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Education loans and wealth building among young adults

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ABSTRACT

With the use of education loans growing rapidly as a way to finance college education, it is important to examine how such loans impact the future financial well-being. This study examines the association between education loans and postcollege wealth accumulation among young adults, the group with the greatest share of outstanding education loans. Data come from 15 rounds of data of the 1997 National Longitudinal Survey of Youth, and the analyses control for a number of student characteristics, college experiences, and parental income. Results from a treatment-effects model indicate that having education loans upon leaving college is negatively related to postcollege net worth, financial assets, nonfinancial assets, and value of primary housing. Furthermore, having education loans also has an additional negative link to the value of net worth among Black young adults. The relationship between the amount of education loans and wealth accumulation is not statistically significant among those with outstanding loans. The study findings indicate the importance of developing alternative approaches, instead of additional loans and other credits, to meet the financial needs of college students.

The use of education loans to finance college education has grown rapidly in recent years (College Board, 2012; Dynan, 2009; Fry, 2012; Payea, Baum, & Kurose, 2013). Increases in the number of borrowers and the amount of borrowing indicate a growing reliance on such loans. For example, about 23% of undergraduates had loans during the 2001–2002 academic year, and this number jumped to 35% in 2011–2012 (College Board, 2012). The average outstanding student loan among student borrowers also has increased – among households with student loan debt, the average outstanding balance increased from $17,562 in 2001 to $26,682 in 2010 (Fry, 2012). As a result, household debt from education loans has risen more sharply in the last decade than other debt (e.g., credit card debt, mortgages). In 2010, education loans became the second-largest source of household debt (next to mortgages; Ratcliffe & McKernan, 2013). Several factors have contributed to the increasing use of education loans, including rising college costs and declining family income (Fry, 2012), the shift of federal aid policy from need-based to merit-based aid and educational tax credits (Long & Riley, 2007), and the easier accessibility of federal and private loans to youth and their families (College Board, 2009).

The burden of education loans is particularly prominent among the households headed by young adults. A recent analysis of a national sample of adults aged 20 or older (Ratcliffe & McKernan, 2013) indicates that 40% of those aged 20 to 29 have student loan debt; in contrast, 30% of adults aged 30 to 39 have such debt, as do 19% of those aged 40 to 49. Fry (2012) similarly reports that 40% of all households headed by individuals younger than age 35 have outstanding student debt. The study by Fry, Parker, and Rohal (2014) further indicates that among young adults (under age 40), debt from education loans is positively associated with the likelihood of having other types of debt; the median debt burden (measured as a debt-to-income ratio) among college graduates with debt from loans is as high as 205% (compared to 108% among their counterparts without education loans).

Along with the widespread availability and use of education loans for higher education, wealth inequality has widened across age groups since the recent economic recession. Young adults were already falling behind before the Great Recession and were among those hit hardest by it (see, e.g., Emmons, 2012; Steuerle, McKernan, Ratcliffe, & Zhang, 2013). During the period from 1984 through 2009, average median net worth increased by 42% among households headed by a person aged 65 or older, but it dropped by 68% among households headed by someone younger than age 35 (Taylor et al., 2011). In 2009, the average net worth of a household headed by a person aged 65 or older was 47 times greater than that of a household headed by someone under 35 (Taylor et al., 2011).

Given the rapid rise in reliance on education loans and declining wealth among young adults, it is timely and important to examine how education loans may affect their ability to build wealth in the future. In this study, we explore two research questions. First, are education loans (i.e., both whether one has a loan and the loan amount) associated with future accumulation of wealth (net worth, financial assets, nonfinancial assets, and values of primary housing) among young adults? Second, does the relationship between education loans and wealth differ among White and Black young adults? We hypothesize that having education loans compromise postcollege financial well-being possibly by imposing credit constraints and/or heightening debt

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holders' aversion to taking out additional loans. And furthermore, higher education loan amount may be related to higher levels of credit constraints and loan aversion, and in turn, less wealth accumulation. We also hypothesize that education loans may pose greater risks for Black borrowers, because they may experience higher levels of credit constraints and/or financial stress related to the loans than their White counterparts. We will detail the rationales for the hypotheses in the next section.

This research expands on emerging studies in this area in several important ways, and the study findings will potentially help identify corresponding policies and practices to improve wealth building among young adults and its different racial groups. First, most existing studies that examine the impact of education loans on financial well-being (e.g., Elliott, Grinstein-Weiss, & Nam, 2013a, 2013b, 2013c; Elliott & Nam, 2013; Fry et al., 2014; Hiltonsmith, 2013) do not focus on young adults. As mentioned above, this group has the greatest share of education loans, and they also may have different labor market and other experiences compared to older adults, therefore, the associations between education loan and wealth building might be different for them. Second, previous research has not explored the possibility that the associations of education loans with wealth building are different for White and Black young adults. Such variations could be caused by the differences in loan burden, availability of parental economic support, and job opportunities. Thus, it is worthwhile to explore these possible differences so that corresponding policies and practices could be developed. Third, previous studies tend to include single or few dimensions of wealth; using 15 rounds of data from the National Longitudinal Survey of Youth (NLSY79), this study includes several measures of wealth accumulation: net worth, financial assets, nonfinancial assets, and values of primary housing. These measures enable us to capture the impact of education loans on different dimensions of wealth, which helps develop more effective policies and program strategies in improving different types of asset building among young adults. In addition, previous studies analyze snapshots (e.g., Fry et al., 2014), assessing short-term impacts of education loans (e.g., Elliott et al., 2013a, 2013b, 2013c), but we examine these issues over a relatively longer time frame.

1. Prior scholarship

1.1. Rationales

Although education loans may help young people to enroll in and graduate from college by bridging the gap between family economic resources and rising college costs, the resulting debt may compromise their postcollege financial well-being, possibly due to credit constraints and/or aversion to additional debt. First, debt from education loans may impose credit constraints by negatively affecting borrowers' credit scores. Debt, especially heavy debt, can limit borrowers' ability to obtain subsequent loans (Gruber, 2001; Nam & Huang, 2009). A study finds that nearly 41% of education loan holders have been delinquent on their loan or have defaulted on it (Cunningham & Kienzl, 2011). Such behavior heightens the likelihood that their subsequent loan applications will be denied; if their applications are approved, they likely will pay high interest rates. Among young adults, credit is a key mechanism for consumption and purchases of financial assets (Keister, 2000; Oliver & Shapiro, 1995). Thus, constrained credit may significantly challenge their ability to accumulate wealth. Second, debt from education and other expenses may prompt young adults to voluntarily delay the process of wealth accumulation because of associated budget constraints and financial stress. In other words, education loans may cause aversion to debt for wealth purchase. Having heavy education debt also might result in financial stress (Drentea, 2000), reducing the indebted student's capacity for future planning and orientation.

We further examine the influence of education loans on financial well-being among White and Black young adults because the credit constraints and financial stress experienced by Black loan holders may be disproportionately higher. Previous evidence strengthens our expectation that such disparities play an important role. First, Black students are more likely to take out loans to finance college expenses (Alon, 2007; Elliott & Friedline, 2013; Perna, 2000; Ratcliffe & McKernan, 2013). For example, the analysis of a national sample by Ratcliffe and McKernan (2013) indicates that the likelihood of having debt from education loans among adults is about twice as high among Blacks (34%) as among Whites (16%). Black borrowers also report greater difficulties with and concerns about repayment (Baum & O′Malley, 2003; Ratcliffe & McKernan, 2013). Therefore, they may face higher credit constraints after leaving school. Second, due to racial and ethnic disparities in income and assets (e.g., Bricker et al., 2012; Kochhar et al., 2011), young adults from Black families are less likely to receive financial support from their parents. In particular, the decline of net worth has been disproportionately larger among Black and other minority households after the economic recession (Kochhar, Fry, & Taylor, 2011). Third, labor market opportunities and economic returns from a college degree differ by White and Black o young adults. Studies indicate that Black students receive less of an economic return from their college education than do their White counterparts (e.g., Crissey, 2009; Jones & Schmitt, 2014). Also, the risk of losing a job in a time of economic recession is greater for Black college graduates than for White ones (Austin, 2009). Therefore, education loans could pose greater risks for Black borrowers than for their White counterparts.

1.2. Empirical evidence

Despite increasing research into the impact of education loans on college enrollment and graduation, fewer studies investigate how debt affects adults' economic well-being after they have completed their education. Most existing studies examine the influence of education loans on career choices, earnings capacity, home and vehicle ownership, and wealth accumulation.

1.2.1. Career choices and earnings capacity

Studies consistently find that education loans are positively related to initial salaries (Eyermann, 1999; Hiltonsmith, 2013; Minicozzi, 2005; Rothstein & Rouse, 2011). This association may be due in part to the need to repay education debt. However, evidence suggests that, despite their association with initial wages, education loans are negatively related to wage growth over time. The study by Minicozzi (2005) examines wage outcomes among a group of men who finished their schooling before age 35. The data come from the National Postsecondary Student Aid Study, and Minicozzi's findings indicate that an increase in education debt from $5000 to $10,000 is associated with a decline (from 8% to 5%) in wage growth over a 4-year period.

However, in presenting results from an analysis of seniors from 27 colleges and universities, Monks (2001) reports that their job plans do not differ by levels of borrowing. Perhaps the subjective measure in Monk's research accounts partly for the differences between his results and findings from other studies.

1.2.2. Homeownership and vehicle ownership

Most research on the relationship between education loans and home and vehicle ownership reports that education loans are associated with reduced ownership rates and delayed purchase of homes and vehicles. For example, examining Survey of Consumer Finances data (1992–2004) on young households (i.e., household heads aged 23–32), Shand (2007) reports that each additional $1000 in debt from education loans is associated with about a 3% decrease in the homeownership rate among adults who graduated from college in 2003. Stone, Van Horn, and Zukin (2012) analyze survey data from a nationally representative sample of 444 college graduates (classes of 2006–2011), finding that 40% reported delaying decisions on purchase of a home or a car due to the burden of debt from their education loans. Brown and Caldwell (2013)'s bivariate analysis of Equifax data