“Making Sense of Loan Aversion: Evidence from Wisconsin”

Goldrick-Rab & Kelchen

Discussion
Sarena Goodman
October 2013

The analysis and conclusions set forth are those of the discussant and do not indicate concurrence by other members of the research staff or the Board of Governors.
What is debt aversion?

• “Unwillingness to take a loan”

• Candidate definitions
  • Disutility from holding debt
  • If students are rational and offered loan terms are favorable (e.g., PDV of lifetime income associated with taking the loan > PDV of lifetime income associated with not-taking the loan), not taking this loan could imply debt aversion

• Key concepts
  • Behavioral: being in debt carries a psychic cost, apart from any of the explicit costs and risks associated with the loan
  • Importantly, debt averse students may be financially literate
Why do we care?

• The “micro”
  • Credit constrained individuals might under-consume education (lower-cost institutions/attendance patterns)
  • Students might finance education in more costly ways to avoid loans

• The “macro”
  • Loans may not be an effective way to subsidize education to meet social goals (e.g., equal access to education)
  • Lower national income
    • Exacerbated if students with highest returns to education are debt averse
Do we observe debt aversion?

Percentage of Students with at Least $2,000 of Remaining Need Who Borrow, 2003-04
From: The Institute for Higher Education Policy and Excelencia in Education, 2008

<table>
<thead>
<tr>
<th>Category</th>
<th>Income</th>
<th>Enrollment</th>
<th>Institutional Type</th>
<th>Race/Ethnicity</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest Quartile</td>
<td>59%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Third Quartile</td>
<td>54%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Second Quartile</td>
<td>43%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lowest Quartile</td>
<td>51%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mixed</td>
<td>47%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Part-Time</td>
<td>31%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full-Time</td>
<td>56%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private For-Profit</td>
<td>20%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Two-Year</td>
<td>79%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Non-Profit Four-Year</td>
<td>68%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Four-Year</td>
<td>57%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asian</td>
<td>35%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hispanic</td>
<td>40%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Black</td>
<td>54%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>White</td>
<td>43%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>49%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SOURCE: NCES 2004

- What generates these differences? How do patterns associate with later outcomes?
- Evidence from experiments suggests framing matters (Field (2009); Caetano, Partinos, and Palacios (2011); Johnson and Montmarquette (2011))
What does this paper say?

• Sample: 684 full-time Pell Students at Wisconsin public colleges

• Two measures of debt aversion:
  1. Survey-based: “Suppose you could take out a loan up to 10K with a 7% interest rate, how much $ would you take?” Choices {0, 1k, 2.5k, 5k, 10k}; anybody that said “0” is debt averse, everyone else is not
  2. Administrative: If students were offered a loan, and declined, they are debt averse; those that accepted offers are not debt averse

• Multivariate results produce vastly different conclusions
  1. Survey measure: Blacks and second generation immigrants more likely to borrow; D.A. sensitive to attitudes toward borrowing/self-control
  2. Administrative measure: no systematic differences
But, is this aversion?

- Market for loans: interest rate \( r \) is “price” of loan – at nonzero fixed \( r \), we shouldn’t be surprised some people are priced out. This doesn’t necessarily make them averse
- Survey measure priced above the “going rate” for a loan
- Either measure could reflect financial illiteracy (or math laziness)
- Measures don’t line up \( (r=0.21) \) – would be affirming if they did; no strong case for either individually
- Is EFC a sufficient statistic for need?
  - “Substantial group of needy students completing FAFSA decline all loans” – could suggest students have access to unreported resources
- What looks like aversion might be self control (Keys & Cadena, 2012)
Where from here?

• Can we generalize these results?
  • Full-time grant holders in Wisconsin public schools

• What is the ideal measure? How far are we from that?
  • Expected income with and without loans (and risk profile)
  • Actual need for loans versus EFC

• Is debt aversion discrete or continuous? How can we capture degrees of debt aversion?
  • Maybe gain insight from early payment behavior

• How can we identify students that do not attend college (or otherwise alter education choices) because of their aversion to taking on debt?

• Can we separate out impact of financial literacy?
  • Causally identify financial literacy effect on observed loan decisions and label the residual “aversion”
What do experiments tell us?

• Field (2009)
  • Funding law school through (absolvable) debt versus grant, both required public service
  • More applicants enrolled when offered grants

• Caetano, Partinos, and Palacios (2011)
  • Survey respondents in Latin American countries choosing 1 of 2 financially equivalent methods to finance postsecondary education
  • For half, words “loan” and “human capital contract” were used; this group much more likely to choose HCC over loan than the other half

• Johnson and Montmarquette (2011)
  • Canadian experiment with a series of binary choices: grants vs. cash, student loans vs. cash, etc.; students paid out for one of their decisions
  • Marginally sensitive to loans vs. grant, but no systematic loan aversion within particular groups