

The Daily Dish

Debt Forgiveness Dilemma

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Eakinomics: Debt Forgiveness Dilemma

President-elect Joe Biden campaigned on the promise of significant, or even complete, forgiveness of student loans. This is a bad idea. Student loan forgiveness does not do anything to improve the quality of educational outcomes in the United States. Student loan forgiveness does not do anything to help a future high school graduate afford college. Forgiveness is a backward-looking policy that does nothing to improve the future efficiency of, and access to, the system of higher education.

The only impact on the future is to create moral hazard – the notion that past forgiveness programs will be repeated, thus reducing the incentive to repay loans in a timely fashion. Student loan forgiveness will take a rotten system and make it worse. Oh, and who will pick up the tab for both any forgiveness and future non-payments? The taxpayer, of course. Since taxpayers back the student loans, forgiveness is conceptually equivalent to sending taxpayer financed checks in the amount of the forgiveness to each loan holder.

The question now facing the future Biden Administration is: Who gets the (conceptual) checks?

Not surprisingly, once you get into a policy as unprincipled as forgiveness, there aren't many principles to guide the decision on who wins and who loses. Some recent research from the University of Chicago, however, provides some surprising insight into who the potential winners might be: "Full or partial forgiveness is regressive because high earners took larger loans, but also because, for low earners, balances greatly overstate present values. Consequently, forgiveness would benefit the top decile as much as the bottom three deciles combined. Blacks and Hispanics would also benefit substantially less than balances suggest." ("Balances greatly overstate present values" because low earners will have their payments reduced under the current system – maybe even to zero – and have

some residual balances forgiven. The current balance is a misleading indicator of actual future payments.)

The notion that the top 10 percent gain as much as the bottom 30 percent combined would seem to fly in the face of the idea that this is a way to make things more fair. So forgiveness is neither efficient nor fair. Instead, the authors note, “Enrolling households who would benefit from income-driven repayment is the least expensive and most progressive policy we consider.”

In the end, the right thing to do is to start anew with federal support for higher education. The worst thing to do is forgive past loans. If the politics demand action somewhere in between, income-based repayment appears to be the best candidate.