the institute for college access & success

EXECUTIVE SUMMARY

ALIGNING THE MEANS AND THE ENDS:

How to Improve Federal Student Aid and Increase College Access and Success

FEBRUARY 2013

WHITE PAPER

Executive Summary

The need for higher education and training has never been so important to individuals and our economy as it is today. Yet, its affordability is seriously in question. College costs have skyrocketed as family incomes and state funding for public higher education have declined, leading millions to take on student debt, drop out, or struggle to keep up with classes while working too many hours to pay the bills. Even after recent significant increases, the maximum Pell Grant today covers the smallest share of the cost of attending a public college since the start of the program 40 years ago. It should be no surprise that the gaps in college enrollment, persistence, and graduation between children from high- and low-income families have widened over the last 30 years, threatening both the American Dream and our nation's economic competitiveness.

Although these gaps cannot be closed with financial aid policy alone, research shows that it can increase enrollment, persistence, and completion. Families would have had a much harder time paying for college over the last five years without the significant increases in Pell Grants, tax benefits, and G.I. Bill benefits. However, even with these increased investments, current federal financial aid policies have not closed the growing gaps in access and success. Based on the available research, there are at least five major reasons why:

- Available need-based grant aid is insufficient to overcome gaps in access and success.
- Students and families lack sufficient information about costs, financial aid, and outcomes to make fully informed decisions about which colleges to apply to and attend.
- The complexity of the current federal aid application process and programs undermines their effectiveness.
- States and colleges are not held sufficiently accountable for ensuring that their students receive a quality education and can complete without burdensome debt.
- Changes to financial aid programs have not consistently prioritized access and success for financially needy students.

This white paper includes recommendations to address each of these problems by reforming federal grant, loan, and tax policies, increasing accountability, and providing students and families with the information they need to make wise decisions about where to go to college. Some of these changes require additional investments, and this paper includes options that would more than pay for the recommended reforms. Many of those options enjoy bipartisan support and have been endorsed by a broad range of organizations and experts, underscoring that the question is whether our nation has the will to make the needed changes.

Student Eligibility and Accountability: Simplify the aid application process while better targeting aid and preventing fraud.

There is widespread agreement that the current federal student aid application process is so complex in structure and timing that it can be an obstacle rather than a path to a college education. While significant progress has been made in recent years, the Free Application for Federal Student Aid (FAFSA) still rivals the full 1040 tax form in length. Students still do not learn how much aid they are eligible for until after they have already applied to colleges, and the lowest income students do not benefit from recent simplification measures. Research shows that both the timing and process can be greatly improved while still targeting aid to needy students.

- Calculate aid eligibility using the tax or W-2 data available when students typically apply to college. This one change would dramatically simplify the process for both students and schools, and tell students how much aid they can expect before, rather than after, they apply to colleges.
- Streamline the verification process that occurs after students submit the FAFSA to ensure eligible students get aid and reduce burdensome paperwork for schools and students.
- Improve the federal needs analysis formula to better target aid while reducing the number of questions that cannot be answered by existing tax and wage data.
- Better prevent fraud by having the U.S. Department of Education (the Department) flag aid applicants with histories that suggest fraud. In these cases, colleges should determine aid eligibility based on the applicant's total enrollment history, including at prior schools, so they cannot enroll and withdraw at school after school while receiving federal aid.

College Eligibility and Accountability: More closely tie a college's eligibility for funding to the risk students take by enrolling and the risk taxpayers take by subsidizing it, and reward schools that serve students well.

While students are, and should, be held accountable for studying and making progress toward a credential, there are few consequences for schools that fail to graduate large shares of students or consistently leave students with debts they cannot repay. Taxpayer dollars should not subsidize schools that routinely do more harm than good. The data are clear that some schools do much better than their peers at enrolling and graduating similar students without burdensome debt. To ensure that available federal aid dollars are spent wisely, we recommend more closely tying colleges' eligibility to the risks they pose to students and taxpayers. This means rewarding colleges that serve low-income students well with more funds and greater flexibility to innovate, while strengthening oversight and accountability measures to prevent waste, fraud, and abuse.

- Sanction schools based on their Student Default Risk Index (SDRI) rather than their Cohort Default Rate (CDR). The CDR reflects only the share of a school's student loan borrowers who default. The SDRI is the three-year CDR multiplied by the school's borrowing rate. By incorporating the share of students who borrow loans into the measure, the SDRI more accurately conveys a student's risk of defaulting at a given school.
- Require risk-sharing by schools if they receive a majority of their revenue from federal student aid and have SDRIs that are relatively high but fall below the eligibility cutoff. Currently, a school's eligibility for federal aid is all or nothing, with no risk-sharing in place, regardless of how much taxpayer funding it receives.
- Reward colleges with very low SDRIs with additional flexible funding based on their low-income student enrollment. By basing the additional funding on Pell Grant dollars disbursed, colleges would be encouraged to enroll low-income students and help them apply for aid and enroll full time.
- Let colleges with strong track records have more flexibility to innovate. With few exceptions, federal policies currently treat all colleges alike, regardless of their record of

serving students well. This one-size-fits-all approach to regulation and oversight tends to over-regulate the best colleges and underregulate the worst.

- Improve oversight and other accountability measures to better protect students. Whether schools are sanctioned using the current CDR standards or a more robust SDRI, additional policy changes must be made to ensure the integrity of the federal student aid programs.

Grant Aid: Secure and improve Pell Grants.

Research shows that need-based grant aid increases college enrollment among low- and moderate-income students and reduces their likelihood of dropping out of college. In particular, studies have found that Pell Grant recipients are more likely than other low-income students to stay enrolled and succeed. Research also suggests that the current complexity of the Pell Grant program and the fact that students do not know how much aid they will receive until after they have applied to colleges reduces Pell's effectiveness. However, even the best designed program will not be effective if it is not adequately funded. To close the widening income gaps in college access and success, we need to both improve the Pell Grant program in ways that do not cost money and dramatically increase our investment, while requiring that states and colleges also do their share.

- Double the maximum Pell Grant to close income gaps in access and attainment. Based on existing research, the maximum Pell Grant needs to be dramatically increased to overcome the current income gaps in enrollment and completion. Even a doubled maximum grant of $11,270 would cover a smaller share of the cost of attending a public college than it did in the late 1970s.
- Make Pell Grants a mandatory program. As long as Pell Grant funding is subject to annual appropriations based on projections that can turn out to be too high or too low, its cost and funding will never be perfectly aligned. This puts the program in jeopardy, creating unnecessary uncertainty for students and schools and putting college access and success at risk.
- Rename Pell Grants as Pell Scholarships to better convey the academic expectations of all recipients.
- Limit Pell eligibility while enrolled less than half time to two terms, to encourage timely completion while recognizing the challenges facing low-income students.
- Limit Pell eligibility to 7.5 years, excluding up to one year of remedial coursework, to allow completion of a bachelor's degree while meeting requirements for satisfactory academic progress. Current federal aid policies permit students to take up to 7.5 years to complete their bachelor's degree, but low-income students may only receive Pell Grants for up to six years.
- Congress should consider maintenance of effort provisions to ensure that new federal dollars supplement – rather than supplant – state and other forms of higher education funding and financial aid.

Student Loans: Reduce complexity, improve targeting, contain debt burdens, and encourage completion and wise borrowing.

The current federal student loan program is too complex, its terms are too arbitrary, and its benefits are poorly targeted. Much of the complexity is a holdover from when banks received subsidies to make Stafford Loans that were guaranteed by the government, shielding lenders – but not borrowers or taxpayers – from risk. Now that these loans are made directly and more cost-effectively by the Department of Education, the entire student loan system can and should be streamlined and improved. Subsidized Stafford Loans currently provide students with particularly valuable benefits, including a low fixed interest rate and no interest accrual while the student is in school. However, these benefits are not well targeted, as high-income students may qualify just because they attend a high-cost college. In addition, eight in 10 students with subsidized loans also have unsubsidized loans, diluting the subsidy's benefits. In July, the subsidized loan's interest rate is scheduled to double from 3.4 percent to 6.8 percent, while interest rates on 10-year Treasury notes are currently two percent. Reform is clearly and urgently needed. Our loan recommendations aim to better support access and success while containing costs and risks for both students and taxpayers.

- Provide a single undergraduate student loan with a fixed interest rate and no fees, in place of the two types of Stafford Loans available today. To support and encourage students to stay enrolled and complete, the loan would have a low interest rate while the student is in school, based on the government's cost of borrowing. When the loan enters repayment, the interest rate would rise by a set margin, but the total rate could never exceed a designated cap.
    - To help borrowers who go to school when interest rates are unusually high, the loan would have a built-in form of insurance that would keep their rates from ever being too much higher than the rate on loans being offered to current students.
    - To provide a targeted safety net for borrowers from low-income families, Pell Grant recipients would be eligible for interest-free deferments during periods of unemployment and economic hardship.
- Streamline and improve federal loan repayment options by:
    - Offering one income-based repayment plan that lets any borrower choose the assurance of manageable payments and forgiveness after 20 years. Right now there are three such plans with different eligibility criteria and payment formulae, with one more set to launch in 2014. Our proposal simplifies and improves this important repayment option.
    - Enabling borrowers to make one payment that covers all their federal loans, and basing standard repayment periods on the borrower's total federal student loan debt. These changes reduce unnecessary complexity and obstacles to continuous, on-time payments.
- Improve the timing, content, and effectiveness of student loan counseling to help students borrow wisely, complete college without burdensome debt, pick a repayment plan that works for them, and repay their loans.
- Prevent student loan defaults by automatically enrolling severely delinquent borrowers in an income-based repayment plan; targeting outreach to borrowers showing signs of

financial distress; and providing discharges when students are defrauded by their college, to be paid for by the school.

- Reduce financial distress by reconsidering the use of private debt collectors for defaulted federal loans; protecting income for basic necessities when collecting on defaulted loans; and ensuring there is a way out of default for all borrowers willing to take responsibility.
- Strengthen consumer protections for private loan borrowers by requiring school certification for all private education loans; enabling private loan borrowers to refinance or modify their loans; and treating private loans like credit cards and other similar types of debt in bankruptcy.

Tax Expenditures: Streamline and improve the targeting of higher education tax benefits.

Current higher education tax provisions are too poorly timed and poorly targeted to efficiently increase college access or success. We therefore recommend eliminating them and redirecting the savings (more than $100 billion over the first five years alone) into Pell Grants and incentive funds for states and colleges to increase college access, affordability, and success. Nevertheless, there is strong bipartisan support for higher education tax benefits. The American Taxpayer Relief Act of 2012 included more than $90 billion in such benefits that would have otherwise expired, including the extension of two of the most regressive and poorly targeted benefits: the student loan interest deduction and the tuition and fees deduction. If Congress is unwilling to eliminate current tax expenditures and redirect the savings to Pell Grants and other programs that more effectively and efficiently support college access and success, then we recommend dramatically streamlining and improving the targeting of higher education tax benefits. Our other tax recommendations call for simpler and more equitable tax treatment of Pell Grants and forgiven loans.

- If higher education tax benefits are to be retained, we recommend:
    - Streamlining the benefits by creating an improved American Opportunity Tax Credit (AOTC). Research suggests the AOTC is the most likely of the current tax benefits to increase college access and success. We recommend improving its likely efficiency and effectiveness by enhancing its benefits for low- and moderate-income students and for students attending community colleges. These changes would be paid for by eliminating other less targeted, less effective tax benefits, including the tuition and fees deduction, student loan interest deduction, Lifetime Learning Credit, and exclusion of earnings from Coverdell education savings accounts.
    - Better aligning eligibility for higher education tax benefits with student aid administered by the Department.
- Stop taxing forgiven or discharged student loans as income. Regardless of the reason for the discharge, no discharged or forgiven student loan debt should be treated as taxable income. This will correct current inequities that, for instance, exempt discharges resulting from school closures from taxation while taxing discharges for totally and permanently disabled borrowers.

- Stop taxing Pell Grants as income. To increase fairness, simplify the tax code, and improve coordination with the AOTC, Pell Grants should not be treated as taxable income if they are used for a qualified education expense.

Better Information: Provide students with key information when they need it.

We can increase the impact of financial aid by providing students and families with key information when they need it to make decisions about whether to go to college, where to go, and how to pay for it. However, much of the information students and families need is not currently available, or not available in a way that students can easily find and use. College is too important, and families and taxpayers pay too much for it, for us to lack basic information about costs, aid, and outcomes.

- Provide key data on cumulative student debt, private loan borrowing, loan defaults, and graduation rates. Before they decide where to apply and go to college, students need to know their chances of graduating and their chances of graduating with debt, particularly high debt and/or risky private loan debt. It is crucial that such data be collected and made available to both consumers and policymakers given rising debt and default levels.
- Provide proactive estimates of federal aid eligibility so students know they can afford college, and improve the free, online FAFSA4caster so it is easier to compare likely aid to costs at specific colleges. For students and families ready to select schools, create and promote College Scorecards with key information on every college, and make net price calculators easier to find, use, and compare.
- Require all colleges to use a standard format for financial aid award letters that makes it easy for families and students to understand and compare what they would need to save, earn or borrow at each college to which they have been admitted.
- Conduct consumer testing to ensure that information is presented in the most effective way, including for audiences with little or no college knowledge or experience.

The Institute for College Access & Success (TICAS) is an independent, nonprofit organization that works to make higher education more available and affordable for people of all backgrounds. TICAS is home to the Project on Student Debt, which seeks to increase public understanding of rising student debt and the implications for our families, economy, and society. For more about TICAS, see ticas.org.

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