Insurance versus Moral Hazard in Income-Contingent Student Loan Repayment

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- Governments often provide subsidized financing for higher education
  - Student loans = $1.6 trillion in US and 10% of household debt in US and UK

Debt

- Standard contract in US
- Hard to discharge

✗ Borrowers bear most of risk

Income-Contingent Loan

- Used in US, UK, Australia, Canada

✓ Insurance
✗ Disincentivize labor supply
✓ Encourage risk-taking
✗ Incentivize over-borrowing
✗ Adverse selection

Equity

- Share of earnings
- Limited successful examples

RQ: How does income-contingent affect labor supply and welfare?

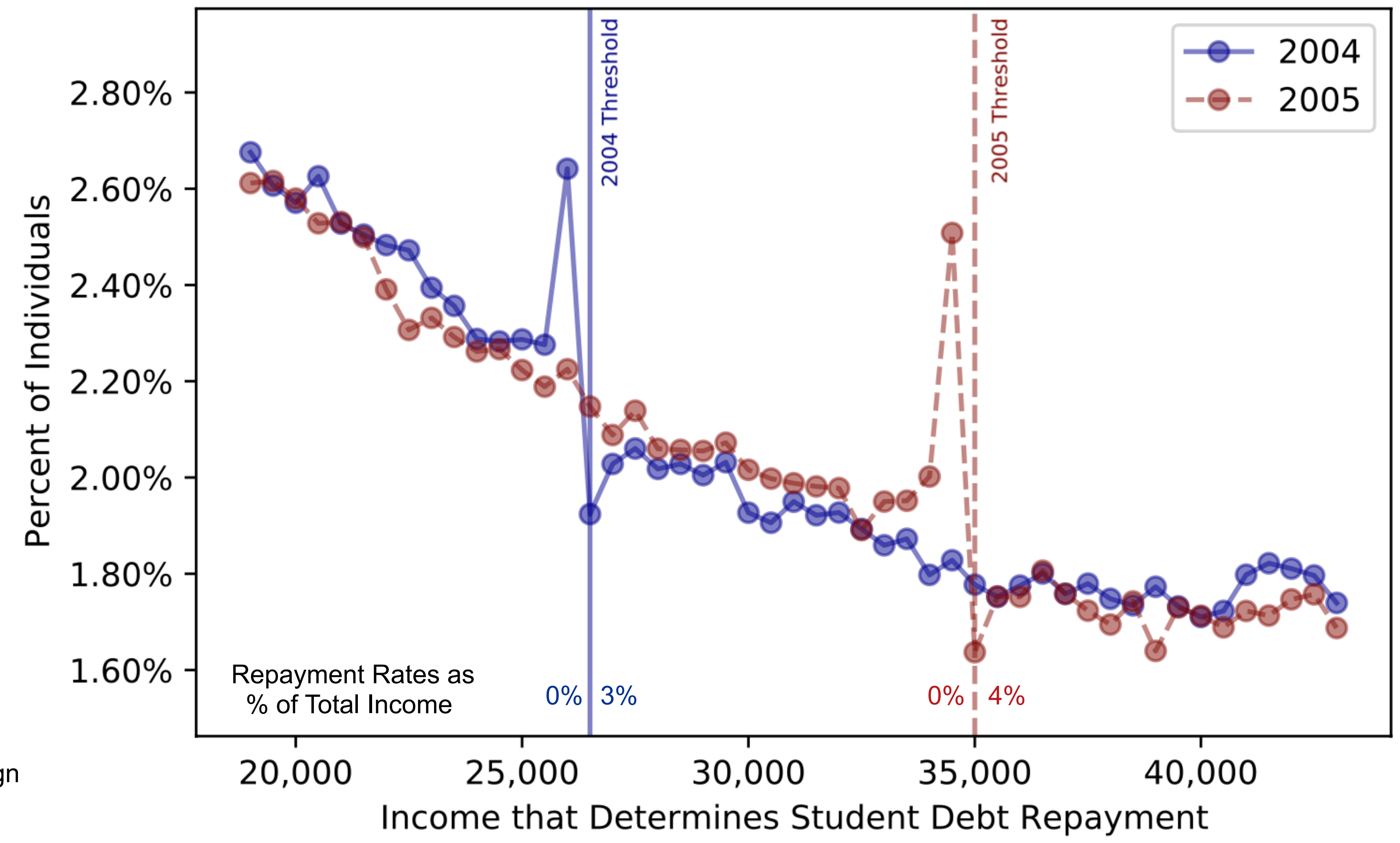
Empirical Strategy

Data:
+ income tax returns
+ student debt balances
+ repayments
+ household Census

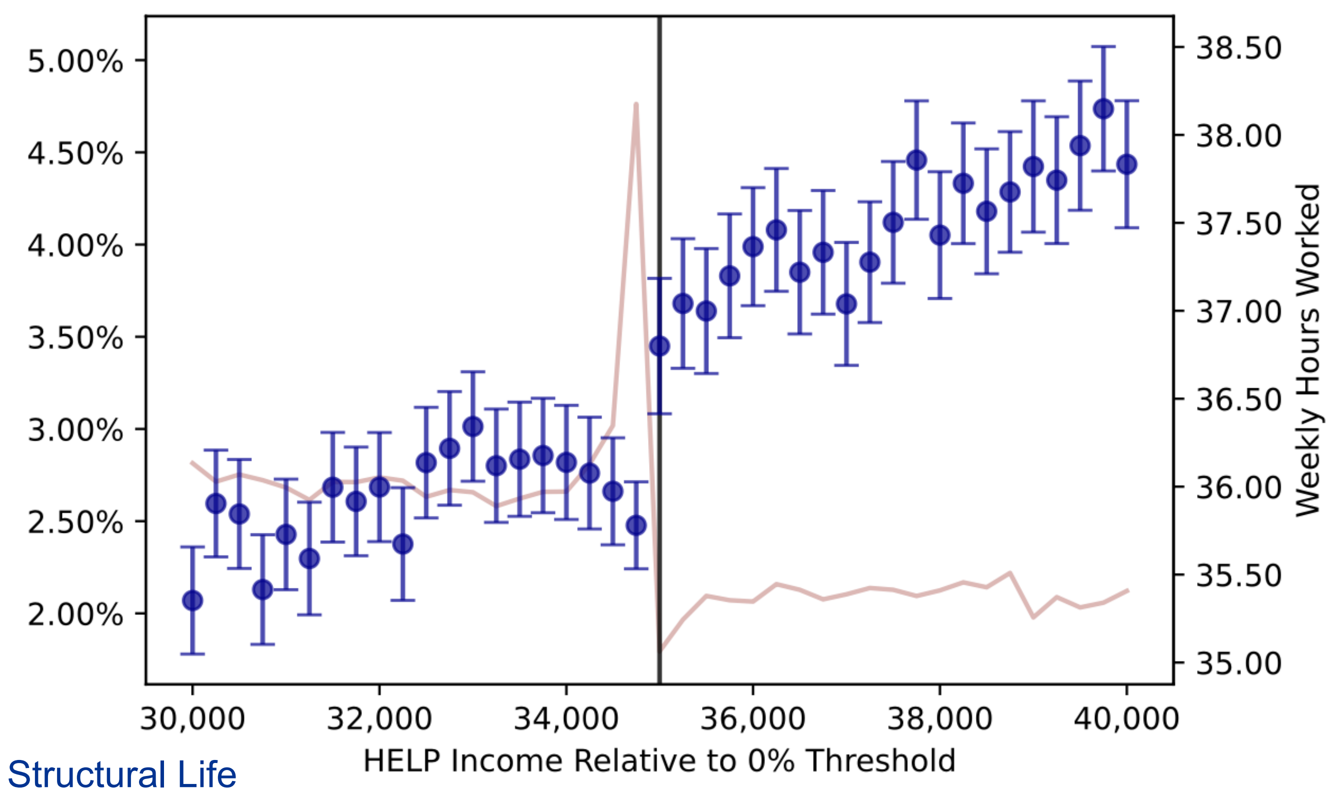
Sample: all Australian citizens

Policy variation: change to design of income-contingent loans

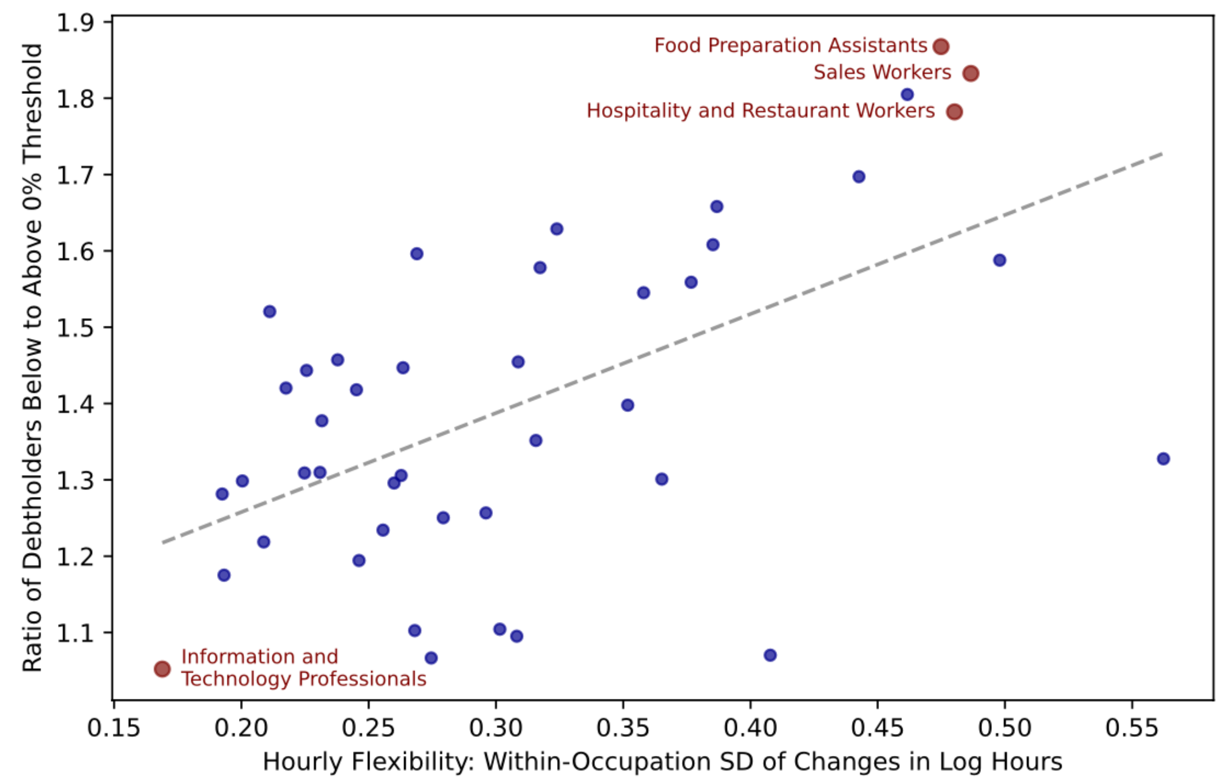
Bunching Below Point at which Income-Contingent Repayments Begin



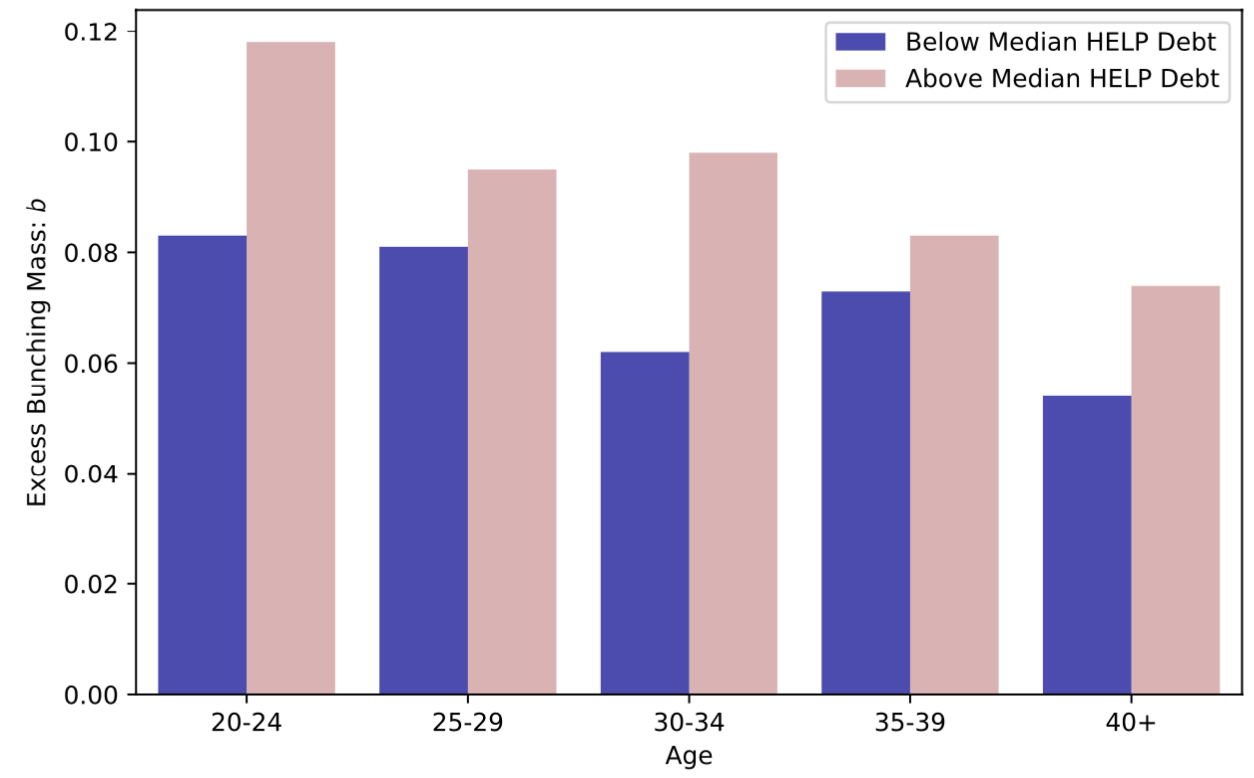
Borrowers Work Fewer Hours to Avoid Repayment



More Bunching in Occupations with Hourly Flexibility

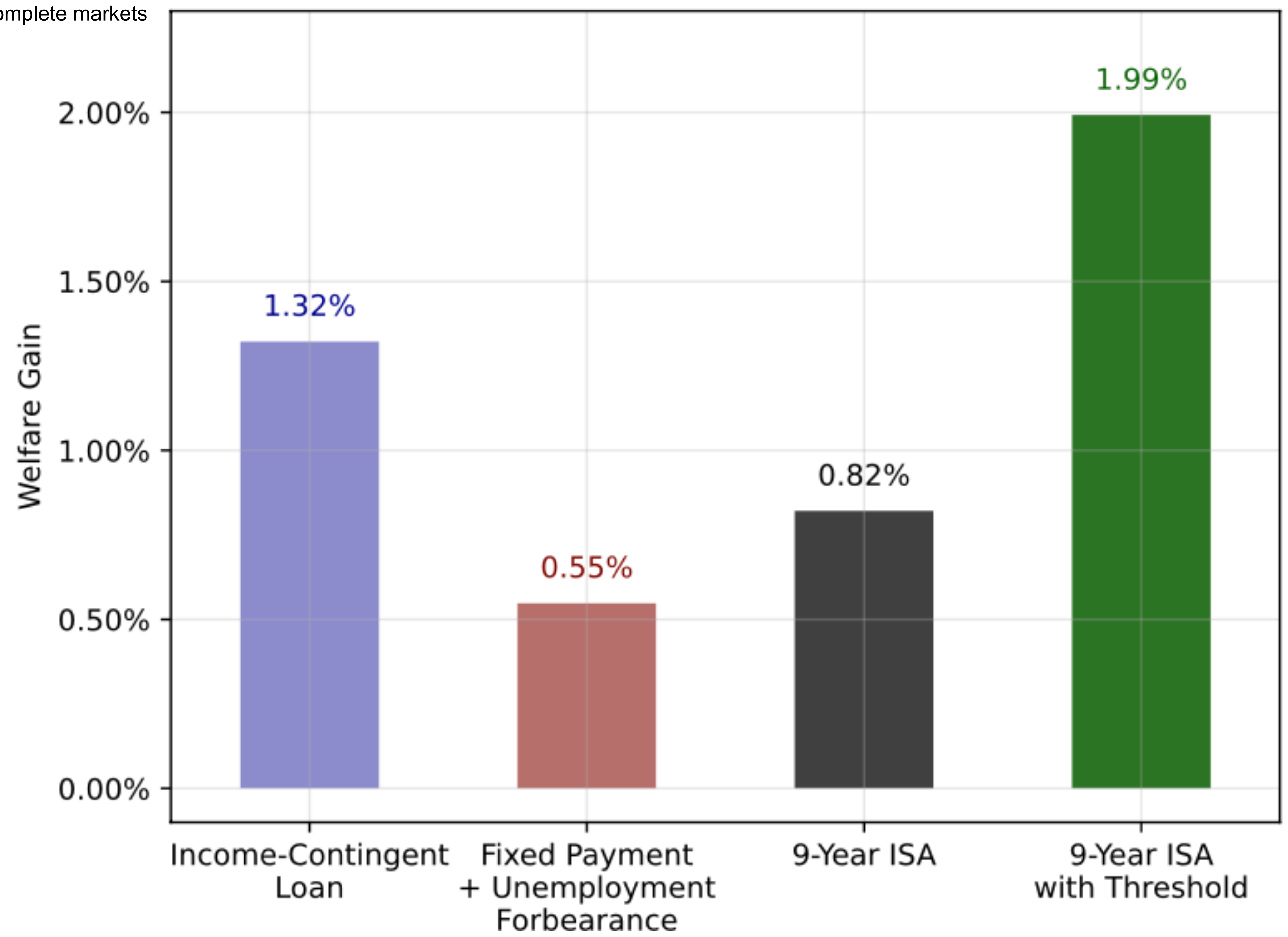


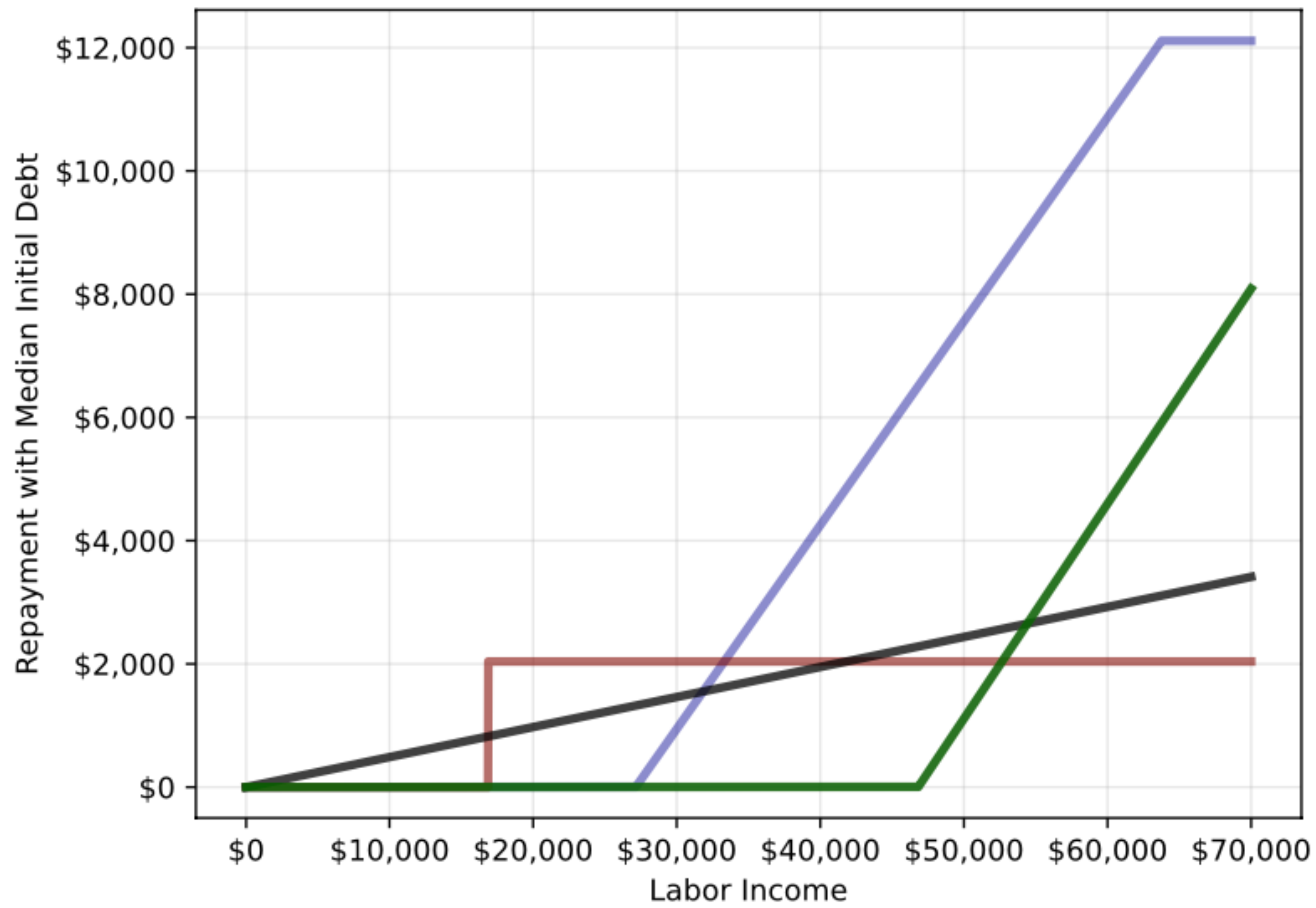
Bunching Higher among Young Borrowers with More Debt



Structural Life Cycle Model
+ endogenous labor supply
+ optimization frictions
+ incomplete markets

Significant Welfare Gains from Improving Insurance with Income-Contingent Contracts that Accelerate Payments from High-Income Borrowers





Takeaway: Income-contingent repayment creates moral hazard, but it is too small to justify fixed repayment