BREAKING THE PATTERN OF WEALTH INEQUALITY IN HIGHER EDUCATION: THE NEGATIVE ROLE OF STUDENT-DEBT AND THE POTENTIAL OF CHILDREN'S SAVINGS ACCOUNTS (CSAS)

Risk in the Pursuit of Post-Secondary Education

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The American Ethos: Education the "Great Equalizer"

- While European nations have relied on the "direct redistributive role of the welfare state to reconcile citizenship and markets," the United States has chosen to use education as a lever for ensuring equitable outcomes (Carnevale and Strohl 2010, 83).

Effort + Ability = Desired Outcomes

Research Question Driving Existing Knowledge Base: Aligns with Paradigm of Equity as Access

- Old Question
  - Is a child who attends college and graduates with student debt better off than if they did not attend college at all?
- New Question
  - Are children who have to pay for college with student loans able to achieve similar outcomes as children who do not have to pay for college with student loans when effort and ability are the same?

Debt Diminishes the Return on a Degree

- Post College Financial Health
  - Labor Market Decisions (Rothstein & Rouse, 2011)
  - Delay Marriage (Gicheva, 2011)
  - Earn less by the time they reach their 40s (Hiltonsmith, 2013)
  - Net Worth (Elliott & Nam, 2013)
  - Retirement Savings (Egoian, 2013)
  - Home Ownership (Cooper & Wang, 2014)
  - Starting up a New Business (Ambrose, Cordell, & Ma, 2015)
- According to the Government Accounting Office (2003), assuming a standard ten-year payback at 7% annual interest, average cumulative undergraduate educational debt exceeded $18,000 in 2000, which corresponds to a $6,000 premium borrowers pay for a college education.
- Elliott and Rauscher (2016) measure mobility as the likelihood and rate of achieving median household net worth among four-year college graduates or above who were at least age 22. After controlling for key differences, they found that acquiring the relatively small amount of $10,000 in student loans is associated with a 18% decrease in the rate of achieving median net worth.

To Understand the Full Effects of Student Loans You have to Consider the Role Wealth Inequality Plays in Higher Education

- Children from lower-wealth families are less likely to attend and complete college than their counterparts (Pfeffer, 2015).
- Poor children earn less from their degree
  - Bachelor degree holders from low-income families start their careers earning about 1/3 less than those from higher income families (Hershbein, 2016).
- Minority children earn less from their degree
  - Hispanic and Black American students with a degree have less income and net worth than their White and Asian counterparts (Emmons and Noeth, 2015).
- Degrees do not Protect Equally
  - During the "Great Recession" Black and Hispanic college-grad families experienced wealth declines far greater than White families without a college degree (Emmons and Noeth, 2015).

A Fundamental Reconsideration of the Financial Aid System is Needed – But, Free Will not Be Enough

- The unequal return on a degree suggests that strategies that focus *only* on college affordability, even free college, will fail to achieve some of our most cherished aspirations for education to fulfill its role as an antipoverty strategy or equalizer.
  - It also means that where you start off in life matters and whether or not you have assets growing up matters for the types of outcomes you will be able to achieve and for whether education pays off equally for all.
- When it comes to investing in higher education as a path to the American Dream of equitable opportunity for all, then, 'free' without asset building will fail to reduce inequality.

Tweaks Necessary but Not Sufficient:
Treating the Symptom (Student Debt Default) not the Problem

- Treating the Symptoms not the Underlying Problem
  - Deferment and Forbearance; Income-Based Repayment; Pay-It-Forward; Income Share Agreements
- Policy Tweaks May be Necessary but May Mask the Growing Problem
  - About 21% of borrowers avoid delinquency by using deferment or forbearance (Cunningham and Kienzl, 2011).
    - 9 years after leaving school, the 2005 cohort has paid down only 38% of its original student debt. Under a standard 10-year amortization schedule, these loans would be approaching full repayment, and only about 10% of the original balance would remain. (Brown et al., 2015)
      - Racial Disparities: Four years after earning a bachelor's degree, black graduates in the 2008 cohort held $24,720 more student loan debt than white graduates ($52,726 versus $28,006). It was less than $2,000 in 1993. (Scott-Clayton & Li, 2016)
    - Of high-balance borrowers, 22% have student loan balances higher in 2014 than they did in 2009, even without ever falling into severe delinquency or default. (Brown et. al., 2015)
      - Racial Disparities: Nearly half (48%) of all black graduates owe more on their federal undergraduate loans than they did at graduation, compared to just 17% of white graduates. (Scott-Clayton & Li, 2016)
  - The average time that it takes to repay student loans grew from about 7 years in 1992 to a little more than 13 years in 2010 (Akers and Chingos, 2014).
  - This is likely to grow since the use of Income-Based Repayment, which extends normal repayment from 10 to up to 25 years, has doubled over the last two years.

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Children's Savings Accounts:
Creating an Asset Empowered Path to the American Dream

- Children's Savings Accounts (CSAs)
  - Universal programs that serve all young people
  - Leverage investments by individuals, families, and, sometimes third parties
  - Initial deposits
  - 1:1 to 5:1 match
  - Sometimes combined with financial education
- Examples of CSA Programs (for more examples see http://cfed.org/programs/csa/directory/)
  - SEED for Oklahoma Kids Experiment; Maine's Harold Alfond College Challenge; San Francisco's K2C; Promise Indiana

Potential for Small-Dollar Effects: Beyond Paying Tuition Bills

- Unlike student debt, CSAs have the potential to work on multiple dimensions—early education, affordability, completion, and post-college financial health
- **College Preparation**
  - Builds Parents' Educational Expectations (Kim, Sherraden, Huang, and Clancy, 2015)
  - Children's Educational Expectations (Elliott, 2009)
  - Improved Social Emotional Development (Huang, Sherraden, Kim, & Clancy, 2014)
    - CSAs mitigate about 50% of the negative association between material hardship and social-emotional development (Huang, Kim, & Sherraden, 2015).
  - Reduced Maternal Depression (Huang, Sherraden, and Purnell, 2014)
- **College Access**
  - Wilt – a sizable number of minority and low-income children with the will and academic ability to attend college fail to transition to college after high school graduation or to succeed once enrolled.
    - Having savings reduces wilt (Elliott & Beverly, 2011; Elliott 2013)
- **College Completion**
  - Children in low- and moderate-income households (i.e., those that have incomes below $50,000 per year) who expect to graduate from college and school-designated savings of less than $500 are about 3X more likely to graduate college than children who only expect to graduate from college (Elliott, Song, & Nam, 2013).

Post-College Financial Health: Return on a College Degree

- Even in Poverty, Parental Savings Matters
  - Researchers at PEW found that 71% of children born to high-saving, low-income parents move up from the bottom income quartile, compared to only 50% of children of low saving, low-income parents (Cramer, O'Brien, Cooper, & Luengo-Prado, 2009).
- Research on the relationship between parental educational supports may also be informative.
  - Rauscher (forthcoming) found that predicted household income and net worth is higher for adults who received parental financial support for education than those receiving no parental educational support when parental support exceeded $600 in the case of income and $2,200 in the case of net worth.
- These findings suggest helping parents build assets to pay for their child's education is associated with their child having more income and wealth in adulthood.

Post-College Financial Health: Return on a College Degree

- Accruing savings as a child is associated with increased likelihood of asset accumulation as young adults. As a result, students may leave college better equipped to pursue important financial goals.
  - Children ages 15 to 19 who have savings are more likely to have a savings account, credit card, stocks, bonds, vehicle, and a home at age 22 to 25 than if they did not (Friedline & Elliott, 2013).
- CSAs may be a gateway not only to greater educational attainment, itself a conduit of economic mobility, but also a more diversified asset portfolio.
  - The majority of young adults own a savings account at or before the acquisition of all financial products including checking, CD, money market, savings bond, stock, and retirement accounts (Friedline, Johnson, & Hughes, 2014).
  - Friedline et al. (2014) find that while owning a savings account as a young adult only contributed $50 toward liquid assets, the added contribution of combined stock and retirement accounts—themselves products of savings account ownership—was $5,283.
- So, by building a more diversified asset portfolio, CSAs may result in increased asset accumulation, which, in turn, may strengthen the return on a college degree.

The Poor Can Save but Only Small Amounts

- Research shows that when lower income families are given meaningful access to facilitate institutions, such as IDAs and CSAs, they can and do save.
  - IDAs
    - In the American Dream Demonstration (ADD), which tested Individual Development Accounts (IDAs), the average monthly net deposit was $25.42, with a range from $16.37 to $36.89 (Sherraden, Schreiner, & Beverly, 2003).
  - CSAs
    - Research from demonstration programs such as Saving for Education, Entrepreneurship, and Downpayment (SEED) suggests that, on average, families in Child Savings Account (CSA) programs save approximately $10 per month (Mason, Nam, Clancy, Loke, & Kim, 2009).

CSA Proposal

- Given that the poor can only save small amounts, saving alone is not enough to eliminate negative wealth effects from the education system. Investment in an initial deposit is needed.
- Through the mechanisms of initial seeds and savings incentives, CSAs provide a vehicle to facilitate a transformative asset building strategy for financing education.
- The Proposal
  - Every kid born in the US automatically enrolled into a CSA (e.g., 529 savings plan)
  - Individual savings - \$5 per month per child (12 months = \$60)
    - As a pay roll deduction or tax
  - Progressive - Initial deposit of \$8,400 for students whose families qualify for the Pell Grant (family income, \$50,000 or below)
    - Adjust the initial deposit (reduce) and amount families are asked to save (raise) as income increases above \$50,000
- Why progressivity is needed:
  - The Annie E. Casey Foundation (2016) estimated that children's accounts could reduce the racial wealth gap in America by 20% to 80% depending on participation and the investment in these accounts.

Note. The initial deposit amount is based on the average cost at a public 4-year college (\$34, 031) (College Board, 2015).

CSAs Combined with an Asset Investment

- There are roughly 1,693,560 kids whose families make $50,000 or less born per year; cost if $8,400 was deposited in low- and moderate-income kid's accounts is roughly $14.3 billion (pays for 4-years of college).

Table 1. Children's Savings Account Program Initial Deposit Proposal – Equity (Stock) Portfolio

Year	Deposit	Saving Per Year	S&P 500 Return	Balance
Year 1	$ 8,400.00	$ -	33.10%	**$ 11,180.40**
Year 2	$ -	$ 60.00	28.34%	**$ 14,408.93**
Year 3	$ -	$ 60.00	20.89%	**$ 17,478.95**
Year 4	$ -	$ 60.00	-9.03%	**$ 15,960.60**
....				
Year 18	$ -	$ 60.00	13.48%	**$ 34,082.04**
Total	$ 8,400.00	$ 1,020.00		**$ 34,082.04**

Data Sources. S&P 500 - http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

Note. If a less risky financial instrument like Fixed Income (Bonds) were used the initial deposit needed would be $11,700. **Data Sources.** Fixed Income (10 Year Treasury Note)

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Over time, This Could Result In Large Savings

- Federal government per year spending on higher education (Goldrick-Rab, 2016):
  - $115 billion dollars in student loans,
  - $42 billion in grants,
  - $34 billion in tax benefits, and
  - About $1 billion in work study
- Savings to the federal government occurs because the program takes advantage of individual savings and the market.

CSAs are a Long-Term Solution, but Short-Term Solutions Also Needed

- Forgiving underwriting guidelines in mortgage markets.
- Hiatus in repayment obligations at specific points.
- Changes to bankruptcy laws might also help.
- Student loan forgiveness
  - If *all* student debt was forgiven for all households it would actually *increase* the racial wealth gap
  - While eliminating student debt for all households regardless of income increases median net worth for young white and Black households, white families see a greater benefit likely due to a higher likelihood of completing college and graduate degree programs.
    - “Moral Hazard” Avoided with long-term solution in place
    - A progressive student loan forgiveness policy would dramatically reduce the racial wealth gap among low-wealth households. Eliminating student debt among those making $50,000 or below reduces the Black-white wealth disparity by nearly 37% among low-wealth households, and a policy that eliminates debt among those making $25,000 or less reduces the Black-white wealth gap by over 50% (Hueslman, Draut, Meschede, Dietrich, Shapiro, & Sullivan, 2015).

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