



# Project on Academic Success

engaging in practice- and policy-oriented research on student success in higher education



## A Review of the Literature

# What Matters to Student Loan Default

### Executive Summary

In 1980 the reauthorization of the Higher Education Act resulted in a significant shift in the emphasis of the federal government from grants to loans as the primary policy vehicle for providing access to postsecondary education for low- and moderate-income families. This shift made it inevitable that policy makers would track student default rates on loans as one indicator of the efficacy of student loan programs. A federal study of default rates authored by Choy in 2006 calculated default rates over four years instead of the traditional 12-to-24-month time period. It revealed a 6% increase in default rate for some groups of students and default rates for some types of institutions also increased. Not surprisingly, as part of the reauthorization process, federal policy makers are again asking questions about acceptable default rates and the causes of default. Is default the direct result of the characteristics of the students who use loans? Is it caused by the types of institutions students attend? Do the types of loans influence the probabilities of default? Do life circumstances such as the types of jobs and income levels of students after they graduate have an impact on default rates? In addition, policy makers are again reexamining the extent to which default rates should be used as indicators of institutional quality or the effectiveness of various types of loan programs.

This is not the first time these questions have been asked. Much of the research cited in this policy brief was conducted during the late 1980s through the mid-1990s—a time period when policy makers were asking similar questions. Indeed, it is worth noting that one limitation to this brief is that most of the best research on this topic was conducted a decade or more ago. Several of the best studies were undertaken with data collected before the Higher Education Act of 1998, which produced changes in policies regarding default that are widely regarded as having affected the financial aid practices of institutions. We lack sufficient research as to whether the policy changes that have occurred during this time period might have influenced the predictors of student default. In addition, in recent years few multivariate studies using national data bases have been undertaken.

For this policy brief we reviewed 32 studies of student loan default. The studies were conducted between 1978 and 2007, with the preponderance of studies being done between 1991 and 1998. In summarizing the results from the studies we reviewed we have placed greater emphasis on empirical research that employed multivariate statistical techniques which enabled the researchers to control for as many student, loan, and institutional characteristics as possible. We also rely more heavily on studies that employed national data bases and that included larger samples of students. With these caveats in mind the research on student loan default reveals the following set of findings:

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1. Students who graduate from a postsecondary educational institution are considerably less likely to default than students who do not graduate.
2. The likelihood that a student will default on his/her loan is related to a complex web of factors including the income level of students once they leave and the total level of debt (which is related to the age of the student and the number of dependents).
3. Although it is counter-intuitive, total loan debt is not a good predictor of default when other student characteristics are considered. Students who drop out generally accrue less debt and students who graduate accrue higher levels of debt and are less likely to default.
4. Institutional characteristics have proven to be a poor predictor of default when the characteristics of the students enrolled are taken into consideration. If some urban commuting two- and four-year institutions, proprietary schools, HBCUs, or Tribal Colleges have higher default rates the evidence indicates that it is because they enroll more students who have characteristics at entrance that place them at a greater risk of defaulting. One intriguing study did find that as greater proportions of institutional revenue was devoted to instruction the probabilities of defaulting decreased but more work is needed on this topic.
5. There is some evidence that African American and Native American students are more likely to default than other students. However, researchers who have examined these relationships suggest that African American and Native American students are more likely to be older, have lower incomes, and higher overall levels of debt which make them more at risk of defaulting.
6. There is little evidence that the types of loans that students take or whether or not they have multiple types of loans has an impact on the probabilities of defaulting.
7. There is modest evidence that students who participate in these loan counseling programs are less likely to default. However, they do not control for self-selection, which means that students who attend counseling sessions are the students who are the least likely to default.

In sum the empirical evidence suggests that default rates are not good vehicles for assessing the quality of institutions or of various types of loans. The causes of loan default are rooted deeply in ever-present tensions around federal financial aid policy.

Since 1965 the federal government has made providing access to postsecondary education for all students, regardless of income, a cornerstone of higher education policy. Over the years, because of fiscal constraints, Congress has moved from grants to loans as the primary vehicle for assuring access. It is axiomatic that providing loans to low and moderate income students—who often come from families with weak credit histories and who may be at greater risk of not graduating or of ending up in jobs with lower income—entails greater risk of default. Absent a federal policy shift toward greater emphasis on grants, it is hard to imagine a scenario where a commitment to access via loans will not also result in default rates among some populations of students that are higher than policy makers might like. The alternative is to stop admitting or providing loans to students who are at greater risk of defaulting. This of course would undercut the very purposes of the student loan program. This literature review, however, does suggest that public and institutional policy makers can help reduce default by increasing their efforts to enhance graduation rates and by taking steps to decrease total student loan debt. In addition, in light of a dearth of recent studies on loan default there is a need for a series of studies on this topic. Because a number of changes have taken place in financial aid policies since the mid-1990s additional research is warranted.