FROM A DEBT-DEPENDENT TO AN ASSET-BASED FINANCIAL AID MODEL

BY WILLIAM ELLIOTT

The price of higher education has increased dramatically in recent decades as higher education financing has shifted from a collectively funded public good to reliance on individual and family contributions. This cost burden has implications for education’s ability to serve as an equalizing force in the U.S., but asset-based financial aid models may have the potential to transform our financial aid system. While high student loan debt may hinder college completion and even serve as a deterrent to enrollment among some disadvantaged students, promoting asset development may reduce the need for loans and improve educational outcomes. Policies that combine smaller student loans with asset-based approaches could create a financial-aid model that builds college readiness among low-income students, improves their access to college, and increases their chances of success in higher education and of financial security post-graduation.

Equity in access: Higher education and the American Dream

- The American Dream is the belief that success is a result of effort and hard work, coupled with ability. Especially in the aftermath of the Great Recession, some have begun to question whether the American Dream is actually attainable.\(^1\) While education—specifically college education—is widely considered to be the path to economic mobility and, therefore, a critical component of the American Dream, there is evidence that education might not benefit everyone equally.
- Still, college degree holders enjoy greater intergenerational mobility than those with less education,\(^2\) indicating that, even in a context of constrained economic mobility, college is still economically valuable, for those who can achieve higher education.
- A key question in evaluating financial-aid models, then, should be the extent to which they represent “institutional facilitation”—efforts by institutions to express high expectations and consistent support, the perception of which is critical for students to confidently progress towards educational attainment.
- Research suggests that debt-centric financial aid may contribute to low institutional efficacy—perception that institutions are supportive of individual goals. While many Americans see taking out a student loan as an investment that supports long-term achievement,\(^3\) this borrowing may have real costs for students’ long-term financial health, and the system’s default to borrowing as the vehicle to finance higher education may serve to discourage some groups of potential students from enrolling in college at all, thus blocking educational progress rather than facilitating it.
- As a result, outstanding student debt actually may magnify the effects of inequality already in the system, putting one child at a disadvantage in comparison to another child.

who does not have student debt. Since students are comparatively more or less likely to have to rely on significant student debt based on the relative disadvantage or advantage they bring to the college financing decision, financial aid is failing to act as an equalizer.

**Shifting the costs: Higher education financing and rising student debt**

- Higher education is largely seen in the U.S. today as a commodity to be purchased by individual students, rather than a collective investment. Reductions in public funding for institutions and grant aid mean students and families are taking more of the burden of paying for college. Rising dependency on borrowing stems, at least in part, from the shift in financial aid policy toward greater individual responsibility. In the 2011—2012 school year about 37% of all undergraduate financial aid came from federal loans.4
- American students have never been in this much debt; 40% of all households headed by an individual younger than age 35 have outstanding student debt.5 The percentage of undergraduate students who took out federal loans increased from 23% in 2001 - 2002 to 35% in 2011—2012.6 The average outstanding student loan debt in 2007 was $23,349 and it rose to $26,683 by 2010.7
- Of course, some students and families are better positioned to bear these cost burdens than others, meaning that this seemingly ‘neutral’ shift in costs to individuals has disproportionate effects on college access and financial well-being of disadvantaged students. That is, even if the basic pattern of how students pay for college is one of creating equality of opportunity, financial aid may not be in sufficient amounts to actually provide equality.8

**Not all financial aid is created equal: Student loans and educational outcomes**

- When financial aid systems are evaluated based on their potential to contribute to human capital development and not just for their ability to help children access college, it is clear that debt-centric and asset-based approaches differ.
- Research suggests that, after a certain level, student loans might not produce the desired effect of increased enrollment and graduation rates.9 Larger amounts of student loans may be counterproductive and fail to meet the goal of making college accessible to more

---

students.\textsuperscript{10} Debt above $10,000, in particular, may have a negative relationship with college completion for the bottom 75% of the income distribution (the vast majority).\textsuperscript{11} The reason for the diminishing positive benefits of student loans above $10,000 might be at least in part because of students’ aversion to taking on large amounts of debt to pay for college. This hesitation may make student loans a particularly less effective strategy for low-income and minority students.\textsuperscript{12}

**When a degree isn’t enough: Student loan debt and post-graduation financial health**

- Of course, college graduation is not the ultimate aim of financial aid policies but, instead, the stronger economic position and superior opportunities afforded by college completion. High student loan debt may impact students’ financial well-being even after leaving college, and these effects are not totally mitigated even by college graduation. There is evidence, for example, that graduates may delay marriage\textsuperscript{13} or big-ticket asset investments\textsuperscript{14} when they are burdened by high debt levels.

- Student loan default is high and rising,\textsuperscript{15} especially for low-income students and those with high debt levels.\textsuperscript{16} Today, nearly 41% of student loan borrowers suffer the negative consequences of delinquency or default.\textsuperscript{17}

- Negative effects of delinquency extend beyond students themselves, because parents often cosign on loans. In 2012, about 2.2 million Americans 60 or older owed $43 billion in federal and private student loans in 2012, up $15 billion from 2007.\textsuperscript{18} About 9.5% were at least 90 days delinquent. This ongoing debt could impair parents’ ability to save for their own retirement, just as younger families may struggle to save for their children’s educations or to prepare for their retirements while paying off outstanding student debt.

- Even when not delinquent or in default, outstanding student loan debt may still negatively affect households’ financial health.\textsuperscript{19} Of particular concern is the effect of student debt on households’ ability to purchase homes, the largest source of asset holdings for most

\textsuperscript{19} e.g., Gicheva, D. (2011). Does the student-loan burden weigh into the decision to start a family? Retrieved February 1, 2013 http://www.uncg.edu/bae/people/gicheva/Student_loans_marriageMarch11.pdf
Americans. Today, the average single student debtor would have to pay close to half of his/her monthly income toward student loans and mortgage payments, disqualifying borrowers for an FHA loan or many private loans.\textsuperscript{20} 

- Households with student loans seem to accumulate far less wealth post-college than households without student loans, even when they have both attained the same level of higher education. Median net worth in 2009 for households without outstanding student loan debt was nearly three times higher than for households with outstanding student loans.\textsuperscript{21} These appear to be more severe for lower-income households than higher-income households; the loss of net worth was far greater as a percentage of total net worth for those in the 15\textsuperscript{th} percentile than for those in the 50\textsuperscript{th}.\textsuperscript{22} 

**Assets as a complement to debt: CSAs might make loans more effective**

- Evidence suggests that loans combined with grants or scholarships might be a more effective strategy than loans by themselves.\textsuperscript{23} However, due to fiscal constraints and the personal-responsibility framing of higher education, there might be little political support to increase scholarship and grant availability. CSAs, however, align with the ideal of personal responsibility because they require students and their families to help pay for college by saving.

- Educational achievement is still the greatest known lever for equality and prosperity. However, given the growing gap in educational attainment by family income, the current education system cannot be said to provide poor children with the same opportunity for economic mobility that it is does for higher-income children.\textsuperscript{24} As American college graduates encounter an increasingly globalized economy, U.S. higher education policies need to confront this gap by enhancing opportunities for students to increase their self-efficacy and expectations related to education, and for their families to prepare in advance financially for college. We also must consider whether our policies place college graduates in a strong position to succeed financially as young adults, as well.

- If one financial-aid model (our current, loan-based model) helps children pay for college only when they reach college age, while another (a hybrid loan and asset-based model) has the potential for multiple positive effects beyond paying for college, the better investment becomes obvious.


\textsuperscript{22} Ibid.


Acknowledgments

This brief could not have been done without the generous support of the Lumina Foundation, Citi Foundation, Ford Foundation, and the Charles Stewart Mott Foundation.

These organizations are not responsible for the quality or accuracy of the report, which is the sole responsibility of AEDI. Nor do they necessarily agree with any or all of the report’s findings and recommendations.

About Us

The mission of the Assets and Education Initiative (AEDI) is to create and study innovations related to assets and economic well-being. The specific focus is on the relationship between children’s savings and the educational outcomes of low-income and minority children as a way to achieve the American Dream. AEDI, a division of the KU School of Social Welfare, builds the field’s capacity to conduct rigorous research and advocates for the economic well-being of low-income and minority children. For more, visit http://aedi.ku.edu/.

Contact Information

William Elliott III
Assistant Professor, University of Kansas
Director, Assets and Education Initiative
Twente Hall
1545 Lilac Lane, Rm 309
Lawrence, KS 66045-3129
aedi@ku.edu
(785) 864-2283