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# Reimagining How Students and Families Pay for College: From Debt Dependency to Asset Empowerment

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## Key Points

- The current debt-dependent model of financial aid through student loans helps children pay for college only at enrollment, while an asset-based model has the potential to have multiple positive effects before, during, and after college.
- Reimagining financial aid and shifting resources to Children's Development Accounts (CDAs)—opened early in childhood or even at birth—may deliver superior outcomes before, during, and after college.
- A national CDA program might be thought of as a type of institution designed, in part, to activate and nurture positive expectations for attending and graduating from college.
- Having even a small amount of savings designated for school (i.e., $1 to $499) can have a positive effect on low- and moderate-income children's persistence in college.
- CDAs may increase children's continued account ownership and acquisition of other types of assets in young adulthood, lending support for children's savings programs as part of a 21st century educational financing system.

## Policy and Research Background

**Student loans do not prepare students for success in or after college.** Declining state funding and stagnant household incomes are eroding the affordability of college rapidly, leaving Americans mired in student loan debt. This threatens to deepen disparities in educational attainment and financial health and undermine higher education's traditional role as a vehicle for social mobility.

**Student loans do not address what may be our most serious educational challenge: early preparation for success.** Unfortunately, no current proposal for fixing financial aid (e.g., forgiving student loans, lowering interest rates, increasing tax credits, or guaranteeing tuition rates) offers a viable solution.

**Collectively, we have failed to create opportunities for increased college access or equitable returns on educational investments.** To make education a true societal equalizer, financial aid must improve students' college readiness, access, and completion and postcollege financial health, particularly among economically disadvantaged students who use college as a path out of poverty.

## The Risks of Debt Dependency

Increasingly, Americans' only option for paying the high costs of college is to take out student loans. Federal, state, and private grants were the largest form of financial aid until 1982, when loans began to outpace grants. Since then, loans have been the largest source of financial aid.[1] Forty percent of all households headed by individuals younger than 35 years of age have outstanding student debt.[2]

**Student loans may not encourage college readiness.** Student loans are designed to be a college access intervention or a just-in-time financial aid program. As such, there is no evidence that they improve precollege outcomes.

**Student loans may not increase college access.** Weak evidence at best suggests that student loans improve college enrollment rates.[4] Low-income and minority students' aversion to taking on large amounts of debt to pay for college shows that student loans are an ineffective strategy for them.[5]

*This Fact Sheet is based on papers by Elliott and colleagues, including Elliott, W. & Nam, I. (2013). Is student debt jeopardizing the short-term financial health of U.S. households? *Review, 95*(5), 1-20 and several working papers from the Center for Social Development (CSD) at Washington University in St. Louis: Elliott, W., Grinstein-Weiss, M., and Nam, I. (2013). *Does outstanding student debt reduce asset accumulation?* (CSD Working Paper 13-32); Elliott, W., Grinstein-Weiss, M., and Nam, I. (2013). *Is student debt compromising homeownership as a wealth building tool?* (CSD Working Paper 13-33); and Elliott, W., Grinstein-Weiss, M., and Nam, I. (2013). *Student debt and declining retirement savings* (CSD Working Paper 13-34).

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Student loans may not increase college completion rates. High-dollar student debt may have a negative effect on college completion rates. For each $1,000 increase in loan amount, a student is 3% more likely to drop out of college.[6] Student debt of $3,000-$7,000 reduces college graduation rates among public school attendees, and student debt of $7,000 or more reduces college graduation rates among private school attendees.[7] Debt above $10,000 may have a particularly negative effect on college completion for the bottom 75%—the vast majority—of the income distribution at public universities.[8]

Student loans do not improve financial health. Research measuring effects of student debt on graduates' postcollege outcomes indicates that having student loans can be negative. Student debt reduces the short-term likelihood of marriage,[9] and while students with outstanding student loan debt have higher earnings right after college, their income falls below that of graduates with no student debt by the time they reach their 40s.[10, 11] College graduates with outstanding student debt have less net worth, less home equity, and less retirement savings.[10, 12–15]

## The Fruits of Asset Empowerment

Policies that combine smaller student loans with asset-based approaches (e.g., child development accounts [CDAs]) could create a financial aid model that builds the college readiness of low-income students, improves their access to college, increases their chances of success in higher education, and improves their financial security after graduation.

CDAs are a policy vehicle for allocating intellectual and material resources to low- and moderate-income children. Unlike basic savings accounts, CDAs leverage investments by individuals, families, and sometimes third parties in the form of initial deposits, incentives, matches. CDAs appear to align well with the ideal of personal responsibility because they require students and their families to help pay for college by saving. Unlike the current debt-dependent approach, which often forces students and families to take on high-dollar debt, CDAs promise significant benefits for children before, during, and after college.[16]

Asset ownership may encourage college readiness. Previous findings show a weak but positive association between assets and students' reading and math scores.[16] Findings also indicate that assets can have a positive association with parents'[17] and children's college expectations, which can increase engagement in school.[18] Assets also can have a positive effect on GPA and high school graduation rates.[17, 19]

Asset ownership may increase college access. Low- and moderate-income (below $50,000) students with school savings of less than $500 are three times more likely to enroll in college than a student with no savings.[20] Obviously, these small amounts of money do not make a huge difference in students' actual college financing, but they may change a student's identity as a person who goes to college. Simply opening an account for college may turn higher education into an important and realistic goal and provide a strategy for overcoming the barrier of high costs. Saving is seen as a way that "people like me" pay for college, which may help students believe that they can attend and graduate from college too.

Asset ownership may increase college completion rates. Low- and moderate-income (below $50,000) students with school savings of less than $500 are four times more likely to complete college than a student with no savings. Five percent of children with no account, 13% of those with a school-designated savings account but less than $1 saved, 25% of those with school-designated savings of $1 to $499, and 33% of those with school-designated savings of $500 or more graduate from college.[20]

Asset ownership may improve postgraduation outcomes. Findings indicate that young adults who had savings accounts as children are two times more likely to own savings accounts, two times more likely to own credit cards, four times more likely to own stocks, and own twice as many types of assets as those who did not.[21]

## Conclusions and Implications

Unlike loans, asset-based policies such as CDAs build resources for college before enrollment. Public policy and the academic literature are beginning to recognize the cumulative effects of CDAs and early commitment financial aid strategies.

## Endnotes


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