Brief

High-Dollar Student Debt May Compromise Educational Outcomes

BY WILLIAM ELLIOTT AND MELINDA LEWIS

THE UNIVERSITY OF KANSAS
School of Social Welfare

ASSETS & EDUCATION INITIATIVE

November 7, 2013

High-Dollar Student Debt May Compromise Educational Outcomes

Student debt is understood as an investment in expanding access to higher education, but there is some evidence that debt may work at cross-purposes by impairing or, at least, failing to support, educational outcomes.[1]

- For some students, the prospect of high-dollar student debt may discourage enrollment.
    - Low-income students who are loan-averse may actually decide not to enroll in college at all in order to avoid debt.[2]
- Debt over a certain amount (about $10,000) may depress graduation rates and harm post-college financial security, especially for those in the bottom 75% of the income distribution.[3]
    - As the student debt threshold level increases so too does the dropout level, particularly for poor and minority students.[4]
    - Higher student loan debt in the first year of college may be associated with lower probabilities of graduating from college among low-income and black students.[5]
    - Studies suggest that a $1,000 increase in student debt is associated with a 3% increase in students dropping out of college.[6]
- Student debt is an ineffective tool with which to tackle the U.S.' greatest educational challenge: helping students prepare to succeed academically in college. Unlike college savings programs, the prospect of costly student debt does not motivate students to prepare for college.

Debt-Dependent Financial Aid Distorts the Higher Education Experience

Higher education is largely seen as an activity that generates individual benefits for students, rather than an investment in our collective prosperity. This cost shifting, financed through borrowing, is distorting the educational experience, leading students toward different decisions regarding courses of study and institutions. Multiplied across a generation, these changes have profound societal and economic effects.

- In the school year 2007-2008, 53% of students who took out debt, took out the maximum amount they could for the year.[7] Students are often unclear about how much student debt to incur based on expected future earnings, and they struggle to make sound financial decisions as a result.

---

1 Cofer, J., & Somers, P. (2001). What influences persistence at two-year colleges? *Community College Review*, *29*(3), 56–76.
2 Callender, C., & Jackson, J. (2005). Does the fear of debt deter students from higher education? *Journal of social policy, 34* (4). pp. 509-540.
3 Dwyer, R. E., McCloud, L., & Hodson, R. (2012). Debt and graduation from American universities. *Social Forces*, *90*(4), 1133–1155.
4 Institute for Higher Education Policy (IHEP) and the Education Resources Institute (TERI). (1995) *College Debt and the American Family.* Washington, DC: The Institute for Higher Education Policy and The Education Resources Institute. Retrieved from IHEP website: http://www.ihep.org/assets/files/publications/a-f/CollegeDebt.pdf; Institute for Higher Education Policy (IHEP). (1999). *State of diffusion: Defining student aid in an era of multiple purposes*. Retrieved from IHEP website: http://www.ihep.org/assets/files/publications/s-z/StateDiffusion.pdf; Cofer, J., & Somers, P. (1999). An analytical approach to understanding student debtload response.
Journal of Student Financial Aid, *29(3),* 25-44; St. John, E. P., Andrieu, S., Oescher, J., & Starkey, J. B. (1994). The influence of student aid on within-year persistence by traditional college-age students in four-year colleges. *Research in Higher Education, 35*, 455-480. Retrievable at JSTOR website: http://www.jstor.org/discover/10.2307/40196136?uid=3739704&uid=2&uid=4&uid=3739256&sid=21102819913487; Zhan, M., & Sherraden, M. (2011). Assets and liabilities, educational expectations, and children's college degree attainment. *Children and Youth Services Review 33*(6), 846-854. Retrieved from Washington University website: http://csd.wustl.edu/Publications/Documents/WP09-60.pdf
5 Kim, D. (2007). The effects of loans on students' degree attainment: Differences by student and institutional characteristics. *Harvard Educational Review, 77*(1), 64-100.
6 Institute for Higher Education Policy (IHEP) and the Education Resources Institute (TERI). (1995) *College Debt and the American Family.* Washington, DC: The Institute for Higher Education Policy and The Education Resources Institute. Retrieved from IHEP website: http://www.ihep.org/assets/files/publications/a-f/CollegeDebt.pdf
7 General Accounting Office. (2011). Federal Student Loans: Patterns in Tuition, Enrollment, and Federal Stafford Loan Borrowing Up to the 2007-08 Loan Limit Increase. Available from: http://www.gao.gov/assets/100/97511.html

- Students whose household economic circumstances have denied them sustained and meaningful opportunities to experience money management and make financial decisions are particularly challenged by these choices, with few supports to guide them.[8]

Student Loan Debt Threatens Educational Equity

While students who use debt to attend and graduate from college are undoubtedly better-positioned for economic security than those who do not go to college, the right question to ask is whether these students realize the same benefit of their college degrees as those who do not have to incur significant debt. There, the answer seems to be no, and the result is an increase in inequity within higher education in the U.S.

- While college students are taking on more debt in the aggregate, the debt burden is not equally shared. Because of low-income students' aversion to borrowing, student debt may be a more effective strategy for middle- and high-income students.[9] Similarly, there is evidence that student debt has a negative effect on enrollment at a four-year college for Black students.[10]
- If students with no or little student debt are more likely to graduate from college and are able to accumulate more assets after graduation than students with high debt, student debt is impacting the ability of education to deliver equity.
- On a macroeconomic level, rising levels of student debt—now more, in the aggregate, than credit card debt—affect growth prospects for the economy as a whole. Over time, these growth effects of student debt may constrain our collective ability to finance critical investments in infrastructure, with corrosive implications for government capacity to redress inequities.
- The existence of two divergent policy streams for financial aid—asset-based for wealthier households who enjoy generous tax benefits to facilitate their saving, and consumption-based for low-income households whose savings can even count against them in eligibility determinations—exacerbates inequities in higher education and impairs the ability of this institution to serve as an arbiter of opportunity.

Student Loan Debt Imperils Graduates' Financial Futures

Many Americans see student debt as a sort of down payment on the American dream, a necessary price to pay for access to human capital that opens doors to promising opportunities. From this perspective, all that matters is that the student who goes to medical school, for example, is better off than if she did not go. But this borrowing may have real costs for students' balance sheets.

- As student debt fails to ensure that students progress towards college graduation, the risk that students will go into debt without graduating increases. Of course, repaying debt is much more difficult for those who do not graduate,[11] given their reduced earning potential.

---

[8] Avard, S., & Manton, E. (2005). The financial knowledge of college freshmen. *College Student Journal, 39*(2), 321-339; Simpson, L., Smith, R., Taylor, L. & Chadd, J. (2012). College Debt: An Exploratory Study of Risk Factors Among College Freshmen. *Journal of Student Financial Aid, 42*(1), 16.

[9] Campaigne, D. A., & Hossler, D. (1998). How do loans affect the educational decisions of students? Access, aspirations, college choice, and persistence. In R. Fossey & M. Bateman (Eds.), *Condemning students to debt: College loans and public policy* (pp.). New York: Teachers College Press; Paulsen, M. B., & St. John, E. P. (2002). Social class and college costs: Examining the financial nexus between college choice and persistence. *Journal of Higher Education*, *73*(3), 189-236.

[10] Perna, L. W. (2000). Differences in the decision to attend college among African Americans, Hispanics, and Whites. *The Journal of Higher Education*, *71*(2), 117-141. Retrievable at JSTOR website: http://www.jstor.org/discover/10.2307/2649245?uid=3739704&uid=2134&uid=2&uid=70&uid=4&uid=3739256&sid=21102819913487

[11] Cunningham, A. F., & Kienzl, G. S. (2011). *Delinquency: The untold story of student loan borrowing*. Retrieved from IHEP website: http://www.ihep.org/assets/files/publications/a-f/Delinquency-The_Untold_Story_FINAL_March_2011.pdf

- An emerging body of evidence suggests that college graduates who have outstanding student debt have less net worth, home equity, and retirement savings than students who do not have outstanding student debt.[12] By limiting and/or delaying graduates' asset accumulation, student debt can set up households for lifelong relative economic disadvantages.
    - With an average debt now in excess of $26,000,[13] college graduates have been shown to delay investments in wealth building assets such as buying a home.[14]
    - Credit functions as a tool for building wealth for many Americans, but credit constraints exacerbated by overly-leveraged student loan exposure can short-circuit this relationship for many college graduates.
    - Analysis reveals that the average single student debtor would have to pay close to 50% of his/her monthly income toward student loans and mortgage payments.[15] As a result, the student debtor would not qualify for an FHA loan or many private housing loans.
    - Even when credit constraints are not a significant factor, households with outstanding student debt might be averse to taking out a mortgage for a home because they perceive their student debt is too high.[16]

---

12 Elliott, W. & Nam, I. (2013). Is student debt jeopardizing the short-term financial health of U.S. households? *Review 95*(5), pp. 1-20; 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

13 Fry, R. (2012). *A record one-in-five households now owe student loan debt*. Washington, DC: Pew Research Center. Retrieved from the Pew Research Center website: http://www.pewsocialtrends.org/2012/09/26/a-record-one-in-five-households-now-owe-student-loan-deb

14 Mishory, J., & O'Sullivan, R. (2012). Denied? The impact of student debt on the ability to buy a house. Young Invincibles (YI). Retrieved from the YI Network: http://younginvincibles.org/wp-content/uploads/2012/08/Denied-The-Impact-of-Student-Debt-on-the-Ability-to-Buy-a-House-8.14.12.pdf

15 Mishory, J., & O'Sullivan, R. (2012). Denied? The impact of student debt on the ability to buy a house. Young Invincibles (YI). Retrieved from the YI Network: http://younginvincibles.org/wp-content/uploads/2012/08/Denied-The-Impact-of-Student-Debt-on-the-Ability-to-Buy-a-House-8.14.12.pdf

16 Hira, T. K., Anderson, M. M. & Petersen, K. (2000), Students' perceptions of their education debt and its impact on life after graduation. *Journal of Student Financial Aid*, Vol. 30, pp. 7-19.

Project supported by:

Assets and Education Initiative | University of Kansas School of Social Welfare
Twente Hall, Office 309 | 1545 Lilac Lane | Lawrence, KS 66044-3184
785-864-2283 | www.aedi.ku.edu | www. Save2LimitDebt.com