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Denying loan access: The student-level consequences when community colleges opt out of the Stafford loan program

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ABSTRACT

The degree to which students are able to make adequate repayments on their student loans and avoid default is of special concern for colleges. If too many former students go into default, the college will face sanctions by the federal government and lose eligibility to provide currently enrolled students federal financial aid, such as the Pell grant. To avoid these sanctions, some colleges have chosen not to participate in federal loan programs by excluding loans from students' financial aid packages. In this article, I investigate the student-level impacts associated with the decision of community colleges to opt out of the Stafford loan program. Utilizing administrative records from over 50 community colleges located in a single state, I estimate the within-college differences in outcomes for Pell-eligible students before and after an institution opts out of the federal loan program. I find that Pell-eligible students enrolling when the community college offered federal loans were 7.6 percentage points more likely to borrow than Pell-eligible students who enrolled when the institutions opted out. Overall borrowing also increased by $368 a year. I also find that students borrowing a loan attempted 19 additional credits in their first year of enrollment and were more likely to attempt and complete math and science courses than non-borrowers.

1. Introduction

Over the past two decades, rising college tuition rates and a decline in the purchasing power of need-based grants have led student loans to become a key component of the financial aid system in the United States. According to the College Board (2013), over 8 million undergraduates borrow federal loans each year, and for the 2011–12 academic year, the federal government provided over $80 billion in Stafford loans. In comparison, roughly $34 billion was spent on the Pell grant, the nation's largest need-based grant program. For 2013, over two thirds of students graduating from college had an average debt load of $28,400, which is up by 2 percent from the year before (The Institute for College Access & Success, 2014b).

Students using loans to pay for college and the resulting debt have been central to the broader national dialogue concerning rising debt levels. The nation's student loan debt grew $124 billion this past year and has become the second largest form of debt at $1.12 trillion (Federal Reserve Bank of New York, 2014). This trend has led to growing concern that the United States is facing a student loan debt crisis (Kamenetz, 2006; Salas Gage & Lorin, 2014) as increasing debt levels, fewer employment opportunities, and low salaries leave some borrowers struggling to repay (Consumer Financial Protection Bureau, 2013). Nationally, student loan default rates have risen steadily over the past decade: today, 13.7 percent of borrowers default on their federal loans within three years of entering repayment (U.S. Department of Education, 2014c).

The degree to which students can repay their loans is of special concern for colleges. Each year, the U.S. Department of Education calculates a cohort default rate (CDR) for colleges, which measures the share of borrowers who fail to

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repay their loans. If a CDR is over 30 percent for three consecutive years, the federal government can sanction and prohibit the college from offering currently enrolled students any federal financial aid, including the Pell grant, for three years. Colleges with a CDR above 40 percent for one year lose their participation in the federal Stafford loan program, but still have eligibility to offer Pell grants to students. Previous research by Darolia (2013) demonstrates the negative effects for institutions having default rates above sanctioned thresholds. Among institutions that offer academic programs of two years or less, becoming ineligible to offer students federal financial aid decreases enrollment by approximately 12–16 percent. The impact is even greater—almost 18 percent—at for-profit institutions.

To avoid sanction and retain the use of federal financial aid, some colleges opt out of the federal Stafford loan program and prohibit students the opportunity to borrow loans with no guarantee of replacing the loan amount with another type of aid.[1] The idea behind this action is simple: if a college has students graduating with no debt, the college is not exposed to having a default rate measure that incurs federal sanction. The Institute for College Access & Success (2014a) has estimated that roughly 8.5 percent of all community college students in the United States do not have access to federal loans because the colleges they attend do not participate in federal loan programs.

While community colleges may believe that opting out is in students' best interest, it is possible that limiting loan access has negative consequences for students. Becker's (1993) human capital investment model helps illuminate how students' inability to take out federal loans may condition their educational trajectories in ways that affect their progression toward degree completion and other educational outcomes. According to Becker, the amount of time an individual spends on school-related activities is inversely proportional to the time spent on leisure and working. Without access to loans, financially constrained students are likely to allocate a larger portion of their time to paid employment in order to pay for college, or enroll in fewer course credits to reduce the direct costs. Alternatively, the receipt of loans provides students an option for financing their education that does not involve reducing the amount of time spent on school-related activities and facilitates faster time to degree completion.

The focus of this paper is to investigate how a community college's participation in the federal Stafford loan program affects students' educational performance and completion. Do existing financial aid programs or employment make up for the loss of student loans? Does loan borrowing affect students' credit accumulation and degree completion? To determine whether student loans help students succeed in college, I exploit the variation in loan policies of the over 50 community colleges that are a part of a statewide community college system (henceforth referred to as SCCS), located in a large Southern state. Of the 50 community colleges, 15 were observed as opting out of the Stafford program. My empirical strategy combines fixed effects and instrumental variable strategies to estimate the within-college differences in student outcomes before and after a college opts out of the federal loan program. I use administrative records of students who enrolled for the first time between 2001–02 and 2009–10; among this sample, I analyze outcomes on Pell-eligible students for whom the data are collected most consistently.

I find that Pell-eligible students enrolling when the community college offered federal loans were 7.6 percentage points more likely to borrow than students who enrolled after the community college opted out of the federal loan program. The overall amount borrowed also increased by $368. I also find that after the switch in loan policy, institutions did not replace the loss in loan amounts with another financial aid program. I find no evidence that loan borrowing statistically improved degree completion and transfer to a four-year institution, but do find that Pell-eligible students borrowing a loan attempted 19 additional credits and were more likely to attempt and complete math and science courses than non-borrowers.

In Section 2, I describe previous research on student loans in order to illustrate the lack of research examining the relationship between loan borrowing and students' educational outcomes. Section 3 highlights students' loan use within SCCS and explanations for why SCCS colleges opt out of the federal loan program. Section 4 describes the data and sample used for analysis and my empirical strategy. Results are in Section 5, and concluding thoughts are in Section 6.

2. Research on students loans

Researchers know little about whether loans help students succeed in college. In theory, the availability of loans removes credit constraints and affords educational opportunities to many students who may not otherwise have been able to attend college. However, the findings on student loans have been inconsistent. Some studies have found that loans exert a positive influence on college outcomes (Chen & DesJardins, 2008; Cofer & Somers, 2000), while others have found insignificant or negative effects (Braunstein, McGrath, & Pescatrice, 2000–2001; DesJardins, Ahlburg, & McCall, 2002b; Dowd & Coury, 2006).

Estimating the effects of loans on college outcomes can be difficult because students' loan receipt is not randomly assigned. In the United States, the federal loan program is designed in such a way that students self-select their loan amount. Simply comparing outcomes between student loan borrowers and non-borrowers is likely to produce biased estimates because there are possible unobserved differences between the two groups that could be associated with the decision on whether or not to borrow. In the absence of a randomized experiment, the challenge is to counteract this self-selection bias. More recently, researchers have begun to employ quasi-experimental approaches by exploiting an exogenous assignment that determines whether a student is eligible for a loan. This approach allows for the development of a counterfactual of what students would do in the absence of receiving a loan.

Two studies examining student loan programs outside of the United States employed a quasi-experimental research method and found positive effects with loan eligibility. Both of these studies used a regression discontinuity

[1] This policy is different from the no-loan policies found at the Ivy League or highly selective postsecondary institutions, as the no-loan policies for these elite institutions substitute loans for another non-repayable grant or scholarship (DesJardins, Ahlburg, & McCall, 2002a).