Don't cut them off: Low-performing students benefit from continued access to loans

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Over the past decade, there has been a growing debate about the value of student loans and the long-term impact of debt for those entering the workforce—particularly for students who struggled to complete their studies.

In the United States, where the average student loan is US$30,000 per borrower, the Biden administration recently announced plans to cancel US$32 billion worth of loans. This move has been blocked indefinitely by the courts but it has put the spotlight squarely on student debt both in the U.S. and elsewhere.

In New Zealand, some 70% of all students borrow from the government to study. The collective student debt is NZ$16 billion, with the average debt per borrower sitting at around $24,000.

As students rack up ever-increasing levels of debt, the question has been raised about whether low-performing students should have their loan access cut off.

Considering the debate around borrowing for study and calls for the debt to be wiped, my colleague and I investigated the effects of access to student loans on university re-enrolment, graduation and earnings for academically struggling students.

The student loan debate

Despite concerns around using student loans for study, funding higher education through government-funded loans can have advantages. At their most fundamental level, student loans reduce the cost of the tertiary education system on the broader tax base, striking a balance between public investment and individual responsibility.

Student loans give students more choice as to where to study and thus can enhance competition across education institutions. Loans also offer an incentive for students to put more effort into study as they share some of the education cost.

Sharing costs allows the government to fund more students. Student loans can also reduce barriers to study resulting from tuition fees, offering students from lower income families access to tertiary education.

While most students who complete their qualifications will increase their earning potential and be able to pay off their debt, there is a concern for low-performing students who may accumulate a large amount of debt but fail to graduate.

Student loans account for nearly half of government expenditure on tertiary education. Students borrow roughly $10,000 for one year of full-time study, costing the government about 45 cents on the dollar. The introduction of free tuition for the first year has reduced the total amount borrowed by students but hasn't changed the average borrowing per year—partly because the government allows students to borrow more in living and course-related costs.

Considering the significant cost to both students and taxpayers, many experts advocate restricting loan access based on student performance and expected future earnings to reduce the risk for borrowers. But is this really the best option?

Long-term benefits of student loans

The linked administrative records from the New Zealand Integrated Data Infrastructure (IDI) allow us to follow students for up to nine years, from the start of university into the labor market.

We began our analysis looking at the data from all students starting university in 2008–2011. Our main analysis focused in on a small subset of students whose grades were around the 50% cutoff.

To continue qualifying for a student loan in New Zealand, students must pass at least 50% of their classes after two years of study. Some 10% of students fail this requirement and are considered low-performing students.

We compared outcomes for students just above the 50% pass rate threshold to those just below. These students are similar in all aspects except for loan access. Therefore any differences in outcomes can be attributed to whether or not they were able to access a student loan.

Several findings emerged from our work. First, in what may not be a surprise, three-quarters of students struggled to find other funding and were not able to re-enroll in study without loan access.

Second, low-performing students with loan access—those who just made it over the 50% threshold—were about 60 percentage points more likely to graduate than those without, even though they take roughly six years to complete a three-year bachelor's degree.

Third, those low-performing students who retained access to student loans earned $2,000 more per month and rose 40 percentile points in the earnings distribution of earners around age 25. This finding suggests the earning returns from a university degree for low-performing students are similar to an average degree holder.

Finally, while students who retain access to student loans initially accumulate significantly greater student loan debt—around $30,000 more than students who lose access—the student loan balance goes down rapidly once students enter the labor market.

Its important to note that New Zealand's tertiary education sector is generally well-regulated. This is different from some other countries grappling with the issue of student loans. Our findings suggest that, instead of limiting individuals' loan access, regulating low-quality education providers and their access to student loan dollars is more effective in places such as the U.S.

Individual responsibility and a public good

Even after repaying the debt, the net present value of a student loan for someone who works 30 years is estimated to be around $300,000.

Considering the life-long benefits of higher education, there is an argument to be made that low-performing students should retain student loan access, even if they are struggling to pass.

In fact, our calculation shows that providing these students with loans is a good public investment because the generated income tax will exceed the cost to the government.

Ensuring students access through the loan scheme is an effective way to guarantee access to tertiary study and, consequently, economic potential in the long run, regardless of grades.

Provided by Victoria University of Wellington

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