No Money Left Behind:
Loan Aversion and College Success among Pell Recipients

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The nation’s campuses are full of students juggling work, family and school in a valiant effort to make ends meet while keeping their academic careers on track. The chances of success are relatively low, partly because these tasks often conflict and create stress. In some cases, borrowing a limited amount of money would likely increase the odds of degree completion, and yet students decline loans, leaving money on the table. While the total amount of student loan debt has recently exceeded one trillion dollars, our analyses suggest that a sizable fraction of Pell Grant recipients are forgoing loans, including the subsidized Stafford, despite their evident unmet financial need. Helping higher education administrators think about the reasons for loan aversion and how to intervene in it is the central task of this brief.

It is well known among financial aid administrators that even though over-borrowing is the current concern of the moment, under-borrowing is not uncommon. Since default rates draw attention to over-borrowing, under-borrowing receives less attention. Even more importantly, it is hard to document the extent of loan aversion among student from low-income families since their preferences do not always align with their actions, yet both are important in affecting the outcomes of borrowing. In other words, declining to borrow when money is necessary for short-term success is problematic, but it may be equally problematic to borrow against one’s will.

It is also difficult to explain the reasons for loan aversion and therefore figure out how to address it. If the decision to decline loans is mainly due to a lack of information about the returns to college or the costs of taking loans, then additional financial education might be effective. But if the decisions are primarily shaped by cultural practices, or driven by concerns about the returns to education, then alternative approaches will be necessary. Sorting out the causes of a problem is always a prerequisite to finding an effective solution.
National data provides little to no evidence on loan aversion and therefore for this brief we turn to data collected on 3,000 Pell Grant recipients in Wisconsin. We leverage detailed administrative records and survey data among students from the Wisconsin Scholars Longitudinal Study, a sample of first-time, full-time, traditional-age Pell Grant recipients with unmet financial need who enrolled in two-year and four-year University of Wisconsin System institutions during the fall 2008 semester.

To determine which students are loan averse, we carefully examined students’ financial aid packages from their first term of college which included information on the loans they were offered, the loans they accepted, as well as critical contextual information including their expected family contribution, cost of attendance, and all forms of other financial aid. In addition, we used data from a lengthy survey regarding college plans and finances administered during the students’ first semester of college. On that survey, students were asked: “Suppose you could take out a loan up to $10,000 with a 7 percent interest rate. How much money would you take?” They could select from the following five options: $0, $1,000, $2,500, $5,000, and $10,000. In Fall 2008, the interest rate on subsidized student loans was 6.0 percent and for unsubsidized student loans it was 6.8 percent. We did not tell the students this information in the survey and the overall responses and level of financial aid knowledge suggested in the study provide little reason to think that they were aware that the rate we inquired about was slightly higher than the current unsubsidized rate and a point higher than the subsidized rate. We coded as loan averse those students who said they would take none of the loan they were offered.

We found that who is determined to be loan averse depends on what data is used to assess it. Based on financial aid records, we determined that 19% of the Pell Recipients declined all loans they were offered, despite having financial need. These students could be called loan averse. But using the survey data, we found that fully 41% of the sample expressed an unwillingness to borrow. In fact, student behaviors as revealed through financial aid records and student preferences as revealed through surveys suggest only a weak correlation between the two: there was agreement just 64% of the time. This may indicate that a sizable number of Pell recipients are accepting loans despite strongly preferring not to take them, which could lead to other consequences down the road. These students might, for example, be more likely to default on their loans.
What distinguishes loan averse students from willing borrowers? We noted common disparities according to race/ethnicity, gender, and immigration status but recognized there are many possible reasons for these differences. Thus, based on common hypotheses in the field, we examined whether they were less likely to aspire to complete their degree, or less sure that they would succeed in degree completion. We also looked to see if loan averse students were less aware of the financial returns to college, or generally less financially literate. In addition, we considered whether their families were relatively financially stronger (so that perhaps they expected gift support), or whether they were more risk averse. A preference for working was also considered, along with information about their social networks. Finally, we also examined their level of self-efficacy, and whether loan averse students agreed with popular sentiment about the reasonableness of carrying debt for school.

Our analyses did little to account for differences in who borrowed and who did not, but we learned a great deal about who prefers not to borrow. For example, Hmong students, many of whom are first-generation Americans speaking English as their second language, are much more likely to be loan averse, whereas African-American students are less likely to be loan averse. Students who prefer to work are unsurprisingly less likely to borrow. But surprisingly, decisions about whether or not to take loans is unaffected by a student’s level of financial knowledge, or information about the returns to college, net of other factors. Rather than informational constraints, we instead found that students are less likely to borrow when they felt that being in debt is not part of today’s lifestyle, or that wanting to live a good life is not a good reason to take on debt. This suggests that cultural practices and community contexts should be considered when developing interventions.

We also considered whether loan aversion affects college success. After accounting for student demographic characteristics and where they attend college, it seems that students who prefer not to take loans are less likely to persist in college and have lower GPAs than students who accept loans.

Thus, a more nuanced look at loan aversion suggests that a sizable fraction of needy students are declining loans, and that a much larger fraction would prefer to. Notably, these preferences are more common among first-generation students whose beliefs do not align with those who suggest that based on the wage premium to the college
degree, students should borrow. Instead, these students have a cultural aversion to
debt, perhaps stemming from the norms in the communities in which they are raised.

We therefore recommend that higher education administrators consider the preferences
and actions of their own students and potential students when it comes to loans. Are
sizable fractions of your Pell recipients leaving loan dollars on the table and engaging
other financing strategies that could reduce their odds of success? If so, what tailored
strategies might be engaged in order to minimize the sense of reluctance around
borrowing in cases where it could enhance degree completion? Would honest and
open conversations in your communities with parents of middle-school students create
avenues for discussing fears about borrowing? Might this lead to lessons about how to
best speak about loans and label them so that families can feel more confident in using
all available resources to maximize the odds of degree completion? These efforts, our
research suggests, could bear fruit while helping students feel more confident and
understood by their educational institutions.