Brief

Student Loan Debt Threatens Household Balance Sheets

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The purpose of higher education is, in large part, to position students for later economic success. While those with college degrees command higher lifetime salaries than less-educated Americans, there is reason to worry that beginning adulthood burdened with significant loan balances may compromise household economic security by tilting balance sheets decidedly toward liabilities.

- About 18 percent of households in our sample have outstanding student debt. The average family in 2007 had about $26,018 in student debt, and this outstanding student debt can have a negative effect on household net worth. Specifically, median 2009 net worth for a household with no outstanding student debt is nearly three times higher than for a household with outstanding student debt.
- The recession seemed to hit households with student debt harder than those without such liabilities. The change in net worth between 2007 and 2009 represents a higher percentage of total 2009 net worth for households with outstanding student debt than it does for households with no outstanding student debt.
    - A hypothetical household with exactly median 2007 net worth ($128,828) *with* outstanding student loans is associated with a loss of about 54% in 2009 net worth compared with a household with similar net worth but no student debt.
- The increasing student debt burden on households may not be equally shared at different wealth levels. While households at the 15th percentile of net worth with outstanding student debt lost less net worth than similar households at the 50th percentile from 2007 to 2009, the loss for households at the 15th percentile represents 285% of their 2009 net worth but only 54% for households at the 50th percentile.
- College graduation is not adequate protection against this loss of net worth. Living in a household with a four-year college graduate with outstanding student debt is associated with a net worth loss of $185,995.90 (about 63% less) compared with living in a household with a four-year college graduate with no outstanding debt.
    - Others have found that an average student debt burden for a dual-headed household with bachelors' degrees from four-year universities leads to a lifetime wealth loss of nearly $208,000.[1] Over time, then, students with outstanding student debt make up some of the wealth loss, likely through leveraging their increased human capital into earnings potential. However, it appears that they still end up far behind their peers without student debt.

Student Loan Debt Impairs Other Asset Accumulation

Student debt threatens balance sheets not only directly—by increasing household liabilities—but also by reducing even college graduates' ability to build other assets that could provide a stronger financial footing.

- Median assets in 2009 for a household without outstanding student debt ($207,000) are higher than for a household with outstanding student debt ($174,000). Living in a household with median assets in 2007 ($225,035) which has outstanding student debt is associated with a loss of about 20% ($44,661.12 less) in assets compared to a household with similar levels of assets but without student debt.
- Living in a household with a four-year college graduate, outstanding student debt, and median assets in 2007 ($451,520) is associated with a loss of assets of about 36% ($163,637.30 less)

[1] Hiltonsmith, R. (2013). At what cost? How student debt reduces lifetime wealth. Retrieved from Demos website: http://www.demos.org/sites/default/files/publications/AtWhatCostFinal_Demos.pdf

compared to living in a household with a four-year college graduate, no outstanding debt, and similar levels of assets.

- Some evidence suggests that students who graduate with average student debt are forced to invest significantly less in things like retirement savings or to delay purchasing other wealth-building items like a home during the early part of their working lives.[2] These early losses may account for much of the wealth inequality seen later in life, as the cumulative effects of less and later wealth building put these graduates further behind their peers.

Student Loan Debt Hinders Homeownership, the Primary Path to Wealth

In the United States, homeownership is the primary source of wealth for all families but the very wealthy.[3] Owning a home is an important source of wealth for establishing economic well-being across the life course.[4] Importantly, homeownership facilitates differential access to opportunities—including educational opportunities—in addition to building a financial reserve that provides a measure of economic security.

- Home equity remains important not only for the well-being of college graduates themselves but also for the education system's ability to act as an equalizer. Studies have found that for every $10,000 of home equity gains, the likelihood that low- and middle-income students (i.e., below $70,000) enroll in college increases by six percentage points.[5] They also find that low- and middle-income students' enrollment in four-year public flagship schools increased by 24 percentage points and college graduation increased by nine percentage points as household home equity grew.
- In the pursuit of homeownership, too, though, college students are hindered by high-dollar student debt.
  - Median home equity in 2009 for a household without outstanding student debt ($115,986.94) is nearly two times higher than for a household with outstanding student debt ($68,349.44).
  - For a hypothetical household with median home equity in 2007 ($107,702), having outstanding student debt is associated with a loss of about 28% in home equity in 2009 compared to a household with similar levels of home equity but no student debt.
  - Living in a household with median home equity and a four-year college graduate with outstanding student debt is associated with a home equity loss of about 40% ($54,333.87 less) compared to living in a similarly-situated household with a four-year college graduate without outstanding debt.

Student Loan Debt can Reduce Retirement Security

Individuals are increasingly responsible for securing their own retirement futures, but there is evidence to suggest that, even as they are advantaged in this pursuit by their relatively greater earning potential, college graduates who begin their careers burdened by high-dollar debt may struggle to save enough for their retirements.

- Median retirement savings in 2009 for a household without outstanding student debt ($55,000) is just over two times higher than for a household with outstanding student debt ($25,000).

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[2] Hiltonsmith, R. (2013). At what cost? How student debt reduces lifetime wealth. Retrieved from Demos website: http://www.demos.org/sites/default/files/publications/AtWhatCostFinal_Demos.pdf

[3] Mishel, L., Bivens, J., Gould, E., & Shierholz, H. (2013). *The state of working America 12th Edition*. Ithaca: NY: Economic Policy Institute Book, Cornell University Press.

[4] Oliver, M. L., & Shapiro, T. M. (1995). *Black wealth, White wealth: A new perspective on racial inequality*. New York, NY: Routledge.

[5] Urahn, S. K., Currier, D. E., Wechsler, L., Wilson, D., & Colbert, D. (2012). Pursuing the American dream: Economic mobility across generations. Washington, D.C.: The Pew Charitable Trusts. Retrieved from Pew Trusts website: http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Economic_Mobility/Pursuing_American_Dream.pdf

- Living in a household at the 50th income percentile with retirement savings of $47,500 in 2007 with student debt was associated with a drop in retirement savings in 2009 of $19,520.17 compared to if they did not have student debt, a loss of about 41%.
- Living in a household with student debt that has retirement savings of $80,983 (50th percentile) in 2007 is associated with having $41,945.55 less retirement savings in 2009 compared to households without student debt, a loss of about 52%.

Compromised Household Balance Sheets Affect the Overall Economy

While rising student debt levels and their significant effects on asset accumulation and overall financial well-being are of particular concern to students and their co-borrowers, all Americans should be concerned about the ripple effects of this increasing indebtedness.

- Balance sheet erosion impacts families directly by reducing access to human capital development, particularly college education;[6] constraining economic mobility,[7] as assets are usually needed in order to accumulate additional wealth and gain access to ladders of economic opportunity; and increasing financial insecurity, as households lack reserves with which to withstand future downturns.[8]
- Shocks to families' asset holdings might affect household spending in the short and long terms,[9] significant given the huge role that consumer spending plays in driving U.S. economic activity.[10]
- Precarious balance sheets also make a family more likely to default on credit obligations. When replicated across many millions of U.S. households, this increased risk of default is alarming, since a growing body of research suggests that large-scale defaults can have significant harmful effects on economic growth.[11]

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[10] Emmons, W.R. (2012). Don't Expect Consumer Spending to be the Engine of Economic Growth it Once Was. The Regional Economist. St. Louis, MO: The Federal Reserve Bank. Retrieved from Federal Reserve Bank of St. Louis website: http://www.stlouisfed.org/publications/re/articles/?id=2201

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