



GERMAN STUDENTS REJECT FREE MONEY IN EDUCATIONAL SYSTEM.

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Annotation: *Tuition fees at German federal institutions of higher education are virtually non-existent, and only small administration fees have to be paid by students. What remains to be covered are expenses for basic needs and accommodation. Among several options to finance living expenses, students can receive financial help from their parents, work to earn their own income, or apply for scholarships and student federal aid, also known as BAföG, which is provided by the Federal Training Assistance Act (Bundesausbildungsförderungsgesetz).*

Depending on various socioeconomic factors, students can receive monthly BAföG payments for the nominal length of their studies. Half of the total BAföG aid is a grant that does not have to be paid back and the other half is an interest-free loan with the repayment being capped at 10,000 (Bundesministerium für Bildung und Forschung). According to the latest student survey ‘21. Sozialerhebung’ published by the Federal Ministry of Education and Research, approximately 79% of students who receive BAföG state that without federal aid they would have not been able to study (Middendorff et al).

In 2012, approximately 67% of students were formally eligible to receive BAföG, i.e. they met the prerequisite to be still under 30 years old when starting their first full-time study program (Herber and Kalinowski). Out of these formally eligible students, only 28% received BAföG (Deutscher Bundestag). There are two potential explanations behind the low share of recipients: Either the students fail the means test for student aid, or they choose to not apply



for aid even though they are eligible for a positive aid amount. While the former explanation is in line with the purpose of the BAföG system, the latter would mean that it fails to support students that are targeted by the system.

The previously mentioned student survey Sozialerhebung provides some insights why some of the students did not file a BAföG application form in the first place. As the top runner, 76% of students state that according to their own expectations, either their parents' or partner's income was too high, followed by 30% of students saying that their own income was too high. Remarkably, 25% of all students state that they did not apply due to the fact that they did not want to accumulate debt. When only students from lower educational backgrounds are considered, the share of students who state that making debt was the main reason for non-application increases to 37% (Middendorff et al.).

This paper shows how the combination of information frictions, attitude towards risk, student income and debt aversion can rationalize this behavior. A student who is eligible for aid but does not apply forgoes financial resources, considering that in the German student aid system, half of the payment is a free subsidy to the student and the other half is a zero-interest loan. Essentially, not applying for BAföG directly translates into rejecting free money. This is particularly controversial for students in Germany, since upward mobility for German students to tertiary education is still low compared to other OECD countries (OECD ; Herber and Kalinowski). Germany has a low participation rate in higher education and also the lowest growth rate in tertiary education in Europe, which Powell and Solga call 'German exceptionalism'. Student aid is supposed to increase enrollment rates to higher education institutions (Cornwell, Mustard, and Sridhar; John and Noell) and encourage potential students to enroll earlier to universities (Steiner and Wrohlich). Moreover, financial aid can also raise the probability that a student finishes her studies successfully instead of dropping out early (Glocker).

We first build a theoretical model that illustrates the tradeoff of a rational student. In the presence of imperfect information about the entitled amount of aid, risk aversion, debt



aversion, and a costly application process, a student might find it optimal to refrain from applying for aid. The model shows that stronger information frictions give rise to a higher likelihood for non-application. While in general, poorer students are more likely to apply for aid, they are also more affected by these information frictions. Moreover, the more risk-averse a student is, the higher is the likelihood to turn down the application. A student with higher risk aversion reacts also more severely to any changes in the information level as well as changes in student income. Lastly, a high degree of debt aversion deters students from applying for BAföG, irrespective of all other factors.

These hypotheses are tested using panel data provided by the GSOEP (German Socio-Economic Panel, Goebel et al, in which students during the years 2001–2013 are observed. Since the GSOEP does not include information on students' eligibility for BAföG, we simulate for each student potential BAföG amounts. We only keep eligible students in the sample, which then reduces the number to $N=988$ observations or $n=412$ students over 13 years. We first use a pooled probit model to predict the probability to not receive BAföG conditional on being eligible. We then control for unobserved heterogeneity with a correlated random effects (CRE) probit model and find evidence for unobserved heterogeneity. The CRE probit shows that an increase of the monthly parental gross labor income by 1% is associated with a remarkable 34.4% increase of the probability to not apply for BAföG despite eligibility (significant at 0.1%-level). This suggests that the misconceptions about eligibility increase with parental income. If the age of a student increases by 1 year, the probability to reject BAföG is 3.3% higher, significant at a 0.1% level in the pooled probit. Accordingly, older students assume to not be eligible even though they are still within the actual age limit. A three-way interaction testing for the relationship between risk aversion, income and information level is highly significant at a 0.1% significance level.

Students with high risk aversion and strong information frictions (no siblings receiving BAföG or being an only child) are particularly likely to not apply for aid. Additional information via a sibling receiving BAföG is associated with a lower non-take-up rate, whereas



there is a stronger relationship for poorer students. Students with low risk aversion are more likely to apply for student aid in general, while the level of information has a very moderate effect on that probability. Moreover, we find that if a student is more accustomed to debt because her family is paying back monthly credit rates, the probability to reject BAföG decreases by 6.9% at a 10% significance level in the pooled probit. This suggests that debt-averse students are more likely to refrain from an application for aid.

The remainder of the paper is structured as follows: Chapter 2 provides some background information about the BAföG system and reviews the most relevant literature. In chapter 3, we build a simple theoretical model to illustrate the student's application decision and derive several testable hypotheses. Chapter 4 tests these hypotheses using GSOEP data and discusses the empirical results. The 5th chapter concludes.

References

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