THIRD WAY

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Targeting Student Loan Debt Forgiveness to Public Assistance Beneficiaries

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Student loan debt has ballooned over the past decade, coming in at $1.7 trillion held by 45 million Americans as of March 2021.[1] And more recently, the additional economic pressures brought on by the COVID-19 pandemic have intensified calls to ease the burden student loans have placed on many borrowers. Some, including the Biden Administration, have suggested that Congress should act to cancel $10,000 of debt for every borrower. Senator Elizabeth Warren (D-MA) and other Democrats have pushed for cancelling $50,000, while others have urged an even more expansive intervention—wiping clean the entire slate of student loans—a proposal originally introduced by Senator Bernie Sanders in 2016 (D-VT).[2] Further complicating the matter, some advocates want to bypass Congress altogether, pushing President Biden to cancel student loan debt through executive action. Regardless of the process the federal government contemplates as it debates the merits of loan cancellation, policymakers should be taking a much harder look at whether the proposals on the table are 1) targeted toward borrowers who are struggling to pay down their educational debt and 2) financially reasonable for taxpayers.

One option to meet both goals is using means testing to target debt forgiveness in a way that will direct relief into the hands of borrowers who have found themselves in a worst-case scenario—they attended college to increase their prospects of getting a good job but now find themselves on social safety net programs. Forgiving the student loan debt of borrowers currently on federal public assistance programs, a proposal that was part of Julián Castro's presidential campaign platform in 2020, is a more logical, progressive, and cost-efficient option that would target forgiveness to the most vulnerable borrowers. [3] We already use means testing at the federal level throughout other social safety net programs, making it a natural fit when it comes to debt cancellation. Congress could build on these precedents by passing legislation that forgives the full student loan debt balances of borrowers enrolled in federal public assistance programs. This nuanced and targeted policy change would have a significant impact, particularly for low-income borrowers and borrowers of color, two populations disproportionately impacted by the student debt crisis as well as the pandemic. [4]

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The Problem

Universal debt cancellation plans offer a one-time, short-term fix—with a massive price tag that benefits upper-income Americans the most.

Universal debt cancellation proposals benefit from simple, easy-to-understand messaging, but the reality is that these plans are extremely expensive and would do nothing to help future students who will still need to take out loans to attend college. A $10,000 universal debt cancellation plan could cost more than $350 billion, over ten times more than we currently spend on Pell Grants, the biggest federal program designed to lower the cost of attendance for low- and moderate-income students. [5] And a $50,000 forgiveness plan with an income phase-out along the lines of Senator Warren's proposal could cost as much as $961 billion, over 30 times more than we spend to make college more affordable with Pell. Universal debt cancellation proposals also tend to benefit upper-income borrowers more than they do low-income borrowers. [6] A 2019 analysis by the Urban Institute found that if all student debt was cancelled, 26% of the benefits, or $416 billion of forgiven student loan dollars, would go to the top income quintile, with another 25%, or $400 billion, going to the fourth-highest income quintile, totaling 51%, or $816 billion of forgiven student loan debt, ultimately benefiting borrowers in the top two income categories. [7] In contrast, only 27% of forgiven loan dollars would go to the bottom two income quintiles (12% to the bottom quintile and 15% to the second).

Furthermore, these giant price tags offer only a short-term solution; a massive debt cancellation proposal that went into effect today would do nothing to address the loans students would begin accumulating again tomorrow. [8] Institutions could continue to charge increasing tuition and fees, and those entering college this year would continue to rack up federal loans immediately after cancellation takes effect, making it a mere band-aid fix on a problem that does nothing to address the needs of future students (dooming us to repeat this hugely expensive cycle moving forward).

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Student loan debt holders on federal public assistance programs have found themselves in the worst-case scenario.

People who go to college typically do so thinking that it will leave them better off than before they enrolled. And that's true for many students—college graduates usually earn more than $1 million more throughout their lifetimes than those with only a high school diploma. [9] But some students who take out loans and enroll with this belief never see these benefits. Instead, they are made worse off because they didn't graduate, got little or no return on their investment, or were even defrauded by their institution—leaving many of these borrowers in a true crisis. [10] Today, 16% of households with student loan debt participate in public assistance programs (and this number is likely underreported because of stigma or confusing or uncommon program names in reporting). [11]

Among all American households, 67% of low-income families with children (defined as families with income that's less than 200% of the federal poverty level) receive food-related assistance and 60% receive public health insurance, including 9 million children who receive coverage through the Children's Health Insurance Program (CHIP) each year. [12] In addition, nearly a quarter of families (23%) received cash assistance for their basic needs through the Temporary Assistance for Needy

Families (TANF) program in 2019, and over 22 million people received the Earned Income Tax Credit (EITC) in 2018.[13] Student loan borrowers who have found themselves in these kinds of public assistance programs are among the least likely to ever be able to pay down their debt without relief. Of the entire balance of outstanding student debt, the federal government already expects to forgive around $435 billion through federal programs that provide some level of debt relief, like income-driven (IDR) repayment programs, which offer full forgiveness after 20-25 years, depending on the plan.[14] So for many of these borrowers, they may be eligible for forgiveness under current law, but unfortunately only 6% of the lowest-income borrowers are enrolled in income-driven repayment plans.

Even debt cancellation at $10,000 will still leave many struggling borrowers in debt.

Limiting debt cancellation to $10,000—the most affordable universal option currently on the table—won't fully solve the problems faced by many of these worst-off borrowers who may hold more than $10,000 in student loan debt. When you look at the distributional effects of $10,000 of loan forgiveness, most benefits still go to the highest income borrowers.[15] Further, providing this level of loan forgiveness would leave over 25 million people with student loan debt who will still be responsible for paying it back. And for low-income borrowers participating in IDR where loan payments are limited to a percentage of their income, $10,000 will do little to ease the burden of their debt because the interest accrual on the remaining principal balance that comes with IDR plans could quickly erase the benefits of the one-time debt forgiveness payment.[16] Furthermore, IDR uses an income formula to determine payments and does not consider the total loan balance. Even if the government canceled part of the debt as part of a one-time policy change, these borrowers' monthly loan payment would be unchanged, and it would do nothing to accelerate the timeline to full forgiveness under IDR. So our lowest-income borrowers would still be left in a lurch if they have remaining debt after a $10,000 cancellation.

The Solution

To create a debt cancellation solution that can address the needs of borrowers in crisis without an exorbitant price tag, Congress has two realistic pathways: limit the amount of forgiveness provided or limit the number of beneficiaries. In terms of benefits distribution, the latter is a much more progressive option, as it gets dollars into the hands of the borrowers most hurt by their looming loan balances. Instead of considering a blanket solution that gives an arbitrary amount of forgiveness to every single person, regardless of their ability to pay, Congress should commit to forgiving the entire balance of the loans held by those who have been enrolled in or received Supplemental Nutrition Assistance Program (SNAP), TANF, Medicaid, CHIP, EITC, housing assistance, Supplemental Security Income (SSI), and other key means-tested federal public assistance programs for at least three of the past five years.

Forgiving the entire balance of student loan debt held by borrowers on public assistance would help keep the costs of cancellation significantly lower than universal cancellation proposals while better targeting it to those in worst-case situations. According to an analysis by the Urban Institute, forgiving all debt of those participating in public assistance programs would target the benefits to a greater proportion of low- and middle-income borrowers—60% of the benefits would go to the bottom two income quintiles ($0-$40,000), with a total cost of $138 billion. This option would cost $823 billion *less* than Senator Warren's plan and would have a tremendous impact on borrowers in the most difficult situations for a tiny fraction of the cost—making it a more realistic and affordable option. It would also reach borrowers of color who are more negatively impacted by student loans than their white peers. [17] Currently, 13.5% of Black Americans participate in public assistance programs compared to only 4.4% of white Americans. [18] Focusing on those participating in public assistance programs will better target loan forgiveness to borrowers of color that are in the most need, in contrast to universal cancellation, which favors white borrowers by the numbers. And if the federal government never expects to be able to collect on these student loans that are burdening our lowest-income borrowers anyways, it makes sense to simply clear the slate now to help these struggling Americans get back on their feet and live the more stable and secure financial life.

Critiques and Responses

Means-tested relief does not do enough to help all borrowers.

Means testing a policy like debt cancellation will not provide forgiveness to all borrowers, but it will target the benefit to those who find themselves in the most distressing financial circumstances. Unlike universal debt cancellation proposals that use no discretion to determine who gets relief, targeting the spending to those on federal assistance programs would ensure the benefits are flowing in higher proportion to borrowers of color and low-income borrowers—groups with less generational wealth and who have been disproportionately impacted by the pandemic and economic downturn. [19] It is also the most affordable and realistic option for Congress to pursue given the significant COVID-19 economic relief packages that have already been passed. And while some may argue that this policy would direct additional federal benefits to those already receiving government assistance while others not on public assistance would get no help at all, it's a worthwhile first step towards ameliorating the impact of student debt on a population of borrowers our higher education system has left most in the lurch, and Congress should continue working to pass longer-term affordability fixes for current students and protections for the broader universe of student debt holders. Freeing up the debt burdens of Americans on federal assistance programs could also save taxpayers money in the long run by contributing to poverty-reduction efforts that would decrease overall enrollment in those programs.

Means-testing debt cancellation may miss borrowers of color who need relief.

Means testing debt cancellation to direct it to borrowers on federal safety net programs will certainly not give relief to every borrower of color who needs it, as only 13.5% of Black Americans and 8.7% of Hispanic Americans currently participate in public assistance programs. [20] Expanding the number of programs included and reforming IDR plans to make them more generous and easier to access are two additional ways Congress could provide loan relief to borrowers of color in need. Policymakers could also add in a separate eligibility requirement based on income, for example, including borrowers earning at or below the poverty line, to avoid missing those who are in similarly bad financial situations but are not on public assistance programs.

Public assistance is primarily targeted at families, so using those programs as the basis for means testing could result in single borrowers and borrowers without dependents being missed.

It is true that single borrowers and borrowers who do not have dependents but are in bad financial shape could be missed by debt cancellation if the mechanism for means testing is based solely on public assistance programs. Public assistance is typically targeted at families with children and, as a result, can leave out those who are in difficult situations but are childless. A prime example of this problem arose in 2016, when up to one million low-income childless adults faced being cut off from SNAP because they did not have dependents and thus faced time limits on accessing food assistance. [21] Childless adults are the only group who face such time limits, are ineligible for Medicaid in 18 of the expansion states, and are eligible for a greatly reduced EITC. [22] Single borrowers or borrowers without dependents who have incomes at or below the federal poverty level are less likely to be able to meet the three-year time requirement proposed above given the much tighter timeframes for how long they can use the public assistance benefits for which they are eligible. Congress could address these issues by using an additional federal poverty level threshold to target funds to those with the greatest need—in addition to participation in public assistance programs. Means testing by income in this way could better ensure that single adults who need help aren't left out in the cold.

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