



Canadian Labour Market and Skills Researcher Network

Working Paper No. 4

The Effect of Student Loan Limits on University Enrolments

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December 2008

CLSRN is supported by Human Resources and Social Development Canada (HRSDC) and the Social Sciences and Humanities Research Council of Canada (SSHRC). All opinions are those of the authors and do not reflect the views of HRSDC or the SSHRC.

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Abstract

Student loan programs are an important feature of post-secondary education systems around the world. However, there is little direct evidence on whether these programs are effective in increasing enrolments of credit constrained students. Unlike other countries, Canada has a system of student loans and grants that is based on combined provincial/federal jurisdiction, leading to policy differences over time between provinces. I exploit these differences to evaluate the effects of changes in maximum student loan limits on enrolments of young people. I find that although there is evidence that increasing nonrepayable assistance leads to increases in enrolments, loans appear to increase only the probability of youth living away from their parents' house while studying.

JEL Code: I2, I28

Key words: Post-Secondary Education, Student Loans; Credit Constraints

¹ Thank you to Michael Baker, Dwayne Benjamin, Rob McMillan, Thomas Lemieux, Azim Essaji and Yvan Guillemette for helpful comments. Research for this paper was funded by the Canadian Labour Market and Skills Researcher Network. This paper makes use of confidential data available under the Statistics Canada RDC program. The views do not represent those of Statistics Canada. Correspondence to: cneill@wlu.ca

Executive Summary:

Student loan programs are an important feature of post-secondary education systems around the world, but there is little direct evidence on whether these programs are effective in increasing enrolments of credit constrained students. Evaluations are complicated by the correlation between the amount of student loan an individual receives and parental income or other characteristics that affect students' enrolment decisions. Students from high income families are less likely to receive a student loan than students from low income families, but they are more likely to enroll in a post-secondary institution. Thus, a naïve evaluation would likely find that higher student loans reduce enrolments.

It is difficult to disentangle all of these effects to isolate the role of student loans. The most promising approach is to identify some important form of variation in student loan payments that is not correlated with other determinants of enrolment. Ideally, this variation would be due to changes in student loans that affect only a subset of the population within a particular country. This is very difficult in countries with national loan programs.

Canada's system of student loans and grants is based on combined provincial/ federal jurisdiction, so that there are policy differences over time between provinces. In this paper, I exploit the differences between the Canada Student Loan Program (CLSP) and Quebec's Aide Financiere aux Etude (AFE) to identify program variation at a sub-national level that causes changes in the loans that students are eligible to receive that is not correlated with parental income or other personal characteristics.

Specifically, I examine how increases in maximum assistance levels affect enrolment rates of 18-23 year olds. Under both the CSLP and AFE, students' need is first assessed. A package of loans and non-repayable assistance is then provided to the student, up to a maximum dollar value, the 'loan limit.' Under the CSLP, this limit is fixed in nominal terms, and is then increased roughly once a decade. In the period for which I have data, there are two episodes when loan limits increased in the CSL zone: first in 1983-84, when limits increased by around \$1500, and again in 1993-94, when limits increased by around \$3500 (in nominal terms).

AFE also has a maximum assistance limit, but this limit is higher than under the CSLP and it is increased regularly in nominal terms, roughly keeping its real value constant. As a result, I can examine whether enrolments increase in the CSL provinces relative to Quebec after the increases in the loan limits.

I find evidence that changes in financial aid programs can have important effects on university enrolments in Canada. A \$1000 increase in non-

repayable assistance (grants) provided under the student loan program is estimated to increase university enrolment rates by just over 1 percentage point. This is not large compared with estimates of the effect of aid on enrolments from the US. Increases in the maximum amount of student loans do not appear to have any effect on overall enrolments, suggesting that credit constraints are not important in restricting enrolments. Larger loans may, however, encourage students to move out of the parental home.

The estimated effects of the increase in grants by family background accord well with the distribution of student loan recipients in the population.

- The largest effect is on the enrolments of youth living away from home. Such students are relatively likely to be receiving the maximum student loan, because of their higher assessed living expenses.
- Students whose parents have relatively low education levels (and because of income tests are more likely to be at the loan limit) are also affected to a significant extent.
- Those whose parents have relatively high education levels (and are unlikely to be receiving loans at all) are not affected at all.

These results suggest several policy implications:

- There is little evidence that loans increase enrolments more than would an equivalent grant. Since loans are administratively costly, this suggests that a system geared to grants more than loans would be more cost-effective.
- The biggest effect of higher loans may be to encourage students to substitute away from local universities to more distant universities. If this helps students go to programs that provide a better fit, it may improve long-run education levels. However, it may simply enable students to achieve a higher level of consumption than otherwise. While not a bad thing, the public benefits of this are likely not large enough to justify the administrative cost of the loan program.

However, several qualifications must be borne in mind:

- The study examines an extension of the loan program. It would not be wise to use these results to argue that a large reduction in student financial assistance would have little or no effect on Canada's post secondary enrolment rate or attainment.
- Since students from low income families are most likely to see their loans increase as the limits increase, and since they might be expected to be more affected by credit constraints than other students, it would be desirable for research to focus on this group. Given the data, this could only be done quite roughly in this study.