

Family Support and Income-Contingent Student Loans

Rising costs of higher education and student debt levels have heightened tensions inherent in post-secondary student loan programs.

The central objective of these programs is to ensure that students have access to the funds needed to benefit from higher education. However, with students borrowing more than ever and tight fiscal budgets, governments must ensure that loans are repaid whenever possible.

With three-year student loan cohort default rates of nearly 15% (in both the U.S. and Canada), concerns naturally arise that some students may be choosing not to repay their

loans even when they are in a position to do so. At the same time, there are growing concerns that some low-income borrowers in delinquency or default may be financially unable to meet their loan obligations, prompting calls for expanding current repayment assistance and income-based repayment schemes. (Box 1 briefly describes current income-based repayment options in the U.S. and Canada.)

In [CIBC Working Paper 2013-7](#), Lance Lochner, Todd Stinebrickner and Utku Suleymanoglu exploit unique new data from the Canada Student Loans Program (CSLP) to study the importance of various forms of financial resources for student loan repayment. The CSLP services all provinces and territories in Canada except Quebec, providing loans to approximately 425,000 full-time students in 2010-11. The most recent official three-year cohort default rate of 14.3% is very similar to the corresponding rate of 13.4% for the U.S.

Combining administrative data detailing debt amounts and repayment outcomes with data from a specially designed survey reveals that more than one in four recent CSLP borrowers experience some form of repayment problem in their first two years of repayment. While those earning more than \$40,000 per year have very low non-payment rates of 2-3 percent, borrowers with annual incomes of less

than \$20,000 are more than ten times as likely to experience some form of repayment problem.

On the one hand, negligible non-payment rates among borrowers with high earnings suggest that student loan repayment is well-enforced in Canada. On the other hand, high delinquency and default rates among low-income borrowers signal important gaps in

Box 1

Main Income-Based Repayment Programs in the U.S. and Canada

Pay-as-you-Earn (U.S.):

Payments do not exceed 10% of discretionary income. After 20 years, any outstanding balance is forgiven.

Repayment Assistance Plan (Canada):

Payments do not exceed 20% of gross family income. After 15 years, any outstanding balance is forgiven.

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formal assistance and loan forgiveness mechanisms. These gaps are behind the growing interest in expanding income-contingent repayment schemes for student loans in both Canada and the U.S.

Family Support and Repayment

Despite relatively high non-payment rates for low-income borrowers, the simple fact is that more than half of borrowers earning less than \$20,000 per year continue to make standard student loan payments. Lochner, Stinebrickner and Suleymanoglu show that other financial resources in the form of personal savings and family support are crucial to understanding

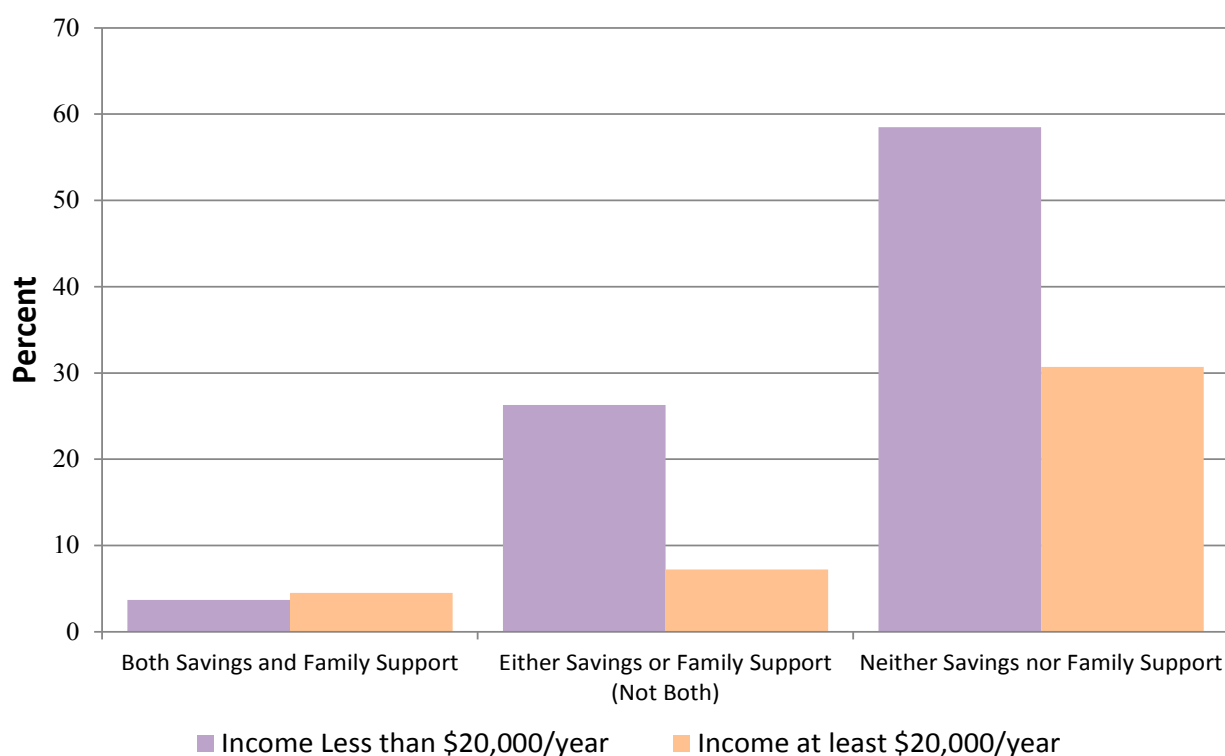
why and how so many of these borrowers still manage to pay off their loans.

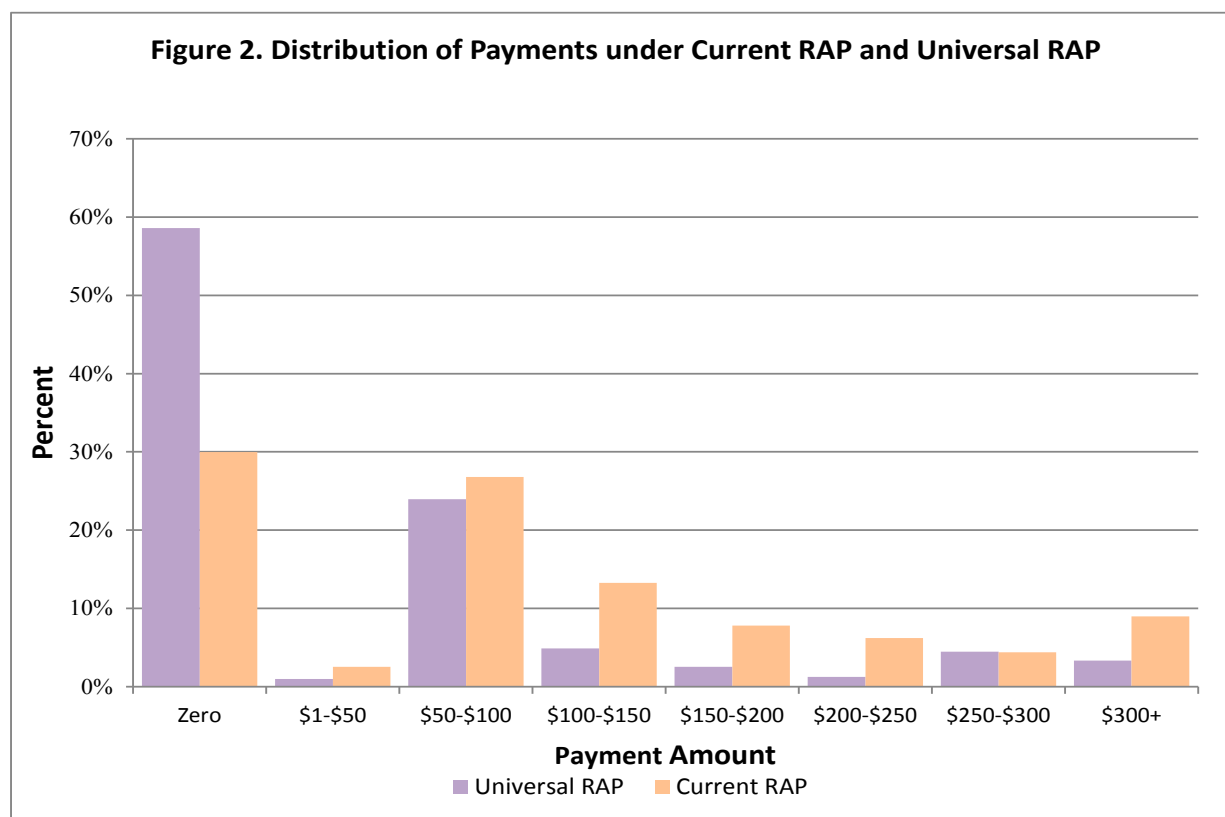
Fewer than 5% of low-income borrowers with both savings and family support experience some form of repayment problem, compared with nearly 60% of low-income borrowers with negligible savings and little or no family support. Borrower income has small and statistically insignificant effects on the likelihood of repayment problems for those with modest savings and access to family assistance. By contrast, the effects of income on repayment are extremely strong for borrowers without access to these additional resources. See Figure 1.

Income Contingent Repayment

These findings have important implications for current efforts to expand income-contingent repayment schemes. Lochner, Stinebrickner and Suleymanoglu show that *expanding income-based repayment under Canada's Repayment Assistance Plan (RAP) to automatically cover all borrowers would reduce average student loan payments – and program revenues – by roughly half for borrowers early in their repayment period*. This is because a more universal income-based repayment scheme would significantly reduce repayment amounts for many low-income borrowers who currently make

Figure 1: Repayment Problems by Income and Additional Resources





standard payments. At the same time, little revenue would be raised from inducing borrowers currently in delinquency or default to make income-based payments, since the vast majority of these borrowers have very low income levels and would be asked to pay little or nothing.

Figure 2 reports the distribution of payments under the current system and under a hypothetical 'Universal' RAP for borrowers in their first two years of repayment. Nearly twice as many borrowers would pay nothing under a 'Universal' RAP.

Importantly, Lochner, Stinebrickner and Suleymanoglu estimate that slightly more than half of all low-income borrowers have little savings or family support. These borrowers currently have high delinquency/default rates and would surely benefit from greater government insurance (i.e.,

some form of repayment assistance or income-based payments). Yet, results also suggest that considerable caution is warranted before broadly expanding income-contingent repayment schemes. Many low-income borrowers have access to savings and family support that enables them to make standard payments. Lowering payments for these borrowers based on their incomes alone could significantly reduce student loan program revenues to the point of threatening the program's sustainability.

All of these results suggest that the optimal design of student loan repayment schemes is more complicated than recent proposals and studies would suggest. Contrary to current thinking, the family plays an integral role in student loan repayment. This neglect is, perhaps, surprising given the established literature on family transfers and the central role

parental resources play in determining financial aid at the post-secondary attendance stage.

The results reported by Lochner, Stinebrickner and Suleymanoglu raise important questions about the extent to which government repayment assistance should depend on broader family resources and transfers, since these clearly influence repayment outcomes. They may also help in understanding puzzling differences in default rates by race in the U.S., where African Americans have much higher default rates than whites even when debt levels and post-school income are held constant (e.g., see [CIBC Working Paper 2014-1](#) by Lance Lochner and Alexander Monge-Naranjo).

References

Lochner, Lance, Todd Stinebrickner and Utku Suleymanoglu, "[The Importance of Financial Resources for Student Loan Repayment](#)," CIBC Centre for Human Capital & Productivity Working Paper 2013-7, 2013.

Lochner, Lance J. and Alexander Monge-Naranjo, "[Default and Repayment Among Baccalaureate Degree Earners](#)," CIBC Centre for Human Capital & Productivity Working Paper 2014-1, 2014.

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