EXECUTIVE SUMMARY

STUDENT LOANS ARE WIDENING THE WEALTH GAP: *TIME TO FOCUS ON EQUITY*

BY WILLIAM ELLIOTT AND MELINDA LEWIS

KU THE UNIVERSITY OF KANSAS School of Social Welfare

ASSETS & EDUCATION INITIATIVE

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According to Dr. Thomas Shapiro, the American dream "is the promise that those who work equally hard will reap roughly equal rewards" (Shapiro, 2004, p. 87). Higher education is widely regarded as a vehicle for sustaining this dream. This belief in the potential of education to act as an equalizer is supported by research, which consistently shows that a person who attains a four-year college degree earns more than a person who does not attain a four-year degree. Indeed, there is considerable evidence that educational achievement is the primary way that Americans born in poverty may leave it. Stories of those who escape poverty through education serve to support a reassuring narrative: providing access to higher education is all that is needed to keep the American dream vibrant.

There have always been holes in this vision of American success, but today more than ever, higher education's role as a force for equity has deteriorated, such that college may serve more to perpetuate the status quo than to create ladders of opportunity. Tracing and naming the factors that contribute to the erosion of higher education's equalizing role is an essential step in reinvigorating the American dream. Uncovering those factors begins with an honest conversation about student debt.

Student Debt May Have Negative Long-Term Effects, for Individuals and the Nation

Although student loans have played an important role in expanding access to higher education, mounting evidence suggests that they may be a major contributor to the inequitable distribution of gains from college. The growing dependence on loans to finance college, which has occurred simultaneously with historic declines in public funding for higher education, has significantly weakened the value proposition of higher education for low-income and minority students.

Higher education today is framed as an individual commodity with benefits accruing primarily to the student, instead of an investment in the common good. Viewed through this lens, the reductions in public investment in education and accompanying rising costs—most commonly financed through growing dependence on student debt—are necessary evils, but not threats to our American ideals.

Research is beginning to call this calculus into question. Findings suggest that student debt, even considerably less than the average graduate accumulates today ($26,500), may harm both educational outcomes and personal finances for decades (Cofer & Somers, 2000; Dwyer, McCloud, & Hodson, 2012; Kim, 2007). The prospect of significant borrowing may even discourage some students from enrolling in college at all and divert other students to two-year instead of four-year institutions. Relatively little attention has been paid, however, to the ways in which student debt threatens students' post-college financial outcomes, further impairing family well-being and compromising the educational outcomes of future generations.

Research described in this report reveals some of the ways in which student debt reduces the prosperity of even college graduates, thus preventing higher education from securing the economic stability that many see as one of its greatest benefits. Elliott and Nam (2013a) found, for example, that college graduates without outstanding student debt have nearly three times the net worth of student borrowers. Measures of asset accumulation alone also show great disparity: Elliott, Grinstein-Weiss, and Nam (2013a) found that median assets are 16% lower for graduates with student loans than for those with no student debt. Loans even impinge on Americans' ability to accumulate home equity, traditionally the bedrock of family finances: those with student debt have 41% less home equity than students with no debt (Elliott, Grinstein-Weiss, and Nam, 2013a). Highlighting the lifelong implications of student debt, those with student debt have less than half as much saved for retirement as those who financed college with no loans (Elliott, Grinstein-Weiss, and Nam, 2013c). For some, loans themselves persist to retirement age: According to the Federal Reserve Bank of New York (2012), 2.2 million student loan borrowers are over age 60, with an average debt load of $19,521.

This research is relatively new, and should be viewed with some caution until findings can be replicated. However, recent analyses of the long-term effects of student loans on college graduates' wealth accumulation by Hiltonsmith (2013) provide some support for these general findings, raising our confidence. Looking at both sets of findings together suggests that the short-term effects examined in this report are much more dramatic: Over time, students with outstanding student debt make up some of the wealth loss reported here. This speaks to the fact that human capital is created by student debt, and graduates can leverage this human capital into earnings and wealth accumulation potential. However, in the end, it appears that they still end up far behind their peers without student debt.

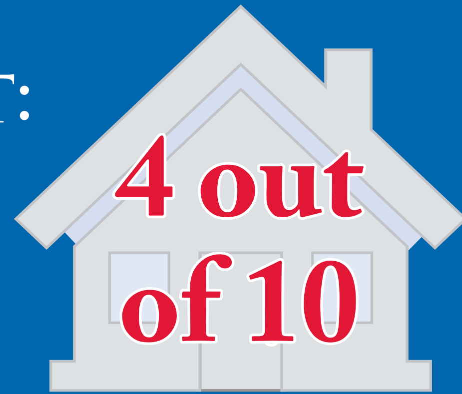
Importantly, our contention is that asking whether college graduates will eventually be able to recover from their student loans is the wrong question. Instead, we must draw attention to the ways in which overreliance on borrowing intensifies inequity in educational outcomes. If two students receive the same college degree, but one has to borrow heavily to finance it and therefore must grapple with the financial effects of loans even far beyond graduation, that student cannot be said to have realized the same return on her education as a student whose college is paid for based, for example, on parental wealth.

These long-term effects of loans likely stem not only from the actual diversion of resources to meet debt obligations, but also from the very different role expectations and behavior patterns encouraged by the nation's bifurcated financial aid system. While higher income families are encouraged to save for their children's college educations through tax-advantaged accounts, such as 529 plans, and other incentives, mostly delivered through the tax system, low-income households face savings disincentives through asset limits in means-tested programs, including Free Application for Federal Student Aid (FAFSA) family contribution determinations and Pell Grant eligibility. Because assets work to shape expectations, behavior, and achievement, those locked out of asset accumulation structures might be at a distinct disadvantage.

Rather than sustaining pathways for economic mobility, this bifurcated financial aid system serves to affirm patterns of privilege. In fact, by establishing expectations that assume some students won't plan ahead for college and will instead rely on debt to finance higher education, the nation's financial aid system may induce disadvantaged populations to act in ways contrary to their own interests. Unfortunately, when they do—enrolling in less selective colleges, failing to compete successfully for merit aid, or failing to enroll in college even when qualified—most Americans and even higher education leaders avoid confronting the institutional structures that produce these individual choices.

STUDENT LOAN DEBT:

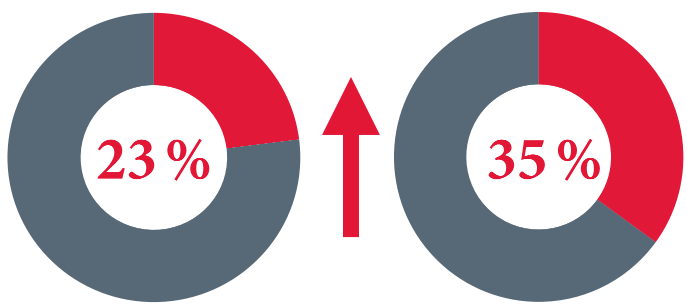
CONSEQUENCES TOMORROW. . . AND FOR YEARS TO COME



U.S. Households Headed by Individuals Younger than 35 Years of Age Have Outstanding Student Debt

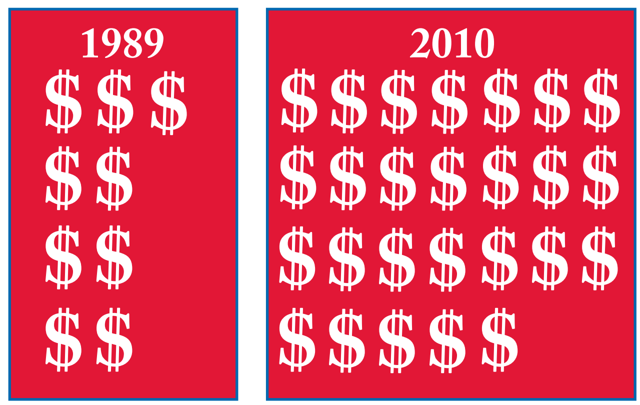
The State of U.S. Student Debt

Rise in Undergraduate Students Who Took Out Federal Loans



2001-2002 | 2011-2012

Average Outstanding Student Debt, 1989 Compared to 2010*

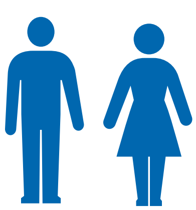


* Pew Research Center tabulations of Survey of Consumer Finances data

$= $1,000

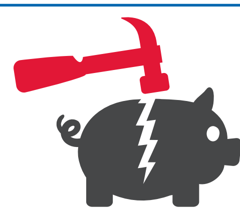
Short-Term Effects of Student Debt

Among Households with College Graduates



> $185,900

Wealth Loss for Four-Year Graduate with Student Debt



2 X

Less Retirement Savings for Those with Student Debt

40 %

Less Home Equity for Those with Student Debt

Toward a 21st Century Financial Aid System

Our financial aid system needn't work this way. Missing from today's proposals for fixing financial aid—loan forgiveness, lower interest rates, or tuition guarantees—is an accounting of the one lever that simultaneously improves college affordability, readiness, completion, and financial health in adulthood: children's financial assets. Children's savings accounts (CSAs) have the potential to change the distributional consequences of education by improving educational and financial outcomes before, during, and after college.

Students with savings designated for education, even with relatively small balances, are more likely to enroll in college (Elliott, 2013b). They may also be somewhat protected from the adverse effects of asset poverty on their educational preparation as they work toward admission (Elliott, 2013a). During college, having assets may help students stay on course to graduate (Elliott, 2013b), as contrasted with high-dollar student debt, which is negatively associated with graduation rates (Dwyer, 2012). Following college, students who had savings prior to graduation may be more likely to hold diverse asset stores and to continue positive financial behaviors, leading to lifelong economic advantages over their indebted peers (Friedline & Elliott, 2013).

Reimagining the financial aid system as a vehicle for encouraging educational saving for all Americans requires concerted policy commitment, but not necessarily a tremendous infusion of additional resources. It is possible, for example, to fund dedicated accounts for all U.S. children at birth for only $3.25 billion in the first year (Cramer, 2006). In comparison, the federal cost of student loans (the subsidy provided within Stafford Loans, GradPLUS, and ParentPLUS programs) is expected to be $36.5 billion in 2013 (Congressional Budget Office, 2012). And the potential for improved return on investment is significant.

CSAs could equip disadvantaged students with asset complements to borrowing, serving as an institution that empowers and equips students for success. In the process, CSAs could help to solve two of our most pressing national challenges: producing enough college graduates to meet the skill needs of a 21st century economy, while closing the wealth gap and revitalizing the American dream.

Growing evidence argues for a robust role for asset-building strategies, such as CSAs, in our financial aid system. For higher education to play its traditional equalizing role, students need school savings to address the long-term challenge of college readiness, particularly for those disadvantaged as a result of their interactions with other institutions. With savings set aside for higher education, children may be more likely to identify as college bound and their parents may increase their engagement with schooling.

A stronger focus on assets benefits everyone. Colleges and universities may improve completion rates and recruitment of talented low-income students, increasing higher education's ability to graduate a diverse, well-qualified workforce and to support students' progress toward greater economic security. Banks may receive new customers as more families save and more students build a foundation of economic security. Students may graduate with stronger financial well-being, better positioned to contribute productively to the overall economy. Additionally, U.S. policymakers concerned about our ability to compete with other nations will see improvements stemming from a financial aid system better equipped to usher students into productive roles in the global workforce.

An asset-based approach to financial aid is a commonsense solution to the student debt and college completion challenges facing our nation. More importantly, our situating of education as a critical path to economic security and mobility suggests that equitably introducing assets into the college financing landscape may also be a way to make the American dream a reality for more of America's children.

Additional PolicyMaker Actions

In addition to wider implementation of CSAs through a policy structure capable of achieving near-universal account provision, there are other steps policymakers should consider to improve the odds for disadvantaged students:

- Eliminate disincentives to save for low-income families, such as removing asset limits from the Supplemental Nutrition Assistance Program (SNAP), Temporary Assistance for Needy Families (TANF), and FAFSA eligibility determinations;
- Incorporate a savings component into the Pell Grant program;
- Leverage the variable of timing in financial aid to convert existing supports into early-commitment strategies, providing low-income students with an assurance that assistance to attend college will be there for them within the current financial aid footprint;
- Incentivize college completion, through such measures as partial forgiveness of loans for low-income students and emergency aid to help low-income student through challenging financial times to completion;
- Mitigate the effects of debt, through measures such as credit score protection for recent graduates and required automatic deposit of loans into banking accounts; and
- Support graduates in building balance sheets, even as they pay off debt, by diverting repayments to savings accounts and developing mortgage products to help indebted graduates build home equity.

To read the full report, visit www.Save2LimitDebt.com

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School of Social Welfare

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Assets and Education Initiative | University of Kansas School of Social Welfare
Twente Hall, Office 309 | 1545 Lilac Lane | Lawrence, KS 66044-3184
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