What if Education Isn't the Great Equalizer?

Reimagining Financial Aid from a Financial Capability Perspective, the Role of Children's Savings Accounts and Assets

EXECUTIVE SUMMARY

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To Become the Great Equalizer, Education Needs to be Paired with Financial Capability?

In this report we hypothesize that the amount of payoff one receives from earning a degree is determined, at least in part, by the level of financial capability they possess. According to Sherraden M. S. (2013), financial capability consists of both one's ability to act (i.e., their financial literacy which consists of their financial knowledge and skills) and the opportunity to act (i.e., financial inclusion). We go on to suggest, because America has put education in the role of equalizing economic outcomes, it must develop in its graduates, strong financial capability for education to fulfill this role.

Asset Ownership as Part of What it Means to Be Financially Capable

However, we suggest that the current notion of financial capability falls short, because it does not include ownership of assets. **In accordance with Sen's (1999a, b) financial capability perspective, in explaining why initial assets matter, we suggest when people own assets the corresponding characteristics of the assets increase their opportunity for being able to use those assets to accumulate more assets, and in turn increase the amount of return they can receive on their degree.** The fact that having wealth is linked to being able to accumulate more wealth might be the strongest argument for why financial capability should include wealth accumulation.

Asset Ownership as Part of What it Means to Be Financially Capable

- Shapiro, Meschede, & Osoro's (2013) findings help shed some light on why this might be. They find that a $1 increase in income translates to a $5 increase in wealth for White families but only a 70-cent increase for Black Families.
    - But, importantly for this discussion, they also find when Black families start off with similar levels of assets, they have a return of $4.03.
- Elliott, Rauscher, and Nam (2018) find that the power of income for generating wealth is

determined at least in part by the amount of wealth older age adults start off with as younger adults; that is, to build wealth you must have a certain amount of wealth as younger adults.

  - They also find that older age adults living at the 50th or 75th percentile as younger adults can expect to generate more wealth from each dollar, they earn than those living at the 25th percentile as younger adults.
    - This is like Shapiro et al. (2013) findings on race but regarding income level.

- Growing up with wealthy parents as a child is linked to being more likely to be wealthy as an adult (Davenport, Levell, & Sturrock, 2021; Pfeffer & Killewald, 2019).
  - Similarly, Fagereng, Mogstad, and Ronning (2021) provide causal analysis of the importance of initial assets. They link Korean-born children who were adopted at infancy by Norwegian parents' data on wealth and socioeconomic characteristics.
    - Their mediation analysis examined the following four factors: children's education, income and financial literacy, and direct transfers of wealth from parents. They found that changes in these mediator variables explained nearly 40% of the average causal effect on these children's accumulation of wealth. The direct transfer of wealth was the most important mediator.
- Importantly, Elliott, Rauscher, and Nam (2018) find evidence that suggests while holding a degree makes a substantial difference in the amount of net worth younger adults have when they are older, a college degree matters more when younger adults start off with assets compared to when they do not.
  - Similarly, Conley (1999) finds that parental net worth is a more important predictor of young adults' net worth than education, income, or age.

To be financially capable, we posit that you not only need knowledge, skills, and access to institutions, you also need assets. This maybe most vividly reflected in data on the highest achieving low-SES children compared to the lowest achieving high-SES children regarding education. Carnevale, Fasules, Quinn, & Campbell (2019) find that a kindergarten student from the bottom 25% of socioeconomic status with ***test scores from the top 25%*** of students has a 31% chance of earning a college education and working a job that pays at least $35,000 by the time they are 25, and at least $45,000 by the time they are 35. However, a kindergarten student from the top 25% of socioeconomic status with test scores ***from the bottom 25%*** of students had a 71% chance of achieving the same milestones.

Modeling Financial Aid After a Financial Capability Perspective that Includes Assets: CSAs, A Tool for Strengthening the Return on Degree

We posit that the best or most readymade tool education currently has for providing access to financial institutions is through financial aid. Children's Savings Accounts (CSAs) are a form of financial aid. More specifically, they are a savings vehicle, most commonly designed for higher education savings. While they have specifically designed features (incentives and explicit structures) to encourage asset building among disadvantaged youth and families, they are meant to universally serve all young people. Unlike basic savings accounts, CSAs leverage investments by individuals, families, communities, employers, local, state, and federal governments, philanthropists, foundations, and others as a way of building assets (Elliott, 2023, March). The small-dollar version of CSAs (initial deposits of $5 to $1,000) that currently exist best align with the current understanding of financial capability which consists of being financially literate and having access to financial institutions (e.g., Sherraden, M. S., 2013). **The initial deposits in small-dollar CSAs are used as a tool for overcoming barriers to access (i.e., initial fees to open an account and/or enough extra money to encourage engagement).**

Children Not only Need Assets to Pay for College, But They Also Need Assets to Launch Successfully into Adulthood

Because education's return on degree problem is also about students' financial capability (including asset ownership) upon leaving college, a CSA designed to help solve the problem, we suggest, must provide children assets not only at age 18 but also at age 24. **By identifying age 24 for a second disbursement, we are suggesting that there are two critical periods where transfer of assets can play a significant role in using financial aid to augment education's ability to be an equalizer by strengthening the return on degree: (1) when children transition from high school to postsecondary education or directly into the labor market, and (2) when most children today are becoming independent adults in America.** The idea of moving from one time point to two for asset distributions is in line with Sherraden's (1991) original vision of what a CSA would look like. He did and still does refer to these accounts as Child Development Accounts (CDAs) because when he introduced them, he introduced them as lifelong accounts designed to assist children's development. As the field evolves, it is just moving closer to this vision of them, and this would be another step in that direction.

Large-Dollar CSAs Equivalent to the Cost of College

Unlike the current version of CSAs which is small-dollar and focused exclusively on paying for college, in *Assets and the Poor*, Sherraden (1991) imagined the possibility of a multipurpose account (e.g., education, start a business, buy a homeownership, or prepare for retirement) that was started with a significant federal investment. Further, he initially imagined a much more robust asset building policy for the poor.

Free college might provide guidance on what the right amount is for a large dollar CSA initial deposit. When most people think of the concept of free college, they can only think of not charging students to attend college (i.e., tuition free college). But another form of free college is providing children with assets in a CSA to pay for college (i.e., asset accumulation version of free college). This better aligns with a financial capability perspective of financial aid, and we posit would be more effective at strengthening the return on degree. Building on the idea that free can also be accomplished through a CSA, in addition to having two time points for disbursement, we suggest connecting the size of the government investment in CSAs for an individual child at age 18 to what it would cost to provide children with a free college education. Currently, the average cost of attendance at a public 4-year college in-state institution in the 2023-2024 school year is $11,260 which would be $45,040 for four years (College Board, 2022).

In addition, given we suggest there is also a need for additional assets to launch children into independent living and strengthen the return on degree, we suggest an additional investment of $12,000 by the federal government. These payments would occur like Senator Corey Booker's proposal, an initial $1,000 at birth for all children, and $2,000 every year after phasing out in a similar fashion based on income (e.g., 100% of Federal Poverty Level (FPL) = $2,000; 125% of FPL = $1,500; 174% of FPL = $1,000, down to 500% of FPL = $0), but after the first disbursement at age 18 (about $45,000), payments would continue through until age 24 when a second disbursement would occur (about $15,000). These amounts only include the federal investment. But as already discussed, CSAs are community accounts that allow for multiple streams of assets to flow into these accounts.

Finally, because these financial aid funds would not only be for students attending college but for children who reach the ages of 18 and 24 who choose not to attend college, **adoption of the financial capability framework of financial aid requires a shift from an understanding of financial aid as an investment in education itself, to understanding it as an investment in economic mobility more generally.** America has invested in education to be a primary tool for providing everyone an equal opportunity to achieve financial outcomes in line with their use of effort and ability. If this is the case, then providing financial aid to all students for that purpose regardless of whether they attend college or not would fulfill the very purpose of providing everyone an equal opportunity to achieve financial outcomes consistent with their effort and ability.

Conclusion

If all children had similar levels of education and faced similar economic conditions, children who worked harder and had more ability would be more likely to achieve a greater economic return on their degree than those who did not work as hard or who had less ability. This feels like what the ideal of meritocracy is meant to be. In this report we suggest that achieving this is impossible without leveling the playing field by ensuring that all children have similar access to financial knowledge and skills, similar access to financial institutions for building wealth, and enough wealth upon graduating that they have the same opportunity to build wealth later in life that their wealthier counterparts do. But as we have shown, this does not currently exist. So, how do we get there? How do we make education the equalizer it was invested in to be.

We suggest reimagining financial aid from a financial capability perspective that includes asset ownership. See Figure 1, it depicts a financial capability model of financial aid for strengthening the return on degree. In this model, CSAs provide all children with access to institutions (i.e., financial inclusion). Financial literacy training, delivered through K-12 schools, represents another component of financial capability. The last component of financial capability is assets. The CSAs' scaffolding allows for multiple streams of assets—including repurposed investments in financial aid, as well as contributions from families, community institutions, and other government revenues—to flow into the accounts all along the education pipeline, up to age 24. In addition to connecting children to the asset building arm of financial institutions and equipping children with an asset foundation from which to launch into adulthood, then, CSAs, provide scaffolding for delivering multiple streams of assets, the context for experiential learning within financial literacy training, and indirect social and psychological effects associated with improved educational outcomes. That is an integrated, expansive, and equitable model for making education a truly equalizing force within the lives of American families.

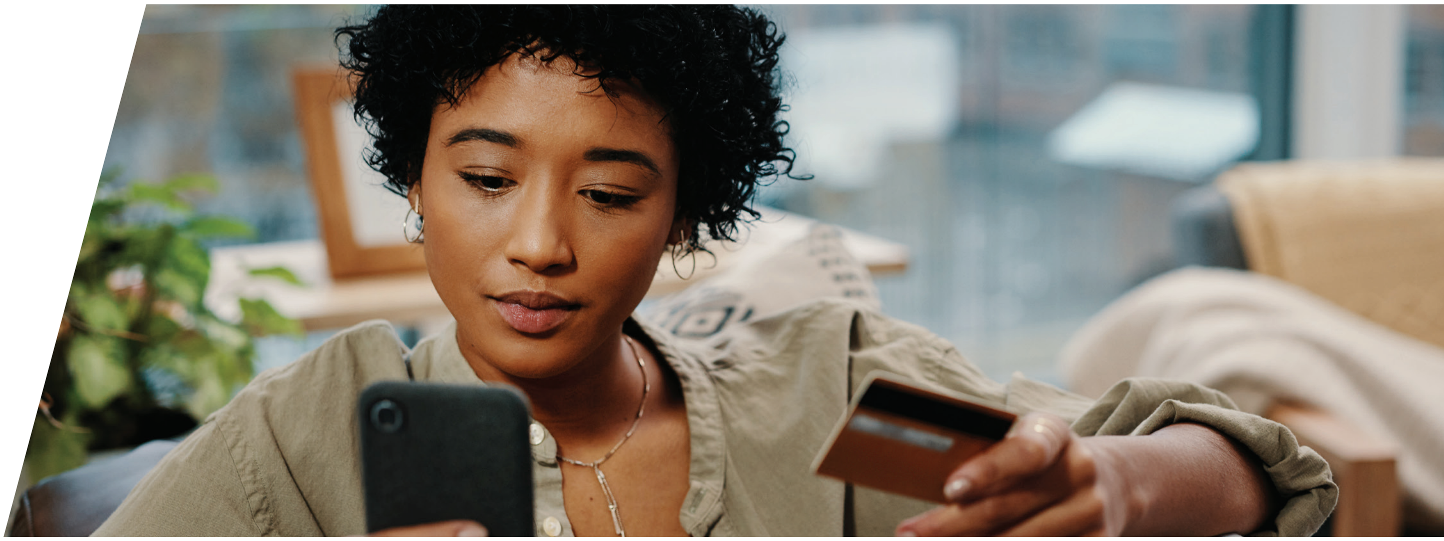
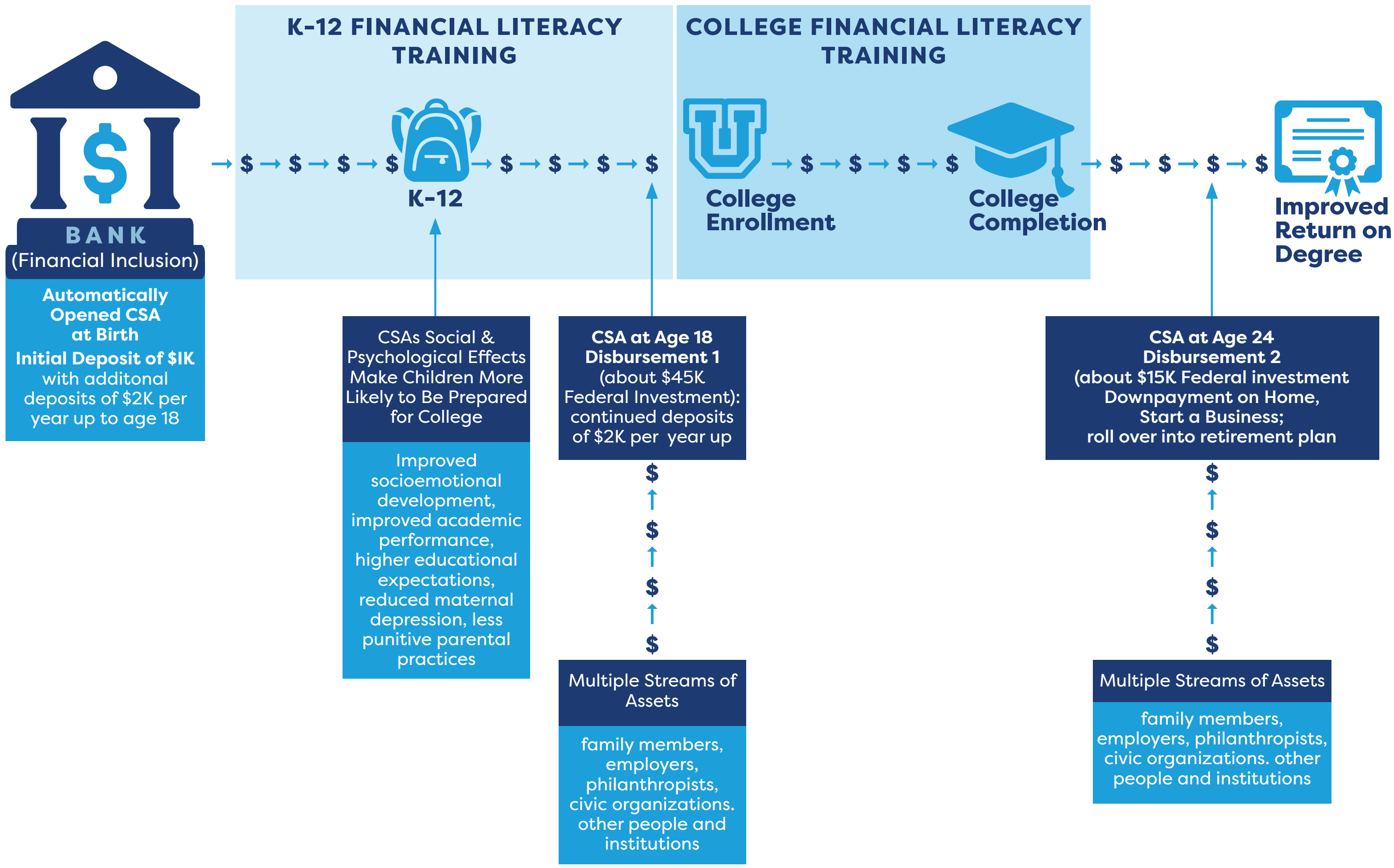


Figure 1. Financial Capability Model of Financial Aid



What makes the financial capability perspective of financial aid so potentially powerful is how each factor (CSAs, financial literacy, financial inclusion, assets, and education) increase the other factors' potential for producing wealth. **And because all the factors work together to increase wealth accumulation and strengthen each factor's independent effect on wealth accumulation, they can be said to have a multiplicative effect on children's capability for increasing their wealth return on degree.**

In sum, the knowledge that education must be combined with financial capability if that education is to serve the equalizing functions society expects must alter our understanding of the purpose of financial aid and the type of financial aid needed. Indeed, this evidence suggests that financial aid should provide children with the financial capability to leverage their degree truly, equitably, and durably—for their own economic success and that of our country.