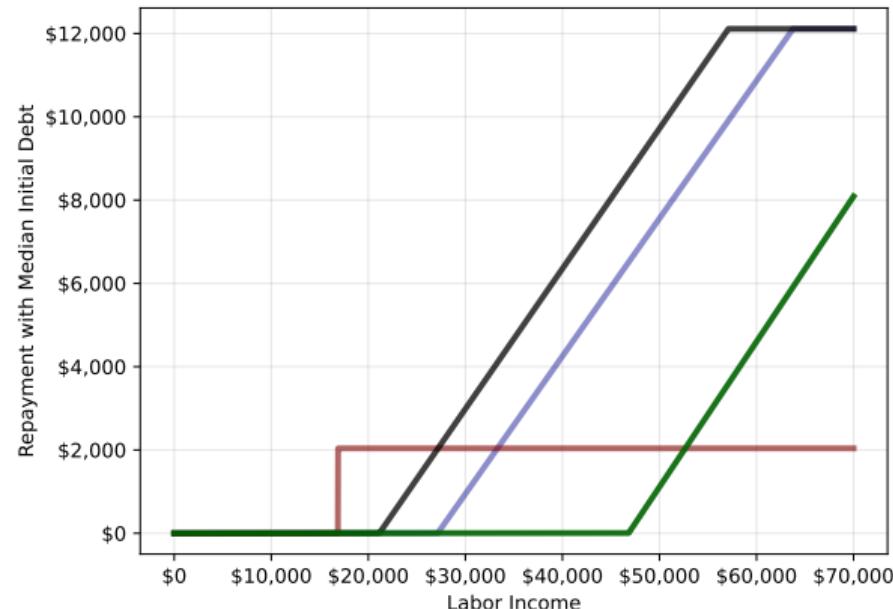
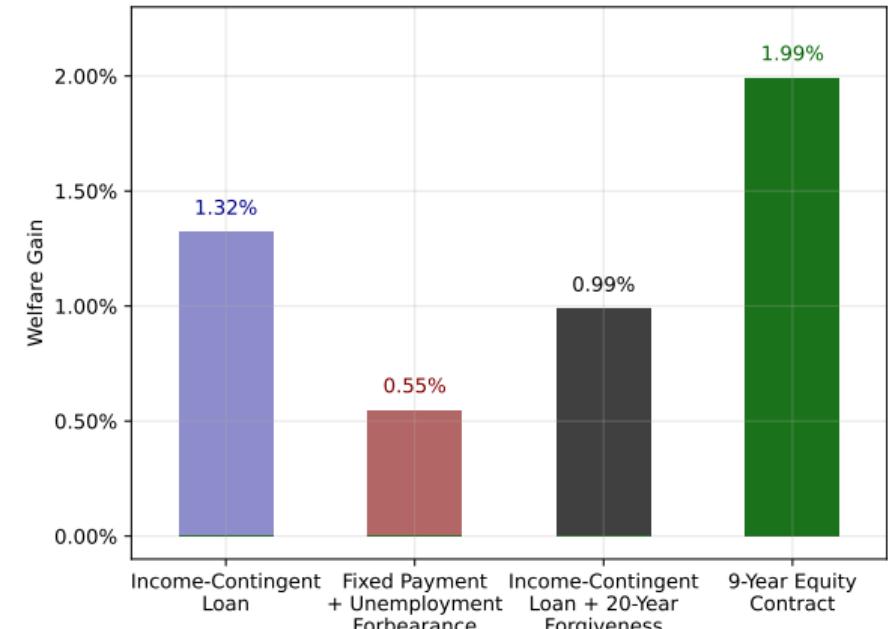
- **Costs** of forgiveness: transfer repayments to young and finite repayment horizon

# EQUITY CONTRACT GIVES LARGER GAINS



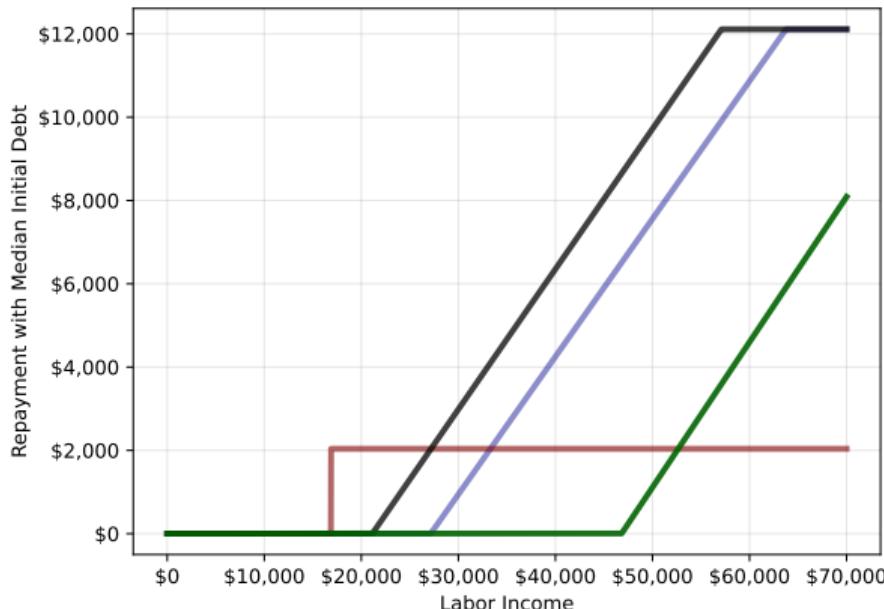
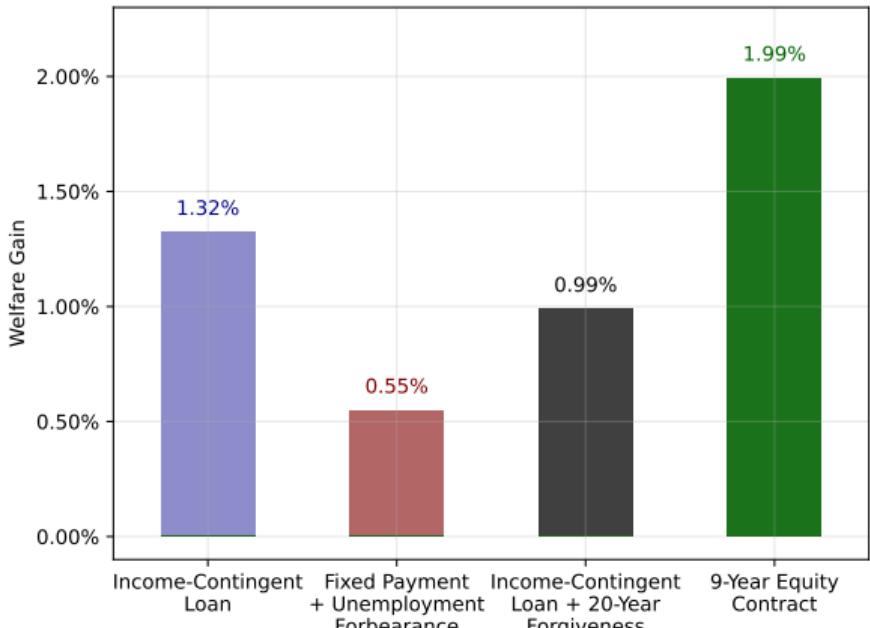
- **Benefit of equity:** uncapped payments from high-income  $\Rightarrow$  70% higher threshold

# EQUITY CONTRACT GIVES LARGER GAINS, BUT MORE DISPERSED



- **Cost** of equity: more likely to cause losses from **ex-ante** responses and **selection**

# EQUITY CONTRACT GIVES LARGER GAINS, BUT MORE DISPERSED



- **Cost** of equity: more likely to cause losses from **ex-ante** responses and **selection**

► Heterogeneity

► Additional Results

# OUTLINE

- 1 Institutional Background
- 2 Labor Supply Responses to Income-Contingent Repayment
- 3 Life Cycle Model with Endogenous Labor Supply
- 4 Welfare Impact of Income-Contingent Repayment
- 5 Conclusion

- US “student debt crisis”: 25% of borrowers default within 5 years of graduation
  - Possible solution = change contracts to be **income-contingent** (e.g., SAVE)
- **This paper:** evidence + model to calibrate the effects of debt restructuring
  - ① Ex-post moral hazard is not a reason to avoid **income-contingent** contracts
  - ② Among these contracts, **income-contingent loans** are relatively effective and robust
- **Open question:** effects of income-contingent contracts on ex-ante choices?
- **Broader question:** is more state-contingent repayment useful for other liabilities?
  - HHs: government-provided shared-appreciation mortgages (UK, Canada)
  - Firms: revenue-based financing

# THANK YOU!

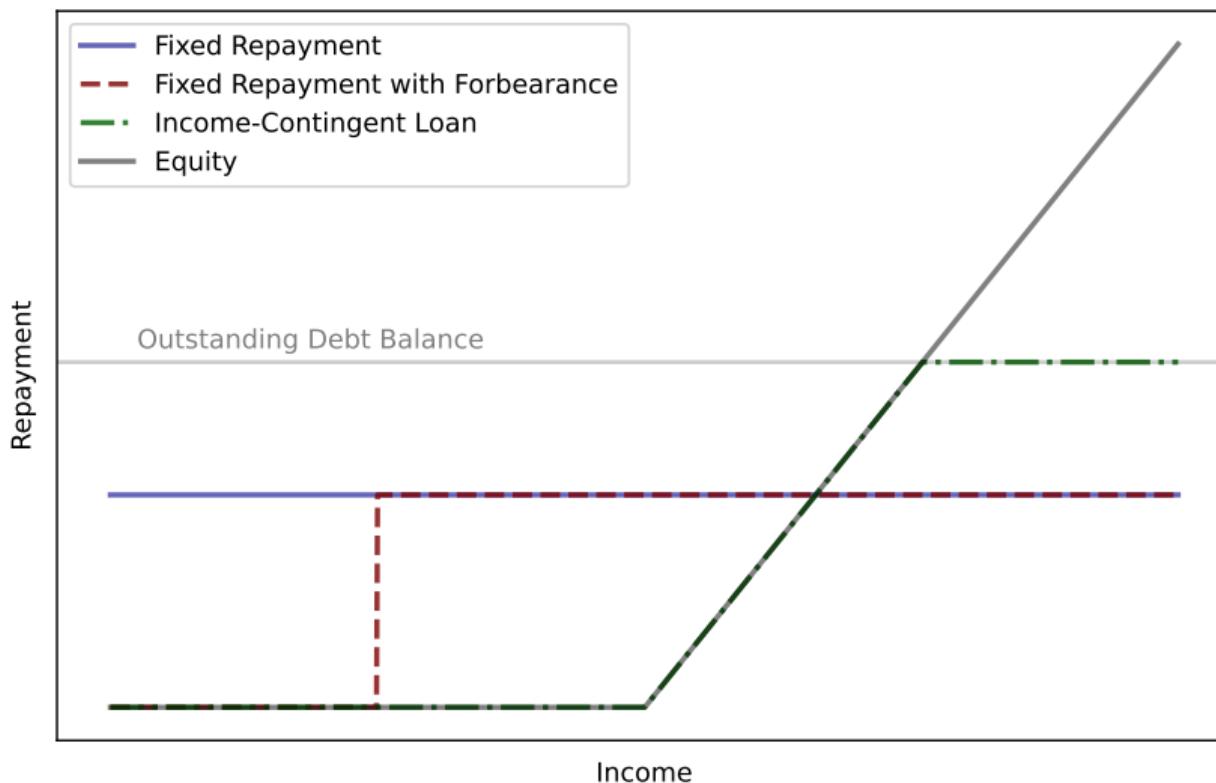
[www.timdesilva.me](http://www.timdesilva.me)

[tdesilva@mit.edu](mailto:tdesilva@mit.edu)

# APPENDIX

# START OF APPENDIX

# ILLUSTRATION OF DIFFERENT REPAYMENT CONTRACTS



◀ Back: Introduction

◀ Back: This Paper

◀ Back: Main Results

## RELATED LITERATURE & CONTRIBUTIONS

- ① Financing of human capital Bovenberg-Jacobs 2005, Lochner-Monge-Naranjo 2016, Stantcheva 2017
- ② Empirical effects of student loans
  - $\uparrow$  Debt  $\Rightarrow$   $\uparrow$  delinquencies,  $\downarrow$  mobility,  $\downarrow$  income Di Maggio et al. 2021,  $\downarrow$  homeownership Mezza et al. 2020,  $\Delta$  occupation Luo-Mongey 2019,  $\Delta$  major Hampole 2022
  - Income-contingent loans  $\Rightarrow$   $\downarrow$  delinquencies Herbst 2023,  $\downarrow$  defaults Mueller-Yannelis 2019

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  - Income-contingent loans  $\Rightarrow \downarrow$  delinquencies Herbst 2023,  $\downarrow$  defaults Mueller-Yannelis 2019

## Contributions:

- ① Empirical evidence of moral hazard from income-contingent repayment  
Britton-Gruber 2020, Herbst et al. 2023
- ② Structural model of labor supply that replicates these responses
  - ✓ Choice of labor supply is dynamic: income-contingent repayment + frictions
- ③ Quantification of how moral hazard affects optimal contract design

## RELATED LITERATURE & CONTRIBUTIONS

- ③ Insurance vs. moral hazard in social insurance: UI Gruber 1997, Chetty 2008, Ganong-Noel 2019, HH bankruptcy Dobbie-Song 2015, Indarte 2023, health insurance Einav et al. 2015
- ④ Mortgages with more risk-sharing Shiller 2004, Caplin et al. 2007, Mian-Sufi 2014, Piskorski-Seru 2018, Hartman-Glaser-Hébert 2020, Greenwald et al. 2021, Campbell et al. 2021, Benetton et al. 2022
- ⑤ Bunching at discontinuities in tax rates Saez 2010, Chetty et al. 2011, Kleven-Waseem 2013
- ⑥ Determinants of labor supply Blundell-MaCurdy 1999, Keane 2011, Chetty 2012, ...

## DATA

- ① Universe of individual tax returns from Australian Tax Office (~ US Form 1040)
- ② Administrative HELP data: debt balances and repayments
- ③ 2016 Household Census: self-reported hours and mortgage + rent payments
- ④ Administrative retirement savings data: superannuation balances
- ⑤ HILDA: survey data on hours worked and asset holdings

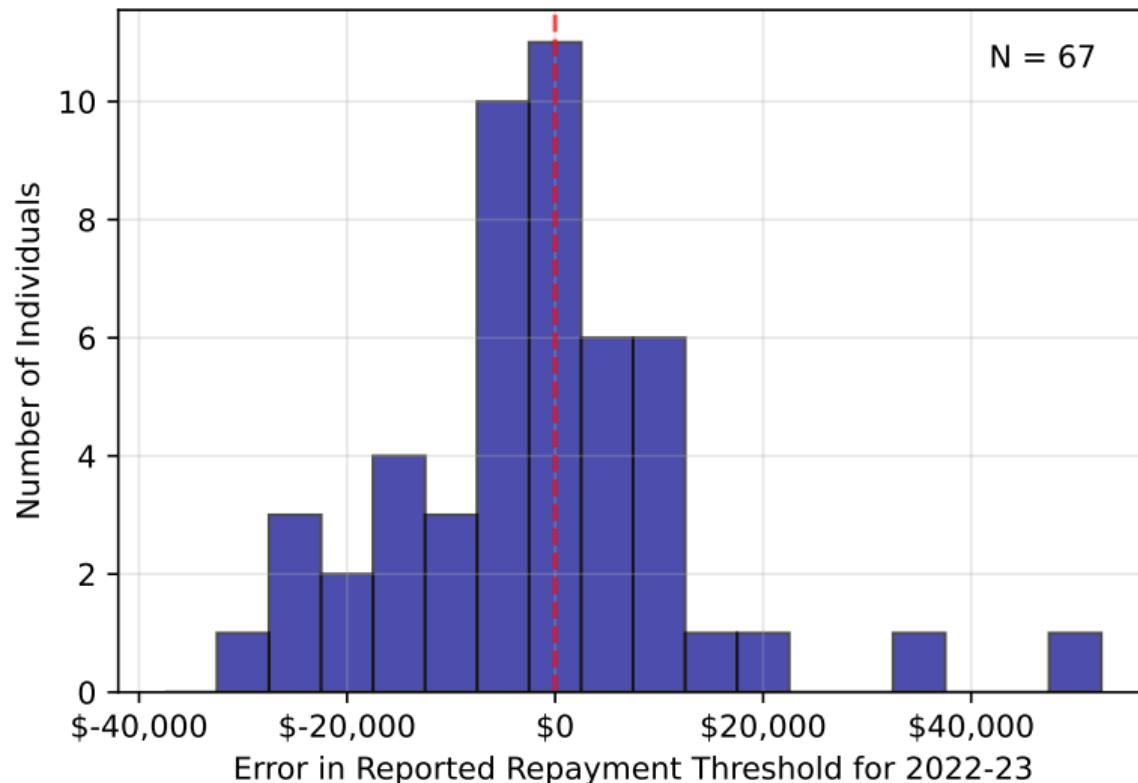
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- ⑤ HILDA: survey data on hours worked and asset holdings

**Sample:** ~ 4 million **unique** debtholders between ages 20-64 from 1991-2018

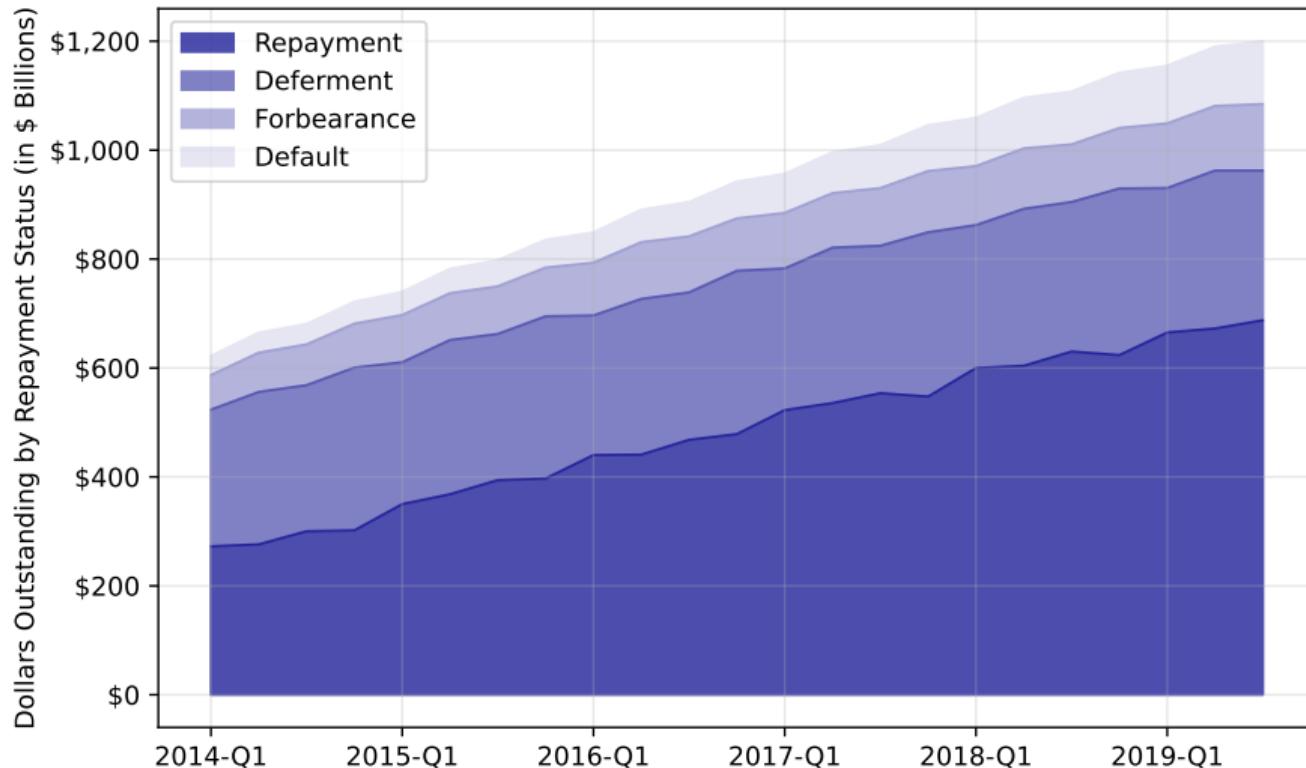
- Mean HELP Income at age 26 = \$34K with 98% from labor income

**Limitation:** no information about borrowing (e.g., degree, institution)

# SURVEY OF THRESHOLD LOCATION



# REPAYMENT STATUS OF US STUDENT LOANS



# PREVALENCE OF GOVERNMENT-PROVIDED INCOME-CONTINGENT LOANS

- Countries with **universal** adoption: Australia (1989), New Zealand (1991), UK (1998), Hungary (2001)
- Countries with **partial** adoption: US (1994), Thailand (2006), South Korea (2009), Brazil (2016), the Netherlands (2016), Japan (2017), Canada (2017), Colombia (2023)
- Countries **considering** adoption (as of 2022): Chile, France, Malaysia, Ireland

Source: Chapman-Dearden 2022

◀ Back

## VARIABLE DEFINITIONS

- HELP Income = Taxable Income + Fringe Benefits + Foreign Employment Income + Investment or Property Losses + Employer Super Contributions
- Labor Income = Salary/Wages + Allowances & Tips + Self-Employment Income
- Capital Income = Interest and Dividend Income + Annuity Income + Capital Gains + Rental Income + Managed Trust Income
- Net Deductions = Labor Income + Capital Income - HELP Income

◀ Back

# AU-US DIFFERENCES MOST LIKELY TO AFFECT CONTRACT DESIGN

- ① More debt in US due to higher tuition, longer degrees, and discretionary items
  - Larger demand for insurance in US, but also more moral hazard
  - Discretionary borrowing in US ⇒ possible ex-ante moral hazard
- ② Active private market in US cream-skims high-income borrowers Bachas 2019
  - Amount of insurance that can be provided might be lower in US
- ③ Student loans more subsidized in Australia than US
  - Different moral hazard in US (if there is selection on moral hazard) Karlan-Zinman 2009
- ④ Tuition and enrollment caps at public universities in Australia
  - Supply-side responses could increase fiscal cost of ICLs in US Kargar-Mann 2023
  - Note: I compare contracts with identical subsidy

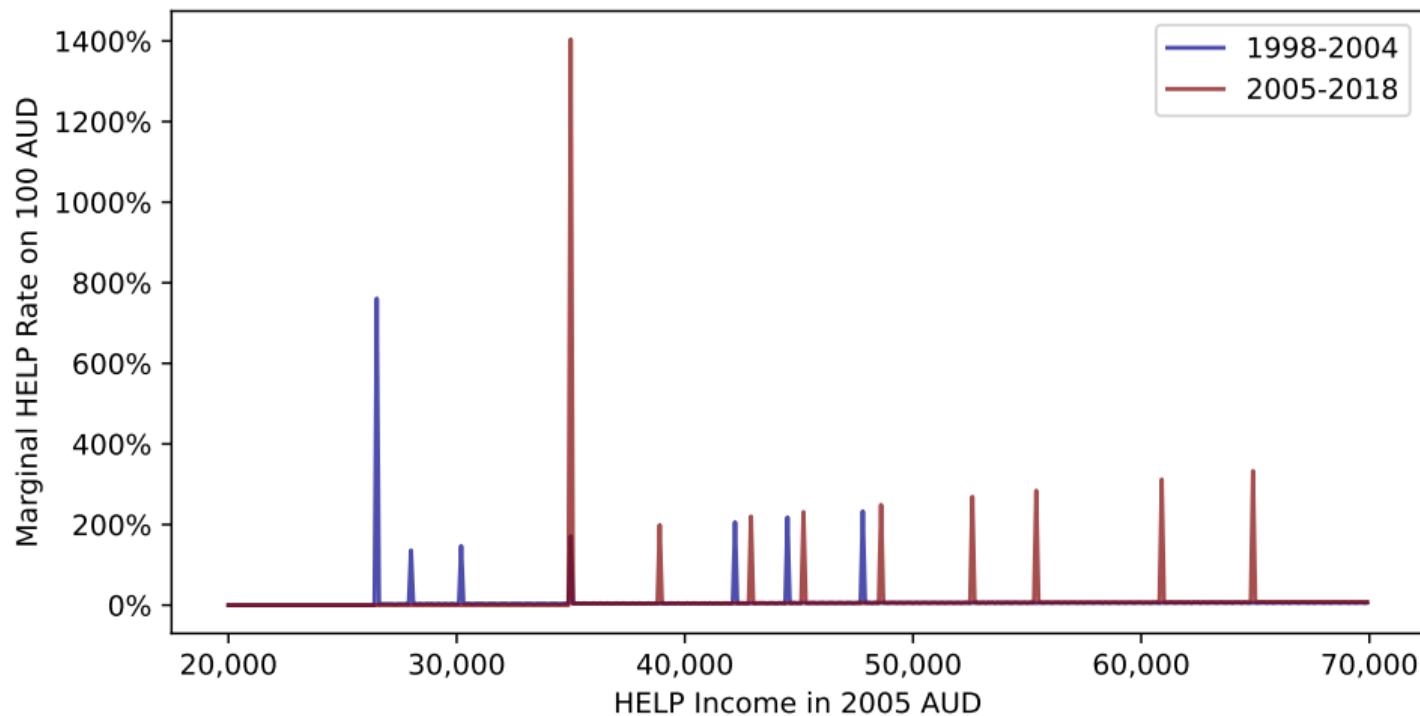
# DIFFERENCES BETWEEN AUSTRALIA AND US: STATISTICS

Feature of Environment	Australia	US
<b>Cost of Higher Education</b>		
Public Undergraduate Tuition Cost	\$2,700–\$10,100 USD per year for CSPs	\$9,500 USD per year for 4-Year In-State \$39,000 USD per year for 4-Year Private Nonprofit
Total Cost of Attendance	\$15,850 USD per year	\$22,700 USD per year
Prevalence of Scholarships	Rare	Common
Initial Student Debt Borrowed	\$8,100–\$30,300 USD	\$51,800 USD (Average)
<b>Student Population</b>		
% of Population with Undergraduate Degree	38%	32%
% of Undergraduates at Private Universities	6%	26%
% of Undergraduates from Abroad	16%	5%
% of Current Students Employed	50%	40%
<b>Income Distribution and Taxes/Transfers</b>		
Median Personal Income	\$33,500 USD	\$40,500 USD
Poverty Line for Single Individual	\$16,200 USD	\$14,580 USD
Gini Coefficient for Income	0.32	0.38
Marginal Tax Rate at Average Income	41%	41%
Heathcote et al. (2017) Tax Progressivity	0.133	0.184
1-Month Individual UI Replacement Rate	23%	35%
Union Membership Rate	13.7%	10.3%

◀ Back: Benefits

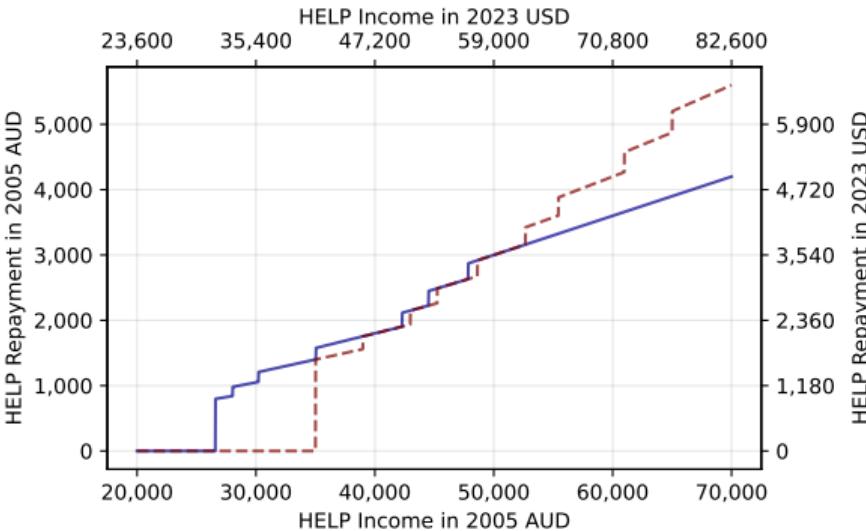
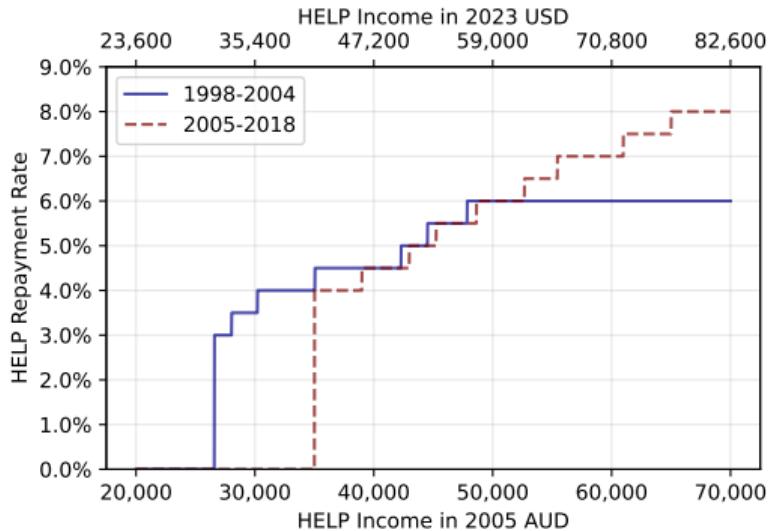
◀ Back: Differences

# MARGINAL HELP REPAYMENT RATES ON 100 AUD



◀ Back

# HELP REPAYMENT RATES AND REPAYMENTS



◀ Back

# NEWS ARTICLE: POLICY CHANGE



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## Ease HECS burden on students, say universities

Kate Marshall

Jan 9, 2003 – 11.00am

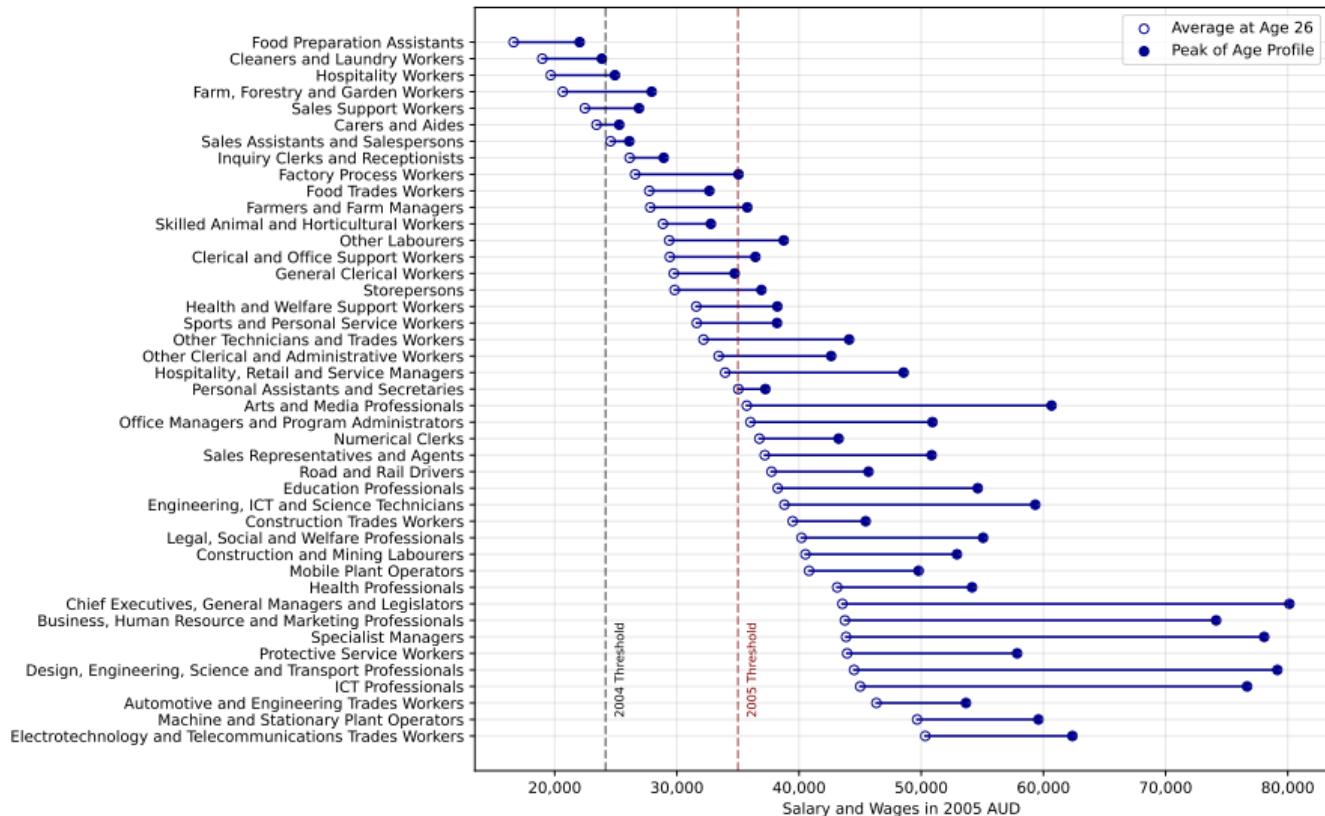
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Share

Australian students owing more than \$9 billion of debts to the federal government should be spared financial heartache under a proposal to lift the income threshold for repayments, the Australian Vice-Chancellors Committee said yesterday.

◀ Back

# OCCUPATION-SPECIFIC INCOME PROFILES RELATIVE TO THRESHOLDS



◀ Back: Policy

◀ Back: Hours

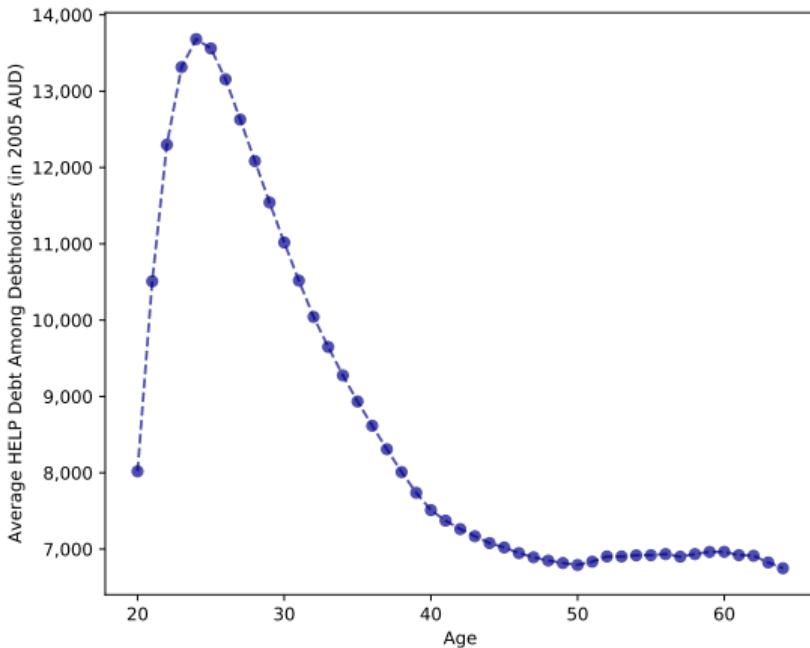
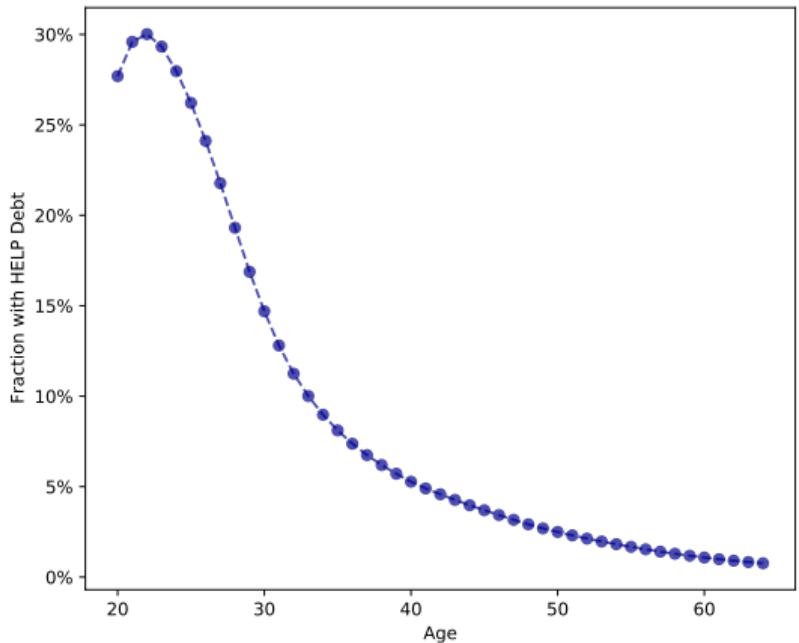
◀ Back: Table

# SUMMARY STATISTICS

	Non-Debtholders (1)	Debtholders (2)
<b>Demographics</b>		
Age	41.1	29.5
Female	0.46	0.60
Wage-Earner	0.85	0.91
<b>Income Totals (in 2005 AUD)</b>		
Taxable Income	37,695	27,796
HELP Income	38,756	28,586
<b>Income Components (in 2005 AUD)</b>		
Salary & Wages	32,415	26,068
Labor Income	35,480	27,136
Interest & Dividend Income	726	242
Capital Income	1,221	324
Net Deductions	-1,548	-1,099
<b>HELP Variables</b>		
HELP Debt (in 2005 AUD)	.	10,830
HELP Payment (in 2005 AUD)	.	991
HELP Debt at Age 26 (in 2005 AUD)	.	13,156
HELP Payment at Age 26 (in 2005 AUD)	.	1,305
HELP Income < 0% Threshold	0.50	0.65
HELP Income < 2004 0% Threshold	0.37	0.51
HELP Income < 2005 0% Threshold	0.52	0.67
Number of Unique Individuals	19,484,517	4,013,382
Number of Individual-Year Observations	247,118,713	27,316,037

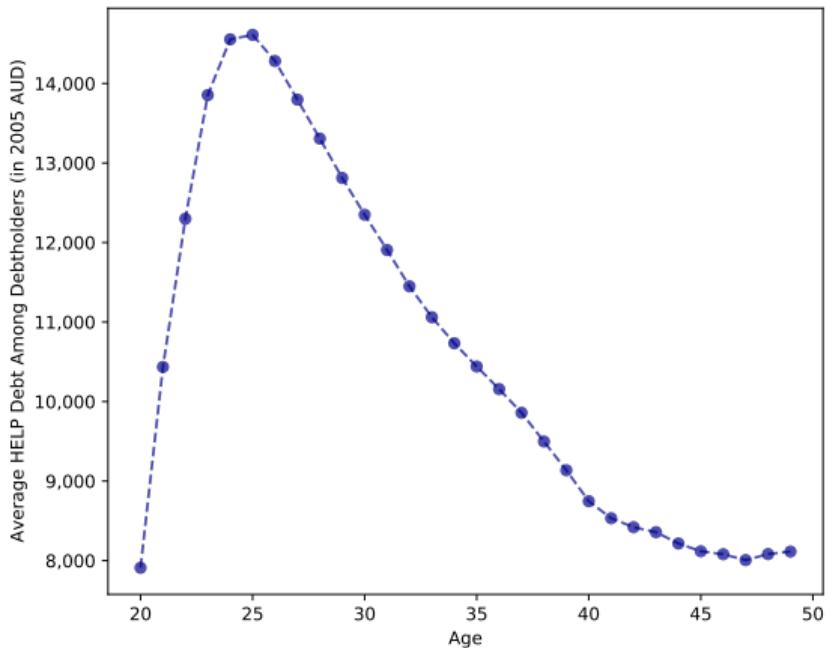
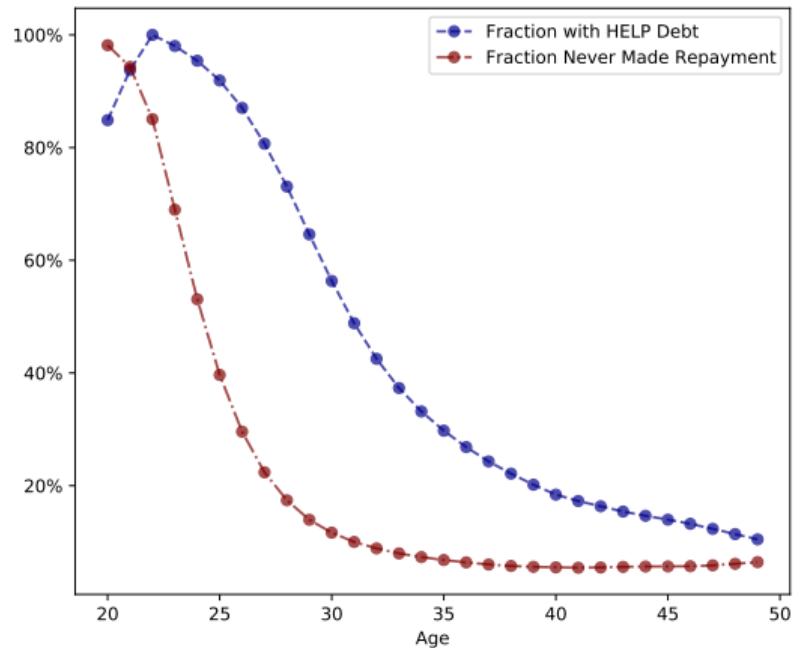
◀ Back

# DEBT BALANCES BY AGE



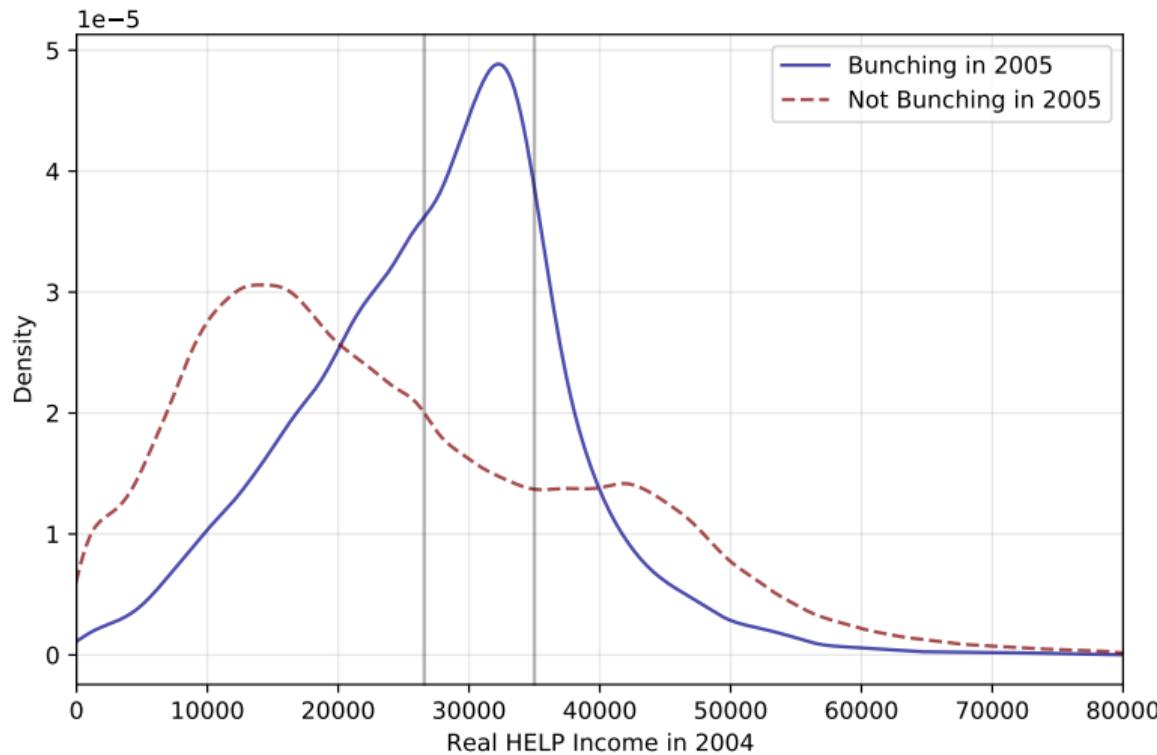
◀ Back

# DEBT BALANCES BY AGE: INDIVIDUALS WITH POSITIVE DEBT AT AGE 22



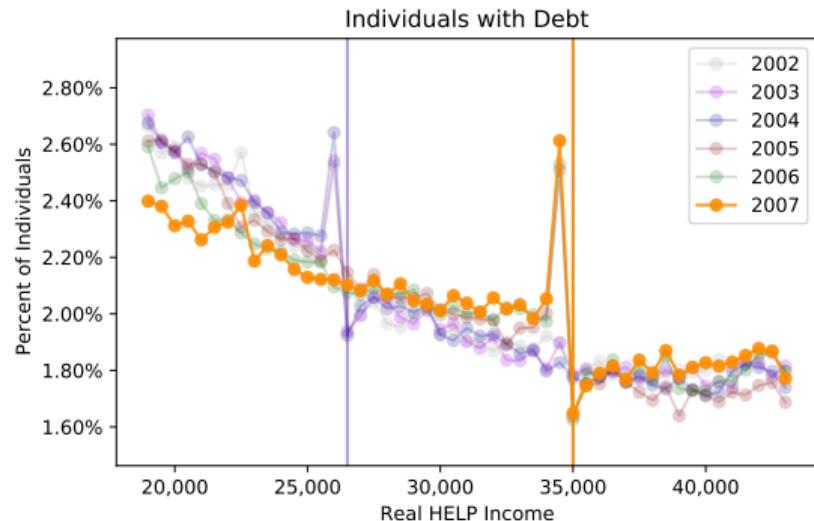
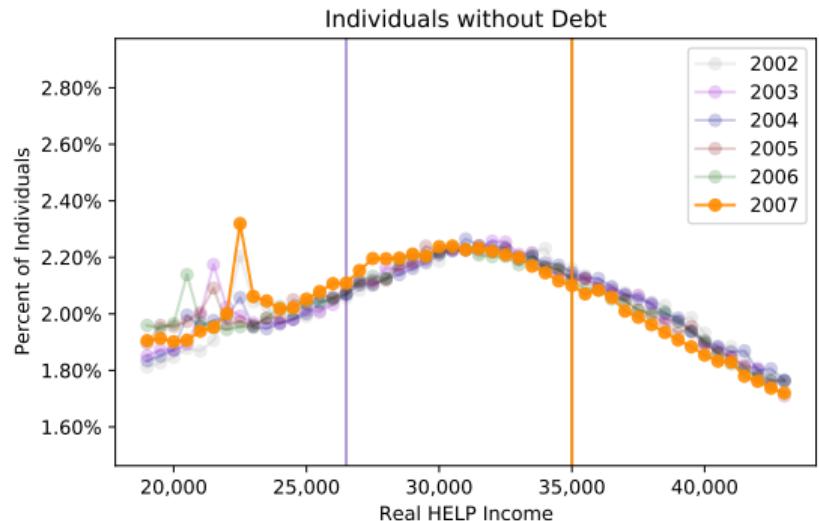
◀ Back

# NEW BUNCHING COMES FROM BETWEEN OLD AND NEW THRESHOLDS



◀ Back

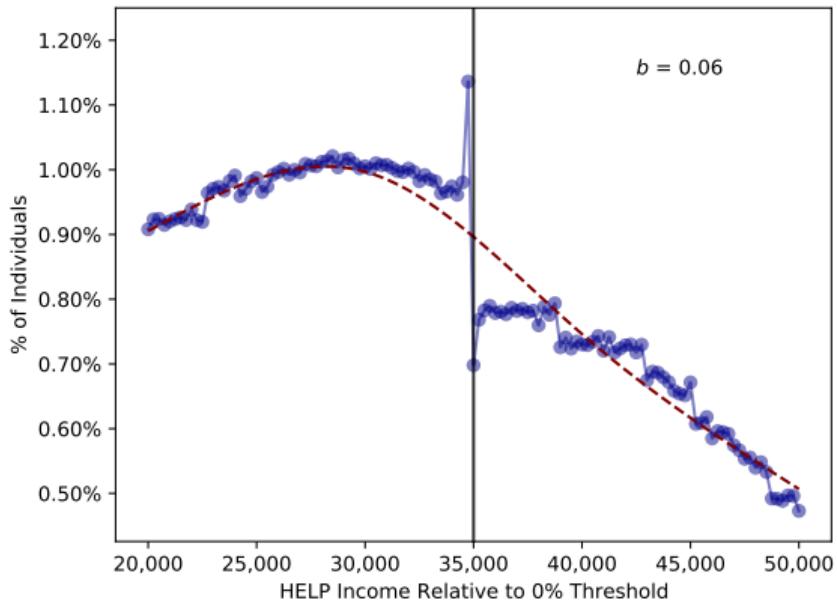
# No BUNCHING AT REPAYMENT THRESHOLD FOR NON-DEBTHOLDERS



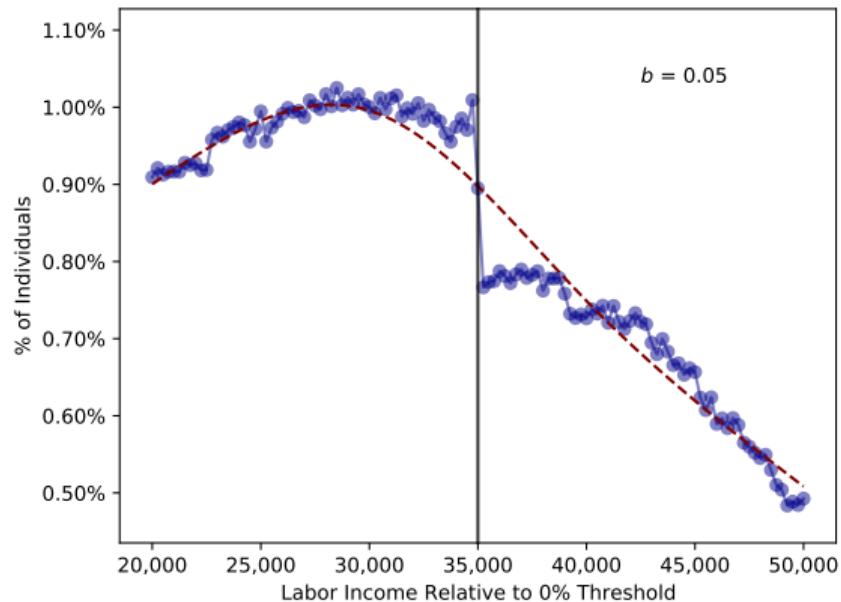
◀ Back

# BUNCHING IN LABOR INCOME = 83% OF BUNCHING IN HELP INCOME

## HELP Income

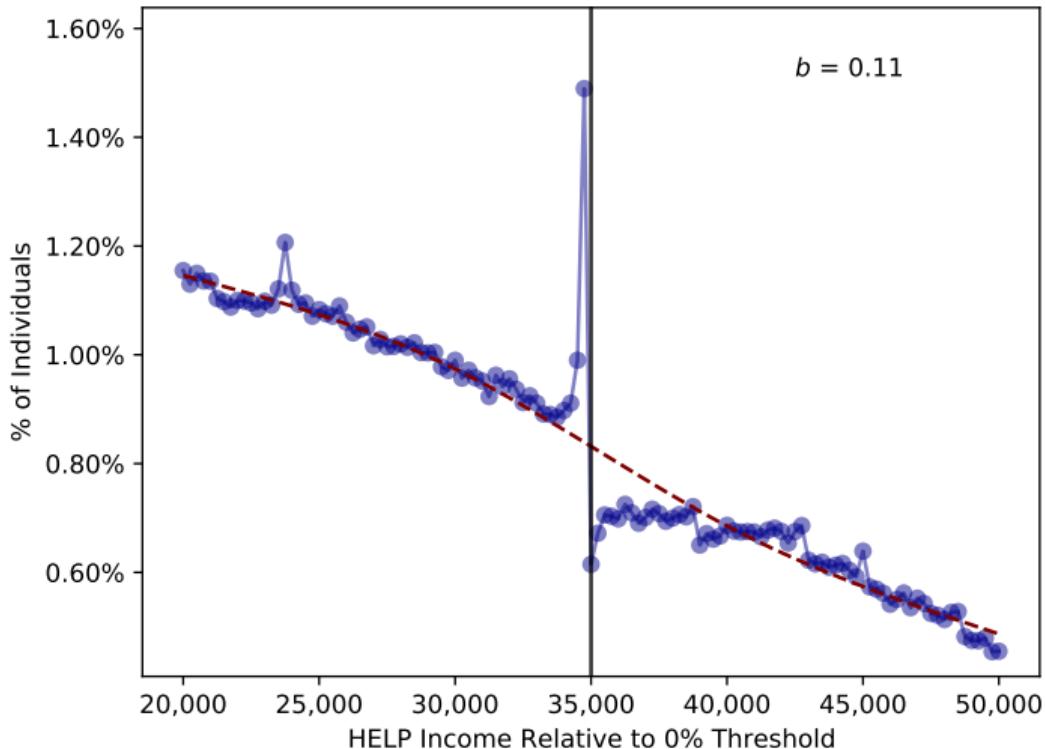


## Labor Income



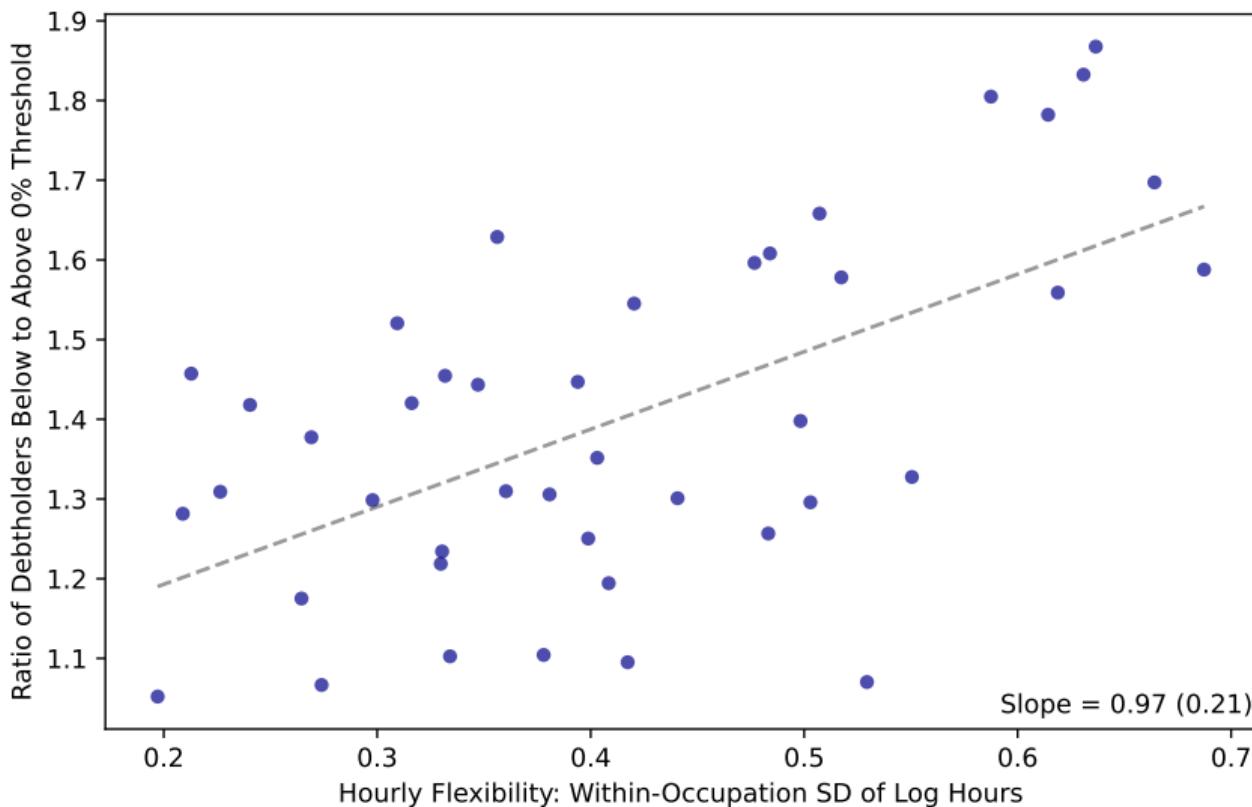
◀ Back

# BUNCHING AT THRESHOLD IS LARGER THAN AT TAX KINK: 2016



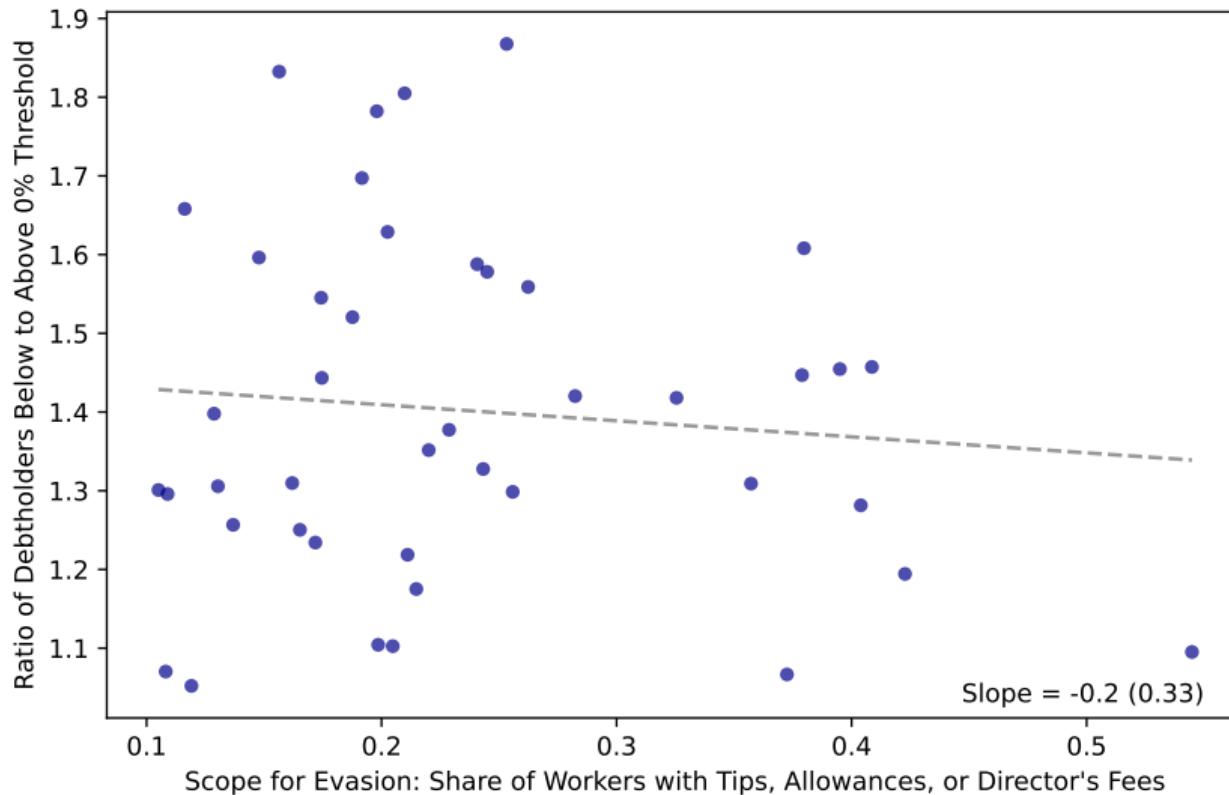
◀ Back

# ALTERNATIVE MEASURE OF HOURLY FLEXIBILITY



◀ Back

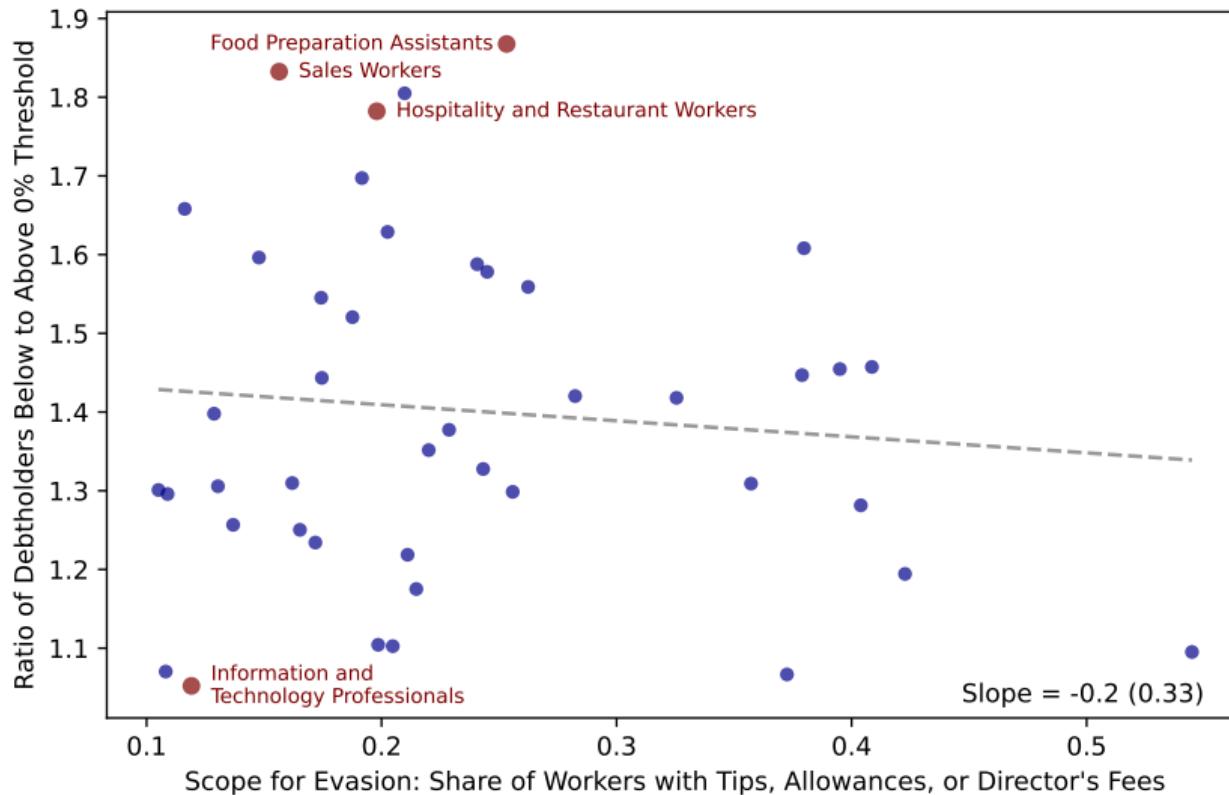
# BUNCHING UNCORRELATED WITH MEASURE OF EVASION



Easier to misreport non-salary and wage income Paetzold-Winner 2016, Slemrod 2019

◀ Back

# BUNCHING UNCORRELATED WITH MEASURE OF EVASION



Easier to misreport non-salary and wage income Paetzold-Winner 2016, Slemrod 2019

◀ Back

# OCCUPATION-LEVEL REGRESSIONS

	Ratio of Debtholders Below to Above Threshold						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Hourly Flexibility: SD of Changes in Log Hours	1.30 (0.35)	.	.	.	1.30 (0.35)	1.05 (0.28)	0.50 (0.23)
Evasion: Share with Non-Wage Income	.	-0.20 (0.30)	.	.	-0.02 (0.30)	-0.17 (0.30)	0.05 (0.25)
Income Slope: Mean Wage at 45 / Mean Wage at 26	.	.	-0.53 (0.10)	.	.	-0.40 (0.12)	.
Income Peak: Maximum Wage in Occupation Profile	.	.	.	-0.48 (0.06)	.	.	-0.40 (0.07)
<i>R</i> <sup>2</sup>	0.34	0.01	0.23	0.58	0.34	0.46	0.62
Number of Occupations	43	43	43	43	43	43	43

[▶ Profiles](#)
[◀ Back: Hours](#)
[◀ Back: Slope](#)
[◀ Back: Summary](#)

## COMPUTATION OF BUNCHING STATISTIC

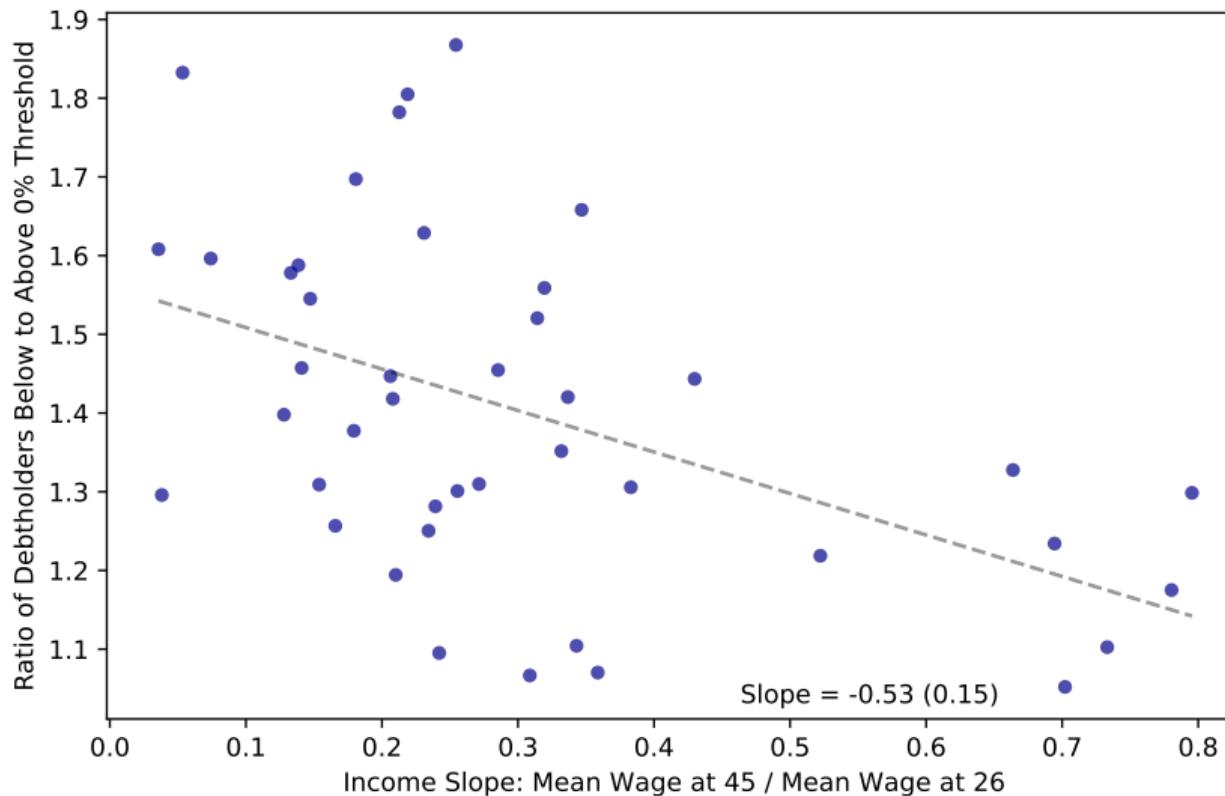
- Bunching statistic calculated as in prior literature Chetty et al. 2011, Kleven-Waseem 2013

- Fit 5-piece spline leaving out  $[\$32,500, \$35,000 + X]$   $\Rightarrow$  **counterfactual density**
- Iterate and choose  $X$  so that counterfactual density integrates to 1
- 

$$b = \frac{\text{observed mass in } [\$32,500, \$35,000]}{\text{counterfactual mass in } [\$32,500, \$35,000]} - 1$$

- $b = 0.1 \Rightarrow$  10% more people below threshold than would be absent discontinuity
  - Note: normalization makes  $b$  comparable across distributions of different shapes
- Sample:** All debtholders age 20 to 64 pooled across 2005 to 2018
  - Income deflated to 2005 so 0% threshold constant in real terms at **\$35,000**

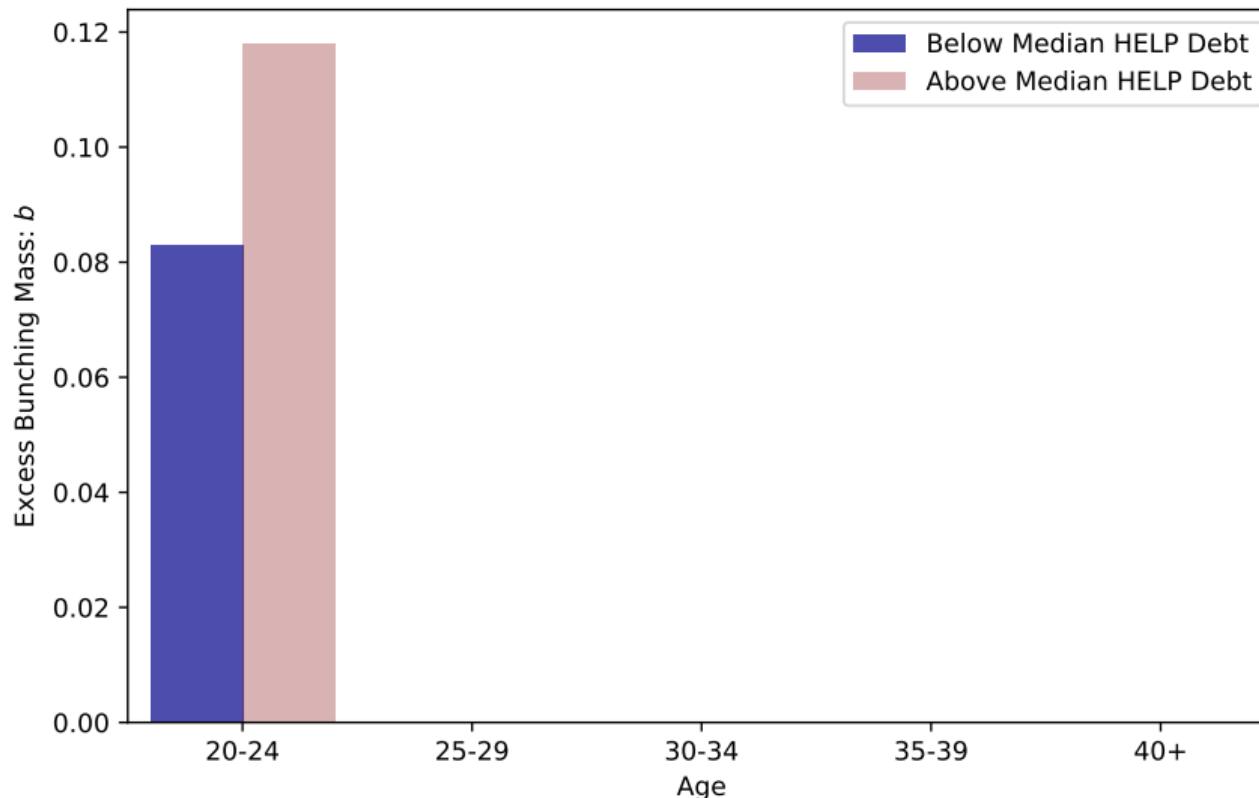
# BUNCHING DECREASES WITH EXPECTED WAGE GROWTH



► Multivariate

◀ Back

# BUNCHING INCREASES WITH DEBT BALANCES

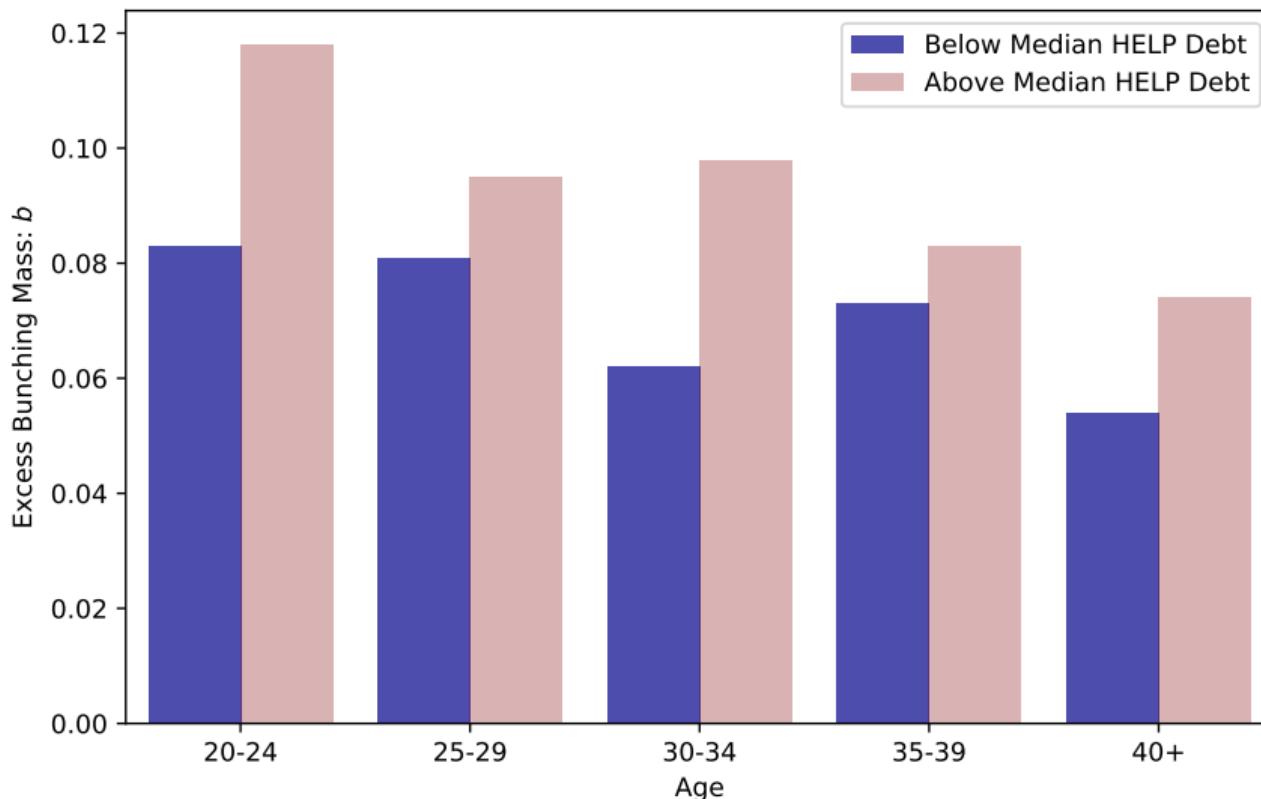


Note: confidence intervals omitted due to small size

▶ *b* Details

◀ Back

# BUNCHING INCREASES WITH DEBT BALANCES

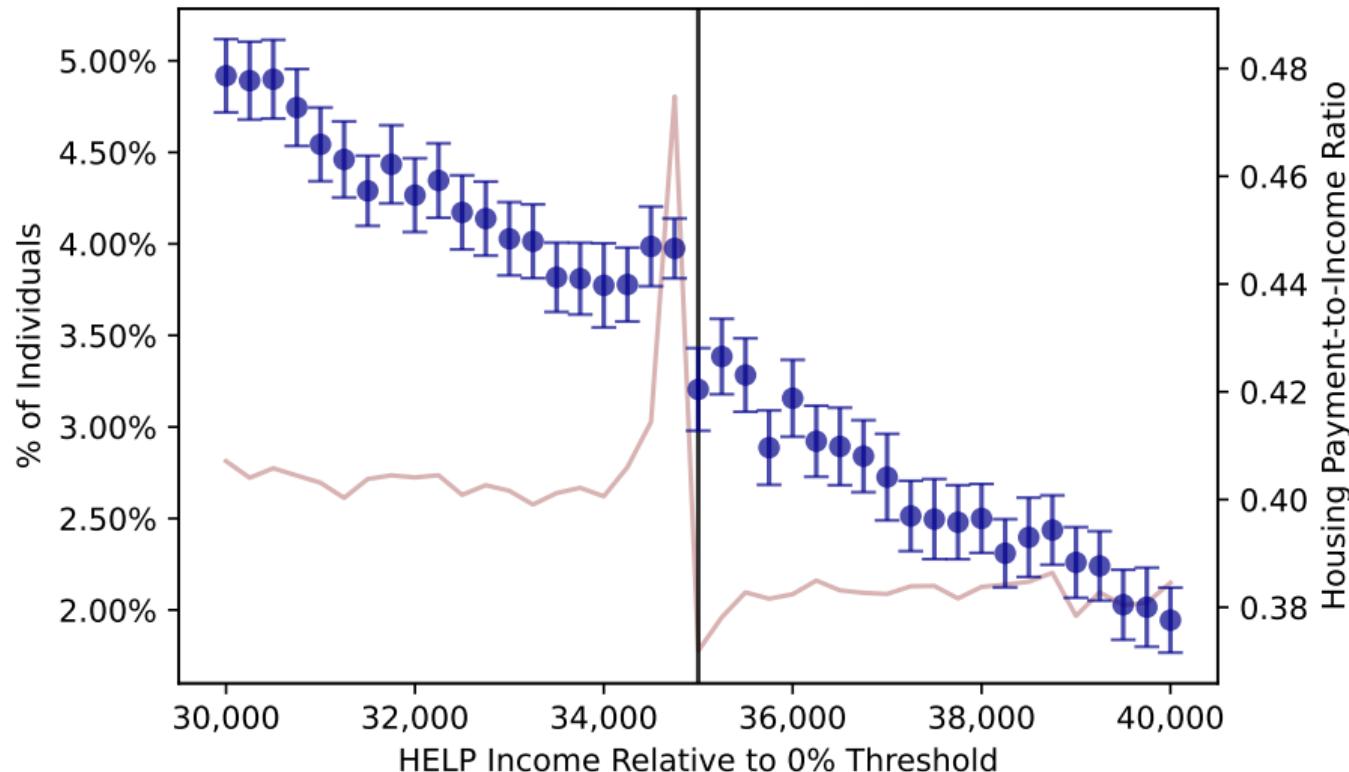


Note: confidence intervals omitted due to small size

▶ *b* Details

◀ Back

# BUNCHING INCREASES WITH PROXIES FOR LIQUIDITY CONSTRAINTS

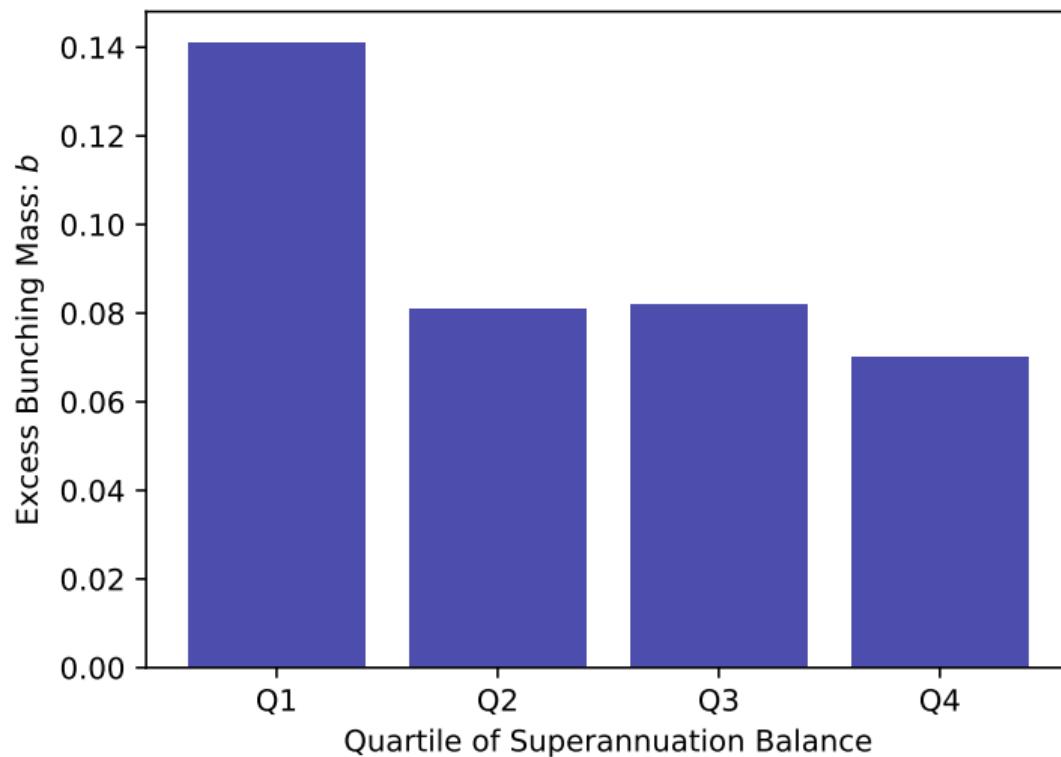


► Retirement Savings

► House Prices

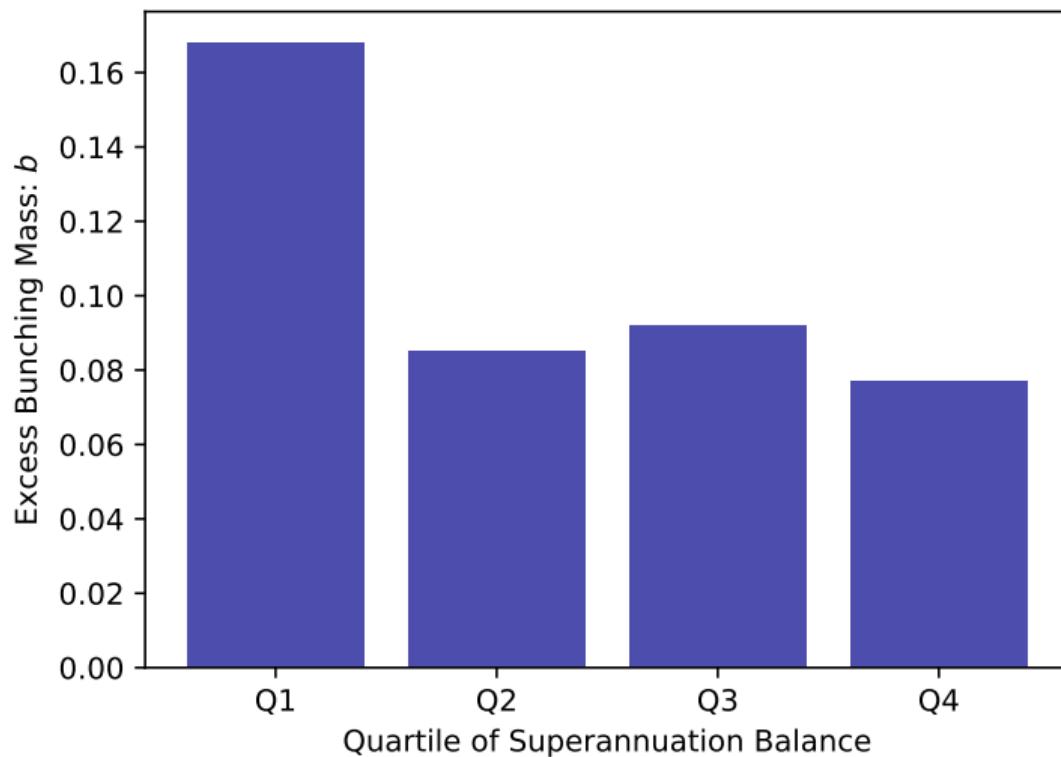
◀ Back

# BUNCHING DECREASES WITH SUPERANNUATION BALANCES



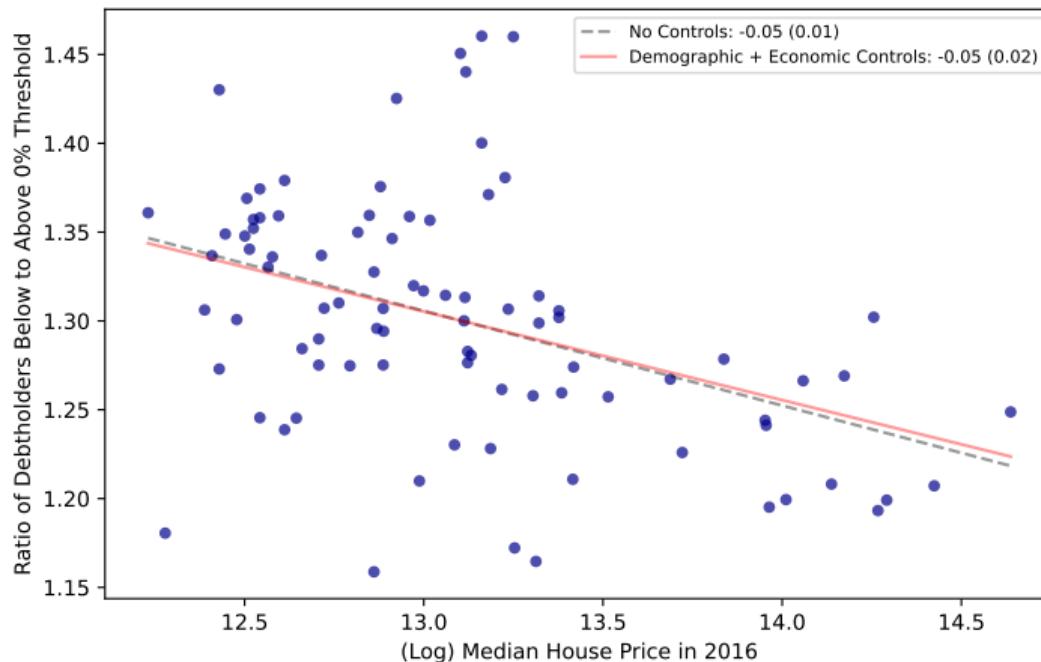
◀ Back

## BUNCHING HETEROGENEITY BY SUPER WEALTH: AGES 20-29



◀ Back

# LESS BUNCHING IN REGIONS WITH MORE HOUSING WEALTH



◀ Back

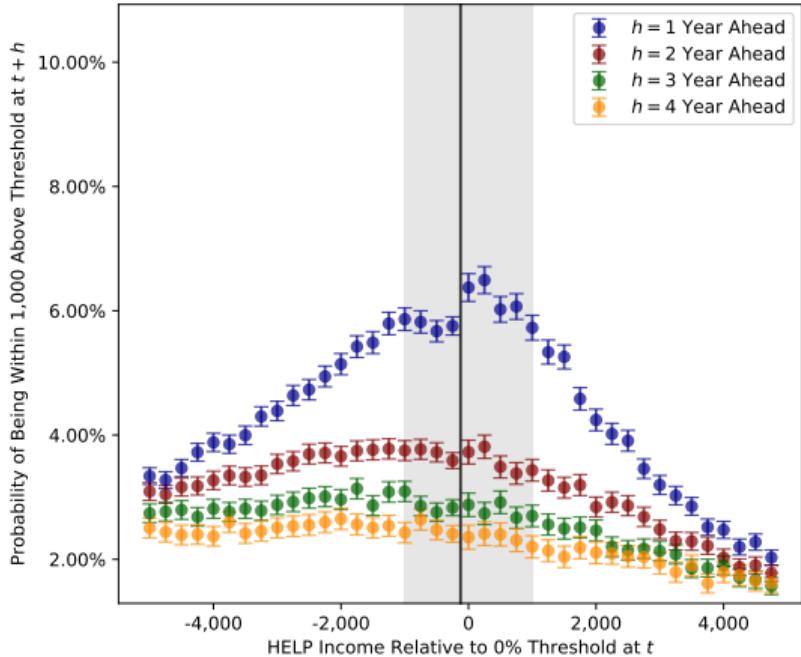
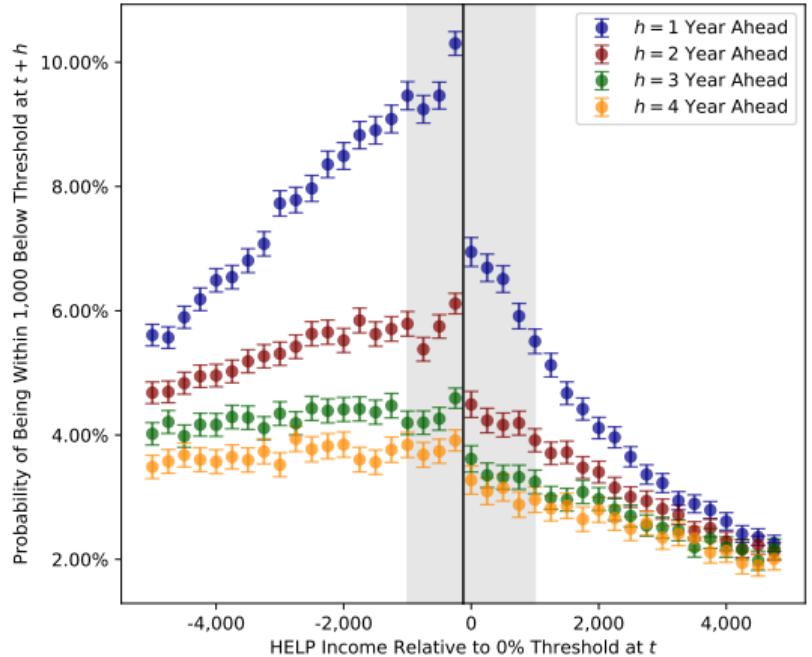
# ADDITIONAL EMPIRICAL RESULTS

- ① **Persistence** of bunching below threshold lasts around three years 
- ② **Long-run**: income of “bunchers” similar to “non-bunchers” after two years 
- ③ No discontinuity in probability of **switching occupations** around threshold 
- ④ Limited heterogeneity in bunching with household **demographics** 
  - Caveat: no extensive margin responses, which can vary across groups Saez et al. 2012
- ⑤ Limited evidence of bunching coming from **firm responses** (as in Chetty et al. 2011) 
- ⑥ Additional tests for **evasion**:
  - Bunching present in **salary and wages**, which is harder to misreport Slemrod 2019 
  - Minimal difference in bunching based on **filing type** 
  - Bunching declines by only 4% when dropping **self-employed** 
  - Borrowers are median income ⇒ less avoidance **opportunities** Slemrod-Yitzhaki 2002

 Back: Hours

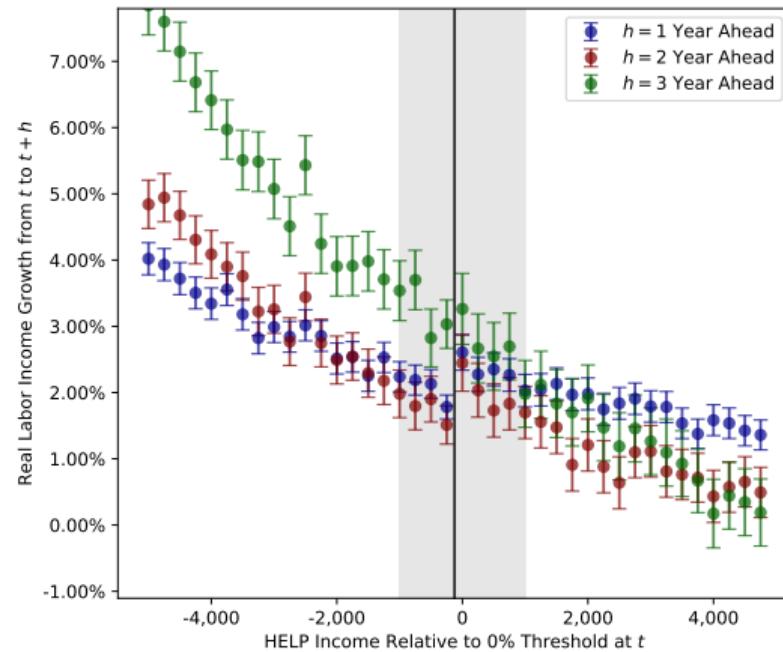
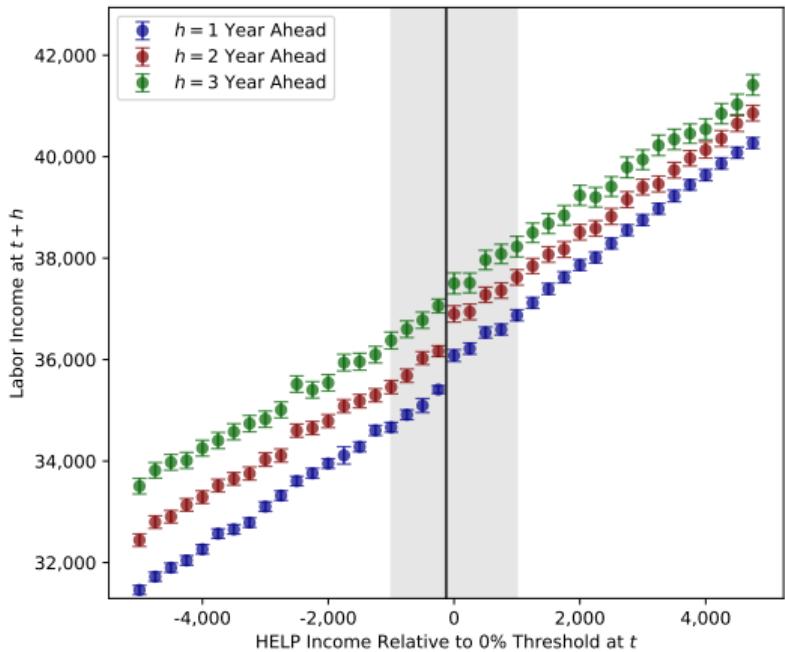
 Back: Summary

# PERSISTENCE OF BUNCHING LASTS AROUND THREE YEARS



◀ Back

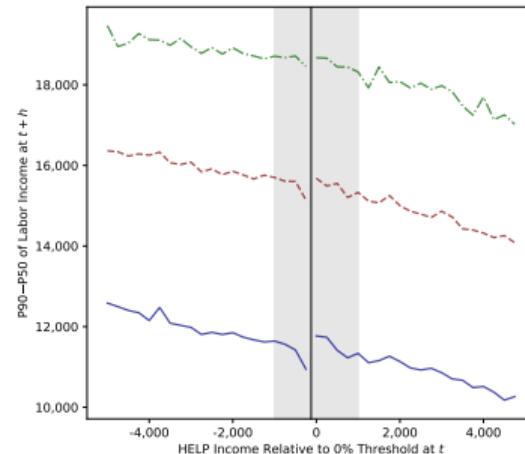
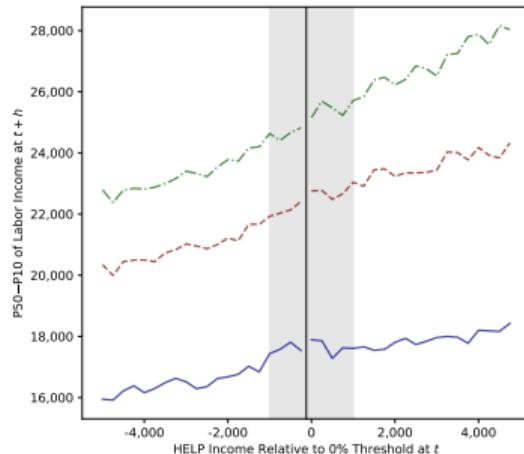
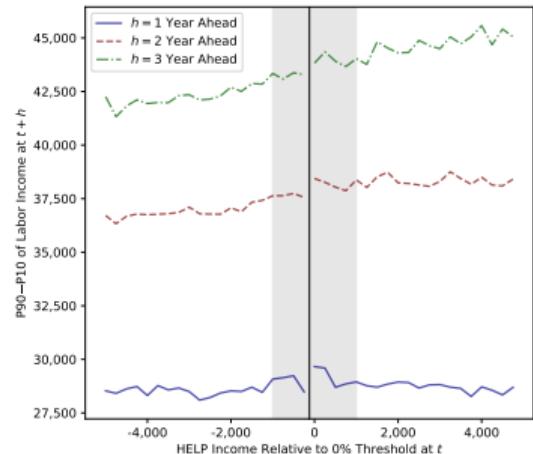
# LIMITED EVIDENCE OF DYNAMIC COST TO BUNCHING



▶ Distribution

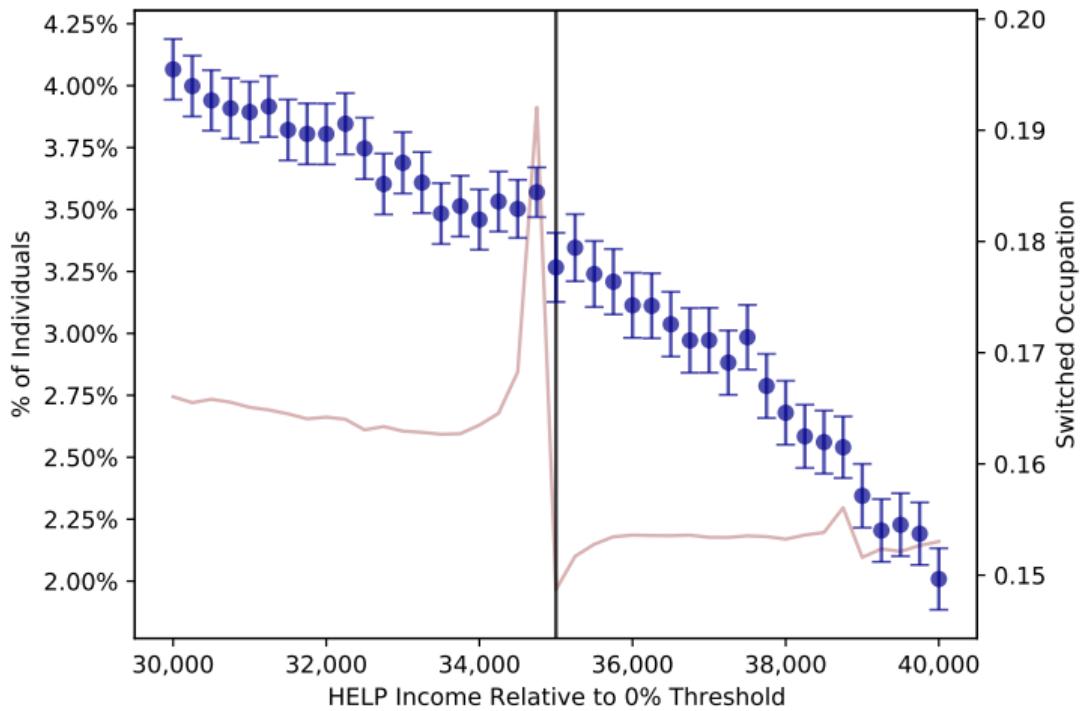
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# LITTLE DIFFERENCE IN DISTRIBUTION OF FUTURE INCOME



Back

# No Discontinuity in the Probability of Switching Occupations



◀ Back

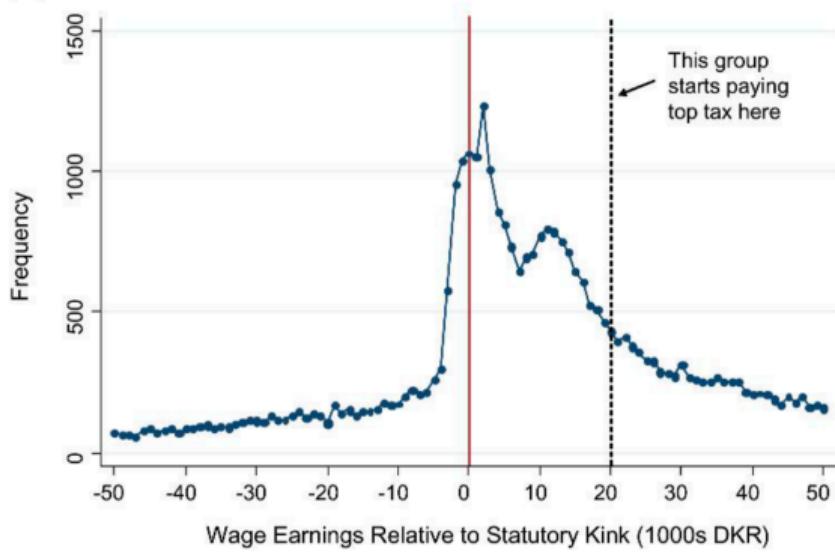
## DEMOGRAPHIC HETEROGENEITY IN BUNCHING

Sample	Estimated Bunching Statistic: b
Non-Electronic Filers	0.086
Electronic Filers	0.082
Wage-Earners	0.081
Entrepreneurs (Not Wage-Earners)	0.117
Females	0.081
Males	0.083
No Dependent Children	0.086
Has Dependent Children	0.077
No Spouse	0.085
Has Spouse	0.081
<b>Full Sample</b>	<b>0.084</b>

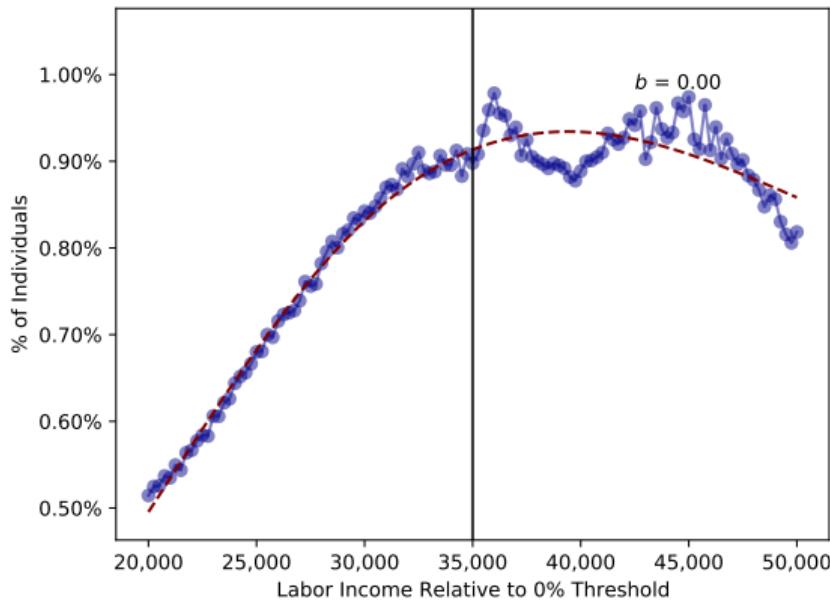
◀ Back

# CHETTY ET AL. (2011) TEST OF FIRM RESPONSES

## Chetty et al: Teacher Wages



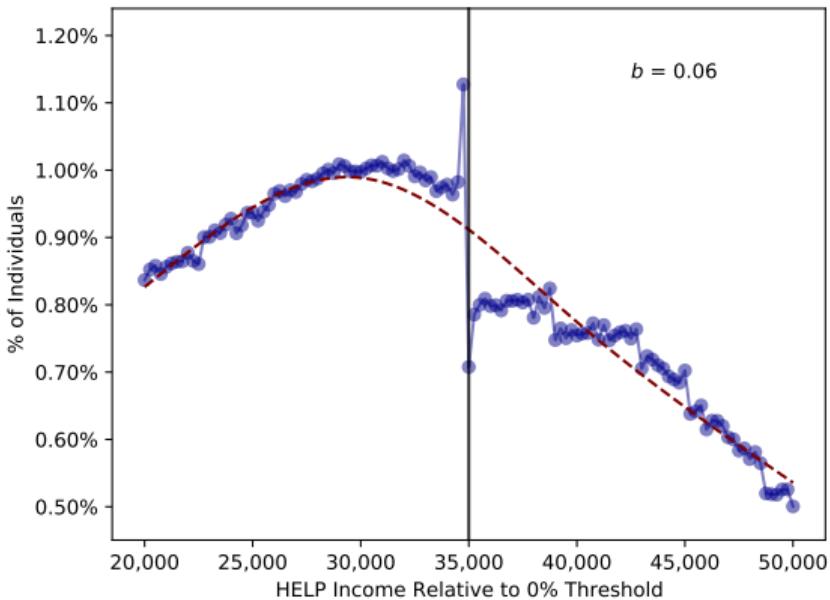
## Borrower Labor Income



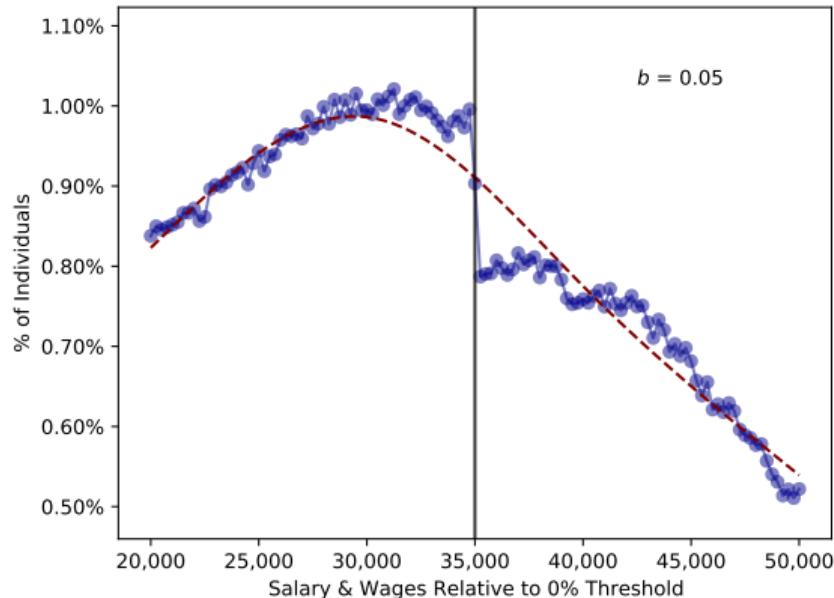
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# BUNCHING IN DISTRIBUTION OF SALARY AND WAGES

## HELP Income



## Salary and Wages



[◀ Back](#)

## FIRST-STAGE CALIBRATION

- **Interest rates and borrowing:**
  - Interest rate = 1.84%, borrowing rate = CC rate, debt interest rate = 0%
  - Borrowing limit = average CC limit by age
- **Demographics:** cohort birth rates and mortality risk taken from life tables
  - Consumption adjusted for equivalence scale using HH size (Lusardi et al. 2017)
- **Government:** use exact (non-smooth) formulas provided by tax office
- **Initial conditions:** assets and debt distributions taken from data at age 22
- **Baseline RRA and EIS:**  $\gamma = \frac{1}{\sigma} = 2.23$  (Choukhmane-de Silva 2023)
  - Welfare analysis: consider alternative values + preference for early resolution

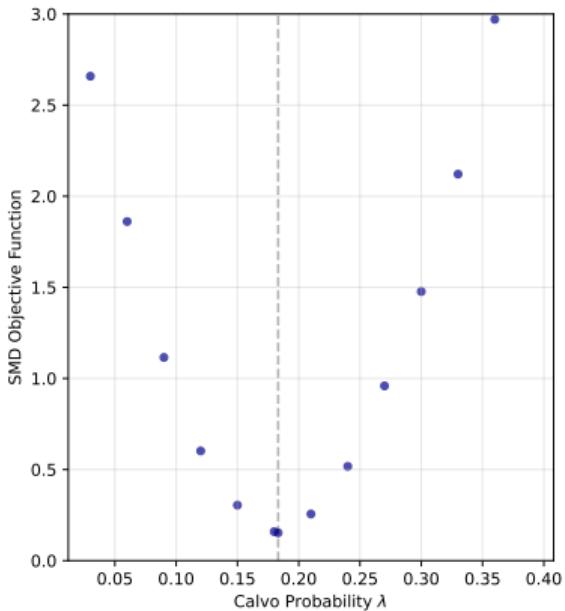
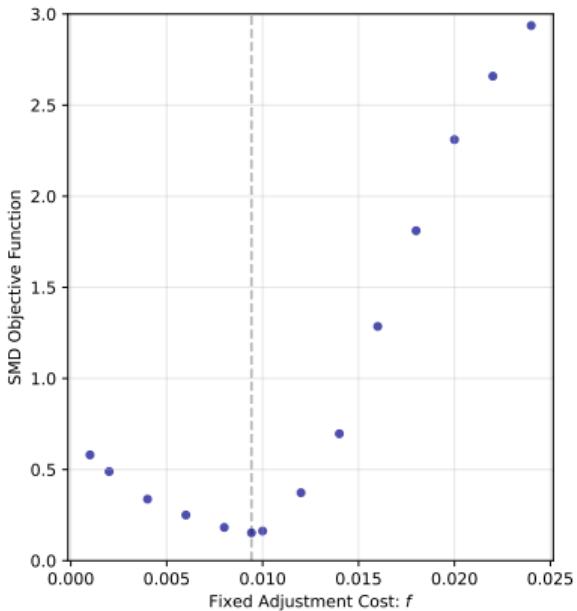
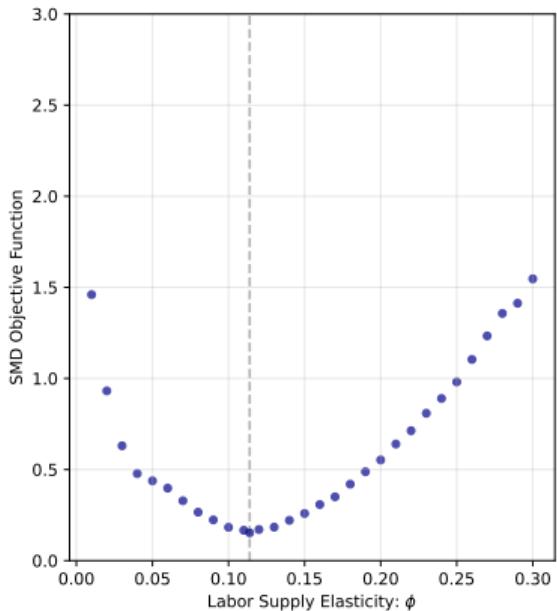
- **Interest rates and borrowing:**
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  - Consumption adjusted for equivalence scale using HH size (Lusardi et al. 2017)
- **Government:** use exact (non-smooth) formulas provided by tax office
- **Initial conditions:** assets and debt distributions taken from data at age 22
- **Baseline RRA and EIS:**  $\gamma = \frac{1}{\sigma} = 2.23$  (Choukhmane-de Silva 2023)
  - Welfare analysis: consider alternative values + preference for early resolution
- **Learning-by-doing extension:**  $\alpha = 0.24$  (median value from Best-Kleven 2013)
-

## ELASTICITY OF MOMENTS WITH RESPECT TO PARAMETERS

	$\phi$	$f$	$\lambda$
Mass Below 2004 Threshold	0.08	-0.16	0.21
Mass Above 2004 Threshold	-0.03	0.09	-0.13
Mass Below 2005 Threshold	0.12	-0.16	0.28
Mass Above 2005 Threshold	-0.04	0.09	-0.19
Ratio 2005 0%	0.22	-0.34	0.64
Ratio 2005 0.5%	0.13	-0.12	0.16
Ratio 2005 0%, Q1 Debt	0.22	-0.34	0.37
Ratio 2005 0%, Q4 Debt	0.20	-0.33	0.82

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# SMM OBJECTIVE IS SMOOTH IN LABOR SUPPLY PARAMETERS



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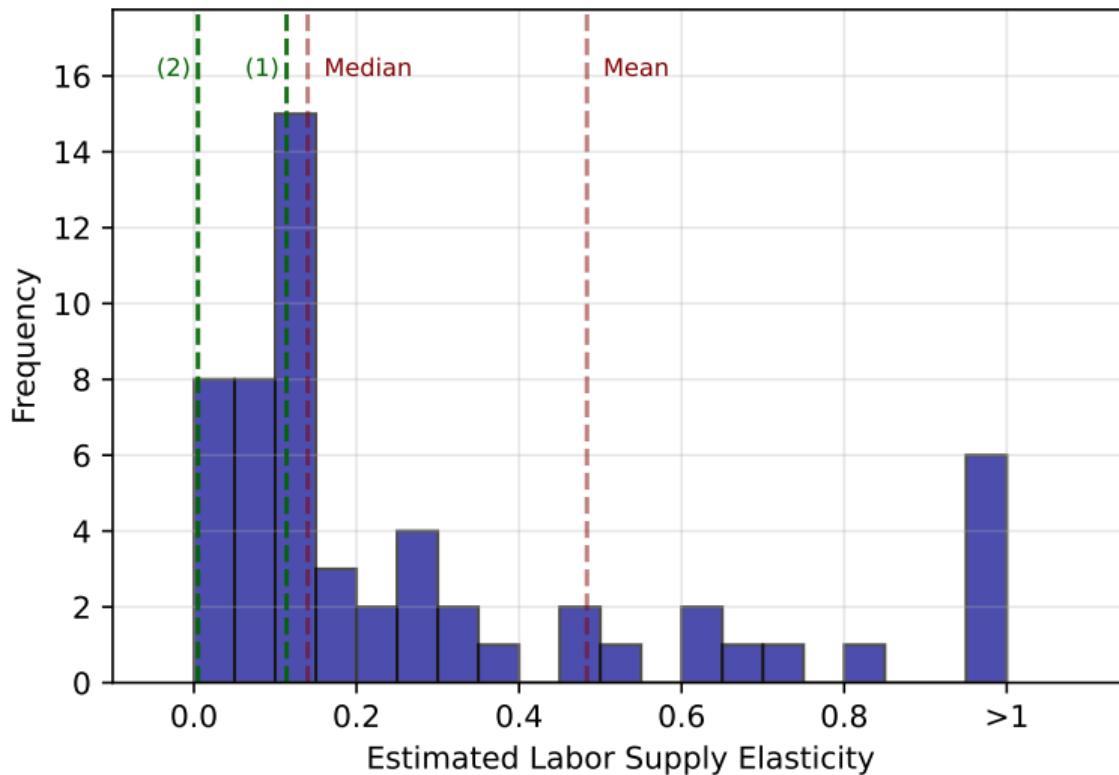
## SIMULATED MINIMUM DISTANCE: OTHER MOMENTS

$$\text{Parameters} = \left( \underbrace{\phi \ f \ \lambda \ \kappa \ \beta}_{\text{preferences}} \quad \underbrace{\delta_0 \ \delta_1 \ \delta_2 \ \delta_0^E \ \delta_1^E}_{\text{wage profile}} \quad \underbrace{\rho \ \sigma_\nu \ \sigma_\epsilon \ \sigma_i}_{\text{wage risk}} \right)$$

- Age profiles of salary & wages  $\Rightarrow$  wage profile parameters
- Moments in Guvenen et al. 2022  $\Rightarrow$  wage risk parameters
- Average capital income at ages 40-44  $\Rightarrow$   $\beta$
- Average labor supply  $\Rightarrow$   $\kappa$

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## COMPARISON WITH EXISTING LITERATURE ON LABOR SUPPLY (1/2)



Source: intensive-margin Hicks and Frisch elasticities reported in Keane (2011) and Chetty (2012)

## COMPARISON WITH EXISTING LITERATURE ON LABOR SUPPLY (2/2)

### Reasons why elasticity may be smaller:

- ① Different **sample**: college graduates with less flexibility and further from  $y_t = w_t l_t$
- ② Elasticity is **local** to threshold: no high-income individuals Gruber-Saez 2002
- ③ Bunching does not identify **extensive** margin responses Saez et al. 2012

### Contributions:

- ① **Empirical** characterization of responses to income-contingent repayment
  - $\ell_t$  of indebted households responds to liquidity not wealth, like  $c_t$  Ganong-Noel 2020
- ② **Dynamic** model of labor supply with time- and state-dependent adjustment
  - ✓ First paper (to my knowledge) to explicitly estimate different types of frictions

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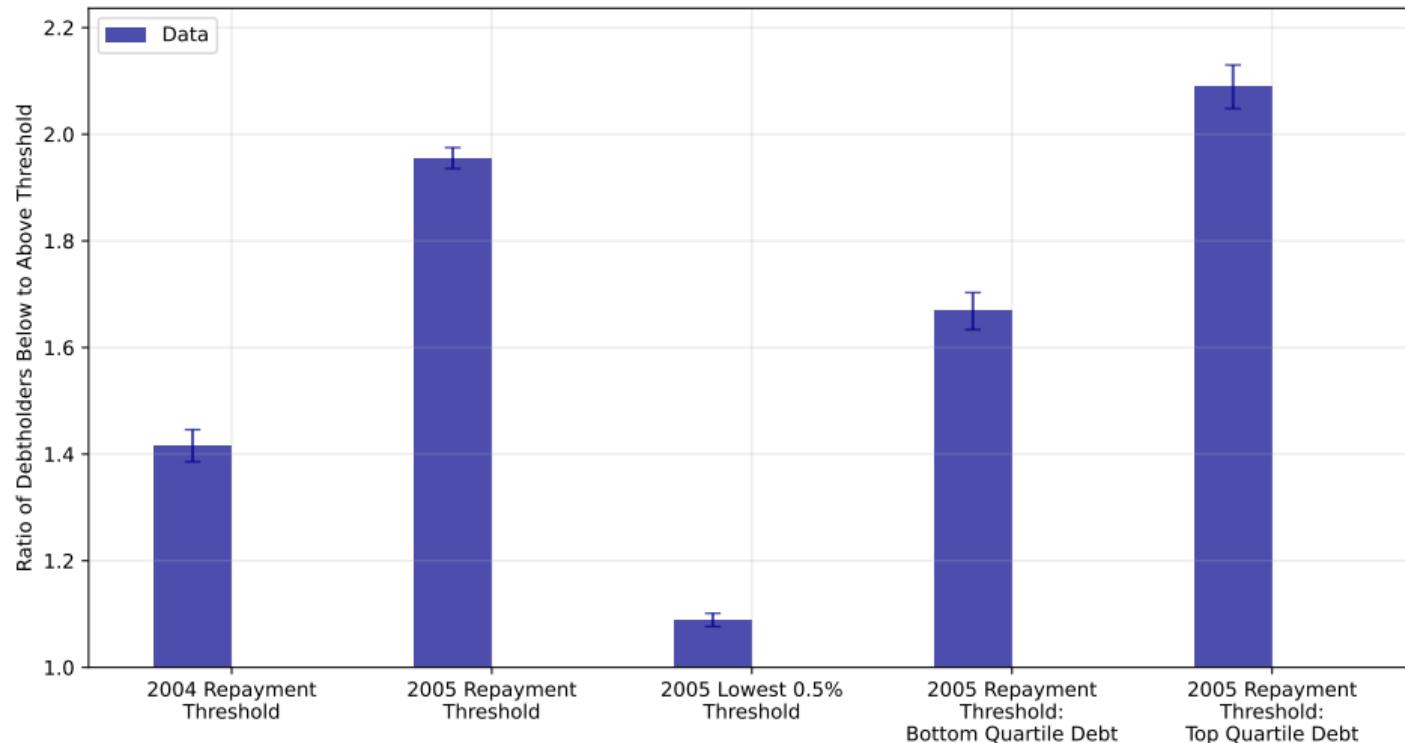
# FULL ESTIMATION RESULTS

Parameter		Estimation						
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
Labor supply elasticity	$\phi$	0.114 (.004)	0.005 (.000)	0.188 (.003)	0.053 (.002)	0.082 (.002)	0.111 (.004)	0.067 (.002)
Adjustment cost	$f$	\$377 (\$13)	\$0 . .	\$2278 (\$21)	\$0 . .	\$762 (\$10)	\$513 (\$19)	\$848 (\$11)
Calvo probability	$\lambda$	0.183 (.003)	1 . .	1 . .	0.147 (.002)	0.346 (.009)	0.191 (.003)	0.266 (.005)
Scaling parameter	$\kappa$	0.560 (.007)	0.030 (.003)	0.059 (.014)	0.510 (.012)	1.242 (.116)	0.593 (.001)	0.448 (.001)
Time discount factor	$\beta$	0.973 (.001)	0.996 (.000)	0.972 (.001)	0.944 (.001)	0.951 (.001)	0.951 (.001)	0.946 (.001)
Wage profile parameters	$\delta_0$	8.922 (.009)	9.862 (.002)	8.680 (.006)	9.389 (.007)	9.197 (.007)	9.143 (.008)	9.211 (.008)
	$\delta_1$	0.073 (.000)	0.111 (.000)	0.073 (.000)	0.063 (.000)	0.070 (.000)	0.075 (.000)	0.074 (.000)
	$\delta_2$	-0.001 (.000)	-0.002 (.000)	-0.001 (.000)	-0.001 (.000)	-0.001 (.000)	-0.001 (.000)	-0.001 (.000)
	$\delta_0^E$	-0.487 (.002)	-0.294 (.000)	-0.450 (.001)	-0.530 (.002)	-0.480 (.002)	-0.478 (.002)	-0.505 (.002)
	$\delta_1^E$	0.020 (.000)	0.032 (.000)	0.018 (.000)	0.021 (.000)	0.018 (.000)	0.020 (.000)	0.021 (.000)
Persistence of permanent shock	$\rho$	0.930 (.000)	0.914 (.000)	0.943 (.000)	0.922 (.000)	0.889 (.000)	0.907 (.001)	0.931 (.001)
Std. deviation of permanent shock	$\sigma_\nu$	0.236 (.000)	0.076 (.000)	0.196 (.000)	0.268 (.000)	0.288 (.000)	0.275 (.001)	0.246 (.001)
Std. deviation of transitory shock	$\sigma_\epsilon$	0.130 (.000)	0.504 (.000)	0.168 (.000)	0.077 (.002)	0.064 (.002)	0.080 (.002)	0.116 (.001)
Std. deviation of individual FE	$\sigma_i$	0.599 (.003)	0.101 (.001)	0.541 (.003)	0.654 (.003)	0.625 (.003)	0.612 (.003)	0.632 (.003)
Learning-by-doing parameter	$\alpha$	0 Fixed No	0 Fixed No	0 Fixed No	0 Fixed No	0.24 Fixed No	0 Linear No	0 Fixed Yes
Adjustment cost function								
Misperception of debt payoff								

◀ Back: Estimation

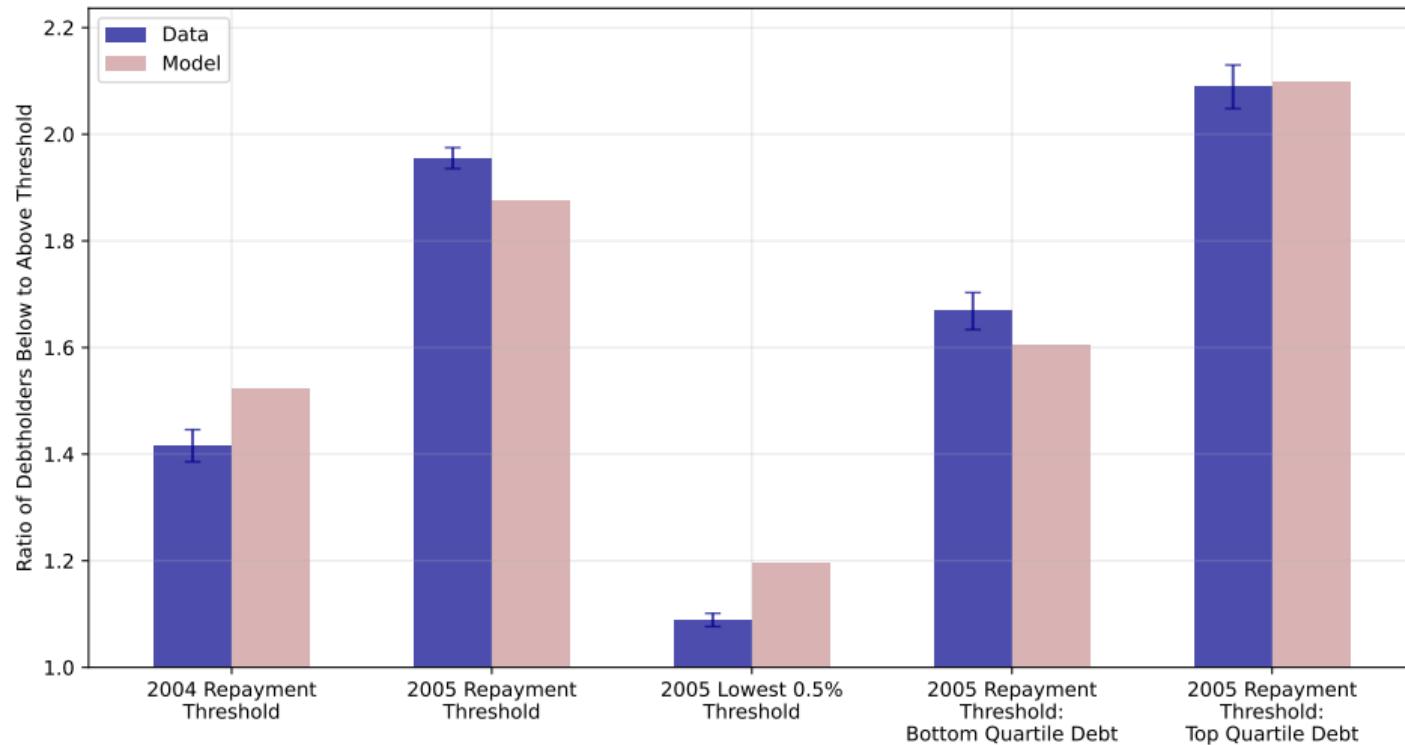
◀ Back: Additional

# MODEL FIT: BUNCHING HETEROGENEITY



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# MODEL FIT: BUNCHING HETEROGENEITY



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## MODEL FIT: OTHER TARGET MOMENTS

Estimation Target	Data	Model
Average Labor Income	\$42,639	\$45,582
Cross-Sectional Variance of Log Labor Income at Age 22	0.453	0.462
Cross-Sectional Variance of Log Labor Income at Age 32	0.555	0.491
Cross-Sectional Variance of Log Labor Income at Age 42	0.577	0.525
Cross-Sectional Variance of Log Labor Income at Age 52	0.539	0.580
Cross-Sectional Variance of Log Labor Income at Age 62	0.608	0.657
Linear Age Profile Term	0.077	0.080
Quadratic Age Profile Term	-0.001	-0.001
Education Income Premium Constant	-0.574	-0.554
Education Income Premium Slope	0.023	0.023
10th Percentile of 1-Year Labor Income Growth	-0.387	-0.392
10th Percentile of 5-Year Labor Income Growth	-0.667	-0.705
90th Percentile of 1-Year Labor Income Growth	0.415	0.393
90th Percentile of 5-Year Labor Income Growth	0.698	0.710
Average Labor Supply	1.000	0.963
Average Capital Income between Ages 40 and 44	\$1,338	\$1,332

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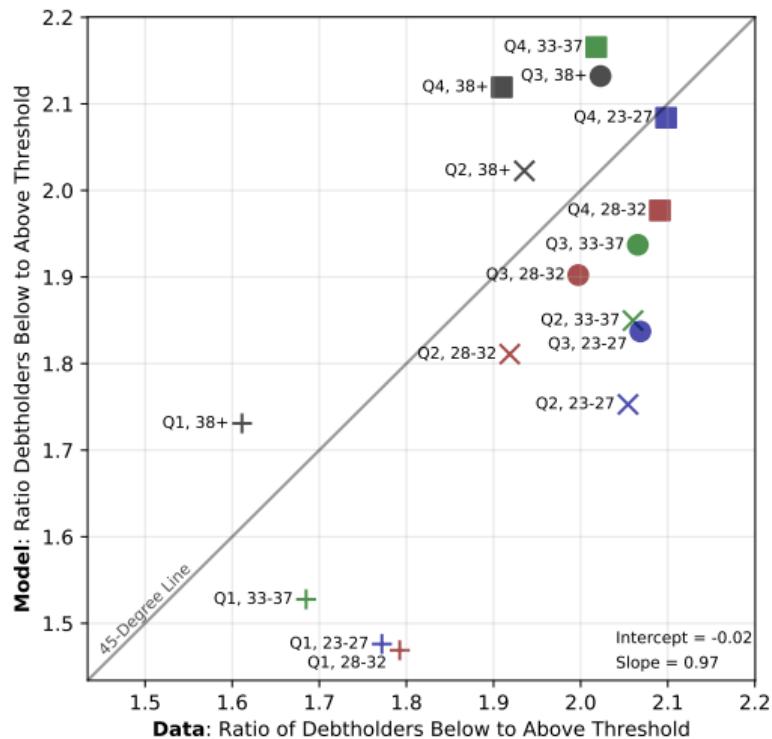
## ADDITIONAL MODEL RESULTS: POSITIVE

- ① **Robustness:**  $\hat{\phi} = 0.111$  with linear adjustment costs (vs. 0.114) 
- ② **Validation** of baseline model on nontargeted moments 
- ③ Bunching **decomposition**:  $P(\text{Repayment}) \approx 60\%$ , liquidity demands  $\approx 40\%$  
- ④ **Learning-by-doing**: cannot match heterogeneity in bunching by debt and age 

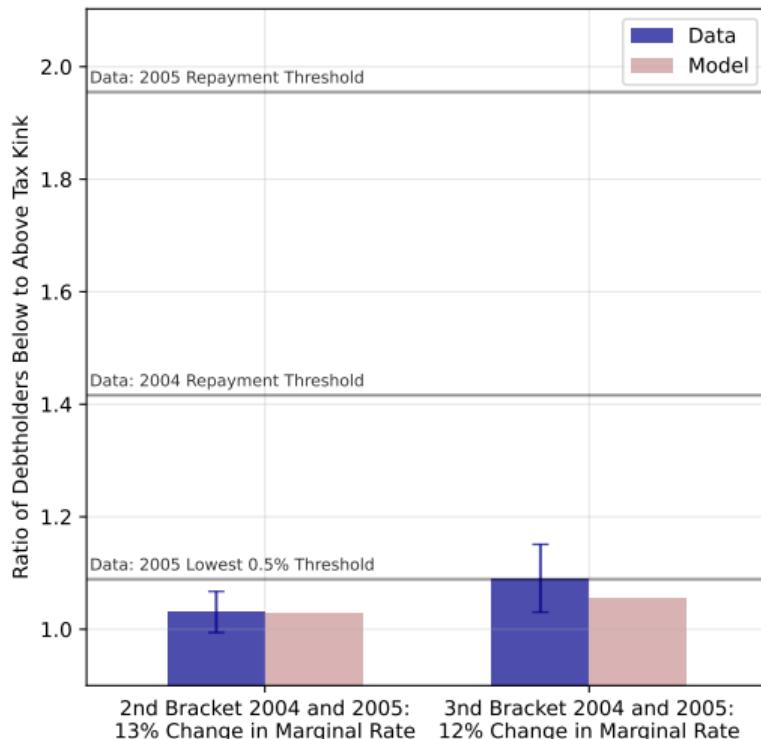
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# VALIDATION OF BASELINE MODEL ON NONTARGETED BUNCHING

## Heterogeneity by Debt and Age



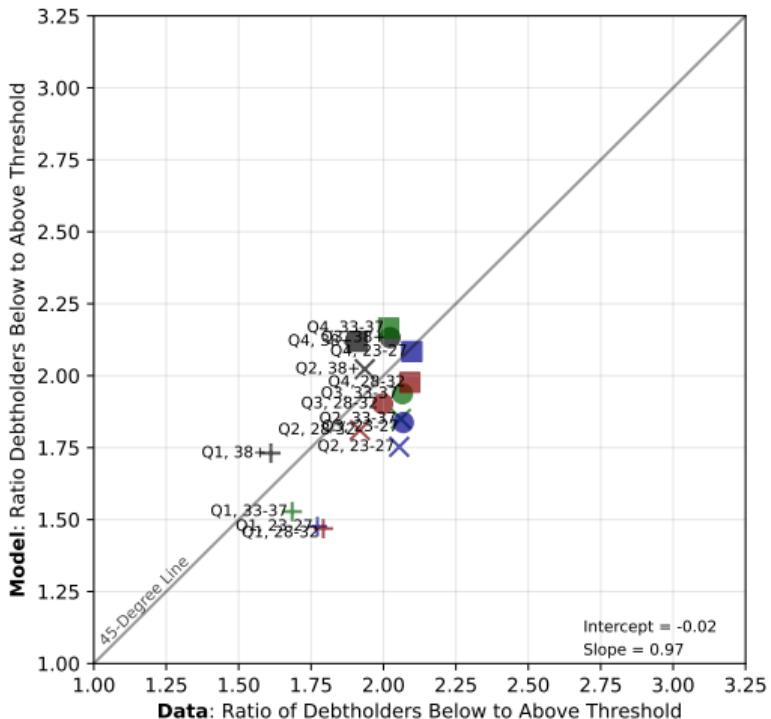
## Bunching at Changes in Tax Rates



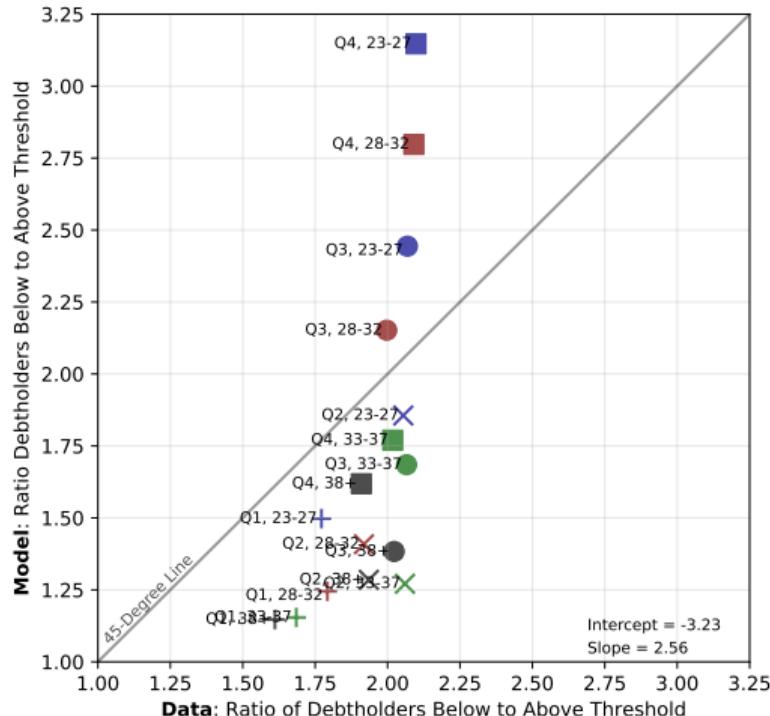
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# LEARNING-BY-DOING MODEL FITS WORSE THAN BASELINE MODEL

## Baseline Model

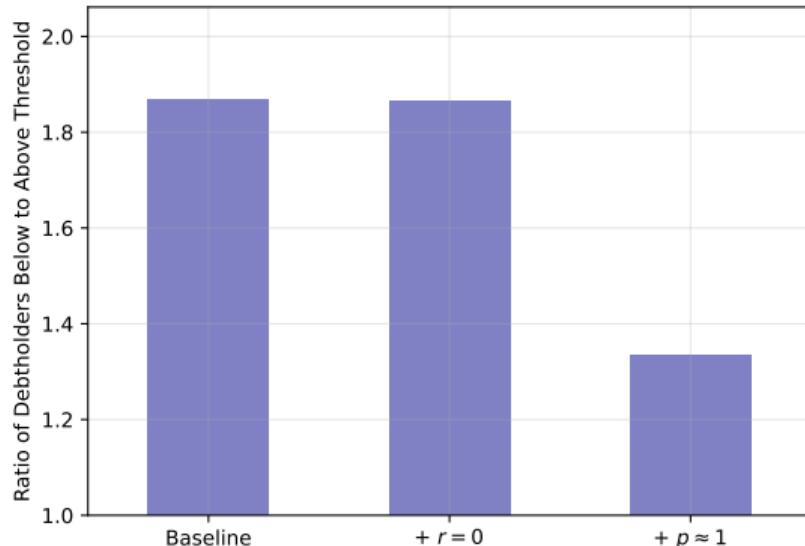
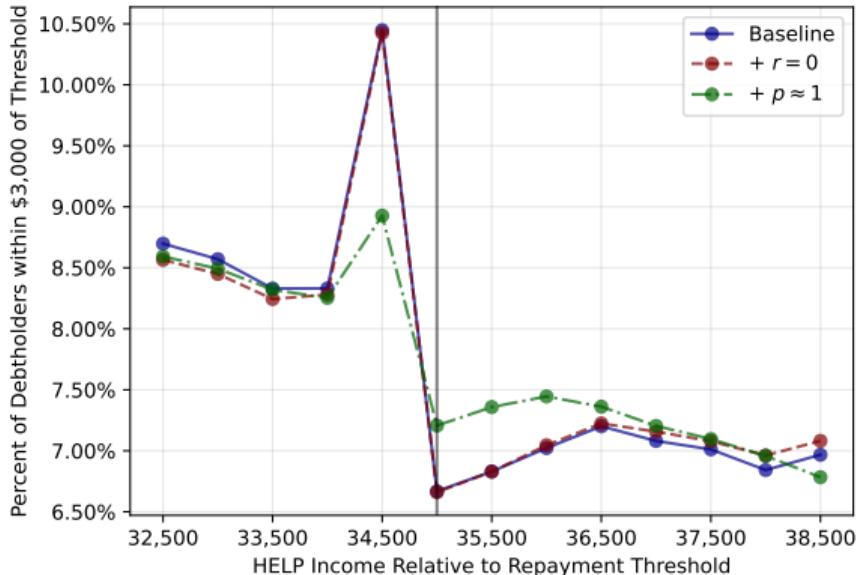


## Learning-by-Doing Model



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# DECOMPOSITION: RATE DIFFERENTIAL, REPAYMENT, AND LIQUIDITY

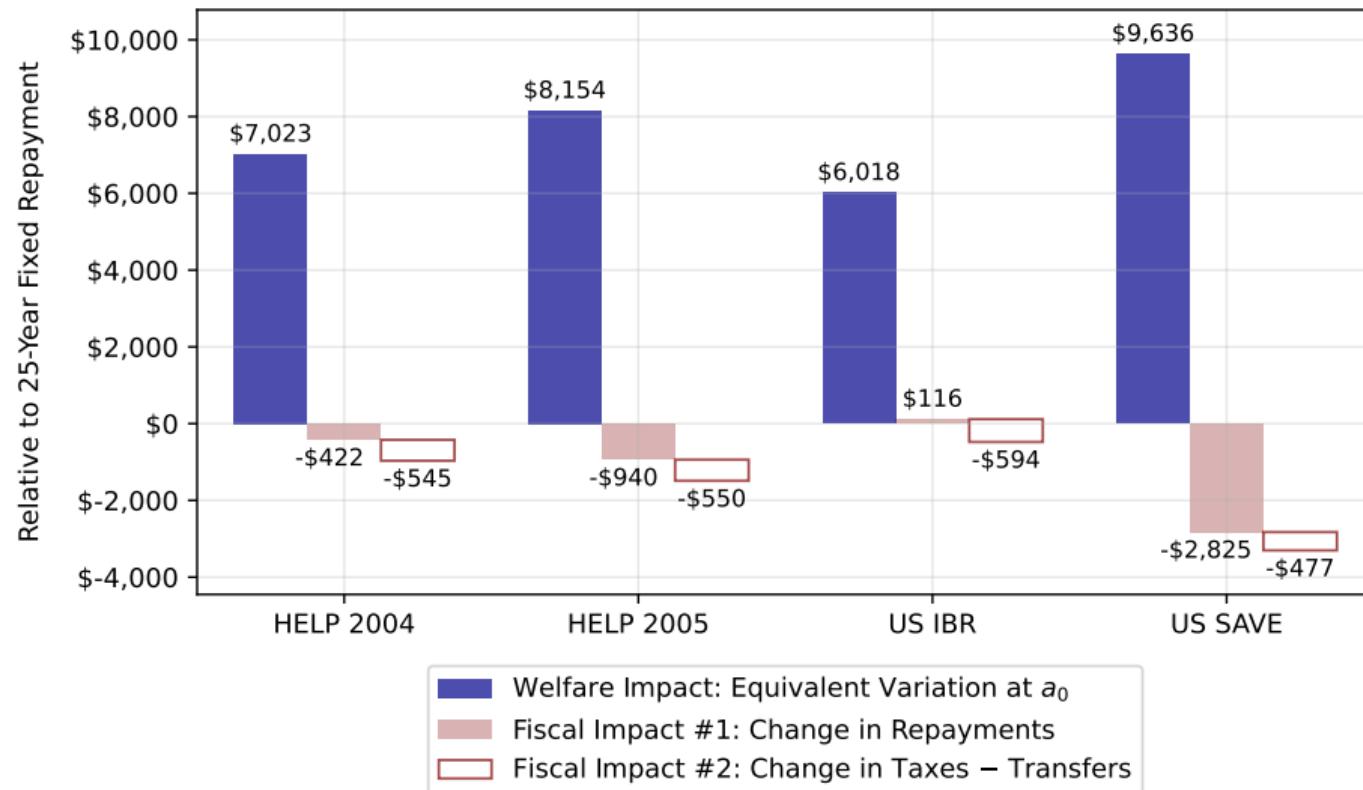


$$\text{Bunching Liquidity Gain} = \$1400 \geq \$1400 \times \frac{r + 1 - p}{1 + r} = \text{Bunching NPV Gain}$$

- Interest rate differential =  $r \Rightarrow 0\%$  of bunching
- Probability of repayment =  $p \Rightarrow 61\%$  of bunching
- Demand for liquidity  $\Rightarrow 39\%$  of bunching (Chetty 2008, Ganong-Noel 2023, Indarte 2023)

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# EXISTING INCOME-CONTINGENT LOANS VS. FIXED REPAYMENT

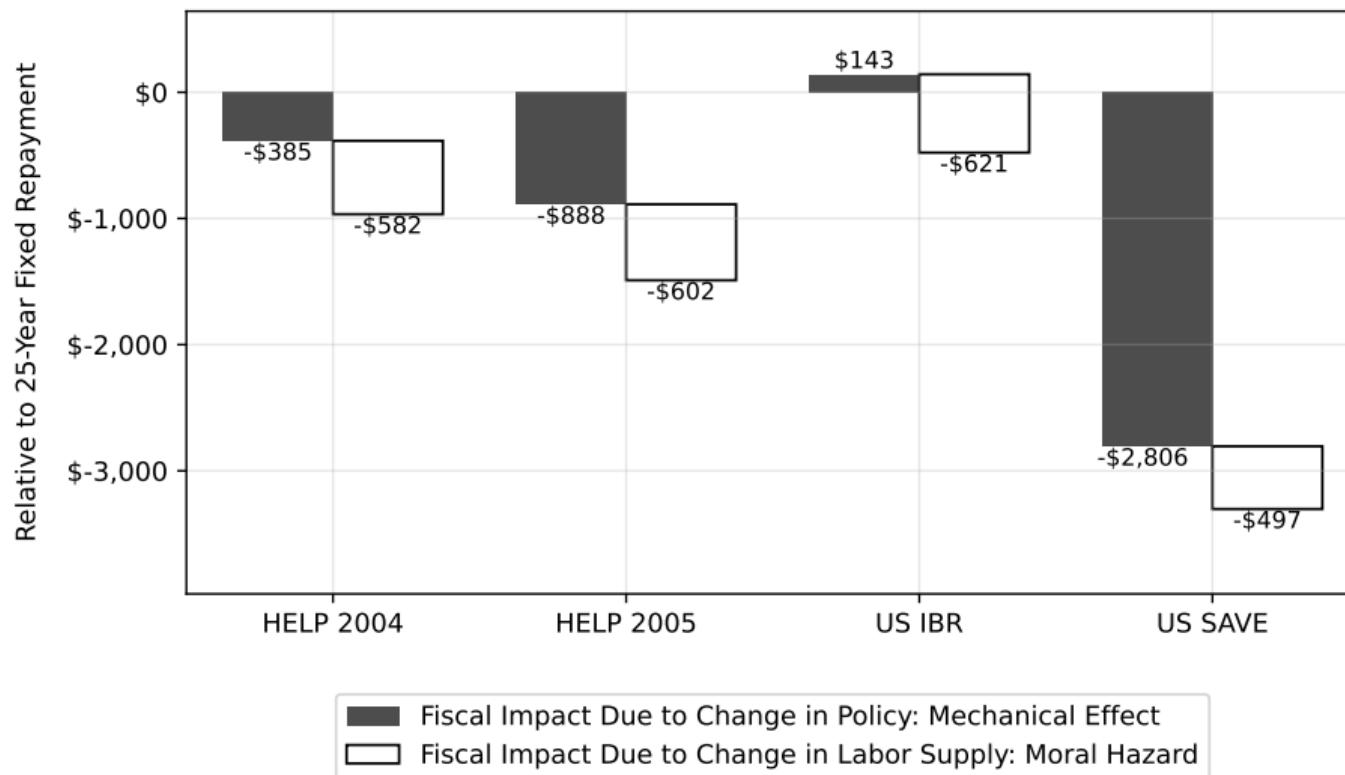


► Decomposition

► MVPF

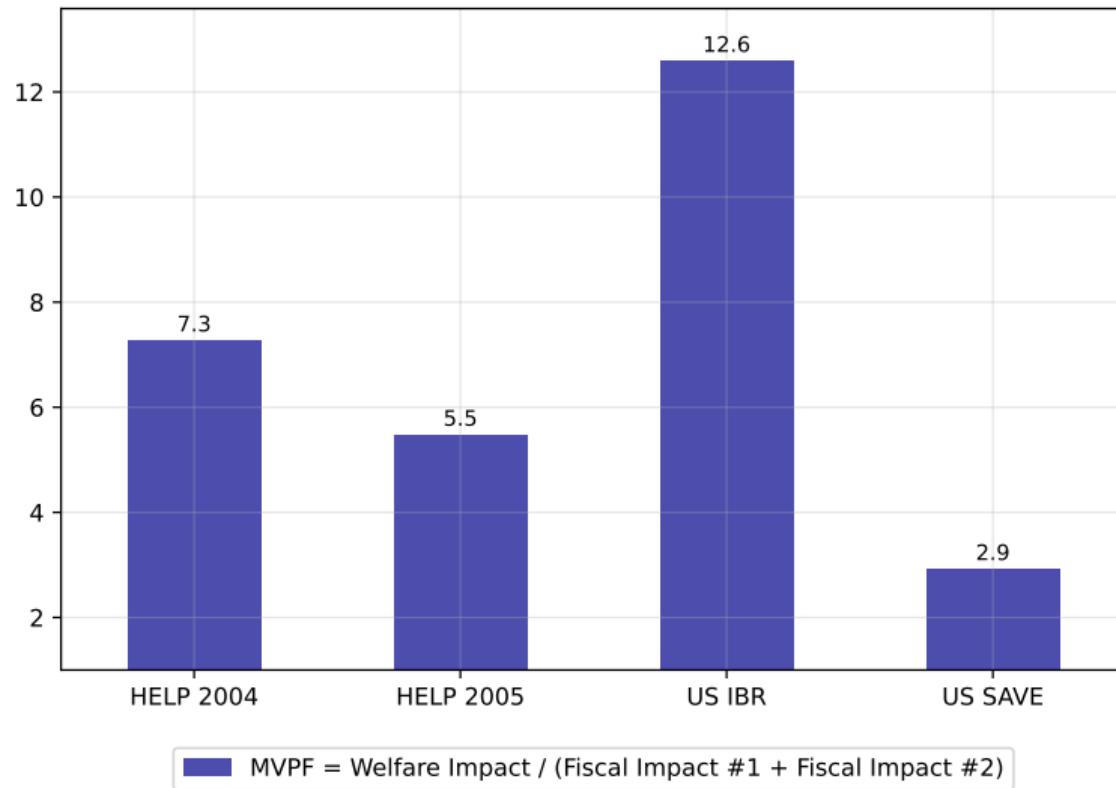
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# DECOMPOSITION OF FISCAL IMPACT: ENDOGENOUS LABOR SUPPLY



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# MARGINAL VALUE OF PUBLIC FUNDS



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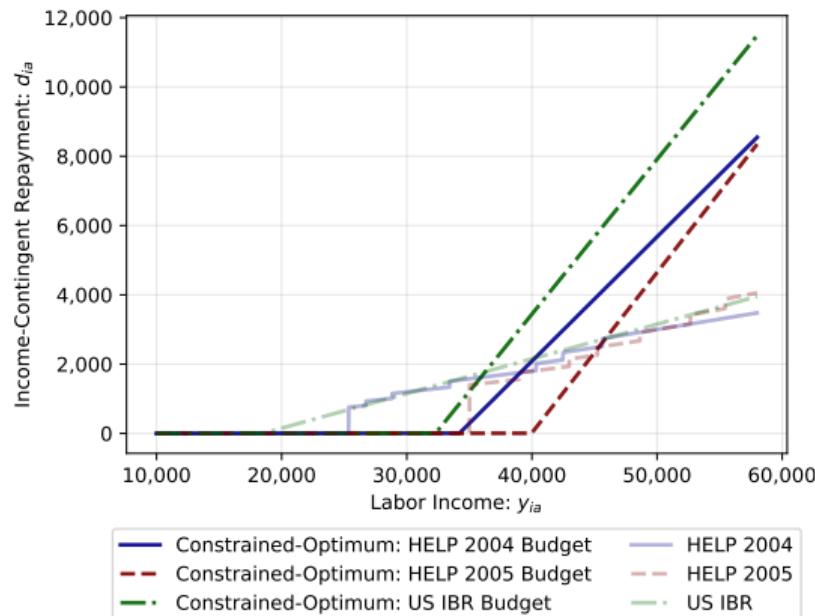
# SOLUTION TO CONSTRAINED-PLANNER'S PROBLEM: QUADRATIC



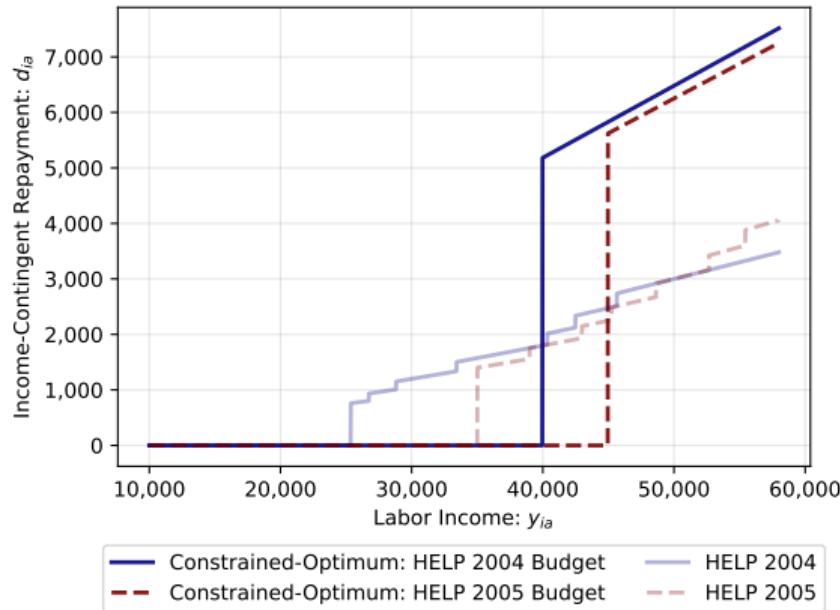
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# OPTIMAL VERSUS EXISTING INCOME-CONTINGENT LOANS

## Change in Marginal Rate

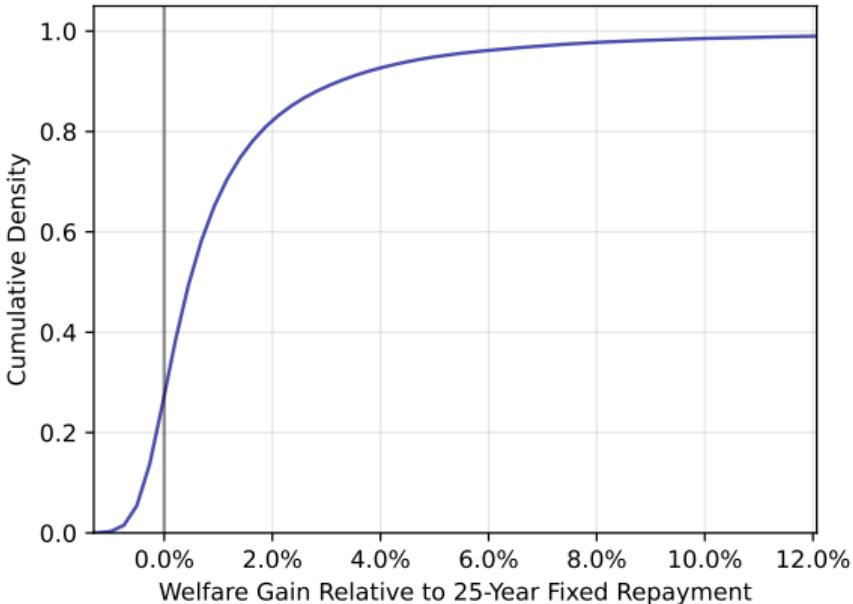
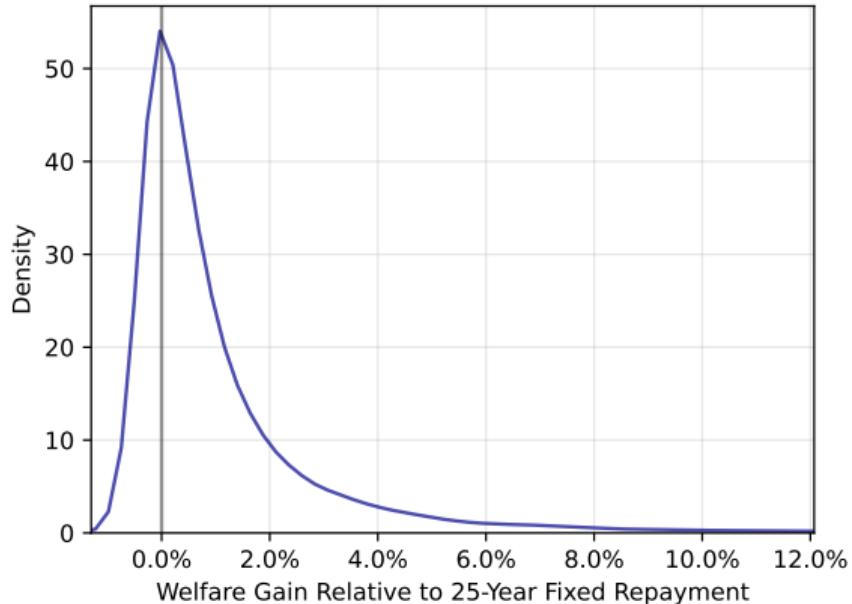


## Change in Average Rate



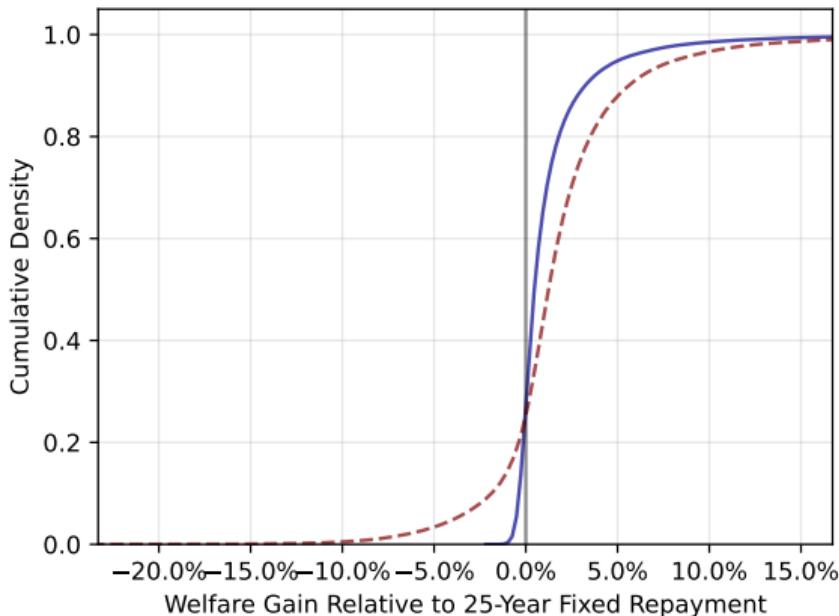
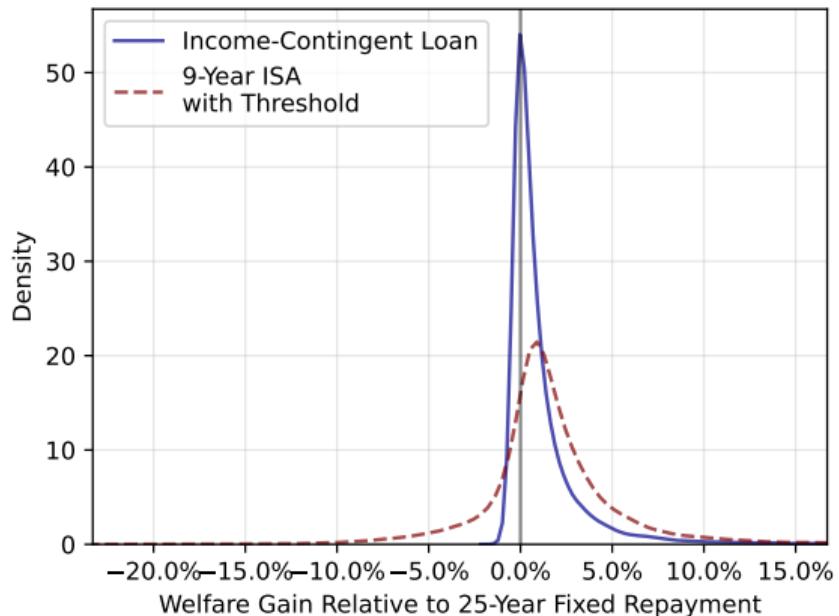
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# DISTRIBUTION OF INITIAL WELFARE GAINS: ICL



- Only **1.2%** of borrowers have welfare loss above 0.5%

# DISTRIBUTION OF INITIAL WELFARE GAINS: ICL vs. EQUITY

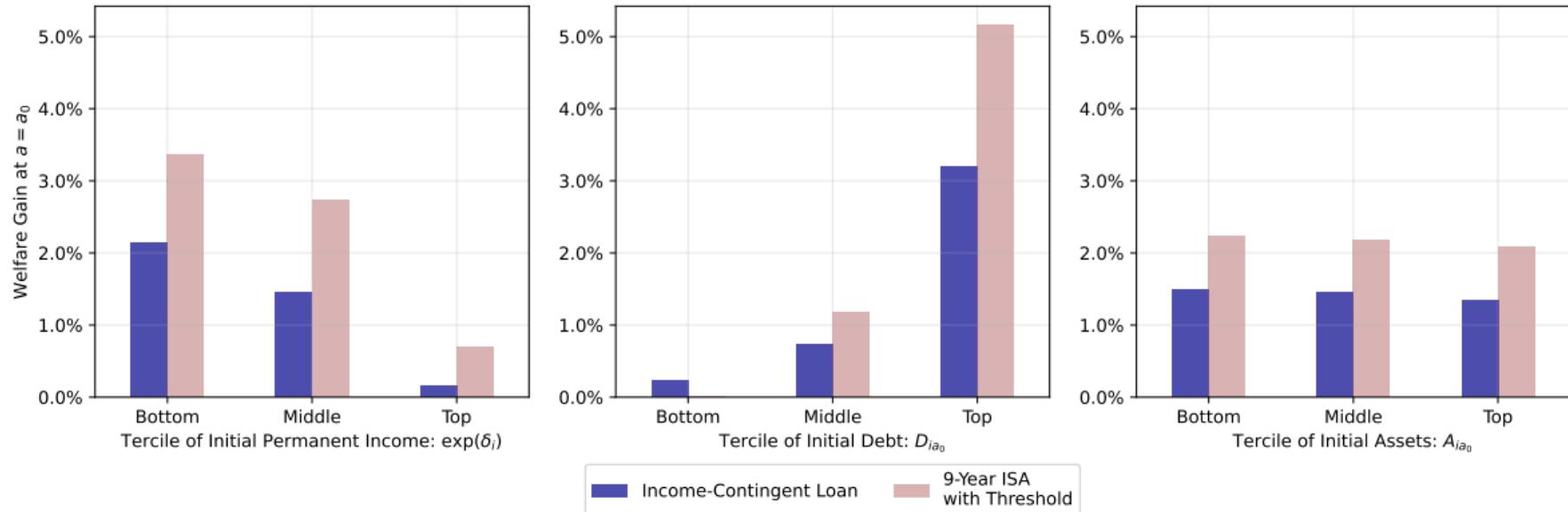


- **18%** of borrowers have welfare loss above 0.5% for equity vs. **1.2%** for ICL

▶ Heterogeneity by Initial States

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# HETEROGENEITY IN WELFARE GAINS ACROSS INITIAL STATES



▶ Losers under ICL

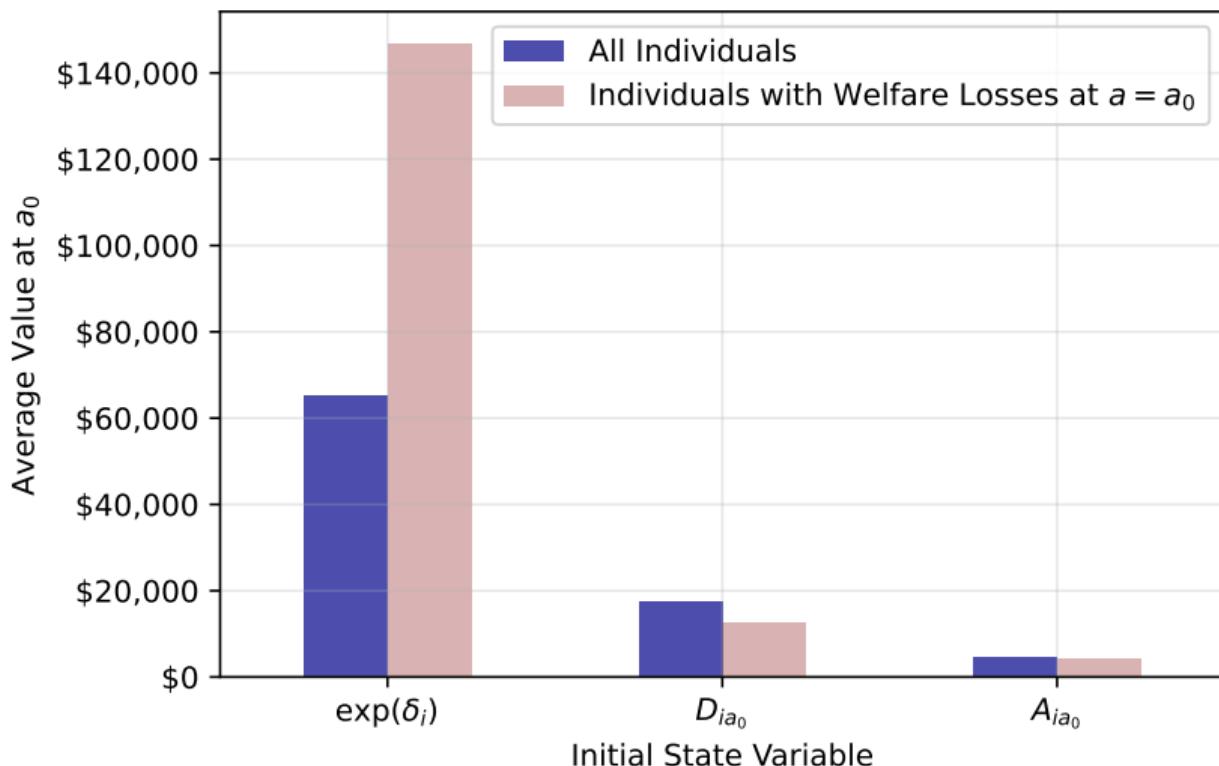
▶ Heterogeneity by Age

▶ Heterogeneity by Initial Debt

◀ Back: ICL Gain

◀ Back: Contracts

# INDIVIDUALS WITH INITIAL WELFARE LOSSES: ICL



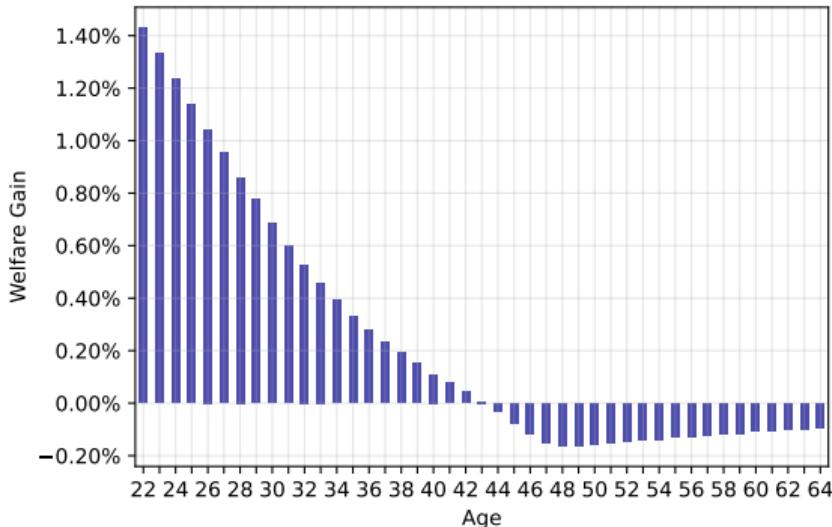
► Heterogeneity by Age

◀ Back: ICL Gain

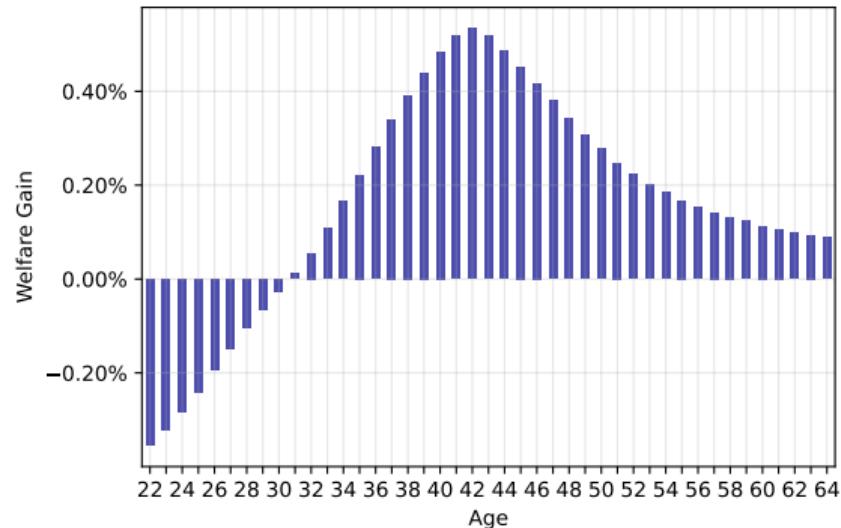
◀ Back: Contracts

# WELFARE GAINS BY AGE

**ICL vs. 25-Year Fixed**



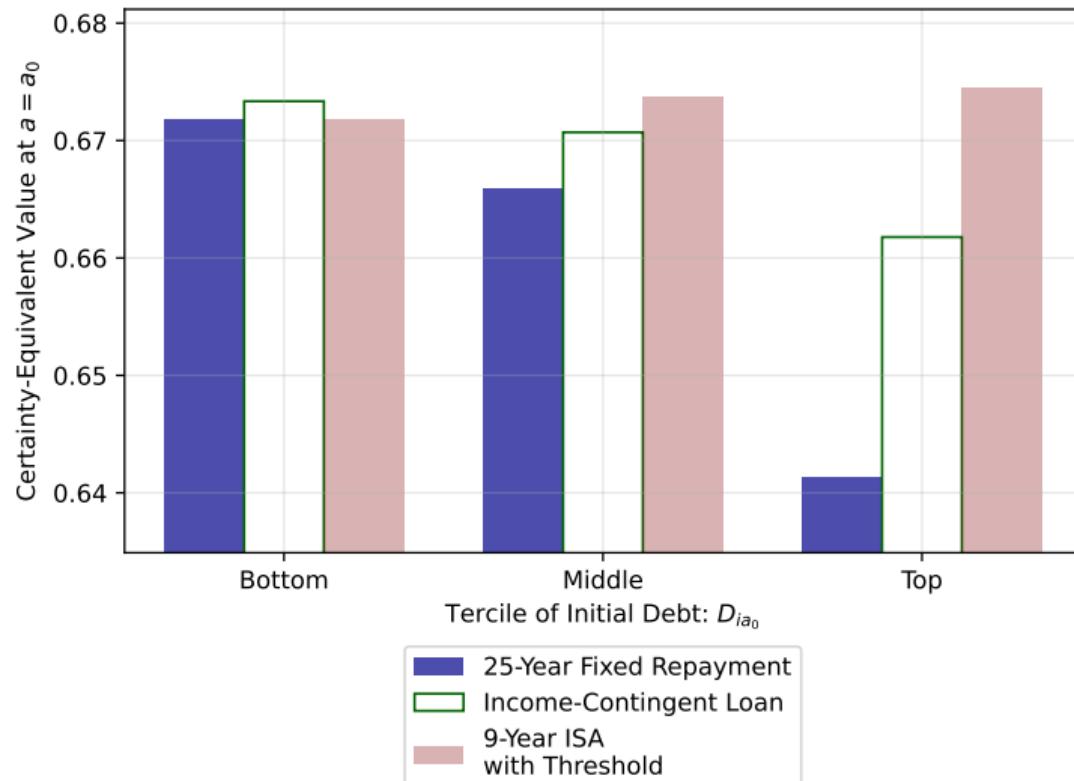
**ICL + 20-Year Forgiveness vs. ICL**



◀ Back: ICL Gain

◀ Back: Contracts

# CERTAINTY-EQUIVALENTS ACROSS INITIAL DEBT

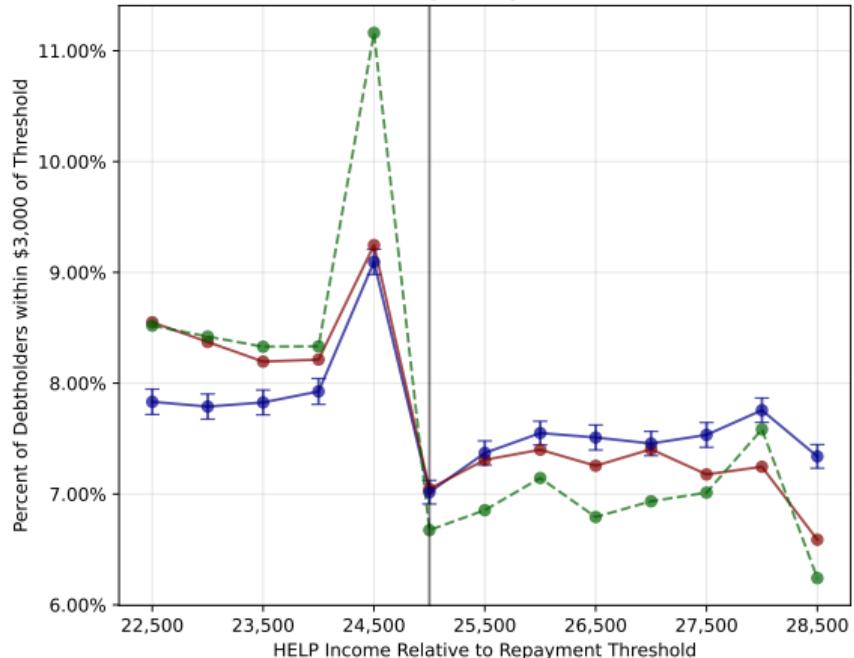


◀ Back: ICL Gain

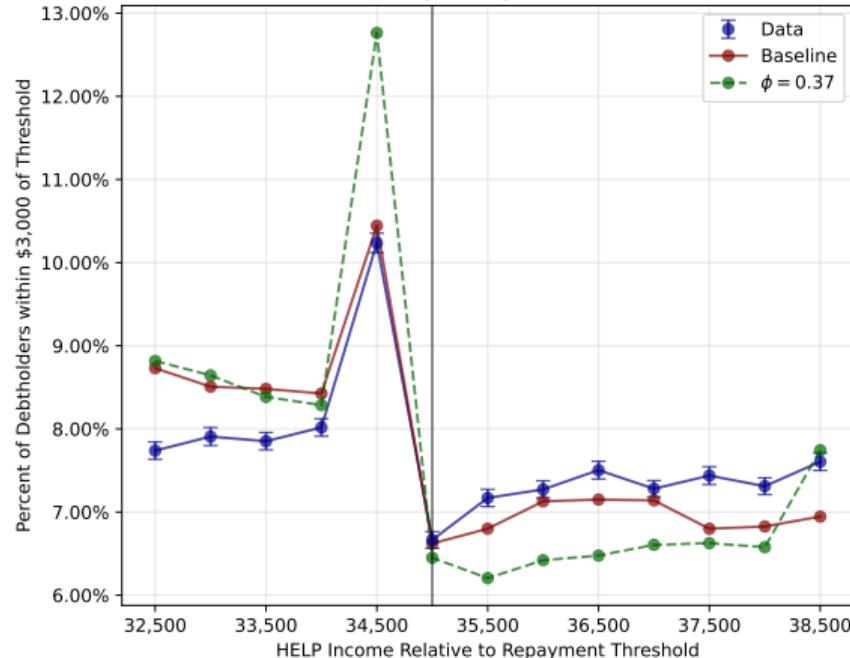
◀ Back: Contracts

# FIT OF MODEL IN WHICH FIXED REPAYMENT IS OPTIMAL

Before Policy Change: 2002-2004



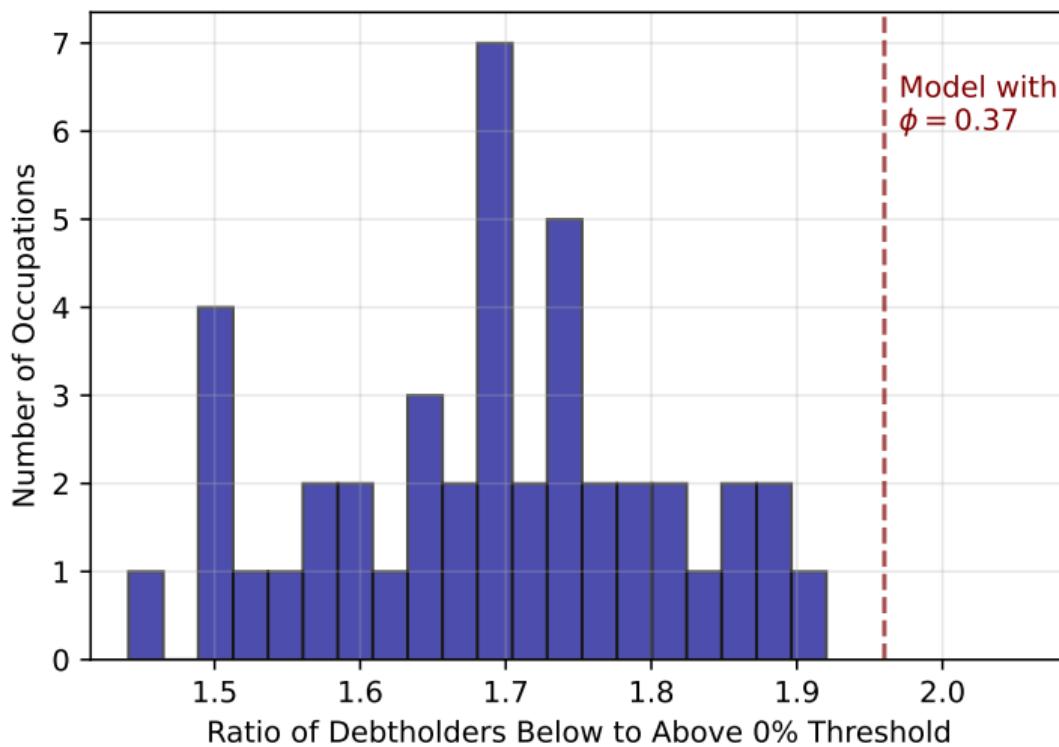
After Policy Change: 2005-2007



▶ Occupations

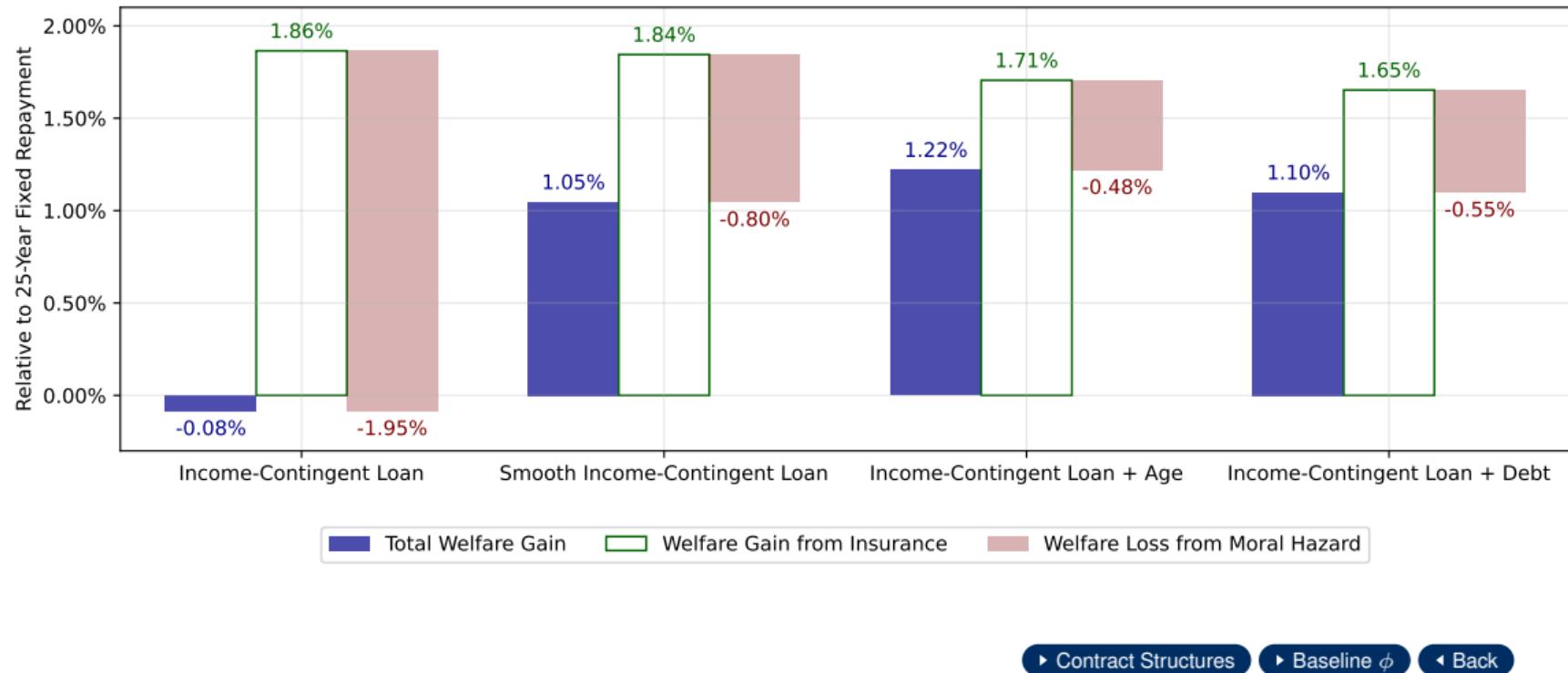
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# BUNCHING WHEN FIXED REPAYMENT IS OPTIMAL vs. OCCUPATIONS

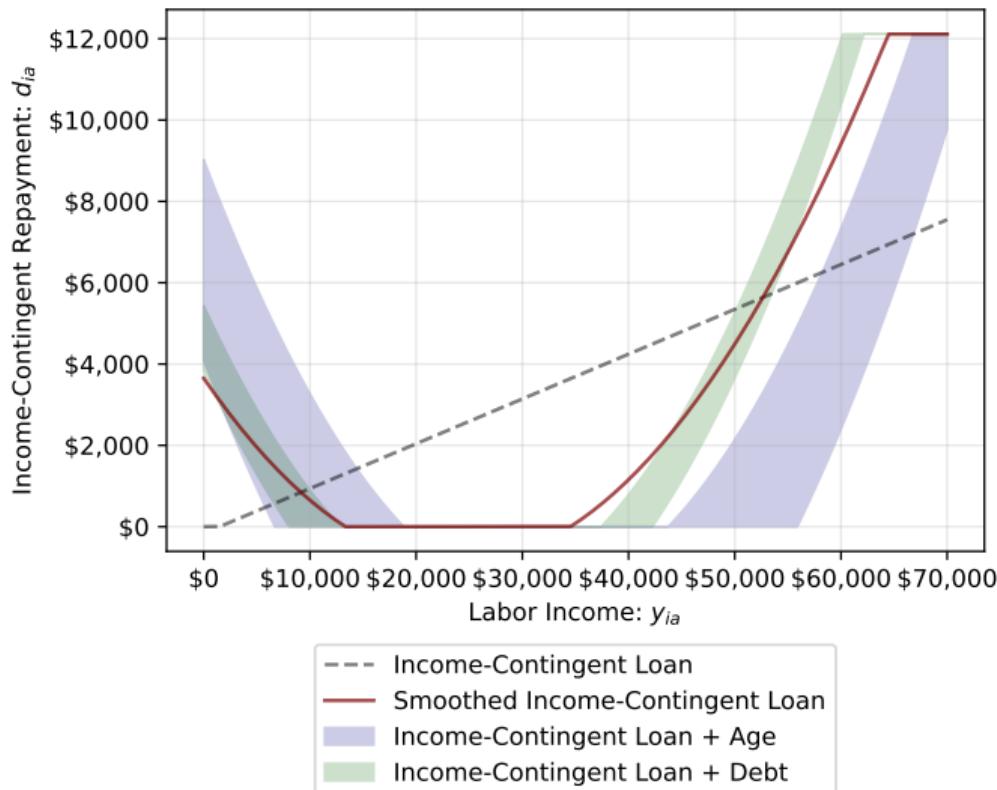


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# ALTERNATIVE CONTRACTS REDUCE WELFARE COST OF MORAL HAZARD

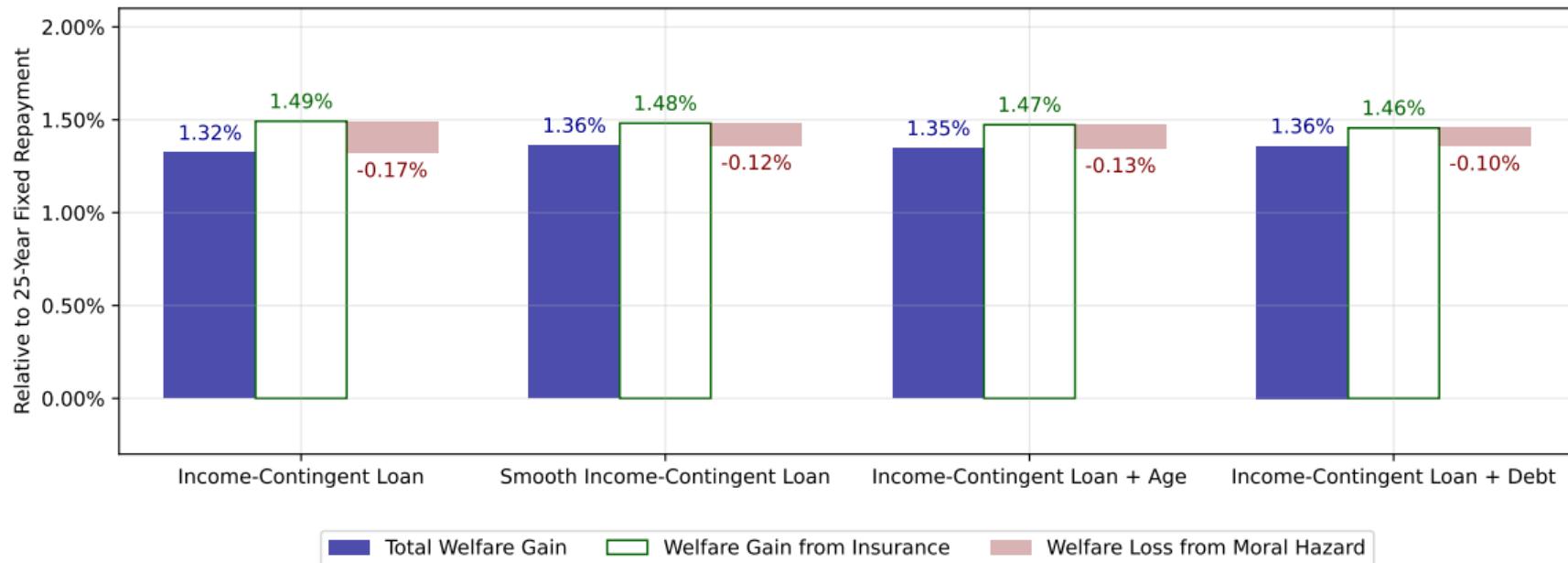


# ALTERNATIVE FORMS OF INCOME-CONTINGENT LOANS: $\phi = 0.37$



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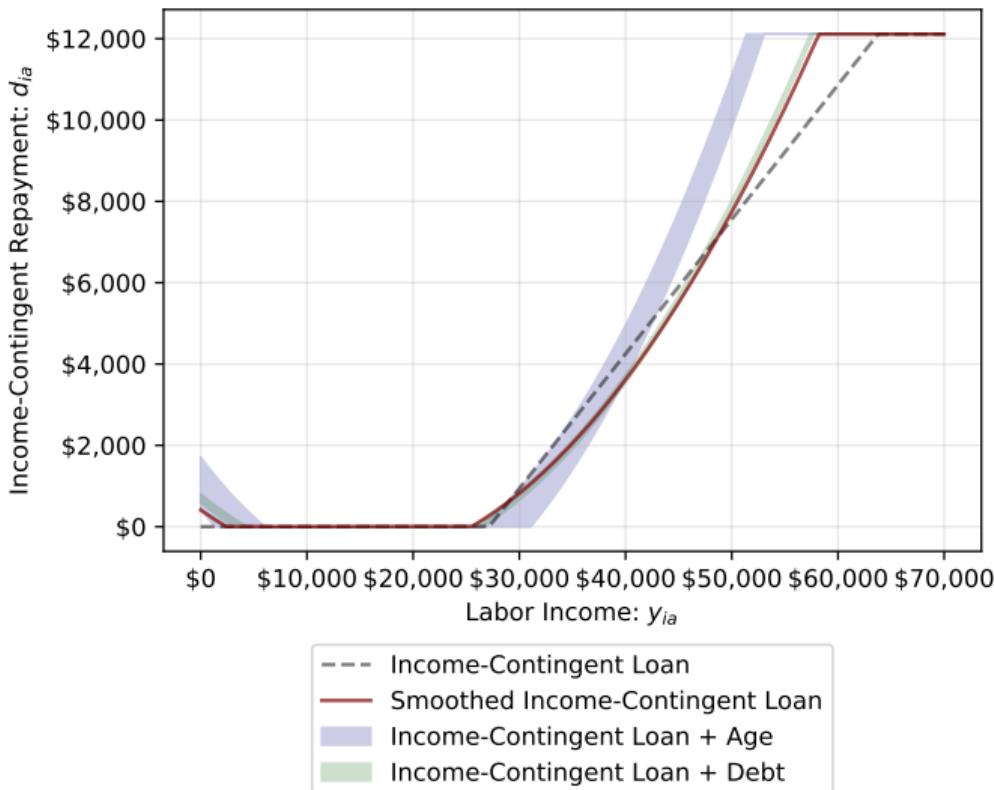
# REDUCING WELFARE COST OF MORAL HAZARD: BASELINE $\phi$



▶ Contract Structures

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# ALTERNATIVE FORMS OF INCOME-CONTINGENT LOANS: BASELINE $\phi$



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# ROBUSTNESS TO MODEL MISSPECIFICATION

	Difference from Baseline	Welfare Gain	= Insurance	+ Moral Hazard	$\psi^*$	$K^*$
(1)	Fixed Cost Only	1.00%	1.49%	-0.49%	21%	\$22,711
(2)	Calvo Only	2.02%	2.10%	-0.08%	64%	\$46,452
(3)	Linear Adjustment Cost	1.74%	1.87%	-0.13%	53%	\$43,560
(4)	Occupation Heterogeneity	1.32%	1.45%	-0.13%	41%	\$28,694
(5)	Learning-by-Doing	1.68%	.	.	35%	\$36,615
(6)	Wealth Effects	0.82%	1.05%	-0.23%	37%	\$30,307
(7)	Less Persistence: $\rho = 0.8$	0.90%	1.14%	-0.23%	42%	\$34,244
(8)	More Persistence: $\rho = 0.99$	1.35%	1.63%	-0.28%	35%	\$18,949
(9)	Non-Normal Shocks	1.14%	1.43%	-0.30%	28%	\$26,933
(10)	Debt Interest Rate = 2%	1.96%	2.14%	-0.18%	38%	\$47,731
(11)	Discount Rate = $R$	1.06%	1.41%	-0.35%	29%	\$22,696
(12)	Discount Rate = $R + 4\%$	1.60%	1.65%	-0.05%	46%	\$34,441
(13)	US Tax System	1.18%	1.36%	-0.19%	38%	\$28,838
(14)	US Initial Debt Levels	3.50%	4.72%	-1.22%	36%	\$18,867
(15)	Riskless Borrowing: $\tau_b = 0\%$	1.68%	1.82%	-0.15%	44%	\$39,809
(16)	No Ex-Post Uncertainty	0.58%	0.76%	-0.17%	27%	\$18,098
(17)	No Uncertainty	-0.17%	0.15%	-0.32%	21%	\$26,906
	Average	1.35%	1.64%	-0.28%	37%	\$30,939
	<b>Baseline Model</b>	<b>1.32%</b>	<b>1.47%</b>	<b>-0.15%</b>	<b>33%</b>	<b>\$27,147</b>

◀ Back: Additional Results

# ROBUSTNESS TO ALTERNATIVE MODELS OF FRICTIONS

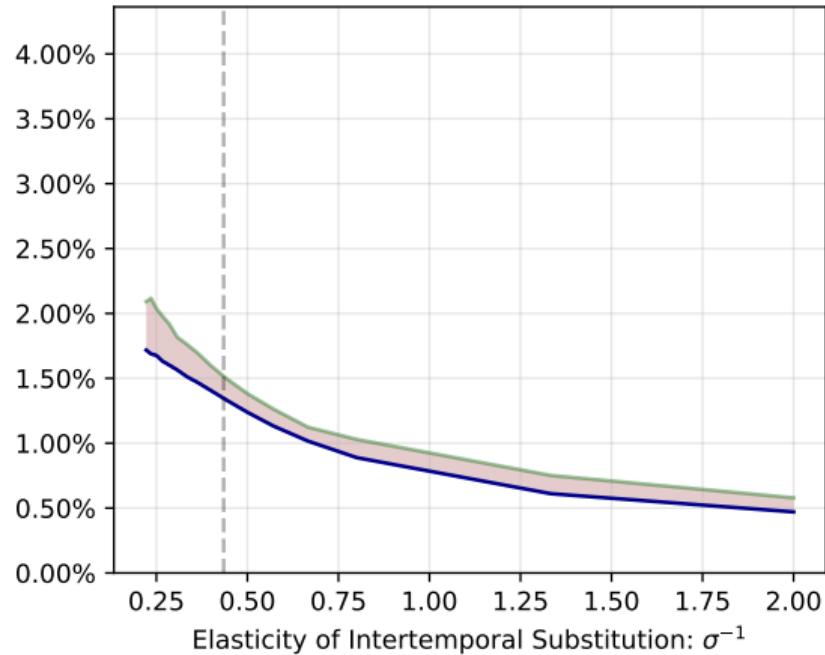
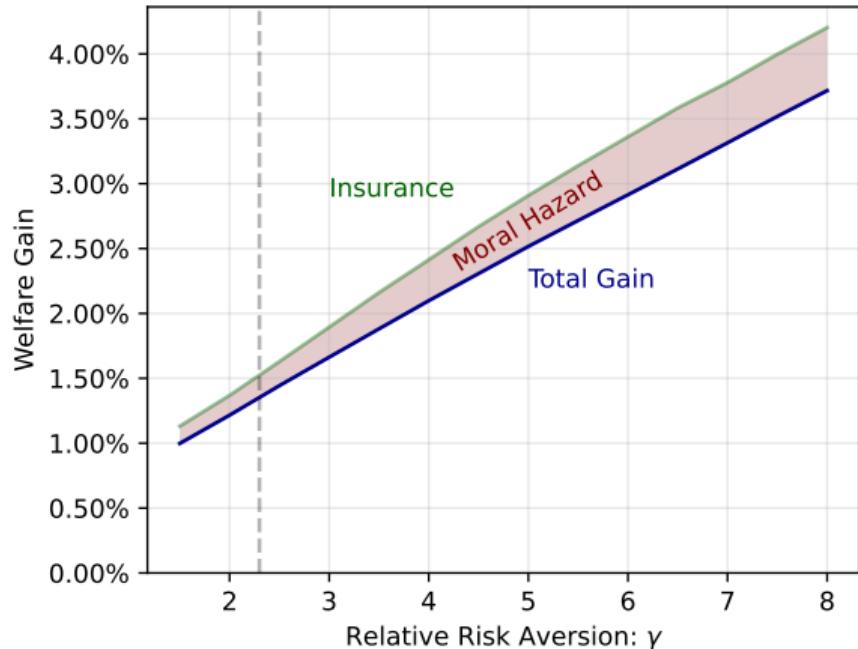
Difference from Baseline Model	Welfare Gain = Insurance	+ Moral Hazard	$\psi^*$	$K^*$
(1) $f = 0$	1.31%	1.61%	-0.3%	46% \$29,618
(2) $f = \$2278$	1.49%	1.65%	-0.16%	64% \$33,915
(3) $\lambda = 1$	1.27%	1.34%	-0.07%	38% \$28,191
(4) $\lambda = 0.147$	1.32%	1.47%	-0.15%	40% \$28,492
(5) Fixed Adjustment Cost Only	1.00%	1.49%	-0.49%	21% \$22,711
(6) Calvo Adjustment Only	2.02%	2.10%	-0.08%	64% \$46,452
(7) Linear Adjustment Cost	1.74%	1.87%	-0.13%	53% \$43,560
<b>Baseline Model</b>	<b>1.32%</b>	<b>1.47%</b>	<b>-0.15%</b>	<b>33% \$27,147</b>

- Loss from moral hazard is larger when adjustment is more **state**-dependent
- Larger gains with **linear** adjustment costs: more insurance and less moral hazard

◀ Back: Fixed Point  $\phi$

◀ Back: Additional Results

# EFFECTS OF CHANGING RISK AVERSION AND EIS



◀ Back: Fixed Point  $\phi$

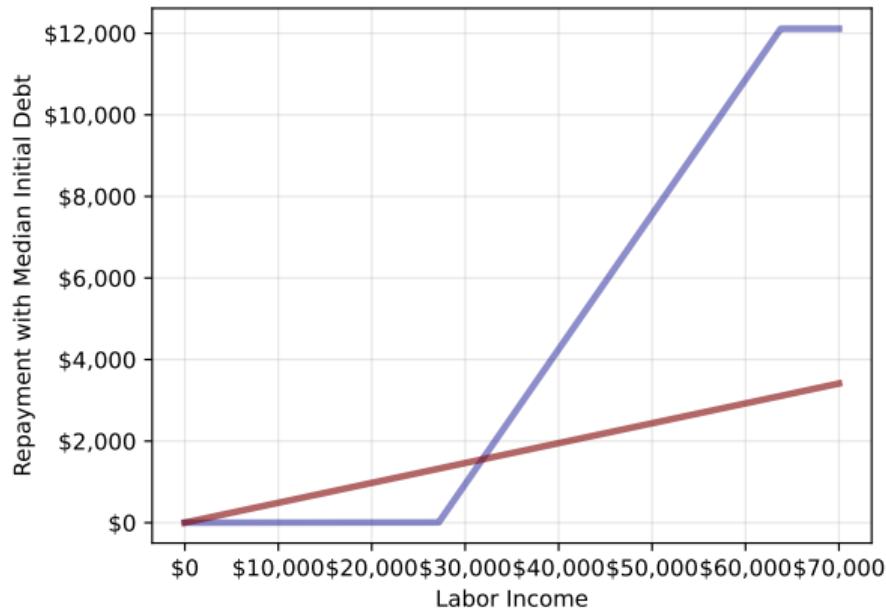
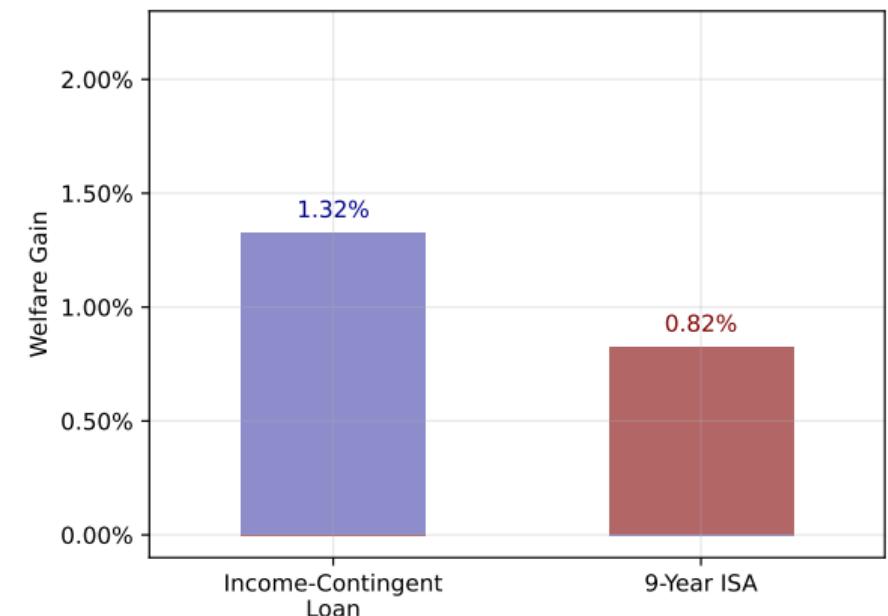
◀ Back: Additional Results

## ADDITIONAL MODEL RESULTS: NORMATIVE

- ① Robustness to
  - Different sources of **model mispecification** 
  - Different adjustment **frictions** 
  - Different values of **RRA** and **EIS** 
- ② **Pure equity** contract does worse than income-contingent loan 
- ③ With **optimal tax** progressivity, forbearance is enough and gains are smaller 

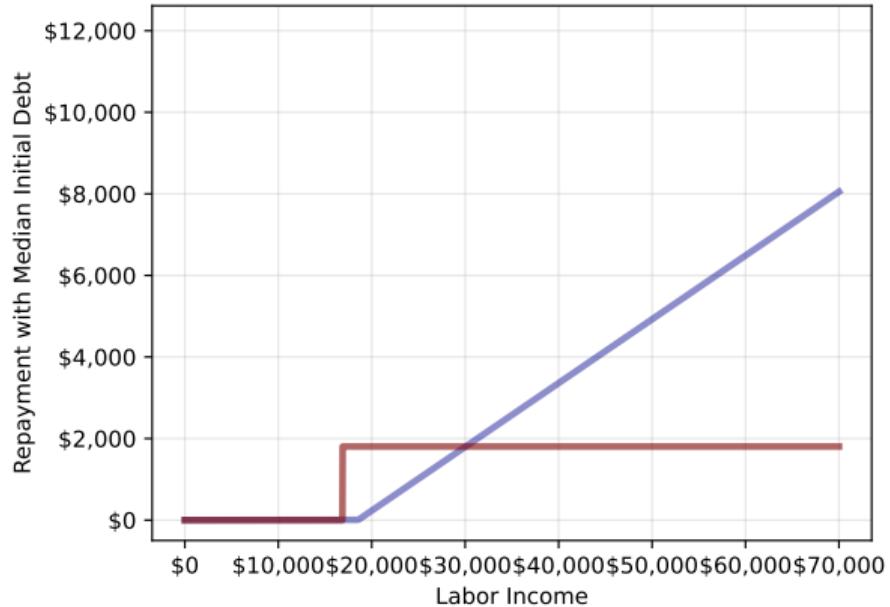
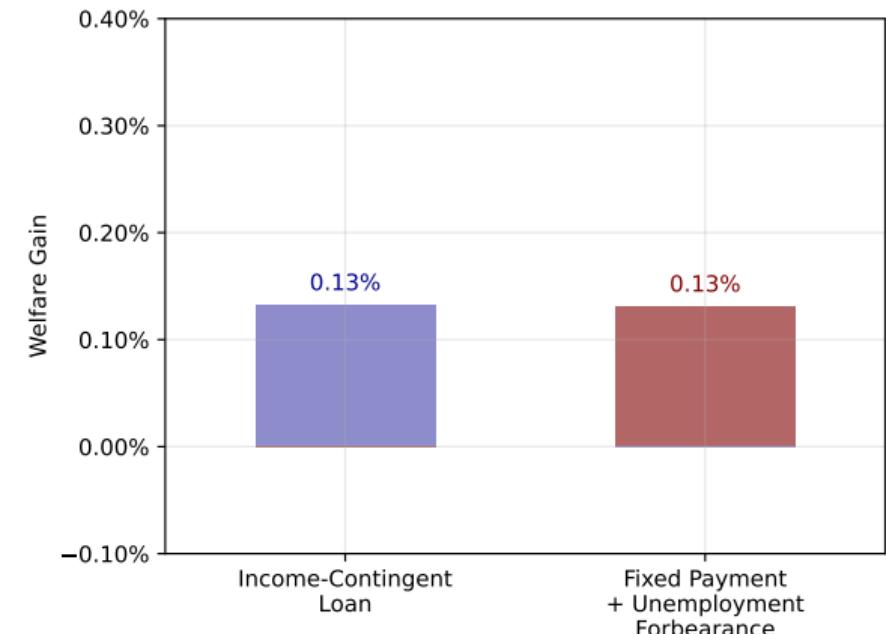
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# PURE EQUITY DOES WORSE THAN INCOME-CONTINGENT LOAN



◀ Back

# WELFARE GAINS WITH OPTIMAL TAX PROGRESSIVITY



◀ Back

# SHORTCUTS IN ADOBE ACROBAT

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- Always toggle on/off closing window and then reopening

## Jump to page numbers

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