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DRIVING RUNAWAY DEBT:

How IDR's Current Design Buries Borrowers Under Billions of Dollars in Unaffordable Interest

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About the Author

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Mark's previous roles include stints at the Institute for Higher Education Policy, New America, and the Brookings Institution. A native of Cincinnati, Ohio, Mark holds a B.A. in Government and Politics from the University of Maryland, College Park and an Ed.M. in International Education Policy from the Harvard Graduate School of Education.

Protect Borrowers

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Introduction

Roughly 45 million Americans now have federal student loans, an increase of nearly 17 million borrowers since 2007. Total federal student loan debt has more than tripled in that same time frame, and now sits at nearly $1.6 trillion.[1] This debt continues to be a drag on household finances and life choices, from the decision to own a home,[2] save for retirement,[3] start a small business,[4] get married,[5] or simply spend money.[6] Student loans continue to contribute to our nation's shameful and persistent racial wealth gap, and to impose an undue burden on Black and Latino borrowers.[7]

In response to the burden of student loans, policymakers have spent the better part of three decades introducing a variety of ways for borrowers to pause or delay repayment through deferment or forbearance, or to ensure that borrowers' monthly debt obligations are determined by their income rather than their loan balance.[8] This second category of payment options, broadly known as Income-Driven Repayment (IDR), is designed to be affordable by aligning student loan payments with earnings, including by offering a $0 monthly payment for borrowers with particularly low incomes.[9] If borrowers are unable to repay any part of their loan balance after 20 to 25 years of qualifying payments, their remaining debts are cancelled.

Borrowers on IDR often face balances that grow rapidly despite making monthly payments, and see their unpaid interest capitalized and added to their loan balance. These expanding balances create a spiral of debt with negative consequences that ripple across their financial lives.

Since the introduction of the first income-driven plan in the early 1990s,[10] federal policymakers have expanded eligibility criteria and tweaked both repayment terms and forgiveness timelines[11] with the goals of including more borrowers, providing a lifeline to those who are most likely to struggle to repay their loans, and reducing default and delinquencies.[12] And indeed, for those who are able to access and persist through IDR payments, research shows that it can be an effective tool in reducing delinquency, improving credit, and increasing savings and consumption.[13]

Yet in many ways, IDR has failed to live up to its promise. Due to intentional design choices across various IDR plans, and substandard implementation of IDR itself, borrowers on IDR often face balances that grow rapidly despite making monthly payments, and see their unpaid interest capitalized and added to their loan balance. These expanding balances create a spiral of debt with negative consequences that, as this paper explores, ripple across their financial lives.[14] This phenomenon is most acute when borrowers are eligible for low monthly payments—or, almost by definition, when they face financial hardship. These structural failures are by design: IDR was built to be a debt trap.

Worse, these borrowers must wait and hope for two decades or more, if ever, to see if any part of those balances will be forgiven. Regardless of whether the promised forgiveness underlying IDR does eventually arrive—something that has proven scandalously elusive for millions—the intervening time in IDR leaves borrowers in a situation in which their loan balance continues to grow with no relief in sight, generating massive ripple effects across their financial lives. IDR's design implicitly treats these snowballing balances as immaterial, a simple technicality that will eventually disappear as borrowers complete the repayment period required for forgiveness under their respective IDR plans. As this paper illustrates, this misses the impact of runaway debt balances on borrowers' financial life, credit, and even physical health and well-being.

Borrowers are Struggling to Access IDR, and Struggling Because of IDR's Design

Despite IDR being expanded and broadly available for all federal student loan borrowers, and despite the ability for low-income borrowers to access $0 payments, delinquency and default rates remained unconscionably high prior to the COVID-19 pandemic and economic crisis. Income-driven repayment has existed in some form since the early 1990s. Yet nearly three decades later, nearly 1-in-5 federal student loans were in default prior to the COVID-19 pandemic,[15] and barely half of borrowers were in current repayment on their loans.[16] A recent SBPC analysis also revealed that in the last academic year before COVID hit, a borrower defaulted on a federal student loan every 26 seconds.[17]

Research also indicates that those who could benefit from IDR the most, including borrowers of color, low-income borrowers, and borrowers who did not complete their course of study, are the most likely to miss out on the protection.[18] In particular, an SBPC analysis found that Black borrowers are two times more likely than their white peers to fall behind on their student loans without accessing IDR, and that more than half of borrowers with incomes below $20,000 fall behind without accessing the protection—even though effectively all borrowers at his income level qualify for a $0 payment through an IDR plan.

This forces policymakers to face a simple truth about student loan borrowing in America, one that sheds light on why IDR, as currently designed and implemented, has failed to solve this crisis: the student loan system, including every iteration of IDR, is designed to trap low- and middle-income people in debt for far too long. Policymakers have designed IDR in a way that ignores the ways that the presence and persistence of debt are burdensome in and of itself, regardless of how payments on that debt are determined. In other words, even if forgiveness is realized after two decades (or more) of payments, which is itself a big assumption given the experience of borrowers who have been repaying for many years, IDR is designed in a way that places an unnecessary burden on borrowers.

Indeed, borrowers may not be able to rely on the hope that cancellation will be available to them 20 or 25 years down the line and plan their lives accordingly—especially when that loan forgiveness has proven almost entirely theoretical thus far. A recent analysis shows that only 32 borrowers total have received cancellation through income-driven repayment, despite over four million borrowers having loans old enough to potentially qualify.[19]

Additionally, the Public Service Loan Forgiveness (PSLF) program, which requires borrowers to enroll in IDR as one of its eligibility criteria, has been plagued by mismanagement and servicer breakdowns, to the point where 98 percent of all applicants have been rejected.[20]

As the Department of Education works to reform student loan repayment and embarks on negotiated rulemaking to reform IDR and the broader federal loan program, policymakers must remember that, at a core level, the debt itself very much matters. Runaway interest, interest capitalization, and negative amortization are all design choices that affect the daily and long-term financial lives of borrowers, with a particular and unnecessary burden being faced by borrowers of color.

Policymakers must understand that these choices have failed borrowers in a fundamental way, and that federal policy based on the assumption that debts will be cancelled and that debt amounts are largely irrelevant does not align with the lived experience of borrowers. Any reasonable student loan repayment system would ensure that borrowers, especially those on IDR, are able to make monthly payments of any amount and see their debts decline. A humane system would not pair the benefit of $0 monthly payment with the horror and financial impact of a balance that grows with no end in sight. The federal government must work to end the debt trap that it created over a period of decades.

The Racial and Economic Injustice of Runaway Student Loan Balances

Borrowers in IDR who qualify for low monthly payments often face the frustrating experience of watching their balances grow over time because their monthly payments do not cover the interest on their loans. This phenomenon, known as negative amortization, is not only psychologically crippling for borrowers whose loan balances spiral seemingly out of control, but it can also extend repayment for years and result in borrowers paying thousands of more dollars than they ever borrowed in the first place, losing years of wealth-building and financial stability in the process.

This outcome is incredibly common. Over half of all borrowers experience negative amortization and the median amount owed in income-driven repayment plans has grown over time,[21] while borrowers in other repayment plans have proven to be more able to make a dent in their principal—indicating that those in IDR are not repaying principal.[22] This issue has also worsened over time: a recent analysis from the Jain Family Institute found that in a single decade, the percentage of student loans held by millenials whose balances were greater than what had originally been borrowed jumped from a quarter to over half of all loans.[23] While this takes place by design, and is presented as being immaterial in light of the hopeful promise of eventual loan forgiveness through IDR, it presents tricky problems for groups like older borrowers, who are more likely to experience negative amortization, and for whom a 20- or 25-year forgiveness timeline is less of a benefit.[24]

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The structure of IDR plans often means that in some cases, the unpaid interest is capitalized, or added to the borrower's loan balance, with the interest then accumulating even more interest. Students and borrowers can face the sticker shock of interest capitalization in circumstances like forbearance, the grace period before payments are required, or deferment on unsubsidized student loans—all periods when they are not required to make payments. But it can be a nefarious feature of IDR, when borrowers are actively repaying and hoping to make a dent in their debt as well. Under plans like Pay As You Earn (PAYE), Revised Pay As You Earn (REPAYE), and IBR (Income-Based Repayment), the government will cover some or all of the interest for borrowers, so long as they continually recertify their income, qualify for reduced payments, and do not leave the plan. But critically, the government will not pay all the interest in perpetuity, and in fact it generally covers only a portion of interest when it does pay.[25] This means that borrowers who make low payments in IDR for a long period of time will experience the compounding effects of interest.

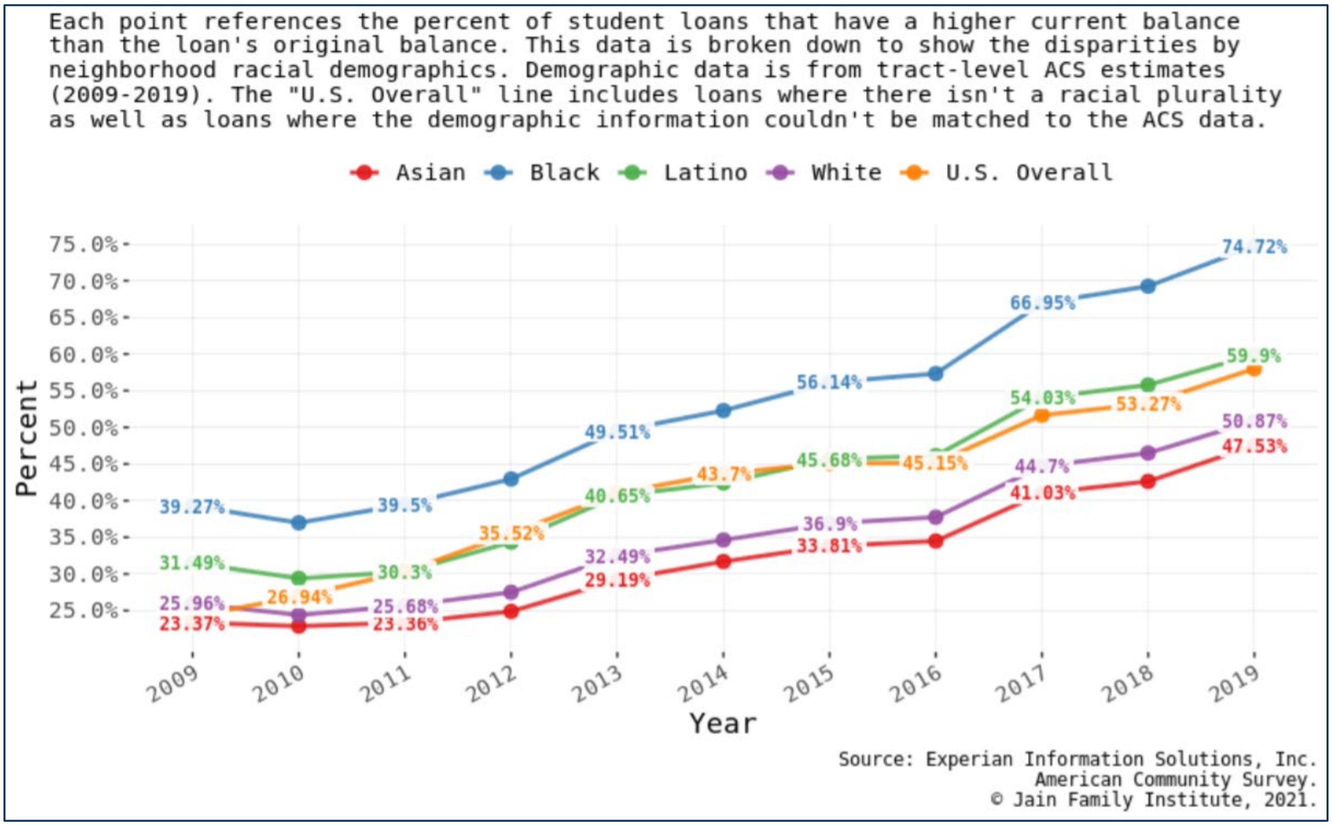
Even for borrowers who receive interest subsidies, this set-up relies not only on them being able to navigate a notoriously complex repayment system, it also assumes that loan servicers will seamlessly help borrowers stay enrolled. Unfortunately, a wealth of evidence shows this not to be the case, as servicers have continually dropped the ball on helping students get enrolled, stay enrolled, and recertify their income in order to avoid interest capitalization and stay current on their loans.[26] For example, in its groundbreaking lawsuit against the student loan servicer Navient, the Consumer Financial Protection Bureau (CFPB) alleges that Navient capitalized more than $4 billion in unnecessary interest charges on more than one million student loan borrowers' accounts—the direct consequence of borrowers with subsidized loans using extended periods of forbearance in lieu of IDR.[27]

IDR and Racial Injustice

But perhaps most importantly, the crisis of growing and capitalizing student loan balances is a civil rights crisis. As we have seen with so much of the student debt problem, the burden of runaway interest, repayment, and perpetual debt falls most heavily on Black and Latino borrowers. Due to the racial wealth gap and perpetual racism in the labor and housing markets, Black and Latino households in particular have fewer resources to avoid student debt,[28] take on larger balances to attend school,[29] and receive less of an earnings and wealth boost from college that might help them pay off their loans.[30]

As a result, data clearly show that borrowers in majority-Black communities in particular are unable to see their balances decline despite making payments and are burdened by a "crisis of non-repayment" with regard to student loan debt.[31] The Black-white disparities that are seen at graduation, or when borrowers leave school, nearly triple in the handful of years after borrowers leave school.[32] And over three-quarters of student loans in majority-minority zip codes have a higher balance than what was originally borrowed (compared to just half of loans in majority-white zip codes).[33]

Figure 1: Borrowers, and In Particular Borrowers of Color, are Facing Massive and Rapidly Growing Student Loan Balances (Share of Loans where Current Balance Exceeds Original)[34]



Data from the U.S. Department of Education confirm the findings in the research literature, that many of the borrowers who stand to benefit most from IDR are stuck in a perpetual debt trap. Twelve years after beginning college, two-thirds of Black borrowers owe more than they had originally borrowed, while only 1-in-9 fully repaid their debts. Fewer than 1-in-3 white borrowers, twelve years after starting college, are faced with a larger balance than their original obligation.

Figure 2: Negative Amortization is Widespread, Particularly Among Borrowers of Color (Percentage of Borrowers Owing More than 100 percent of Original Balance, 12 Years after Beginning College)

	FULLY REPAID	OWE MORE THAN 100 PERCENT OF ORIGINAL LOAN BALANCE
Total	25.5%	37.2%
White	28.8%	30.2%
Black or African American	11.7%	65.5%
Hispanic or Latino	26.4%	36.1%
Asian	36.1%	21.4%
Other	16.2%	40.5%
More than one race	24.8%	38.1%

Source: SBPC Calculations from U.S. Department of Education, National Center for Education Statistics, 2003-04 Beginning Postsecondary Students Longitudinal Study, Second Follow-up

Indeed, as borrowers of color face a longer and more tumultuous path to repayment, they are left to face an outsized share of the negative effects that flow out of simply owing on student loan debt.

Racial inequity also complicates the potential benefit of income-driven repayment due to the fact that there are substantial disparities in wealth and financial health across race, even among households who have similar incomes.[35] Due in part to the legacy of discrimination in housing and education, and various forms of predatory inclusion, college-educated white families are three times more likely than college-educated Black families (41 percent vs. 13 percent) to receive an inheritance or gift of $10,000 or more, and such gifts average over $150,000, compared to $40,000 for Black college-educated households.[36] Middle-income Black Americans have seen wealth and savings—which can either address student debt, pay it off entirely, or reduce the anxiety around repayment—completely decimated in back-to-back recessions.[37] Indeed, borrowers who finally do pay off student debt often do so with one-time, large, lump-sum payments—suggesting that borrowers who become debt-free do so because they have inherited wealth or otherwise seen their wealth spike.[38]

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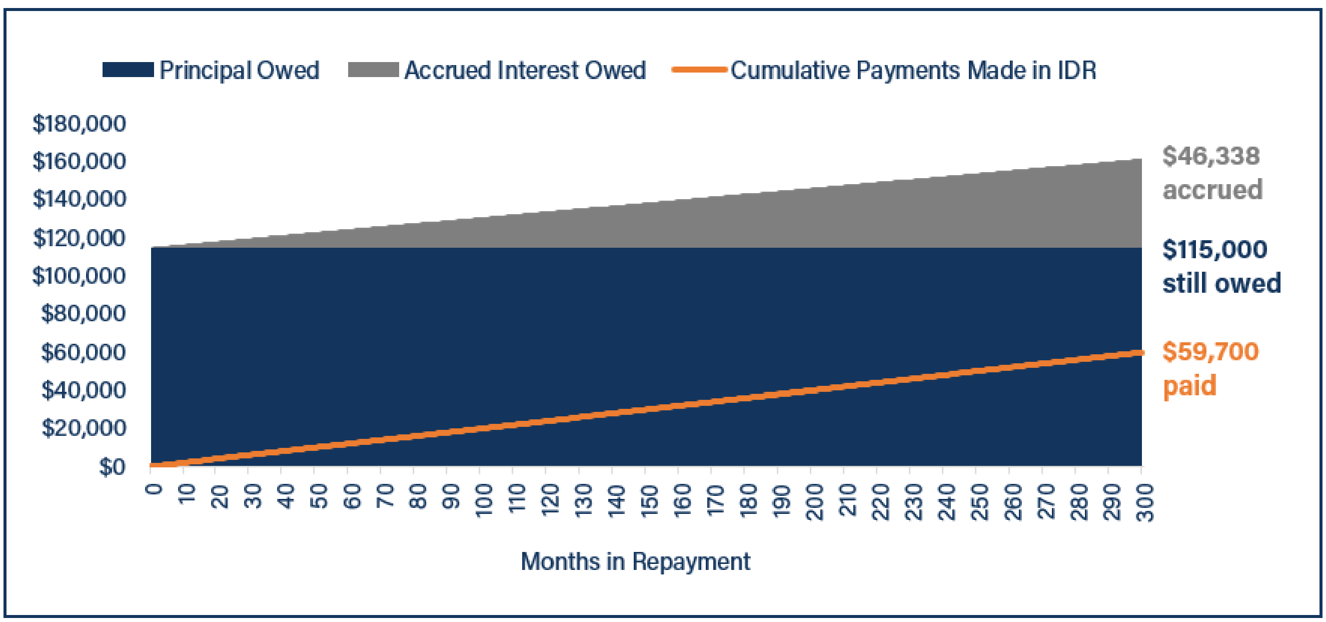
Finally, middle-income Black and Latino families are more likely to report a late debt payment than white households, likely due to the safety net that the latter have accumulated due to intergenerational wealth and friendly public policy. This financial precarity among Black households and Black borrowers, and the risk brought about by rising balances, help explain why Black borrowers still face much higher rates of default,[39] and why despite the existence of IDR, Black and Latino communities remain far more likely to fall behind on their student loan payments.[40] To put it bluntly, IDR in and of itself is unlikely to be enough to counter racial injustice in the economy and our student loan system in particular. For that, we likely need broad-based and equitable cancellation of student debt balances themselves.

How Runaway Debt Works in Practice

An illustration of negative amortization underscores how harrowing and financially damaging it can be for borrowers. Consider Casey, a hypothetical borrower who works as a social worker. Casey holds a master's degree and owes on $115,000, an amount typical for someone in her field,[41] but she can find only part-time work earning $30 per hour, a salary level that is unfortunately common even for social workers with graduate degrees.[42] Moreover, beyond implying low annual earnings, Casey's part-time status makes her ineligible for the Public Service Loan Forgiveness program. Under a standard repayment plan, Casey's monthly student loan payment would cost more than $1,200.[43] IDR offers substantial relief on these student loan bills, allowing Casey to pay only $199 per month.[44] However, even with the interest rate subsidy available under her IDR plan, utilizing IDR will lead Casey's student loan balance to grow by over $1,854 per year.[45] Over the 25-year time horizon she faces before loan forgiveness through IDR,[46] Casey will see her balance grow by more than 40 percent even though she will have paid more than $59,000 toward her loans.[47]

Figure 3: Even While Paying Tens of Thousands of Dollars Toward Their Loans, Borrowers in IDR Can Still Be Trapped Under Runaway Student Debt[48]



As discussed below, the consequences that Casey will face under the weight of this ever-growing balance in either scenario are far-reaching and extremely serious. Casey will likely have to pay thousands of dollars more in interest charges for other forms of badly needed credit,[49] be unable to begin building wealth through homeownership or by starting a business,[50] have to delay family formation or marriage,[51] and grapple with widespread detrimental effects on her physical health and emotional well-being.[52] Casey will have done everything that she was told was "right"—she took on the debt needed for her degree, utilized the alternative repayment options the government made available, and faithfully made the payments she was asked to under IDR's current payment and interest accrual calculations. And yet, despite having followed in good faith the path that she was directed toward by her own government, she will face years of serious and wide-ranging personal distress.

The Short- and Long-Term Consequences of Having Student Debt

The Congressional language authorizing the earliest IDR plans was vague, establishing that the Department of Education "shall require payments that vary in relation to the appropriate portion of the annual income of the borrower (and the borrower's spouse, if applicable)," and that payment periods should not exceed 25 years.[53] While this left considerable room to design specific repayment plans and eligibility rules, the bargain of IDR, in theory, was that borrowers' monthly obligations will always be affordable relative to their earnings and that it will offer a path to a debt-free future regardless of borrowers' future financial success.[54]

In actuality, policymakers have broadly failed to consider the total expenses and obligations borrowers face while dealing with their student loans.[55] Federal policymakers have designed IDR such that borrowers must view their student loan burden almost entirely through the prism of their monthly payments while ignoring their total debt balance, and trust that their debt, while on the books, is always manageable. In other words, for IDR to allow borrowers the financial flexibility to build their future, the federal government assumes that the monthly payment, rather than the debt balance itself, is what matters.

However, a large and growing body of research makes clear that this is not the case. Instead, it appears that borrowers are acutely aware of and responsive to the fact that they continue to owe on a large and often growing mass of student loan debt while on IDR, even given the knowledge that their payments are not determined based on that balance and the promise that their debt will eventually be forgiven. Indeed, even for borrowers enrolled in IDR, the simple fact of owing on student loan debt continues to have negative consequences across their financial and personal lives, with particularly dire consequences and ripple effects for Black and Latino borrowers and communities. This runaway debt disproportionately impacts borrowers and communities of color, who must take on greater debt to finance higher education in the first place, and who stand to benefit the most from a well-designed, generous, and responsive loan repayment system.[56]

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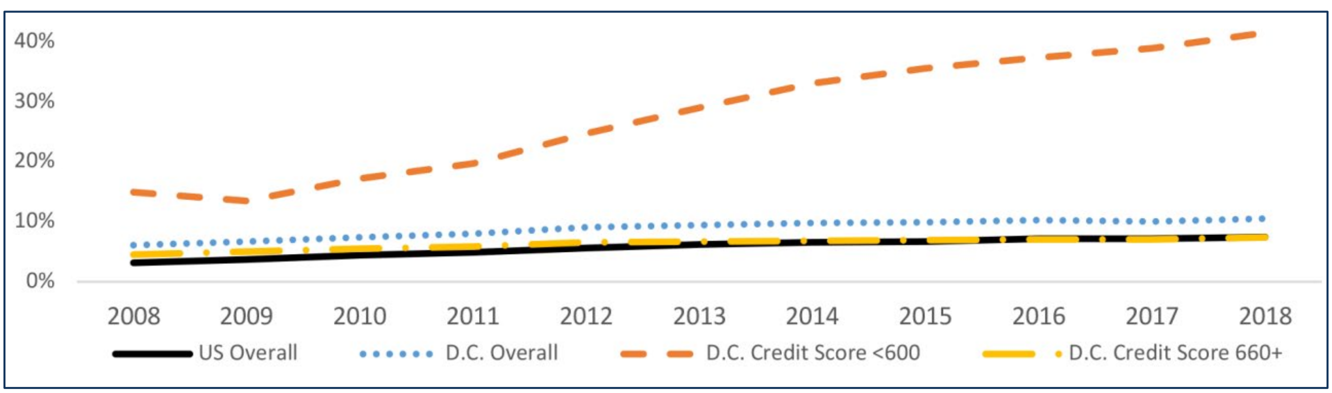
Elsewhere in consumer finance, income-driven loan payments have proven to be a rare win-win due to their short-term structure—borrowers avoid default and creditors may ultimately be repaid even more money over time. Although this arrangement may make sense for a mortgage lender considering short-term alternatives to foreclosure, it does not appear to be consistent with Congress's focus on IDR as a long-term pathway to a debt-free future. In fact, exotic repayment structures, when permanent, are often a hallmark of predatory lending when borrowers have no viable path out of debt.

Student Loan Debt Balances Harm Borrowers' Financial Wellbeing and Introduce Additional Life Costs

Beyond stoking anxiety, the very existence of debt can leave families worse off financially in the short- and long-run. According to one analysis, an additional $10,000 in student loan debt is associated with 1 to 2 percent lower income after graduation, and evidence suggests that borrowers do not catch up over time.[57] Further, the existence of debt can constrain borrowers' career choices, which can lead to lower earnings and lower earnings growth.[58]

The balance of a borrower's student loans can also affect their credit profile, in part by ballooning their credit utilization ratio. Across cities, student debt makes up a much larger portion of debt for those with low credit scores, compared to those with higher credit scores.[59]

Figure 4: Runaway Student Loan Balances are Concentrated Among Borrowers with the Lowest Credit Scores (Student Loans as a Percent of Aggregate Debt, 2008-2018)[60]



And a recent SBPC analysis shows that a typical borrower can pay tens of thousands of dollars in additional charges when attempting to finance a home, car, or use a credit card—just due to the damage that student loan debt does to borrowers' perceived creditworthiness.[61] These findings are confirmed by a Federal Reserve Bank of Dallas analysis demonstrating that younger student loan borrowers appear far less creditworthy than those without student debt, leading them to face higher interest rates and diminishing their ability to be approved for a loan.[62]

Figure 5: Student Loan Borrowers Pay More Across their Financial Lives—and Those With Larger Balances Face the Greatest Added[63]

Typical Borrower Bundle

Auto loan: $32,797 balance, 70 month term
Mortgage: $354,000 balance, 360 month term
Credit card: $6,194 balance, 60 month term

	Baseline level of student debt stress	Moderate level of student debt stress	High level of student debt stress
Total auto loan cost	$39,625	$40,927	$42,915
Total mortgage cost	$651,189	$661,119	$676,538
Total credit card cost	$8,672	$8,914	$9,101
Total combined cost	**$699,487**	**$710,959**	**$728,553**

The secret price tag of student debt: +$29,066

Student debtors are also more likely to owe credit card debt or auto loans in the first place, with even average levels of student debt making households more likely to show signs of financial distress such as being denied credit or being delinquent on other forms of debt.[64] Importantly, families with other forms of consumer debt show no major differences in levels of financial distress.[65]

Student Loan Debt Balances Harm Borrowers' Ability to Build Wealth

In terms of long-term wealth building, the existence of student debt reduces small business formation,[66] retirement savings,[67] and homeownership.[68] These things compound: one estimate suggests that average levels of household student debt results in over $200,000 in lost wealth over a lifetime.[69] The Federal Reserve has estimated that nearly a quarter of the decline in homeownership in recent years among young households can be attributed to rising student debt, resulting in nearly 400,000 fewer student borrowers owning homes between 2005 and 2014—a devastating blow to Millennial aspirations of wealth-generation through homeownership.[70] Indeed, research shows that in the first five years after school, when income-driven repayment may be an attractive option, the chance of homeownership drops by 1 to 2 percentage points for every 10 percent increase in borrowers' student loan balances.[71] The impact of this cannot be overstated: for nearly a century, the U.S. has relied on homeownership as the primary driver of household wealth;[72] locking generations of student borrowers out of homeownership, even for a short time, can exacerbate intra- and intergenerational inequality.

Locking generations of student borrowers out of homeownership, even for a short time, can exacerbate intra- and intergenerational inequality.

Part of this phenomenon is attributable to the fact that borrowers paying off debts cannot accrue savings for a down payment, and part is because student debt affects a prospective homebuyer's Debt-to-Income ratio. The latter pattern diminishes borrowers' credit scores and bumps up against rules that lenders and government entities set for mortgages, which vary regarding how student loan payments are factored into the ability to qualify for a home loan.[73]

Additionally, households without student debt have far more retirement savings than those with any debt at all. Research from the Consumer Financial Protection Bureau (CFPB) indicates that among consumers aged 50 to 59 with an IRA account, the median consumer with student loan debt has a retirement balance that is 45 percent smaller than that of the median consumer without student loan debt.[74] Critically, the amount of loans that a household owes appears to matter less than the very existence of debt itself with regard to levels of retirement savings: according to one study from the Center for Retirement Research at Boston College, borrowers early in their careers have lower retirement savings than non-borrowers, but the amount of retirement savings is similar between those with smaller debts and larger debts.[75] In other words, having debt at all can reduce retirement savings, regardless of the amount of debt or the monthly payment facing borrowers.

Student Loan Debt Balances Harm Borrowers' Health and Perceived Well-Being

Beyond the obvious financial implications, evidence suggests that the overall debt burden facing families poses problematic consequences for borrowers' physical and mental wellbeing. Feelings of stress and anxiety around debt can affect students even before they leave school and begin repaying,[76] and adults with any student loan debt report lower levels of financial well-being compared to those who have either repaid their loans or never had to take on student loans in the first place.[77] For example, in 2020, nearly half of all borrowers with some college or an associate degree reported that they were not doing at least okay financially, including those whose payments had been paused or who were otherwise receiving relief through the federal CARES Act.[78] Student debt can impact career choices, forcing borrowers away from public interest professions,[79] and steering them into careers unrelated to their course of study.[80]

These worries about debt can spiral into something more sinister. Researchers have found that high debt amounts relative to household assets can increase stress and anxiety and even affect physical health,[81] and cumulative student loan debt in particular is associated with "poorer psychological functioning."[82] Surveys suggest that the mental and psychological weight of student debt is heavier for women in particular, especially single women from relatively low-income households.[83]

Student Loan Debt Balances Harm Borrowers' Ability to Grapple with an Ever-More Expensive World

Income-driven repayment, at least implicitly, is supposed to alleviate some of these financial and emotional burdens by promising borrowers that their monthly debt obligations will never spiral beyond their control and that they will always have a path to becoming debt-free. Unfortunately, by focusing only on two measures—the borrower's income and the amount of debt they owe—IDR as currently designed exacerbates the problem. While borrowers may be protected from massive fluctuations in income and pay less if their earnings drop, borrowers still must contend with the increasing cost of necessities like housing and childcare, both of which have grown increasingly expensive and are less affordable than when many IDR plans were being designed.[84] Even if these borrowers' payments are income-based, simply owing on student loan debt—and, in particular, doing so for an extended period of time—makes it all the more difficult for borrowers to grapple with these growing costs.

Nearly half of all families who rent are now "cost burdened," meaning they pay over 30 percent of income on rent, and around a quarter of families are "severely cost burdened, or pay over half their income in rent each month.[85] In almost every state in the country, rent increases have outpaced income over the past 20 years.[86] It is no surprise, then, that young renters with student debt have substantially less cash savings on hand compared to those without debt.[87]

Meanwhile, the monthly cost of childcare has grown twice as fast as inflation since the 1990s—incidentally, the time period when the monthly payment thresholds for income-driven student loan repayment were first being designed.[88] Families with children can expect to pay $1,300 on average monthly for infant and toddler care.[89] In some states, typical childcare costs eat up a full quarter of family income per month, despite the fact that the federal government considers child care "unaffordable" if it rises above 7 percent of income.[90] In addition to facing childcare costs, parents who are stuck paying off their loan debt for many years are substantially less likely to invest in their children's college savings, thereby potentially prolonging the cycle of debt into future generations.[91] As other costs rise, the fact that ongoing student loan payments are income-based, at the same percentage of income for years on end, could inadvertently make IDR less affordable for many borrowers over time.

Thus, even on its own terms, IDR may provide less of a safety net as other financial obligations become more burdensome over time. Elongating the period that borrowers are paying their loans, and forcing them into a decades-long payment period while other costs swirl around them, is unlikely to be effective in helping families feel financially secure.

The Uneasy Promise of Forgiveness Under IDR

As we have seen, forcing borrowers into runaway balances is problematic in and of itself. But the basic arrangement behind IDR is that borrowers should be able to withstand 20 or 25 years of monthly payments tied to their income, with the assurance that any leftover debts will then be cancelled. Thus, borrowers in IDR are encouraged to believe that their debt levels matter far less than their income and ability to navigate monthly payments. As discussed above, this view ignores various realities about borrowers' financial lives. However, more importantly, this bargain is predicated on trust that forgiveness will indeed be an option for borrowers who cannot repay their balances and interest in two decades' time.

Evidence suggests that borrowers are right to worry about their balances, and that forgiveness may be illusory. Recent investigations show that only 32 total federal student loan borrowers out of approximately two million with undergraduate debts that are more than two decades old have received cancellation under the oldest IDR plans.[92] Similarly, the Public Service Loan Forgiveness program, which requires borrowers to enroll in IDR and promises to cancel debt after ten years' worth of loan payments, has denied 98 percent of applicants, in part because of inconsistencies in IDR enrollment, poor servicing and communication, and outright malfeasance from loan servicers.[93]

The administrative burdens placed in front of borrowers should act as a warning sign that borrowers who work for the better part of their careers to dutifully repay their loans may nevertheless face a broken promise at the moment they expect to be rid of their debt burden. In other words, if forgiveness is illusory, we have designed a repayment system that simply acts as a massive debt trap.

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Policy Recommendations

Rising student debt levels threaten to undermine borrowers' trust in the system, and they can make those who are stuck with loans for decades feel that the education and lending system is rigged against them. In some ways, it is. As discussed above, debt itself negatively affects borrowers' ability to secure a reasonable standard of living and acts as yet another barrier to building wealth, particularly for Black and Latino households.

Rising student debt levels threaten to undermine borrowers' trust in the system, and they can make those who are stuck with loans for decades feel that the education and lending system is rigged against them. In some ways, it is.

IDR is a noble policy idea that, when it is implemented competently and reaches vulnerable borrowers, can help reduce delinquency and default. At the same time, the impact of the debt that accrues for borrowers cannot be ignored or dismissed because borrowers qualify for low monthly payments. As the Department of Education embarks on new rounds of rulemaking around income-driven repayment and the loan program more broadly, it must work to answer key questions about who is served by IDR and address the critical flaws in its design:

- **The Department of Education should fully subsidize unpaid interest for IDR borrowers and ensure IDR borrowers' payments reduce principal.** Borrowers who make timely payments should see those payments have an effect on their debt, and those who qualify for $0 payments or need to pause their payments should not see their balances balloon while they get back on their feet. Currently, the federal government will cover a portion of interest for borrowers experiencing negative amortization, though interest subsidies apply in certain plans and for certain time periods, while borrowers who pay over a longer period potentially see their balances grow at exactly the time they believe they should be making a dent in principal. ED, through its rulemaking authority, should eliminate the phenomenon of negative amortization for borrowers in IDR by fully subsidizing any difference between a borrower's calculated monthly payment and the interest owed on their loan for the full duration of a borrower's time in any IDR plan. ED has previously used this authority, most recently in the design of the REPAYE plan, and it should expand this protection to ensure no borrower making a payment on their student loans sees their balance increase.

- **The Department of Education should stop capitalizing interest for borrowers, including those who leave IDR plans or fail to recertify income.** ED, through its rulemaking authority, has the ability to address the fact that borrowers who leave an IDR plan or cannot recertify their income—often because of poor loan servicing—see their interest capitalized on their loans, costing them thousands of dollars. ED should end the practice of interest capitalization on loans for borrowers, including those who switch repayment plans or take advantage of other options within the loan program, such as deferment or forbearance, before or after enrolling in IDR.

- **The Department of Education should cancel a portion of principal for IDR borrowers who make low monthly payments for a certain period of time, and cancel all unpaid interest charges accrued by borrowers who have used IDR since its inception.** For borrowers who consistently have low enough incomes to make low, or $0, payments under IDR, the promise of debt-financed higher education has been broken. As it moves forward in addressing the demoralizing phenomenon of runaway interest, ED through its rulemaking authority should guarantee borrowers who are enrolled in IDR plans for a certain period of time, and meet certain income or monthly payment thresholds, see some of their loan principal automatically wiped away. This should also be retroactive: borrowers who have been making low, or $0 monthly payments in IDR plans for a period of time should see the unpaid interest that has accrued on their debts retroactively cancelled, and see principal forgiveness as well. For borrowers, since much of this debt is likely to be cancelled after the 20 or 25-year timeframe under current IDR rules, this would allow them to more quickly enjoy peace of mind and financial flexibility. For ED, the front-loading cancellation of debts that are likely to be discharged anyway would present minimal additional cost.

- **The Office of Civil Rights at the Department of Education and the Consumer Financial Protection Bureau should work to analyze inequities within the loan portfolio, including who experiences negative amortization and interest capitalization.** ED's Office of Civil Rights must be brought to the table to help understand the full weight of student loans for borrowers of color, especially those enrolled in IDR. In addition, in its role as the nation's top consumer watchdog, the Consumer Financial Protection Bureau has unique insight into the household financial experiences of student loan borrowers,[94] including their experiences with other debts and credit products. ED OCR and CFPB should collaborate to release data on the number and percentage of borrowers, particularly borrowers of color, who experience negative amortization, and the payment periods that borrowers of color face under IDR relative to white borrowers. These analyses can inform policy decisions about ending the practice of negative amortization and interest capitalization, and better understand the borrowers who are left further behind despite enrolling in IDR. Further, these analyses should include a look at the other debts facing IDR borrowers, especially IDR borrowers of color, in order to better inform the design of future repayment plans or broader student loan policy.

- **The Department of Education should establish a maximum loan term in line with the policy goals of IDR, ensuring that borrowers are guaranteed a debt-free future beyond a fixed date.** As described above, borrowers encounter a range of obstacles to enrolling and persisting in IDR. As a result, only a handful of borrowers have been able to have their loans cancelled under IDR, ensuring that millions of others remain in repayment on decades-old debt. Rather than only delivering loan forgiveness for borrowers based on the number of payments they have pursued through IDR, the Department of Education, through rulemaking, should create a maximum loan term for all federal loans, regardless of the payment plans the borrower has pursued throughout repayment. This maximum term could align with the repayment term under IDR, resulting in the cancellation of any federal student loan regardless of the borrower's choice of repayment plan, use of forbearance and deferment, or repayment behavior.[95]

- **While addressing runaway interest, the Department of Education should set IDR payments at an affordable level.[96]** Currently, borrowers have up to 150 percent of their income protected from IDR payments, in recognition that borrowers should be allowed to address basic needs before making student loan payments. This threshold is far too low, and it leads to situations in which borrowers must choose between housing, healthcare, childcare, food, and student loan payments. ED, in addition to examining whether the monthly income payment amounts of 10 percent or 15 percent of discretionary income are appropriate, should use its rulemaking authority to increase the amount of income that is protected from calculations of borrowers' discretionary income in the first place. This should be done in addition to addressing and preventing runaway interest, and in doing so would make the student loan repayment system more humane and ensure borrowers truly have affordable repayment options that do not result in runaway debts.

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