A New Test of Borrowing Constraints for Education

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We discuss a simple model in which parents and children make investments in the children’s education and investments for other purposes and parents can transfer cash to their children. We show that for an identifiable set of parent–child pairs, parents will rationally underinvest in their child’s education. For these parent–child pairs, additional financial aid will increase educational attainment. The model highlights an important feature of higher education finance, the “expected family contribution” (EFC) that is based on income, assets, and other factors. The EFC is neither legally guaranteed nor universally offered: our model identifies the set of families that are disproportionately likely to not provide their full EFC. Using a common proxy for financial aid, we show, in data from the Health and Retirement Study, that financial aid increases the educational attainment of children whose families are more likely than others to underinvest in education. Financial aid has no effect on the educational attainment of children in other families. The theory and empirical evidence identifies a set of children who face quantitatively important borrowing constraints for higher education.

Key words: Education, Borrowing constraints

JEL Codes: H52, I18

1. INTRODUCTION

There has been long-standing interest in whether U.S. students have access to sufficient resources to support efficient human capital investment (see, e.g. Becker, 1967). But despite a large literature, no paper on borrowing constraints for higher education focuses on the family’s role in financing college, particularly through their expected family contribution (EFC). The EFC is the difference between a child’s cost of attending college and what the federal financial aid formulas determine is the family’s “adjusted available income” for college. The EFC, however, is neither legally guaranteed nor universally offered. Children whose parents for one reason or another refuse or are unable to make their EFC may face financial constraints in attending college.1

1. Diana, posting on 1 November, 2005, to the Becker-Posner Blog, writes, “...Currently if you are under 25 and not in graduate school you are considered dependent on your parents’ income and have to include their income on your FAFSA which will count against you when figuring your expected family contribution. For those of us who did not receive any financial support from parents other than cosigning loans this is a real kick in the ass. Not only is my family lower middle class and unable to contribute to my education, but the government will tell me that they expected them to contribute and will punish me by lowering my available loan total” (http://www.becker-posner-blog.com/2005/01/governments-role-in-student-loans-becker.html#comments, last accessed October 12, 2011).
The detailed data that are needed to examine the family’s role in financing college, namely on parental income, assets, demographic factors, and the contributions parents actually make for college, are scarce. Moreover, the EFC is determined, in part, by the college that children attend. Consequently, the EFC is endogenous to the outcomes, namely college entry or years of completed education, that are of typical interest to researchers. Even if an arguably exogenous EFC measure could be computed, borrowing constraints may have their most important effects on the decision of whether or not a child goes to college. For a child who ends up not going to college, the parent will clearly not provide college expenses. So the counterfactual—what the parent would have contributed had the child gone to college—is unobserved. This unobserved counterfactual makes it difficult to examine directly the effect of parents’ education transfers on educational attainment.

In this paper, we introduce a new approach to studying borrowing constraints and higher education. Our starting point is the observation that parents and children are distinct decision-makers. Specifically, in our model we assume that parents face complete credit markets and they care about their own consumption and about the well-being of their adult child. We assume that a child cannot borrow against future earnings and they care only about their own consumption (and not their parent’s). We show that the child’s education may be suboptimal due to borrowing constraints. The parent may be poor relative to the child or care too little about the utility of their child to provide financial help for college since parents cannot access the returns to their child’s education. Alternatively, parents and children may disagree about the optimal investment in education because of the possibility that the child will end up relying too heavily on the parent.

There are two regions in the equilibrium of our model. One region is distinguished by the presence of post-schooling cash transfers (and parents are relatively wealthy, or altruistic, or the child’s ability is relatively modest). In this portion of the equilibrium, children achieve the efficient level of investment in education, so the return to education equals the financial market rate of return. There are strategic concerns, however, so the parent “ties” a portion of their intergenerational transfers by purchasing education for the child. The other region is distinguished by no post-schooling cash transfers (and parents are relatively poor, or egoistic, or the child is relatively able). In this portion of the equilibrium, there will be underinvestment in the child’s education, so the return to additional human capital investment will exceed the financial market rate of return. It is precisely this group of parents that will rationally not meet their EFC. Parents will tolerate this inefficiency because they have no way to write a binding contract to ensure that some portion of the child’s future earnings will be repaid in return for supporting their child’s education.

Financial aid will have sharply different effects on parent–child pairs in the two regions of the model’s equilibrium. For parents who make post-college transfers, additional financial aid should have no effect on educational attainment because parents will already make the efficient level of investment in their child’s education. But children of parents who do not make post-college transfers underinvest in education, due in part to their inability to borrow against future earnings. For these children, increases in financial aid will increase educational attainment.

For expositional clarity, our model abstracts away from important considerations both in parent–child relations and in higher education finance. Among the most important is the fact that a child’s post-college earnings are uncertain, which may affect post-college transfers, and the fact that some children finance college by working while in school or by extending the amount of time they attend college. We extend the model to address these concerns in a Supplemental Appendix (available from the authors) and show that the central intuition still holds: financial aid should be more likely to affect the educational attainment of children whose
parents do not make post-college transfers than children whose parents do make post-college transfers.

Examining the empirical implications of the model requires data on three things: parent–child pairs, financial aid, and intergenerational transfers, ideally for a substantial period following college so we can separate parent–child pairs into those parents who do and those who do not make post-college transfers. No data set has all three features. The Health and Retirement Study (HRS) comes close, with good data on parent–child pairs and intergenerational transfers over a long period. The HRS also offers a good proxy for financial aid. The dollar amount of financial aid will depend on the overlap of a child’s college years with those of his or her siblings. As a result, we rely on the birth spacing of siblings as a proxy for variation in students’ federal aid.

As implied by our analytic model, we find a positive and statistically significant relationship between educational attainment and sibling overlap when no post-schooling cash transfers are reported and no significant relationship when positive transfers are reported. Our primary empirical model is based on variation in birth spacing among children within the same family and our results are consistent across many alternative specifications. The magnitude of the association implies a difference in educational attainment of 0.4 years of schooling between a constrained child with 4 years of sibling overlap relative to a child with no sibling overlap while in college. A child with 4 years of sibling overlap while in college would receive, on average, about $3600 more in financial aid (in 2009 dollars) over 4 years than an otherwise equivalent child with no years of sibling overlap. About half of the children in the sample are potentially constrained. This implies that $3600 in additional financial aid would result in 0.2 additional years of schooling for the sample, on average. Borrowing constraints for higher education appear to be important for children in families where parents are unwilling or are unable to meet their EFC.

2. A MODEL OF INTERGENERATIONAL TRANSFERS

The starting point for our model is the small theoretical literature on collective family schooling decisions. To generate an equilibrium that distinguishes between education and cash transfers and the timing of these, there must be scope for disagreement between parents and children over children’s investments. Repeated transfer opportunities can generate a threat of strategic over-reliance of a child on an altruistic parent. The possibility of strategic behaviour by children may lead parents to tie transfers in the form of education or, as we discuss in our model, to underinvest in education, given that the parent cannot access the returns from the child’s education.

2. When studies of borrowing constraints for education include analytic models, they invariably assume that families make unitary college decisions based on parents’ resources and children’s ability. Two interesting papers that do not examine borrowing constraints but do investigate behavioural consequences of parental transfers to school-age children are Sauer (2004) and Perozek (2005). Sauer examines the effects of parental transfers during law school on borrowing, work while in school, and post-school earnings for a sample of University of Michigan law school graduates. Perozek characterizes altruistic transfer rules in a dynamic setting and empirically explores the education investments of a parent and multiple children using the HRS.

3. The Samaritan’s Dilemma, evident here in the possibility of the child’s over-reliance on the parent, was first described by Buchanan (1975), and results on the Samaritan’s Dilemma in Lindbeck and Weibull (1988), Bergstrom (1989), and Bruce and Waldman (1990) have shaped our approach. Bruce and Waldman (1991) are the first to connect the Samaritan’s Dilemma to the motive for tied transfers. Pollak (1988) uses preferences for education to motivate parents’ investments and observes that distinctions among transfer forms must rely on a disagreement between parents and children and that effective tied transfers cannot function as collateral or be resold.
2.1. The economic environment

Consider a two-period model where parents care about their children’s utility. We assume that parents and children make independent non-cooperative decisions. In particular, the parent moves first, choosing his or her consumption and physical capital investment, along with the dollar amounts of a cash transfer to the child and a tied transfer for college education. The child sees these choices and then decides how much to consume, invest in schooling, and save. In the second period, the parent again consumes and chooses a cash gift to the child; the child’s only action is to consume the gift and the returns to his or her various investments. While the parent has full access to credit, we assume that the child cannot borrow against his or her future income.

Define $a$ as the total parent and child investment in physical capital, and define $e$ as their total investment in the child’s post-secondary education. Assume that the rate of return on physical capital is constant at $R$ and the return to total human capital investment $e$ is $h(e)$ such that $h'(\cdot) > 0$, $h''(\cdot) < 0$, and $h'(0) > R$. A child can receive financial aid $\tau$, which augments family human capital investments. Total human capital investment $e = e(e^p + e^k, \tau)$, with $\frac{\partial^2 e}{\partial e^p \partial e^k} \geq 0$, where superscript $p$ identifies parents and superscript $k$ identifies children. We also assume that $h'(e(0, \tau)) \geq R$. In the course of our analysis, we consider two particular descriptions of financial aid. In the first, aid functions as a price subsidy, so that $e = (1 + \tau)(e^p + e^k)$. The analogy we have in mind is to the practical case where the marginal dollar a family invests is leveraged through federal subsidized loan programs such as guaranteed student loans (GSLs). In the second, aid is given as a lump-sum transfer, so that $e = e^p + e^k + \tau$. The analogy we have in mind is to all cases in which aid is inframarginal. This occurs, e.g. when a family receives a Pell grant or subsidized loan, but the grant or loan is less than total $e$, so the last dollar spent on education is wholly out-of-pocket.

The child and parent utilities are given by

$$U^k(c^k_1, c^k_2) = u(c^k_1) + \beta u(c^k_2)$$

and

$$U^p(c^p_1, c^p_2, c^k_1, c^k_2) = u(c^p_1) + \beta u(c^p_2) + \alpha(u(c^k_1) + \beta u(c^k_2)),$$

where $c^j_t$ represents the period $t$ consumption of agent $j$, $\alpha$ expresses the parent’s degree of purely altruistic concern for the child’s welfare, and $\beta$ is the discount factor. Single-period utility of consumption for each agent, $u(\cdot)$, is such that $u'(\cdot) > 0$, $u''(\cdot) < 0$, and $u'(0) = +\infty$.

The parent acts as a Stackleberg leader, moving first in Period 1, choosing $c^p_1$, $a^p$ (assets), $e^p$, and first-period transfer to the child, $g_1$, subject to constraints $c^p_1 + a^p + e^p + g_1 \leq x^p$, $g_1 \geq 0$, and $e^p \geq 0$, where $x^p$ are total parental resources. As a result of the one-sided altruism and

4. Non-cooperation is a critical assumption of our work. Altonji, Hayashi and Kotlikoff (1992) and Brown et al. (2006) reject income pooling, an implication of both the unitary model and the non-cooperative model with active financial linkages, for extended families. The rejection of income pooling is consistent with non-cooperative interactions and inactive financial linkages that characterize our modelling approach.

5. An implication of our model of one-sided altruism is that there will be no child-to-parent transfers. The empirical literature suggests that child-to-parent transfers are uncommon and small relative to either parent-to-child transfers or transfer support for college education (see, e.g. Gale and Scholz, 1994; McGarry and Schoeni, 1995).

6. As discussed in Brown et al. (2006), both assumptions that we make—non-cooperative behaviour and children have more limited ability to borrow than parents—are necessary to obtain empirical predictions on the timing and magnitude of transfers.

7. The repeated, annual higher education decision complicates our definition of inframarginal aid. Aid may be inframarginal in a given year but affect whether the student enrolls in another year of schooling.
non-cooperative interaction between the parent and child, the parent is unable to draw resources from the child through a negative transfer or through negative investment in the child’s education. The non-negativity of parental cash transfers in the second period will play a crucial role in determining equilibrium investments.

The child takes the parent’s choices of $c^p_1$, $a^p$, and $e^p$ as given, choosing $c^k_1$, $a^k$, and $e^k$ subject to constraints $c^k_1 + a^k + e^k \leq g_1$, $e^k \geq 0$, and $a^k \geq 0$. In the second period, the parent determines consumption $c^p_2$ and the amount of the second-period cash transfer to the child, $g_2$, subject to constraints $c^p_2 + g_2 \leq Ra^p$ and $g_2 \geq 0$. The child consumes his or her total resources, so that $c^k_2 = Ra^k + h(e) + g_2$.

2.2. Period 2

The parent’s problem in the second period is

$$
\max_{g_2 \geq 0} \{u(Ra^p - g_2) + au(Ra^k + h(e) + g_2)\},
$$

and the optimal transfer, given the second-period resources of the parent and child, is

$$
g_2(Ra^p, Ra^k + h(e)) = \begin{cases} 
g_2 & \text{such that } u'(Ra^p - g_2) = au'(Ra^k + h(e) + g_2) \\
0 & \text{if } u'(Ra^p) < au'(Ra^k + h(e)) \end{cases}
$$

When the transfer that equates second-period marginal utilities across generations is positive, the parent achieves his/her preferred allocation of the family’s total final-stage resources (see, e.g. Altonji, Hayashi and Kotlikoff, 1997). The parent’s altruism towards the child implies that the final transfer decreases with the child’s assets and earnings, no matter what choices preceded them, so second-period transfers, when made, are compensatory. The key point of equation (1) for our purposes, however, is that when the parent’s marginal utility from consuming everything in Period 2 exceeds the marginal utility they would get from the first dollar of cash transfers, the parent will not make second-period transfers. Whether or not second-period cash transfers are made distinguishes the two segments of the equilibrium.

2.3. Period 1: child

In the first period, the child determines his or her own consumption, saving, and educational investment given the $(g_1, a^p, e^p)$ chosen by the parent. The child’s problem is

$$
\max_{c^k_1, c^k_2, e^k \geq 0, a^k \geq 0} \{u(c^k_1) + \beta u(c^k_2)\}
$$

s.t.

- $c^k_1 + e^k + a^k \leq g_1$,
- $c^k_2 = Ra^k + h(e) + g_2(Ra^p, Ra^k + h(e))$,
- $g_2(Ra^p, Ra^k + h(e))$ as in equation (1) and $e = e(e^p + e^k, \tau)$.

$e^p$ is the parent’s optimal expenditure on education, which will depend on income, altruism, and the shape of the child’s human capital production function, among other factors. The EFC, in contrast, is an important determinant of the aid that a child will receive but it is not the optimal family educational expenditure. Moreover, children whose parents meet their EFC could still be constrained (if, e.g. aid packages change over time or unanticipated expenses occur) and vice versa (as their efficient human capital investment may fall below EFC $+ \tau$).
The function \( g_2(Ra^p, Ra^k + h(e)) \) is continuous but non-differentiable where \( au'(Ra^k + h(e)) = u'(Ra^p) \).

The first-order conditions for the child’s problem make it clear that whenever \( g_2 > 0 \), the child would like to over-consume in the first period in order to achieve a consumption path \( \{c^k_1, c^k_2\} \) such that

\[
u'(c^k_1) = \beta \max \left\{ R, h' \left( e(e^p + e^k, \tau) \right) \frac{\partial e(e^p + e^k, \tau)}{\partial (e^p + e^k)} \right\} \left( 1 + \frac{\partial g_2}{\partial (Ra^k + h(e^p + e^k, \tau))} \right) u'(c^k_2).
\]

(2)

Since the second-period gift described by equation (1) compensates the child for low post-schooling consumption, partial derivative \( \frac{\partial g_2}{\partial g} \) is negative. Hence, equation (2) indicates that the child would like to exploit their parent’s altruism by consuming more in the first period and less in the second relative to the standard intertemporal consumption smoothing condition \( u'(c^k_1) = \beta \max \left\{ R, h' \left( e(e^p + e^k, \tau) \right) \frac{\partial e(e^p + e^k, \tau)}{\partial (e^p + e^k)} \right\} u'(c^k_2) \). The consumption profile satisfying equation (2) extracts a greater post-schooling gift from the parent in the event that \( g_2 > 0 \). The child’s preferred consumption profile will be possible only if there exists an \( e^k \geq 0 \) and \( a^k \geq 0 \) satisfying equation (2), given the parent’s choices. We show in the Online Appendix that the parent will choose \( g_1, e^p \), and \( a^p \) such that \( e^k \geq 0 \) and \( a^k \geq 0 \) bind, thus eliminating the strategic concern (and equation (2) ends up not holding in the \( g_2 > 0 \) case).

2.4. Period 1: parent

In Period 1, the parent chooses \( c^p_1, g_1, e^p \), and \( a^p \) to maximize his or her utility, subject to \( c^p_1 + a^p + e^p + g_1 \leq x^p, g_1 \geq 0 \), and \( e^p \geq 0 \). We note three features of the model in Proposition 1.8

**Proposition 1.** (i) Equilibrium consumption levels \( \{c^p_1, c^p_2, c^k_1, c^k_2\} \) are unique. (ii) If \( g_2 > 0 \) in any equilibrium, then \( h'(e(e^p + e^k, \tau)) \frac{\partial e(e^p + e^k, \tau)}{\partial (e^p + e^k)} = R \) and the equilibrium transfers \( e^p, g_1, g_2 \) are unique. (iii) If \( g_2 \geq 0 \) binds in any equilibrium, then \( h'(e(e^p + e^k, \tau)) \frac{\partial e(e^p + e^k, \tau)}{\partial (e^p + e^k)} > R \)—there is inefficient investment in education from the family’s point of view—and the equilibrium transfers need not be unique, since only the sum, \( g_1 + e^p \), is determined.

The solution partitions the parameter space into two regions. In one region, \( g_2 > 0 \) and \( h'(e(e^p + e^k, \tau)) \frac{\partial e(e^p + e^k, \tau)}{\partial (e^p + e^k)} = R \). The parent’s \( c^p_1, g_1, e^p \), and \( a^p \) meet conditions

\[
u'(c^p_1) = au'(c^k_1), \quad u'(c^p_1) = \beta Ru'(c^p_2), \quad h'(e) \frac{\partial e}{\partial (e^p + e^k)} = R, \quad \text{and} \quad u'(c^p_2) = au'(c^k_2),
\]

where \( c^p_1 = x^p - g_1 - e^p - a^p, \quad c^k_1 = g_1, \quad c^p_2 = Ra^p - g_2, \quad e^k = 0, \quad \text{and} \quad c^k_2 = h(e(e^p, \tau)) + g_2 \).

The solution will be in this region when parents are relatively wealthy, or altruistic, or the child’s return to human capital investment falls relatively quickly to the real interest rate.

In the \( g_2 > 0 \) equilibrium, strategic concerns lead the parent to make a cash gift of only what she prefers for the child to consume in the first period. The parent then ties all additional first-period transfers to education, exhausting the region of educational investment that yields a

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8. Proofs of both propositions are provided in the Online Appendix.

9. Note that the fact that \( e^k = 0 \) in the \( g_2 > 0 \) case arises as a product of the equilibrium. The parent’s first-period choices in the \( g_2 > 0 \) case cause the \( e^k \geq 0 \) constraint to bind, avoiding the strategic overconsumption by the child reflected in equation (2).
return at or above the real interest rate. Should the parent prefer to claim some part of the return to education for herself, she can easily accomplish this by withholding a portion of intended post-schooling transfers. To summarize, we find that families in the \( g_2 > 0 \) equilibrium face strategic concerns, yet they make efficient educational investments and hence they relieve the child’s educational borrowing constraint.

The other region of the parameter space occurs where conditions (3) can be met only with \( g_2 < 0 \). In this case, \( g_2 = 0 \) and \( h'(e(e^p + e^k, \tau)) \frac{\partial e(e^p + e^k, \tau)}{\partial (e^p + e^k)} > R \). The equilibrium is described by

\[
  u'(c_1^p) = a u'(c_1^k), \quad u'(c_2^p) = b R u'(c_2^k), \quad h'(e) \frac{\partial e}{e^p + e^k} > R, \quad u'(c_2^p) > a u'(c_2^k),
\]

and

\[
  u'(c_1^k) = b h'(e) \frac{\partial e}{e^p + e^k} u'(c_2^k), \quad \text{where } c_1^p = x^p - g_1 - e^p - a^p,
\]

\[
  c_1^k = g_1 - e^k, \quad c_2^p = R a^p, \quad \text{and } c_2^k = h(e(e^p + e^k, \tau)).
\]

The absence of a second-period transfer means that the child has no incentive to behave strategically. However, the \( g_2 = 0 \) equilibrium is inefficient from the family’s perspective. Conditions (4) imply \( c_2^k < h(e^*) \), where \( e^* \) is the amount of education investment that would make \( h'(e^*) \frac{\partial e}{e^p} = R \), so that the post-schooling child consumption generated by the equilibrium is less than the earnings produced by the efficient human capital investment. If the parent could write a binding contract requiring that the child repay the share of returns to education necessary to achieve the parent’s preferred \( c_2^k < h(e^*) \), then the parent would fund the efficient educational investment. However, parents cannot write such contracts. Instead, the parent invests in human capital to support the child’s second-period consumption and physical capital to support his or her own. This leads parents to tolerate the \( h'(e(e^p + e^k, \tau)) \frac{\partial e(e^p + e^k, \tau)}{\partial (e^p + e^k)} > R \) wedge in investment returns, despite their unbounded access to credit. Families in the \( g_2 = 0 \) equilibrium face no strategic concerns, yet are led by an intergenerational borrowing constraint to invest inefficiently in their children’s human capital.

It is this group of \( g_2 = 0 \) families, where parents are relatively poor, or egoistic, or a child’s return to human capital investment falls relatively slowly with additional education, who rationally may choose not to meet their EFC.

The next proposition shows that financial aid will have different effects on the educational attainment of children in the \( g_2 > 0 \) and in the \( g_2 = 0 \) groups. We distinguish between the model’s predictions for the price subsidy and lump-sum aid cases, but the qualitative prediction is the same: financial aid will have a larger effect on the educational attainment of students in the \( g_2 = 0 \) group than the \( g_2 > 0 \) group.

**Proposition 2.** There are two cases to consider.

First, when aid takes the form of a price subsidy, i.e. \( e(e^p + e^k, \tau) = (1 + \tau)(e^p + e^k) \), and when \( g_2 > 0 \), \( \frac{de}{d\tau} = \frac{-h'(e)}{h'(e)(1+\tau)} > 0 \). When \( g_2 \geq 0 \) binds in equilibrium, \( \frac{de}{d\tau} > \frac{-h'(e)}{h'(e)(1+\tau)} \). Financial aid in the form of a price subsidy increases equilibrium educational attainment for both \( g_2 > 0 \) and \( g_2 = 0 \) equilibrium types, but the response is larger in the \( g_2 = 0 \) equilibrium.

10. A knife’s-edge case exists where \( g_2 = 0 \), though \( g_2 \geq 0 \) does not bind, and at the same time \( h'(e) \frac{\partial e}{e^p} = R \). But given incomes, altruism, and other model parameters, this case has no consequence for our empirical work.

11. There are two justifications for this assumption. First, children under 18 cannot enter into binding contracts. Second, because of the assumed power differential between parents and children and possible concerns about practices that may be “contrary to public policy” in the U.S., even if a contract existed, disputes over the contract would be unlikely to be upheld in court if a child failed to follow through on their obligation to repay educational loans made by a parent.
Second, when aid is lump-sum, i.e. \( e(e^p + e^k, \tau) = e^p + e^k + \tau \), and when \( g_2 > 0 \), \( \frac{de}{d\tau} = 0 \). When \( g_2 \geq 0 \) binds in equilibrium, \( \frac{de}{d\tau} > 0 \). Lump-sum financial aid does not influence equilibrium educational attainment in the \( g_2 > 0 \) equilibrium, but it increases equilibrium educational attainment in the \( g_2 = 0 \) equilibrium.

Propositions 1 and 2 formalize our new approach to examining borrowing constraints for education. With data on \( g_2 \) and financial aid for specific parent–child pairs, we can examine the correlation between children’s years of schooling and financial aid, conditioning on child characteristics, using two separate subsamples. The first is one in which parents make a post-schooling transfer (\( g_2 > 0 \)) and the second is one in which they do not (\( g_2 = 0 \)). Our model implies that financial aid will have a greater effect on children’s educational attainment in the second (\( g_2 = 0 \)) sample than in the first (\( g_2 > 0 \)) sample. Indeed, when aid is inframarginal, it will have no effect on children’s educational attainment for the \( g_2 > 0 \) sample but a positive effect on children’s educational attainment in the \( g_2 = 0 \) sample.

To summarize, the model shows that the \( g_2 = 0 \) parent will fail to relieve the child’s educational borrowing constraint because he or she has no means of enforcing repayment of their efficient educational investment. The \( g_2 > 0 \) parent, however, can extract the preferred share of the return by foregone post-schooling transfers, so the parent funds the child’s efficient level of human capital investment. Financial aid, therefore, will have a larger effect on the educational attainment of children with \( g_2 = 0 \) parents than otherwise equivalent children with \( g_2 > 0 \) parents. Moreover, financial aid will increase education for children in the latter group in proportion to any price effect created by aid or not at all. Guided by these predictions, we use data from the HRS to examine the extent to which educational attainment responds to financial aid among U.S. students who do and do not receive post-schooling financial support from their families.

2.5. An economic environment with greater realism

A skeptic might argue that our simple model abstracts away from too many important features of reality. Our model is written as if all parents have one child but the theoretical predictions are unaffected by siblings. Recall that the first-order condition for human capital investment equates the marginal return to investment in human capital with the real interest rate. With multiple children, the parents will seek to equate marginal returns for every child. It follows immediately that the parent will not give a cash gift to a child (the marginal return of a cash gift is the real interest rate) until the parent has exhausted all possibilities for investment in human capital. It will have no effect on children’s educational attainment for the \( g_2 > 0 \) sample but a positive effect on children’s educational attainment in the \( g_2 = 0 \) sample.

To summarize, the model shows that the \( g_2 = 0 \) parent will fail to relieve the child’s educational borrowing constraint because he or she has no means of enforcing repayment of their efficient educational investment. The \( g_2 > 0 \) parent, however, can extract the preferred share of the return by foregone post-schooling transfers, so the parent funds the child’s efficient level of human capital investment. Financial aid, therefore, will have a larger effect on the educational attainment of children with \( g_2 = 0 \) parents than otherwise equivalent children with \( g_2 > 0 \) parents. Moreover, financial aid will increase education for children in the latter group in proportion to any price effect created by aid or not at all. Guided by these predictions, we use data from the HRS to examine the extent to which educational attainment responds to financial aid among U.S. students who do and do not receive post-schooling financial support from their families.

The key intuition of the theoretical results also carries over in a world where parents’ preferences may differ from the child’s. To fix ideas, let us assume that parents have a utility function of the form \( U^p(c_1^p, c_2^p, h^k, g) = u(c_1^p) + \beta u(h^k) + \omega(h^k) + w(g) \), where \( \omega(h^k) \) denotes the utility that parents enjoy from their child’s college education and \( w(g) \) proxies for warm glow that parents get from intergenerational transfers. The formulation captures the idea that parents value the child’s college education for its own sake. With these preferences and under the assumption that \( w'(0) \) is finite, the main proposition in the paper goes through. The intuition behind this is straightforward—if the marginal utility from leaving gifts is low enough and finite, some parents will not want to give gifts until they have exhausted all options for investing in human capital.
credit card promotions on college campuses are commonplace, so we allow the child to borrow at a higher rate than the parent, rather than not borrow at all. Third, many children work while in college. Consequently, we incorporate a standard production function where time and expenditures are complementary in producing human capital. This allows us to model a child’s decision to work while in college. The model does not have an analytic solution, so we solve it using numerical methods.

For a broad range of utility and human capital production function parameters, we confirm the simple model’s central intuition: families who do not pass on post-college gifts to their children are more likely to underinvest in their children’s education. Children of parents who make post-college gifts are likely to have received transfers that allow them to reach their efficient level of education. Parents who have the option to make an education transfer and choose not to are foregoing a high rate of return investment opportunity. Since parents are at a point in their life cycle where they do not face borrowing constraints, the decision to underinvest cannot be rationalized if parents have sufficient resources to make cash gifts later on. For reasonable parameters of the income process, the intuition from the simple model holds probabilistically, but the sample split based on \( g_2 \) is no longer sharp.

In our numerical model, children of parents who do not make education transfers can borrow, work while in college, or even postpone college. Still, their optimal schooling is less than the efficient level. The reason is that each of these “make do” options are costly. This is obviously true for borrowing at an interest rate that exceeds the financial market rate of return. Working while in college helps relieve borrowing constraints but takes time away from human capital acquisition as well as leisure. In short, we find that a constrained child who receives no help from his or her parents will, at the margin, consume less, work a little more while in college, and choose to go to a lower cost college for fewer years than would an otherwise identical child with more generous parents. Thus, the additional model features we examine mitigate the importance of borrowing constraints, but they do not eliminate their importance.

3. THE EFFECTS OF FINANCIAL AID ON EDUCATION

The HRS has good information on parent–child pairs and post-college transfers. It is a national panel study with an initial sample (in 1992) of 12,652 persons and 7607 households. It oversamples blacks, Hispanics, and residents of Florida. The baseline 1992 study consisted of in-home, face-to-face interviews with the 1931–1941 birth cohort and their spouses, if married. Follow-up interviews were given by telephone in 1994, 1996, 1998, 2000, 2002, and 2004. Other cohorts, born before 1923 (Asset and Health Dynamics of the Oldest Old), between 1923 and 1930 (Children of the Depression), and between 1942 and 1947 (War Babies), were added to the main HRS cohort in 1998. We use data from all these cohorts as long as needed information is available.

13. Work while in college is the mechanism children use to relieve borrowing constraints in Keane and Wolpin (2001), e.g. They differ from our approach by assuming all children face the same tuition. In contrast, we assume that there are colleges of varying costs and consequently low-income families with high-ability children will choose to attend less expensive colleges and go to school for fewer years (since time and expenditures are complements), if they are borrowing constrained.


15. A 1948–1953 cohort (Early Baby Boomers) was added in 2004, but because we do not have information on this group in earlier waves, we do not include them in our study.
We also make limited use of data from the NLSY-97, a national panel survey of 8984 youths who were born between 1980 and 1984, first fielded in 1997.\textsuperscript{16} We discuss these data as they are used in our analyses.

3.1. Measuring post-college cash transfers

In Waves 3 through 7, HRS respondents are asked the following question about cash transfers exceeding $500 in the last 24 months.\textsuperscript{17} The specific wording in 2000 (Wave 5) reads:

\begin{quote}
Including help with education but not shared housing or shared food (or any deed to a house), in the last 2 years did [the Respondent or Spouse] give financial help totaling $500 or more to any of their children or grandchildren?
\end{quote}

Those answering “yes” were then asked how much. We aggregate transfers reported by parents over the period 1998–2004 (Waves 4 through 7) for our first measure of post-college cash transfers, $g_{2}$.\textsuperscript{18} There are three reasons for using this measure. First, starting in 1998 (Wave 4) the HRS is a representative sample of all households born before 1948, so it is natural to start with this wave. Second, even if we were willing to ignore data from the new cohorts added to the HRS in 1998, it is not clear how to aggregate over the first three waves due to differences in the way the transfers question was worded in each wave. Third, problems with missing responses increase with the number of waves we use.

We would prefer, however, to use a measure of significant post-college transfers over a longer time period in our empirical work. While no long-term retrospective question on major cash transfers to children is available in any of the HRS core surveys, Wave 2 of the HRS, fielded in 1994, does include a topical module on parent–child transfers. The Wave 2 survey (in Module 7) asked 827 HRS respondents in 427 households:

\begin{quote}
Other than contributions toward education expenses, have you ever given substantial gifts to your grown children?
\end{quote}

Those who answer “yes” are asked the total amount of these gifts. This is arguably the exact question we require to distinguish families with relatively wealthy or altruistic parents who have active post-schooling financial linkages from those with relatively poor or egoistic parents who likely have no post-schooling financial linkages. The drawback to this question is that it was asked only of a small subsample. Thus, we report estimates using both the shorter window of cash transfers observed for the full HRS sample and this longer transfer window observed only for Wave 2 Module 7 respondents. Responses to this question are available for 334 of the 9471

\begin{itemize}
\item 16. The earlier NLSY-79 is not ideal for our work because the latest measure of $g_{2}$ in that survey was elicited when children were 21–28 years old. The ideal measure for identifying parents with active post-schooling financial linkages gathers information over a long post-college period. Moreover, the age distribution of the sampling frame is such that there are too few siblings to estimate models with family fixed effects. The value of conditioning on time-invariant family-specific factors is discussed below.
\item 17. Wave 1 asks about transfers exceeding $500 in the last 12 months and Wave 2 asks about transfers exceeding $100 in the last 12 months.
\item 18. Recall that the purpose of $g_{2}$ is to separate the sample into intergenerationally constrained and unconstrained parent–child pairs. The fact that the primary transfer question includes grandchildren is not ideal, given that the model we write down considers only two generations. But we think parents making cash gifts to grandchildren are likely to have relieved educational borrowing constraints for their children, so we do not view the inclusion of grandchildren in the transfers question to be an important limitation of our study.
\end{itemize}
families for whom we have complete demographic and education information on multiple siblings aged 24 years and older. These families include 1262 children. 19

3.2. A proxy for financial aid 20

Financial support for college in the U.S., besides the resources that come from parents, relatives, and the student, comes in three primary forms: federally supported grants, federally supported loans, and state and institutional aid. 21 Grants and loans for students pursuing post-secondary, graduate, and professional education were initiated by the U.S. Higher Education Act (HEA) of 1965. The HEA was reauthorized every 4 years between 1968 and 1980 and every 6 years thereafter.

It would be difficult to trace and aggregate all the historical details of U.S. financial aid policy over the relevant period for our sample children and impossible to uncover parental asset and income information relevant to financial aid formulas at the potential date of college entry for each sample child. 22 One consistent feature of the aid formulas, however, allows us to infer a major component of within-family aid variation from family structure alone. Each major need calculation formula used to allocate financial aid from the leading federal grant and loan programs over the relevant period includes an EFC that decreases sharply as the number of college-going children in the family increases.

The Basic Educational Opportunity Grant (BEOG), a successor (along with the Supplemental Educational Opportunity Grant) of 1965’s Educational Opportunity Grant, was established in 1972. 23 In determining a student applicant’s eligibility, the formula for the BEOG calculated the student’s family’s “adjusted available income” (AAI). The family contribution (or EFC) required by the formula was then a proportion of the AAI, and the proportion depended on the number of children the family would have in college in the coming academic year. As an example taken from the application forms for the 1979–1980 academic year, a family with one child in college was expected to contribute 100% of its AAI towards college costs, a family with two children in college was expected to contribute 140% of its AAI in total (70% per child), and a family with

19. Table A1 in the Appendix gives more detail on the construction of the full HRS sample and the module sample that we use for our analyses.

20. We are extremely grateful to Lance Lochner, and to Dan Madzelan of the Department of Education, for sharing detailed correspondence and files on historical U.S. financial aid rules. Additional information is drawn from Baum (1987). Other helpful discussions of federal financial aid policy can be found in NCES, U.S. Department of Education (2004), Kane (1998, 2006), Kim (1999), and Monks (2004).

21. We do not know the specific college the student attended or the state the student lived in when they attended college or the state the parent lives in at the time of sampling. Consequently, we do not account for institutional/state aid. The aggregate amount of this aid, however, is dwarfed by the aid distributed by the federal formulas, which are the focus of our discussion. Moreover, the types of institutions that have significant amounts of merit-based aid (generally Ivy League schools and some additional private institutions with large endowments) educate a small proportion of the students that attend college in the U.S. So the omission of private, merit-based financial aid is likely to be minor. States’ support for higher education comes largely through allocations to their state university system. They provide relatively little financial aid to students. According to Baum (1987) and the College Entrance Examination Board (1986), state and institutional aid constituted 18%, 17%, and 23% of financial aid to students in 1975, 1980, and 1985, respectively. Some of this state and institutional aid was allocated based on the rules we describe. Almost all the remaining aid came from the federal programs we describe.

22. Twenty-three percent of children in the underlying data set reached college age in the 1960’s or earlier, 37% attended in the 1970’s, 34% attended in the 1980’s, and 6% attended in the 1990’s.

23. It was renamed the Pell Grant in 1980 but retained the basic structure of the Basic Educational Opportunity Grant.
four children in college was expected to contribute only 160% of its AAI in total (40% per child). Over the entire sample period, the expected contribution declined steeply and non-linearly in the number of children in college for all types of need-based federal education grants.

Similar rules apply to loans, though of course, institutional details differ. The GSL program was established by the 1965 HEA as the major federal student loan program. 24 While rules determining loan eligibility and amounts have varied over the years, all treated student siblings the same way. 25 For a given student applicant, a family AAI was calculated based on the student’s family’s income and assets. The EFC was then determined as the AAI divided by the number of children from that family attending college in the relevant academic year. This is also a feature of some forms of campus-based aid.

To summarize, the objective of federal aid, in cooperation with most U.S. colleges, is to provide grants and loans that cover the cost of attendance after the individual student’s EFC is removed, where the cost of attending college for a given student includes tuition and fees, room and board, books, and travel expenses. Given the rules determining grant and loan awards, there may be large swings in individual siblings’ costs of college as family members age through the education process, which can result in substantial differences in the costs of educating siblings within the same family. 26

We use the variation in college financial aid due to children’s birth spacing to proxy for unobserved aid levels. 27 The median year in which children in our HRS sample reach the age of 18 is 1977, with most being college age in the 1970’s, 1980’s, and early 1990’s. The landmark 1965 reforms in higher education finance occurred after the vast majority of children in our sample were born, so decisions about birth spacing were very unlikely to be affected by financial aid considerations.

A natural question to ask is whether sibling overlap is significantly positively correlated with financial aid. We cannot examine the relationship between sibling overlap and financial aid using the HRS because it does not include information on financial aid. But we can examine the relationship using the NLSY-97. To do this, we regress the financial aid a student received in his or her first term of college on a set of covariates, including parental income, parental income squared, net worth, net worth squared, Armed Forces Qualification Test score (AFQT), AFQT squared, a constant, and a measure of sibling overlap. We measure a point-in-time sibling overlap variable as the number of siblings who are college age (ages 18 through 21) at the time financial aid is being measured for the child in question. 28 The sibling overlap variable does not require the sibling to be in college at the time since this information is not available in the HRS,
the data used for our primary analysis. The coefficient of the overlap variable is $367 and it is significant at the 5% level. This result, along with evidence from Liu and van der Klaauw (2007), adds to our confidence that the financial aid proxy used in the HRS analyses does, in fact, capture financial aid differences within and across families.

Given that parental resources affect financial aid, families might want to declare their children’s financial independence. The standards for independence, however, are strict. In order to declare independence, a student must (i) reach age 24 by January of the academic year, (ii) enroll in a graduate program, (iii) be married, (iv) have a dependent child or other dependents, (v) be an orphan or ward of the court, or (vi) be a veteran of the U.S. Armed Forces (IFAP, 2006). Thus, a child under age 24, whose parents decide not to make the EFC will need to cut back their schooling, work while in college, stretch out the time they are in college, or find some other way to adapt. As discussed earlier, all these adaptations lower the net returns to schooling, so, as argued in the Supplemental Appendix, the implications of the model still hold.

3.3. Estimation samples and covariates

Our sample selection criteria include the requirement that we observe parents’ household income and net worth and complete information on the education, date of birth, and relationship to the family of each child reported by the HRS respondent. We also require that children included in the estimation have at least one sibling (this drops 1502 one-child households). Finally, we include only children aged 24 years or older (in 2000) in our estimation sample. The intention of this restriction is to allow the sample children time to complete their schooling and to consider only cash transfers that take place following completion of the children’s schooling. This leaves us with a sample of 34,593 children from 9471 HRS families.

Our empirical models include child variables that allow us to condition on factors that may influence the schooling attained by a young adult student, particularly relative to his or her siblings. These include the child’s age in 2000, the child’s gender, indicators for whether the child is an oldest or youngest child, and a cumulative measure of sibling-years of overlap for a college-age child. Specifically, the child’s sibling-years of overlap is the sum of the number of siblings the child had between the ages of 18 and 21 while he or she was 18 plus the number of siblings aged 18–21 years while he or she was 19, and so on, until the child is of age 21.

Table 1 gives descriptive information for these variables for both the full HRS analysis sample and the Wave 2 Module 7 respondents. Forty-nine percent of core sample children have parents who made positive cash transfers to them or to a sibling between 1998 and 2004, and 37% of the children of module respondents have parents who ever made substantial non-educational transfers to their adult children. These variables allow us to split samples based on post-schooling transfers as suggested by the analytic model. Roughly half of each sample

29. Another reason the overlap proxy relies on potential and not actual overlap in college attendance is because realized overlap or a sibling’s realized college attendance while the child is 18–21 would be mechanically related to our outcome variable of interest, educational attainment, in a fixed-effects specification.
30. The mean financial aid for all NLSY-97 college students is slightly under $3000.
31. The qualitative results are similar if we require sample children to be aged 30 years or older in 2000.
32. Triplets, e.g. each have eight sibling-years of overlap in college ages. A child with two siblings who are 3 and 6 years younger, respectively, has one sibling-year of overlap in college ages. The middle child in this family has 2 years of overlap, and the youngest child has 1.
33. Readers might expect that the fraction of the sample ever giving cash gifts would exceed the fraction of the sample giving cash gifts between 1998 and 2004. Three factors make the 49% and 37% responses not comparable. First, the Wave 2 Module 7 question refers to “substantial” gifts, while the other question asks specifically about gifts exceeding $500. Second, the Wave 2 Module 7 question is asked of a much narrower cohort of households. Third, the core sample question includes gifts to grandchildren exceeding $500.
TABLE 1
Child-level descriptive statistics for the HRS samples

<table>
<thead>
<tr>
<th>Variable</th>
<th>Sample size</th>
<th>Sample mean</th>
<th>Median</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parent made any gift to children, 1998–2004</td>
<td>34,593</td>
<td>0.4888</td>
<td>0.0000</td>
<td>0.50</td>
</tr>
<tr>
<td>Parent ever made major gift to child</td>
<td>1262</td>
<td>0.3700</td>
<td>0.0000</td>
<td>0.4988</td>
</tr>
<tr>
<td>Parent’s 2000 household income</td>
<td>34,462</td>
<td>$42,123</td>
<td>$25,564</td>
<td>$65,395</td>
</tr>
<tr>
<td>Parent’s 2000 household net worth</td>
<td>34,462</td>
<td>$299,392</td>
<td>$111,000</td>
<td>$798,656</td>
</tr>
<tr>
<td>Child years of education</td>
<td>1262</td>
<td>13.80</td>
<td>13.00</td>
<td>6.870</td>
</tr>
<tr>
<td>Child gender (male = 1)</td>
<td>1262</td>
<td>0.5000</td>
<td>1.0000</td>
<td>0.5000</td>
</tr>
<tr>
<td>Child age in 2000</td>
<td>1262</td>
<td>41.83</td>
<td>41.00</td>
<td>9.65</td>
</tr>
<tr>
<td>Oldest child indicator</td>
<td>1262</td>
<td>0.2859</td>
<td>0.0000</td>
<td>0.4518</td>
</tr>
<tr>
<td>Youngest child indicator</td>
<td>1262</td>
<td>0.2699</td>
<td>0.0000</td>
<td>0.4441</td>
</tr>
<tr>
<td>Years of overlap with siblings’ college ages</td>
<td>1262</td>
<td>2.336</td>
<td>2.000</td>
<td>2.133</td>
</tr>
</tbody>
</table>

Note: Sample children are aged 24 years and older.

is female. The median child age in 2000 is 41 (38) for the core (module) sample. Birth-order indicators tell us that 29% (27%) of core (module) sample children are oldest siblings, 26% (23%) youngest, and 45% (50%) are middle siblings. We exclude any variables that were likely determined after the completion of the child’s schooling such as marital status or earnings in 2000.

The dependent variable in our primary empirical specification is the child’s education. Core sample children have attained a mean of 13.8 and a median of 13.0 years of schooling (it is 13.3 and 12.0 in the module sample). The large sample and broad range of ages give us a standard deviation of 6.87 years of schooling, despite the top coding of schooling years to 17 for graduate and professional education. The primary independent variable of interest is years of overlap with siblings. Its mean and median are 2.34 and 2.00 in the core sample and 2.69 and 2.00 in the module sample. There is substantial variation in sibling-years of overlap in both samples, with a standard deviation for this variable of more than two years in each.

4. THE EMPIRICAL MODEL, RESULTS, AND ROBUSTNESS

Many factors likely influence the difference in schooling between two arbitrarily chosen, unrelated students. Among other issues, parents may differ in their attitudes towards education and the investments they make in their children. Heritable components of academic aptitude that the students received from their parents might also differ. We would have a difficult time controlling adequately for these between-family differences using the HRS data. We therefore examine the implications of Proposition 2 by making within-family comparisons, examining the educational attainment of closely-spaced siblings (who are expected to get more financial aid) relative to the

34. The youngest children in the sample are 24. The oldest 1.8% of children have reached retirement age.
educational attainment of siblings spaced further apart (who are expected to get less financial aid). Moreover, we expect the effects of financial aid to be larger for children who come from families who do not make post-college transfers \( (g_2 = 0) \) than for those that do \( (g_2 > 0) \).

Our empirical model is

\[
e_{is} = o_i + X_{is} \beta + \gamma o_{is} + e_{is},
\]

where families are indexed by \( i = 1, \ldots, N \) and siblings in family \( i \) by \( s = 1, \ldots, S_i \).\(^{35}\) In this expression, \( e_{is} \) represents the education of sibling \( s \) in family \( i \), \( X_{is} \) is a vector of exogenous characteristics of sibling \( s \) in family \( i \), and \( o_{is} \) represents the number of years of overlap in college ages that sibling \( s \) in family \( i \) shares with his or her siblings.\(^{36}\) The family fixed effect \( o_i \) represents the unobservable contribution to educational attainment shared by the children of family \( i \) and accounts for the effect of family wealth and other characteristics that do not vary within the family. Because siblings in two-child families will have identical overlap, \( \gamma \) is identified directly by families with three or more children. Most parent–child pairs remain in the sample for our empirical work. More than 57% of families in the HRS have three or more children; about 80% of the parent–child pairs in our sample come from families with three or more children. Two-child families, of course, help identify coefficients on other covariates in the empirical models and since the sibling overlap estimate is determined jointly with all of these other coefficients, two-child families contribute indirectly to the identification of the sibling overlap estimate.

The main coefficient of interest is \( \gamma \), the effect of the overlap variable (which proxies for financial aid) on children’s total schooling. Table 2 reports estimates for the gift and no-gift subsamples using the full HRS sample and the special question asked of Wave 2 Module 7 respondents. We find a coefficient on overlap of 0.105 in the no-gift, full HRS sample which is significantly different from zero at the 1% level.\(^{37}\) The corresponding coefficient in the gift, full HRS sample is 0.034. The estimate is not significantly different from zero at standard confidence levels. A similar pattern emerges in the results using the Wave 2 Module 7 sample. The coefficient on overlap in the no-gift sample is 0.094 and differs significantly from zero at the 1% level. The coefficient on overlap in the gift sample is \(-0.050\) and is insignificant.\(^{38}\)

The overlap estimate of 0.105 implies that a twin with no other siblings in a family that does not make post-college transfers will complete, on average, 0.42 years more schooling than an otherwise equivalent only child, all else equal. The estimate applies to the specific child in the parent–child pair.

To help assess the economic importance of these estimates, consider the following calculation. Assume that the child has two parents, one of whom worked and earned the 1983 median U.S. household income of $20,885.\(^{39}\) We assume that students first get whatever Pell grants they

\(^{35}\) The number of siblings varies from 2 to 11 across families, creating an unbalanced panel.

\(^{36}\) In the empirical model, \( e \) is years of schooling, while it is monetary investment in education in the theoretical model. A student chooses both the amount of time to spend in school and the dollar expenditure on schooling in each year. Schooling in years is the measure of human capital investment available to us in our parent-reported data.

\(^{37}\) To the extent there is error in our sample-splitting strategy, as would occur, \( e.g. \) in the numerical model in the Supplemental Appendix, the size of the estimates and power of the tests will be reduced and hence bias us away from finding significant results. Guo (2007) provides a straightforward proof.

\(^{38}\) In the module sample, we pool the gift and no-gift groups and estimate all coefficients reported in Table 2 at the group level using the pooled data. An \( F \)-test of the null hypothesis that the overlap coefficients are the same for the gift and no-gift groups rejects with a \( p \)-value of 0.06. The analogous \( F \)-test in the full sample rejects with a \( p \)-value of 0.10.

\(^{39}\) The detailed financial need formulas (and the tax calculations they necessitate) require several other assumptions regarding family characteristics. We assume that the child has assets that do not exceed asset exemption thresholds, is dependent on their parents, and receives no Social Security or Veteran’s education benefits. We assume that parents
Table 2
Family fixed-effect estimates of years of schooling, HRS, gift vs. no gift

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Child gender, male = 1</td>
<td>-0.242** (0.087)</td>
<td>-0.09 (0.088)</td>
<td>-0.249 (0.195)</td>
<td>-0.314* (0.134)</td>
</tr>
<tr>
<td>Child age</td>
<td>-0.01 (0.013)</td>
<td>-0.048** (0.121)</td>
<td>-0.008 (0.258)</td>
<td>-0.051** (0.186)</td>
</tr>
<tr>
<td>Oldest child indicator</td>
<td>0.15 (0.117)</td>
<td>0.296* (0.121)</td>
<td>0.08 (0.258)</td>
<td>0.290 (0.186)</td>
</tr>
<tr>
<td>Youngest child indicator</td>
<td>0.12 (0.124)</td>
<td>-0.09 (0.126)</td>
<td>0.19 (0.265)</td>
<td>-0.06 (0.194)</td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages</td>
<td>0.03 (0.031)</td>
<td>0.105** (0.030)</td>
<td>-0.050 (0.064)</td>
<td>0.094* (0.046)</td>
</tr>
<tr>
<td>Number of children</td>
<td>16,892 (17,701)</td>
<td>467 (795)</td>
<td>125 (209)</td>
<td></td>
</tr>
<tr>
<td>Number of families</td>
<td>4890 (4581)</td>
<td>125 (209)</td>
<td>0.59 (0.65)</td>
<td>0.57 (0.59)</td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.59 (0.53)</td>
<td>0.41 (0.45)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: * Significant at 5%, ** significant at 1%.

are entitled to, based on rules from the Pell Grant Index that applied to the 1984–1985 academic year. Remaining unmet need is then met through GSLs and campus-based aid, which is allocated based on applicable rules. We assume that the student attends an average-cost four-year, public, in-state institution. Total annual tuition, fees, room, and board, based on figures from the National Center for Education Statistics was $3682 in 1984 dollars. Over 4 years of college, the difference in total financial aid offered to two otherwise identical students, one with a twin attending college and the other with no siblings attending college, was $1728 in 1984 dollars, which is $3568 in 2009 dollars. Thus, we infer on average that $3568 (in 2009 dollars) of additional financial aid would result in 0.4 additional years of educational attainment for a student whose family does not make post-college transfers. Of course, not all students appear to be intergenerationally constrained. Further, it would be very difficult to offer aid exclusively to intergenerationally constrained but not to intergenerationally unconstrained students. About half the sample is in the “no-gift” group. Hence, we infer that the overall effect of an increase in available financial aid of approximately $3600 to all students would led to an average increase of 0.2 years of final educational attainment.

Proposition 2 suggested that aid could have a positive effect on educational attainment even in the sample of parent–child pairs where parents made post-college gifts. A key question is whether the last dollar the family invests comes from the family or comes from financial aid. If it comes from the family, aid is a lump-sum transfer and we would expect no effect of overlap in

have assets that do not exceed the exemption thresholds, pay average state taxes given their income level, make no IRA/Keogh contributions, and have no other untaxed income, excessive medical expenses, or primary or secondary tuition expenses.

40. This figure is very similar to the difference in aid between an only child and a twin implied by the NLSY-97 estimates. The estimate of $367.19 multiplied by eight semesters is $2939 in 2000 dollars, which is $3662 in 2009 dollars.
the \( g_2 > 0 \) sample. If it does not come solely from the family, aid would be expected to increase educational attainment but by not as much as in the \( g_2 = 0 \) sample. We do not know the relative prevalence of the two forms of aid in the data, but the fact that we get little or no estimated aid effect for the unconstrained families suggests that the inframarginal aid case better characterizes the data for the \( g_2 > 0 \) sample.\(^{41}\)

Other coefficients in Table 2 reflect the correlations between children’s demographic characteristics at the time of schooling decisions and their educational attainment. Brothers get less schooling than their sisters on average, and this effect is significant at the 5% level in two of the samples. The implied difference in schooling between brothers and sisters on average is a third of a year or less. Controlling for birth order, older siblings get significantly less schooling than younger ones in both no-gift samples; one year more of age is associated with five hundredths of a year of school in the two samples. Oldest children receive more education than their middle-child siblings on average, though the estimated coefficient on the oldest child indicator is significantly different from zero for only one of the four samples. There is no clear pattern in the level of schooling of youngest children relative to those of middle children.

A question may arise about why we focus on financial aid instead of, e.g. more general resources that improve the income of the parent. In particular, whenever \( e^p > 0 \) at the initial \( \tau \), the parent has chosen a level of educational investment that exceeds the amount of financial aid. If aid came in the form of a financial transfer to the parent rather than through \( \tau \), the parent would choose the same net educational investment. The interesting case for our paper, therefore, occurs when \( e^p = 0 \) at the initial \( \tau \), since in this case the allocation between \( \tau \) and \( x^p \) will affect equilibrium education. This is an empirically important case. When \( g_2 = 0 \) and we can see \( e^p \) (i.e. the child attended some college), \( e^p = 0 \) 54% of the time for at least one child in the family.

Given that parents do not face borrowing constraints in the model, it might also seem curious that we focus on the overlap of the child in the specific parent–child pair, rather than the general overlap of all siblings. When \( g_2 = 0 \) and \( e^p = 0 \), however, the parent and child are intergenerationally constrained—indeed, if anything, the parent would like to borrow against the child’s resources but cannot do so due to their inability to write a binding contract with their child. As noted above, for the no-gift (\( g_2 = 0 \)) sample, among those families where at least one child got some college or more, 54% of families have at least one child with some college or more and \( e^p = 0 \). For these families, a closely spaced sibling in college does not generate resources that can be used by a sibling five years younger since the parent cannot crowd out financial aid with a further reduction in private parental transfers. Consequently, the constrained parent is unable to move around resources from twins, e.g. to assist a younger child.

Before describing our robustness checks, we briefly mention two less far-reaching specification and sampling alternatives. First, we recognize that the coefficient estimates on gender, age, and youngest and oldest child indicators vary across samples in magnitude and significance. Specifications where we exclude all within-family covariates except the family effect and the overlap measure also yield a positive and highly significant overlap coefficient for the

\(^{41}\) The financial aid proxy in the full sample results is almost always positive, though imprecisely estimated in the \( g_2 > 0 \) (unconstrained) subsample.

As a further check on our arguments, we estimated the model of Table 2 with two additional subsamples, those where \( g_2 = 0 \) and \( e^p = 0 \) and those where \( g_2 > 0 \) and \( e^p = 0 \). We expect the overlap coefficient to be larger and even more significant in the first subsample than in the Table 2 (no gift) sample, despite the smaller sample size (since we eliminate families that might undo financial aid given to closely spaced siblings). We continue to expect no (or undetectable price) effects for the second subsample. Strikingly, this is precisely what we find. The overlap coefficient for the first subsample is 0.146 with a \( t \)-statistic of 4.11. The overlap coefficient for the second subsample is –0.037 with a \( t \)-statistic of 0.78.
no-gift group and a small insignificant overlap coefficient for the gift group. So, the key result in Table 2 is not sensitive to the inclusion of covariates. It also does not depend on whether or not step-children are included in the sample. Several authors have noted that parent–child behaviour and outcomes can differ for step-children relative to biological children of either parent.42 We repeated the central estimation shown in Table 2 using only never married parents and parents who were still married to their first spouses in 2000 in an effort to drop step families. The results for the parameters of interest were very similar.

4.1. Estimation issues and sensitivity analyses with the HRS sample

In the remainder of this section, we describe five sampling or robustness checks that increase our confidence that we are interpreting the empirical results sensibly.

1. Who is being affected? The distributional effects of financial aid policy

There are non-linearities in the financial aid system that we do not account for in the equation (5) empirical model. In particular, the children of very wealthy parents should expect no federal financial aid whether or not they have siblings in college (also see Monks, 2004). Similarly, federal aid formulas provide approximately full support to the children of very poor parents, and therefore educational achievement should be unrelated to sibling overlap. Thus, even in the no-gift subsample, we might expect years of schooling to be unresponsive to sibling overlap for children in low-income families, because they receive full financial aid, and for children in high-wealth families, because there will be no differences in schooling costs across children (within a family) due to financial aid considerations.43

To address the concern about non-linearities, we repeat the initial estimation, but this time estimate separate overlap coefficients for each parental net worth tercile. Estimates are given in Table 3 using the full HRS sample and a sample based on the special question asked of Wave 2 Module 7 respondents. The estimated overlap coefficients are small and not significantly different from zero for each of the net worth terciles of both gift samples. In the no-gift samples, we find small, insignificant overlap coefficients for the poorest and wealthiest terciles. However, the significant (at conventional level) point estimates on sibling overlap are 0.189 for the middle tercile of the full HRS sample and 0.197 for the much smaller special module sample. F-tests reject the null hypotheses that the middle tercile coefficient is equal to the high- and low-tercile coefficients at the 5% and 10% levels, respectively, in the full sample (but only reject the equality of the middle and high coefficients in the smaller module sample).

Parental net worth, observed when children are, at the median, 40 years old, is clearly an imperfect measure of parental income and net worth while the child was in school. Some children whose parents’ net worth is in the bottom tercile presumably did not receive aid, while some children whose parents’ net worth is in the top tercile perhaps did. We nevertheless believe this specification is useful in helping us understand whether the Table 2 sibling overlap

43. Before the Middle Income Student Assistance Act (MISAA) in 1978, students with family incomes above the median U.S. family income of roughly $15,000 were ineligible for BEOG (Pell grant) funding. The MISAA expanded BEOG (Pell grant) aid beyond the $15,000 cap. However, in the 1979–1980 (1983–1984) academic year, roughly 80% (95%) of BEOG (Pell grant) dollars went to students with family incomes below the median. Given that 33% of U.S. college students received Pell grant aid in 1980 and that 38% of the High School and Beyond seniors in 1980 who attended college came from the lower half of the family “socioeconomic status” distribution (17% from the first quartile), it seems reasonable to characterize access to federal grant aid for low-income students as extensive in the late 1970’s and early 1980’s (see Baum, 1987, U.S. Bureau of the Census, 1985, and information from the College Entrance Board). Other forms of student aid, including GSLs and work study, were available to students with family incomes well above the median.
results are driven by something other than financial aid. Given the extensive aid available to low-income students when the bulk of our sample was college age, and the manner in which aid availability phased out for higher incomes, we would be suspicious of estimated sibling overlap effects on educational attainment that were as strong for students from bottom-tercile or top-tercile families as they were for students from more representative families. But this is not what we find. The evidence that the effect of sibling overlap on educational attainment is strongest for middle wealth families in two samples is encouraging, given the structure of financial aid policy.

2. Who is being affected? Historical changes in financial aid policy

Financial aid to middle and higher income families increased substantially in 1978 as a result of the MISAA. Before the MISAA, the Pell Grant and GSL family income caps were $15,000 and $25,000, respectively. These caps represent roughly the median and the 80th percentile of the 1978 U.S. household income distribution. The MISAA extended both types of aid to children of families with higher incomes and was followed by a tripling in the number of GSL program loans over three academic years (also see Baum, 1987).

With more aid available for middle-income children as a consequence of the MISAA, we expect the main beneficial effects on attendance to occur for those children who now have greater access to aid but whose parents, for one reason or another, were not fully committed to paying for college. In the context of the Table 3 empirical specification, we expect the interaction of overlap and the middle wealth tercile to be larger (while still positive and significant) following the MISAA than before enactment of the MISAA. We further expect the MISAA to have smaller or no beneficial effects on attendance for the $g_2 > 0$ subsample (though parents presumably benefit from inframarginal subsidies).

### Table 3
**Family fixed-effect estimates of years of schooling, HRS**

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Parameter (Standard error)</th>
<th>Parameter (Standard error)</th>
<th>Parameter (Standard error)</th>
<th>Parameter (Standard error)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998–2004 gifts to children</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gifts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No gifts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer module gifts to children</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gifts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No gifts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** * Significant at 5%, ** significant at 1%.
We split the sample into a pre-reform subsample that includes only students who reached age 18 in 1978 or before, prior to the bill passage and expansion in aid. The post-reform subsample includes only students who reached age 18 in 1979 or later, after the aid expansion. Estimates for the Table 3 empirical model, pre- and post-reform, are given in Table 4.

As expected, the coefficient for the overlap by middle wealth tercile interaction is precisely estimated and larger—nearly twice the size—in the post-reform subsample as in the pre-reform subsample. Hence, the expansion of aid to families above the median income following the MISAA is accompanied by a shift in the estimated association between the aid proxy and attainment of children in middle wealth families.44

As in the previous specification, the overlap by high-wealth interaction is insignificant in both groups both pre- and post-reform. In addition, five of six coefficients in the $g_2 > 0$ subsample are insignificant, as expected. We find two unexpected results in Table 4, both occurring for the pre-reform sample for the overlap-by-lowest-wealth-tercile coefficients. The positive significant coefficient for the low-wealth, no-gift pre-reform subsample might suggest that aid was scarce even for low-wealth (and income) children, so having a closely spaced sibling enhanced the ability to finance college relative to observationally similar children without a closely spaced sibling. The negative significant coefficient for closely spaced siblings in families who made post-college gifts is puzzling. The Basic Educational Opportunity Grant was limited to half

44. The coefficients also reflect the fact discussed by Kane (2006) and Belley and Lochner (2007) and others that the real cost of college has risen sharply while federal financial aid has not kept pace.
of the cost of college when it was implemented in 1972, and no supplemental grant program existed to cover the residual. It is possible that students whose need profiles qualified them for full Basic Educational Opportunity Grant aid without the presence of a sibling might not have been aided and might in fact have been hurt, by a sibling entering college around the same time and competing for family resources, even in families who made post-schooling transfers in the pre-reform period.

3. Who is being affected? The attainment margin should be related to college

Many children in our samples were born in the late 1940’s and 1950’s. A high school degree for this cohort was less common than it is today. Our preferred interpretation of our results would clearly be wrong if the margin through which education increases for closely spaced children in the no-gift sample is that they were more likely to get to 11th grade rather than 10th grade. Put differently, college financial aid should have its primary influence on college enrollment and attainment.

When we exclude high school dropouts, we get similar results for the association between overlap and educational attainment, with the exception that the positive significant overlap coefficient in the no-gift sample is substantially larger. As in Kling (2001), we find that the response to our schooling cost measure is greatest at the college entry margin.

4. Is it something else? Ability and birth spacing

We do not have an ability measure in the HRS. This is one of the reasons why a within-family (fixed effect) specification is useful since it accounts for time-invariant, family-specific ability differences that might arise from the home environment. Nevertheless, there are obviously ability differences between children within a family. If closely spaced children have significantly different ability than children with greater birth spacing, our HRS-based estimates might be biased. For this bias to explain most or all the results, it must be the case that the ability levels of closely spaced children exceed the ability levels of children spaced apart in families where there are no post-schooling transfers (constrained families or families with $g_2 = 0$), and this ability differential with birth spacing does not occur in unconstrained ($g_2 > 0$) families. If families with closely spaced kids are resource-constrained over their life cycle, either in the time or the money they are able to allocate to closely spaced siblings, it seems unlikely that the constrained subset has higher ability children relative to others, at least in an economically important magnitude.

We can shed a little further light on this potential explanation using data from the NLSY-97: in particular, we look at whether sibling overlap is correlated with AFQT. Specifically, we regress AFQT on sibling overlap and covariates that we expect to be correlated with AFQT, including mother’s education, parental income, parental income squared, indicator variables for the number of siblings, female, black, Hispanic, broken home, living in an urban area, and living in the South. Sibling overlap is significantly correlated with AFQT, but the relationship is negative, and the empirical magnitude is $-0.51$, while the standard deviation of AFQT is 29.2 in the sample. Hence, we find it implausible that unobserved ability accounts for the empirical patterns we document in the HRS data.

5. Is it something else? The role of altruism

Underlying family characteristics—parental resources, the shape of the human capital production function, and altruism—will determine the region of the parent–child equilibrium. One unusual feature of the HRS is that it includes, for a small subsample, self-reported measures of

45. We used a conditional logit specification to estimate the effect of sibling overlap on high school completion in samples and specifications otherwise identical to those in Table 2. We found no significant association between sibling overlap and high school completion for either the gift or the no-gift samples.
parents’ financial generosity towards their children. Wave 5 of the HRS from 2000 contains an Economic Altruism Module where parents were asked

Suppose that [your child/one of your children] had only half/three-quarters/one-third as much income per person to live on as you do. Would you be willing to give your child 5% of your own family income per month, to help out until things changed—which might be several years?

Our analytic model shows that post-college giving will be more common among parents with higher $\alpha$ values. If the responses to the special HRS module question are informative about $\alpha$, we expect financial aid to have a smaller effect on the educational attainment of children with high-$\alpha$ parents than those with low-$\alpha$ parents.

Nine hundred and fourteen parents (with 3292 children) responded to this question and have complete information on other covariates included in our empirical model. Only 3% of children had parents who said they would give at 1/3 but not above. So we pool the 1/3 respondents with those who indicate that they would not give 5% of their income under any of the scenarios.

We estimate the empirical model given in equation (5), modified so that

$$e_{is} = \omega_i + X_{is}\beta + 3 \sum_{j=1}^{\gamma_j m_j o_{is}} + e_{is},$$

where indicators $m_1 = 1$ if the parent gives under no circumstances or only when the child’s income is 1/3 of hers (12% of the sample), $m_2 = 1$ if the parent gives when the child’s income is 1/2 of hers but not when it is 3/4 (26% of the sample), and $m_3 = 1$ if the parent gives when the child’s income is 3/4 of hers (62% of the sample).

The estimates are presented in the first column of Table 5. The overlap coefficient is insignificant (with a $t$-statistic below one) for the most altruistic families: those who will give 5% of their income when their child’s person-adjusted income is 3/4 of theirs. The overlap coefficient is large, positive, and highly significant for each of the less generous parent categories. $F$-tests fail to reject the null hypothesis that $\gamma_1 = \gamma_2$ but strongly reject the null that $\gamma_1 = \gamma_2 = \gamma_3$. To the extent that high self-reported generosity is predictive of the giving equilibrium, these results also align with the model and our previous results in that financial aid is inframarginal for children of the most altruistic parents but that it matters for the children of other parents.

Bequests are another type of post-schooling transfer. In a similar altruism module fielded in 1994 (Wave 2 Module 7), a subset of HRS parents were asked whether they thought “leaving a significant estate for grown children” was “very important, somewhat important, or not at all important”. In the last two columns of Table 5, we replace the previous altruism measures with indicators for whether or not parents thought it was very important to leave a significant estate. We find that the estimated overlap coefficient among students whose parents did not think it very important to leave a significant estate is 0.186 and significant at the 1% level. The overlap coefficient among students whose parents did think leaving a significant estate is very important is 0.055 and not significantly different from zero. We also used the bequest measures available to us for living parents in the HRS 2000 core sample. Parents were asked the probability of their leaving a bequest of $100,000 or more. Using the set of HRS 2000 core families who had complete responses, the overlap coefficient for students whose parents expect to leave a bequest of $100,000 or more is 0.047 and is not significantly different from zero. For students whose parents do not expect to leave a bequest of $100,000 or more, the overlap coefficient is

46. Where both parents responded to the bequest question, we take the answer from the financial respondent for the household.
TABLE 5
Family fixed-effect estimates of years of schooling, HRS 2000 economic altruism module, and bequest measures from HRS 1994 economic altruism module and 2000 core

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Altruism module</th>
<th>Altruism module</th>
<th>HRS 2000 core</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Parameter</td>
<td>Parameter</td>
<td>Parameter</td>
</tr>
<tr>
<td></td>
<td>(Standard error)</td>
<td>(Standard error)</td>
<td>(Standard error)</td>
</tr>
<tr>
<td>Child gender, male = 1</td>
<td>-0.0877</td>
<td>-0.0801</td>
<td>-0.196**</td>
</tr>
<tr>
<td></td>
<td>(0.203)</td>
<td>(0.247)</td>
<td>(0.0755)</td>
</tr>
<tr>
<td>Child age</td>
<td>-0.0464</td>
<td>-0.0738*</td>
<td>-0.0127</td>
</tr>
<tr>
<td></td>
<td>(0.0313)</td>
<td>(0.0367)</td>
<td>(0.0111)</td>
</tr>
<tr>
<td>Oldest child indicator</td>
<td>0.581*</td>
<td>0.224</td>
<td>0.299**</td>
</tr>
<tr>
<td></td>
<td>(0.276)</td>
<td>(0.335)</td>
<td>(0.102)</td>
</tr>
<tr>
<td>Youngest child indicator</td>
<td>0.134</td>
<td>-0.0123</td>
<td>0.600</td>
</tr>
<tr>
<td></td>
<td>(0.286)</td>
<td>(0.354)</td>
<td>(0.107)</td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages × give 3/4</td>
<td>0.0982</td>
<td>(0.0894)</td>
<td></td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages × give 1/2</td>
<td>0.644**</td>
<td>(0.109)</td>
<td></td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages × never give</td>
<td>0.398*</td>
<td>(0.157)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages × bequest very</td>
<td>0.0552</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>important</td>
<td>(0.165)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages × bequest</td>
<td>0.186**</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>somewhat or not at all important</td>
<td>(0.0868)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages × 100,000</td>
<td>—</td>
<td>0.0466</td>
<td>(0.0347)</td>
</tr>
<tr>
<td>bequest Pr ≥ 50%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sibling-years of overlap in college ages × 100,000 bequest</td>
<td>—</td>
<td>0.109**</td>
<td>(0.0336)</td>
</tr>
<tr>
<td>Pr &lt; 50%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of children</td>
<td>3292</td>
<td>2214</td>
<td>23,326</td>
</tr>
<tr>
<td>Number of families</td>
<td>914</td>
<td>568</td>
<td>7628</td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.3</td>
<td>0.47</td>
<td>0.55</td>
</tr>
<tr>
<td>Adjusted $R^2$</td>
<td>0.03</td>
<td>0.29</td>
<td>0.32</td>
</tr>
</tbody>
</table>

Note: * Significant at 5%, ** significant at 1%.

0.109 and is significant at the 1% level. The estimated differences in the effect of the financial aid proxy by whether parents are likely to leave bequests works precisely as Proposition 2 suggests.

6. Summing up

We develop an analytic model that tells us precisely how to approach the data to examine whether borrowing constraints affect education decisions. The key issue is whether parents meet their EFC. Children whose parents do not will have a harder time financing college than children whose parents do. Issues may arise with any single specification we examine, but it is hard to provide a coherent alternative explanation for the empirical patterns we have documented. Specifically, close birth spacing increases college financial aid. Among the children of a parent who makes no post-schooling transfers, siblings with closer birth dates complete more
education than their siblings with more isolated birth dates. Birth spacing does not matter for families making post-college transfers. The effects are strongest for middle-wealth families who would be expected to receive incomplete (or no) financial aid. The effects are larger during periods when more financial aid is available. Similar results arise when the sample is split based on an experimental proxy for parental altruism: birth spacing has no effect on educational attainment of children with the most altruistic parents, while spacing is significant for children with less altruistic parents. Birth spacing does not matter for children whose parents expect to make substantial bequests. It does for children whose parents do not. We think that the evidence, taken together, supports the implications of the model where intergenerational borrowing constraints result in some parents investing less than the efficient level in their children’s education.

5. CONCLUSIONS

A student’s federal assistance for college is determined based on their parents’ presumed ability to pay, and standards for financial independence from parents are stringent. Parents are under no legal obligation to meet their expected contribution as specified in federal financial aid formulas. If parents refuse to pay, children may face financial constraints in attending college. According to their parents, a third of all children in the HRS who got some post-secondary education did so without their parents’ financial assistance. This fact is not solely a consequence of need-based financial aid differences. A quarter of children whose parents held $200,000–$400,000 in net worth in 2000 attended college without parental support, as did 16% of those whose parents’ net worth exceeded $400,000. The scope for some students having financial difficulty in attending college appears quantitatively important.

Given this fact, we present a theory of efficient human capital investment focusing on the roles of parent and child decisions and financial aid. The theory implies that financial aid increases the educational attainment of intergenerationally constrained children who receive no post-schooling gifts from their parents, but financial aid does not matter to the attainment of intergenerationally unconstrained children. These effects each rely on an asymmetry in the access of parents and their college-aged children to credit.

Estimates using data from the HRS support the model’s predictions. Based on an idiosyncrasy in the dependence of U.S. financial aid on the number of children a parent has in college, we use years of overlap with college-age siblings as a proxy for financial aid. We find that the educational attainment of children whose parents are not observed to make post-schooling cash gifts is affected by financial aid. The educational attainment of children whose parents do make gifts is not affected by financial aid. These results, along with a series of specification and robustness tests, suggest that parents can relieve educational borrowing constraints for their children but that they do not always choose to do so.

Our empirical estimates are economically significant. The Table 2 point estimates imply that a twin with no other siblings in a family that does not make post-college transfers will complete, on average, 0.4 years more schooling than an only child, all else equal. This twin would receive roughly $3600 (in 2009 dollars) more financial aid than an otherwise identical student with their nearest sibling spaced five or more years apart (or without a sibling). It is impossible, however, to target aid to just those children whose parents do not make post-college transfers. Because about half the sample are children whose parents do not make post-college transfers, our estimates imply that $3600 in aid would generate, on average, 0.2 additional years of schooling.

An insightful prior literature documents empirical relationships that authors interpret as being consistent with educational borrowing constraints (see, e.g. Manski and Wise, 1983; Hauser,
1993; Kane, 1994; Card, 1999; Kane and Rouse, 1999; Ellwood and Kane, 2000; Keane and Wolpin, 2001; Rothstein and Rouse, 2010; at least in data from the National Longitudinal Survey of Youth, 1997 cohort, Belley and Lochner, 2007). An additional set of insightful papers argue that U.S. educational credit markets are nearly complete (Cameron and Heckman, 1998, 2001; Shea, 2000; Carneiro and Heckman, 2002; Cameron and Taber, 2004; Stinebrickner and Stinebrickner, 2008). 47

None of these papers, however, model explicitly how the interactions between parents and children may rationally lead to credit constraints for college. Carneiro and Heckman (2002), e.g. describe a model of human capital investment that is used to motivate their empirical analysis. They write “The agent possesses exogenous income flows in each period, $Y_0$ and $Y_1$. One can think of $Y_0$ as parental income” (p. 1000). They then derive empirical predictions on the importance of parental income on schooling attainment and infer the significance of borrowing constraints from their estimates. Our analysis suggests that such an interpretation may be misguided. In a richer model of parent–child behaviour, one needs to carefully distinguish intergenerational borrowing constraints from life cycle borrowing constraints. The lack of relationship between children’s schooling and parental resources may reflect the fact that the parent is unwilling to fully support the child’s college aspirations, so the child does not have full access to parental income. This would occur if parents perceive themselves to be poor relative to their children or the parent is not particularly altruistic. In this case, the parent’s income is not a relevant state variable for the child’s decision problem and an empirical finding of the lack of dependence of child schooling on parents’ income does not help identify borrowing constraints.

In general, our framework suggests that research strategies that investigate the importance of credit constraints by examining the income gradient of college attendance (or attainment) will be difficult to interpret. In our model, holding all else equal, educational attainment will vary inversely with parental resources for those intergenerationally constrained families where parents contribute nothing to their children’s education. The explanation comes directly from financial aid rules. As parents’ resources increase, the EFC increases. If children have parents who refuse or are unable to meet the EFC, the larger the unmet EFC, the more difficulty the child will have in financing college. For low-income families who get full financial aid, educational attainment will be non-decreasing with parental resources. Of course, other factors, some likely unobserved, may lead to a positive correlation between parental income and educational attainment.

Our work suggests a new direction for those interested in studying credit constraints in the context of higher education. The raw difference in college enrollment rates between students who do and do not receive post-schooling gifts in the full HRS sample is 16 percentage points. If the two groups have similar college enrollment propensities absent credit constraints, then this 16% times the proportion of the sample in the no-gift group provides an estimate, in this example, 8.2%, of the proportion of the population whose college enrollment decisions are affected by binding intergenerational constraints. It is unclear, of course, whether students in the no-gift group would have a higher or lower enrollment propensity in the absence of constraints. 48 A more credible estimate would require (among other things) access to data on ability, completed schooling, and a long period of post-schooling transfers. This is a potentially useful path for future work.

47. Carneiro and Heckman (2002) find that up to 8% of the relevant U.S. population may be short-run credit constrained.

48. For example, the theory in Section 3 predicts that greater student ability, holding all else fixed, leads to the no-gift equilibrium. This would seem to indicate higher unconstrained schooling choices for the no-gift group.
Two features of the economic environment we construct cause students to have difficulties in financing their education when parents, for one reason or another, are unwilling or unable to make the EFC. First, parents and children are unable to write binding contracts. Second, students cannot borrow against their future human capital. It is difficult to imagine changing rules governing parent–child contracts in ways that are useful for alleviating credit constraints without also having more important undesirable consequences. It may be possible to relax restrictions students face on borrowing, particularly in cases where parents are unwilling (or unable) to cosign loans. Increases in financial aid for children whose parents are unwilling to meet their EFC would increase educational attainment. At the same time, greater financial aid would likely reduce contributions made by families currently meeting (or exceeding) their EFC. So policy-makers will need to grapple with this trade-off—providing marginal subsidies for borrowing constrained students against inframarginal subsidies to families willing to support their children’s educational goals. Our evidence suggests that financial aid increases can increase educational attainment, though clearly at a cost that exceeds a perfectly targeted policy.

**APPENDIX TABLE A1**

*HRS sample construction*

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full HRS 2000 sample, with 1998–2004 gift data</td>
<td></td>
</tr>
<tr>
<td>Initial number of households</td>
<td>13,091</td>
</tr>
<tr>
<td>Number of children of these households</td>
<td>40,667</td>
</tr>
<tr>
<td>Of these, children with complete age and education data</td>
<td>37,875</td>
</tr>
<tr>
<td>Of these, children aged 24 years and over</td>
<td>36,353</td>
</tr>
<tr>
<td>Of these, children with complete gender and relationship data</td>
<td>36,351</td>
</tr>
<tr>
<td>Of these, children with at least one sibling</td>
<td>34,610</td>
</tr>
<tr>
<td>Of these, have 1998–2004 gift data</td>
<td>34,593</td>
</tr>
<tr>
<td>Number of families represented by remaining children</td>
<td>9471</td>
</tr>
<tr>
<td>HRS Wave 2 Module 7 sample</td>
<td></td>
</tr>
<tr>
<td>Initial number of module respondents</td>
<td>827</td>
</tr>
<tr>
<td>Number of families represented by the respondents</td>
<td>427</td>
</tr>
<tr>
<td>Number of children in the above families</td>
<td>1542</td>
</tr>
<tr>
<td>Of these, children with complete age data on all siblings</td>
<td>1536</td>
</tr>
<tr>
<td>Of these, children who are 24 years and older</td>
<td>1458</td>
</tr>
<tr>
<td>Of these, children with gift data</td>
<td>1444</td>
</tr>
<tr>
<td>Of these, children with complete education, gender, and relationship data</td>
<td>1362</td>
</tr>
<tr>
<td>Of these, children with at least one sibling</td>
<td>1262</td>
</tr>
<tr>
<td>Number of families represented by remaining children</td>
<td>334</td>
</tr>
</tbody>
</table>
Acknowledgment. We are grateful to the National Institutes of Aging and Child Health and Development and to Bob Hauser and the Center for Demography of Health and Aging at UW-Madison for supporting our work. Seshadri also thanks the Alfred P. Sloan Foundation and Brown thanks the National Science Foundation for financial support. Ben Cowan and Caleb White provided excellent research assistance. We thank the editor, two anonymous referees, Joe Altonji, Lance Lochner, Cecilia Rouse, Todd Stinebrickner, Chris Taber, Arthur van Soest, Michael Waldman, and seminar participants at Brookings, Brown, Chicago, Cornell, Duke, Einaudi Institute for Economics and Finance, the Federal Reserve Bank of New York, the Board of Governors of the Federal Reserve, Iowa State, Johns Hopkins, London School of Economics, Maryland, McMaster, Michigan, NBER, Netspar, Northwestern, Purdue, University of California, Los Angeles, Virginia, Western Ontario, Wharton, and Yale for helpful comments. The views and opinions offered in this paper do not necessarily reflect the position of the Federal Reserve Bank of New York or the Federal Reserve System.

Supplementary Data

Supplementary data are available at Review of Economic Studies online.

REFERENCES


