



MAKING SENSE OF THE SYSTEM

Financial Aid Reform for the 21st Century Student

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EXECUTIVE SUMMARY

As postsecondary education becomes increasingly vital to participate and succeed in the modern economy, the student financial aid system has been tasked with ensuring that more students can afford and attend higher education, and also complete their studies with manageable levels of debt. However, there is substantial debate about whether the current financial aid system, particularly at the federal level, is effective in achieving those goals. The makeup of today's student population is substantially different than that of the generation for which many aid programs were designed, and it continues to evolve. Meanwhile, the cost of higher education has increased, state funding levels have receded, and students—particularly those from low-income households—have been required to take on greater levels of debt in order to attend and complete college, even as they are told that postsecondary education is essential in today's society.

Fortunately, there is a growing body of research on what financial aid programs have and have not been effective in helping students, particularly students who have been traditionally underserved by the system. These research insights on the effectiveness of grants, loans, tax incentives, and other programs, as well as the timing and delivery of financial aid, will be crucial as policymakers rethink how best to help students afford higher education. The research suggests that need-based grants are more effective than loans and tax credits in promoting access and success for underserved students. It also suggests that when grants are ineffective, it is often because they do not cover a substantial portion of tuition costs. Additionally, tax credits suffer from timing and delivery issues, in that students do not receive them until well after they have enrolled in higher education and paid tuition bills. Loans have proven effective in helping middle- and upper-income students finance college, but the increased reliance on them has likely deterred many low-income students from attending. Given this moment, as well as the evidence available, it is

important not only to reassess policies—particularly at the federal level—that aim to provide students with financial aid, but to design new policies with an eye toward meeting the challenges, financial and otherwise, that today's students face. This paper lays out a set of guiding principles in the reimagining of financial aid design and delivery, including:

- **The primary targets of need-based financial aid should be low-income students, but given rising costs, programs should be balanced to support reducing debt levels for middle-income populations as well.**
- **Financial aid reform should focus first on crafting policies that can more effectively help students gain access to and succeed in college, and then focus on the availability of public resources.**
- **There is room for simplification, efficiency, and cost-effective reforms that may be accomplished without additional public investment.**

- **The earlier financial aid can be communicated or delivered, the more likely it is to benefit students.**
- **The financial aid system should better reflect the needs of nontraditional students.**
- **New federal financial aid programs should leverage, not replace, effective support from states, institutions, and the private sector.**
- **Aid should be coordinated as a shared responsibility among students and their families as well as the federal government, states, institutions, the K–12 education system, and others that hold a stake in a more equitable and efficient financial aid system.**

In light of these principles as well as the research literature, this paper outlines 13 policy recommendations to improve the financial aid system. These recommendations are organized to reflect student goals and outcomes, and recognize that financial aid can be beneficial to student access and success at many points throughout their educational career. Ideas to improve student financial aid include the following:

PROMOTE EARLY AND COORDINATED PREPARATION FOR COLLEGE

- Create a system of early financial aid “accounts” that can leverage family savings and public/private resources.
- Match family college savings for low-income households through public or employer dollars.
- Make the American Opportunity Tax Credit (AOTC) fully refundable so it may be utilized by low-income households, and create a pilot program for early delivery of the credit.
- Communicate potential financial aid awards in a statement based on Internal Revenue Service (IRS) information that allows families to plan for the cost of college.

RESTRUCTURE OR REPURPOSE GRANT AND LOAN DELIVERY MECHANISMS

- Maintain the Pell Grant program as the centerpiece of need-based aid, and make it an entitlement.

- Provide block grants to states to coordinate institutional student services and public benefits to financial aid.
- Reform the Supplemental Education Opportunity Grant (SEOG) to provide institutions with money for “emergency” aid to students.

PROVIDE INCENTIVES FOR COMPLETION

- Institute a system of loan forgiveness for on-time completion for Pell-eligible students.
- Tie campus-based aid to student debt repayment levels and degrees awarded, in addition to cohort default rates.
- Create incentives for performance-based grants.
- Incentivize that spending be maintained on need-based aid for students.

REDUCE DEBT BURDENS AND PROVIDE BETTER REPAYMENT OPTIONS FOR STUDENTS

- Make Income-Based Repayment (IBR) the default option for student loan repayment
- Incentivize pre-tax employer matching for student debt repayment for the first five years after a student has completed college.

Finally, it is important that any recommendations, and their underlying principles, support student success without reducing access. Therefore, it is crucial to highlight the benefits, trade-offs, and unintended consequences of each financial aid proposal from multiple perspectives—in other words, to better understand the implementation challenges of each policy or program.

Financial aid proposals may have positive or negative impacts on different stakeholders: Students and families (and distributional effects on specific groups of students), higher education institutions (and specific types of institutions), and federal and state governments and the taxpayers they represent. Therefore, this report offers a framework for determining potential trade-offs for each actor in the higher education system, and examines the trade-offs for several of the policy recommendations listed above.

INTRODUCTION

The student financial aid system has been tasked, intentionally or otherwise, with accomplishing several goals for students. The primary goals include increasing access for the nation's most underserved students as well as promoting student retention and success. But over time, other goals have emerged, including supporting student choice to a broad range of institutions, managing debt levels upon completion of a degree, or encouraging students to enter particular fields of study. These goals and investments reflect the view that increased levels of higher education attainment will benefit both individual students and society as a whole.

In recent years, however, there has been a series of debates over the proper role of government—at all

levels—in helping students afford the cost of higher education and using scarce public resources to help students attain high-quality degrees and credentials that lead to employment. At the same time, many in the business community have discussed the need for a highly skilled, dynamic pool of potential employees who can fill the jobs of an increasingly specialized and global economy. These debates have occurred against the backdrop of increasing tuition and declining state support for higher education over the past few decades, as well as a decade of stagnating and declining family incomes and several years of high unemployment in the aftermath of the most recent recession. Furthermore, the makeup of the country's undergraduate student population continues to evolve, to include more non-traditional, minority, and first-generation students—populations for whom the design of the current financial aid system may be inadequate or ineffective.

In light of these new realities, it is important not only to reassess policies, particularly at the federal level, that aim to provide students with financial aid, but to design new policies with an eye toward meeting the challenges, financial and otherwise, today's students face.

Equally important, however, is the recognition that policy is a series of choices and trade-offs, particularly in a world of scarce public and institutional resources. Therefore, all policy recommendations—in this paper and elsewhere—need to be examined through a critical lens to assess their intended or unintended trade-offs for different groups of students and institutions, as well as any fiscal and political considerations.

This white paper is organized into three sections. **PART I** seeks to provide context to the current financial aid debate by laying out the research on which aid best promotes student access and success. **PART II** provides several principles and assumptions that should undergird financial aid design and delivery, along with policy recommendations based on both the principles and the research. Finally, **PART III** proposes a framework for assessing policy trade-offs that policymakers at all levels can use to inform their decision making on how changes to the financial aid system will affect students.

ABOUT THIS REPORT

This white paper has been generously funded by the Bill & Melinda Gates Foundation through the Reimagining Aid Design and Delivery (RADD) project. It has been informed by the Institute for Higher Education Policy (IHEP) mission of increasing postsecondary access and success for all students, with a special focus on underserved populations. With this perspective, IHEP conducted several strands of research activities to inform this white paper, including policy scans and literature reviews that helped to provide historical and international context for reform. Additionally, IHEP sought insight from audiences inside and outside of traditional higher education discussions by sending surveys to over 1,000 representatives from civic groups, students, youth groups, media, government, and business groups on the overall health and equity of the financial aid system. To further refine the list of options for reform, the survey responses were used to develop a framework and a set of protocols to guide focus groups consisting of both traditional and nontraditional higher education audiences. The focus groups provided insight into ways in which each community believed that the system could be made more equitable and responsive to student needs, and helped develop ideas for reform.

PART I. DEFINING FINANCIAL AID EFFECTIVENESS

Background on Federal Financial Aid

Student financial aid is delivered in several ways, at several points along a student's career, and through various mechanisms. Students may receive money to finance postsecondary education from the federal government, states, higher education institutions, or private sources.

Federal financial aid is delivered in several forms, including:

- Grants to students that act as vouchers to offset the cost of college at eligible Title IV institutions.
- Subsidized loans that allow students to borrow at lower rates, or borrow interest-free while enrolled in school, in order to finance the cost of attendance.
- Tax incentives, including credits and deductions, that reduce the tax liability of families with members enrolled in college.
- Federal work-study, which incentivizes students and employers to work while enrolled in school.
- Campus-based aid for institutions to distribute to students.
- Incentives through 529 plans and other financial products that allow families to save portions of their income to finance future college costs.

To be eligible for federal financial aid, students must first complete the Free Application for Federal Student Aid (FAFSA). Awards are distributed based on a formula that determines a student's ability to pay based on their financial circumstances and potential educational costs.

Overall, nearly \$174 billion was provided in federal financial aid in 2011–12, which represents 71 percent of total funds (including state, institutional, and private grants, and state and private loans) used by postsecondary students (College Board 2012). The federal government is the largest provider of student aid, with more than 60 percent given as federal loans and 28 percent as federal grants. Over the past decade, the federal government has increased total financial aid

by 140 percent, resulting in a 79 percent increase in federal aid per full-time equivalent student.¹

The overall increase in student aid must be understood, however, in the context of rising tuition and declining family income. For example, published tuition, fees, room, and board at public four-year institutions increased by 45 percent (adjusted for inflation) over the past decade (College Board 2012). Meanwhile, median household income declined 7 percent over the same period (U.S. Census Bureau 2012). These dynamics have effectively decreased the purchasing power of federal financial aid. The maximum Pell Grant, for example, will cover only 31 percent of the cost of attending the average four-year public institution in 2012–13, despite an increase in the overall maximum award. This represents a decrease in purchasing power of 41 percent in 2002–03, and more than 70 percent since the late 1970s (Mahan 2011).

“No qualified student who wants to go to college should be barred by lack of money. That has long been a great American goal; I propose that we achieve it now.”

—President Richard Nixon, 1970

In short, although the federal government—and to a lesser extent, states and institutions—has supplied more funding for students to finance college, much of this increase has been absorbed by the rising cost of attendance as well as increased strains on household budgets. Moreover, while grants have increased more rapidly than loans in recent years, much of the increase in federal aid over time can be attributed to an increase in federal loans that must be paid back with interest after a student leaves an institution, even if the student does not complete a degree.

¹ Because total student enrollment increased by 34 percent during this time, maintaining federal aid at 2001–02 levels per student would increase the total federal expenditure on financial aid. In the same decade (2001–02 to 2011–12), state and institutional aid also grew, but at a slower pace adjusted for inflation. State grants, for example, increased by 11 percent per full-time equivalent student in this period (College Board 2012; author's calculations).

How and When is Federal Aid Most Effective in Promoting Access and Success?

Federal aid programs vary by size, scope, structure, and timing. Given this variety, it is not surprising that the research on the effectiveness of federal student aid varies by program. Most studies attempting to determine the effectiveness of financial aid have concentrated on enrollment outcomes, or whether students are more likely to attend college with federal aid than without. Less well known is the effect of federal aid on student persistence and completion, though more attention has been paid to these outcomes in recent years. However, it is important to keep in mind that the value, timing, and conditions in which students receive aid may have a sizable impact on whether the goals of aid programs are achieved. For example, a grant is less likely to be effective in inducing access if it loses purchasing power (relative to college costs), but it also will not be effective if a student is unaware that it exists or does not receive the grant when it is most likely to make a difference.

There is ample room for more research on the effectiveness of financial aid, particularly on progress and degree completion. The following section briefly describes the existing research on the effect of grants, loans, tax credits, and work-study on student outcomes, and how simplification and delivery may affect the success of each program.

Grants

Several studies have shown that need-based grants, which effectively lower a student's net cost of attendance, increase the likelihood that a student will attend college (Dynarski 2003a; McPherson and Shapiro 1991). Generally, grants have been shown to be more effective than loans in promoting college participation among low-income students (Heller 2012). This finding is especially true for nontraditional students, for whom the impact of the Pell Grant program has been particularly strong (Seftor and Turner 2002). Given that the majority of students currently attending postsecondary education are in some way "nontraditional" (defined as adult, independent, part-time, delaying enrollment, or not having received a high school diploma), the impact of need-based aid on these populations is worth examining. Finally, there is evidence that need-based grants reduce the likelihood that low- and moderate-income students will drop out of

college, and a recent study also indicates that a \$1,000 increase in grant aid increases receipt of a bachelor's degree by 4.6 percent (Bettinger 2004; Castleman and Long 2012). Evidence of the effectiveness of Pell grants in particular is almost certainly complicated by variations in cost from year to year for students, and thus the fluctuations in purchasing power of the Pell Grant program.

Of course, not all grants are need-based. Many state or institutional grants are awarded on the basis of academic merit or other non-need factors. Research has consistently shown that merit grants are awarded disproportionately to students from wealthier families, meaning that their impact on inducing college access for low-income populations is limited or at least compromised (Baum, Little, Ma, and Sturtevant 2008; Dynarski 2003a; Heller 2006; Long 2007). Although federal aid is primarily distributed on the basis of need, more than half of all grants awarded by institutions and nearly one-third of all grants awarded at the state level are based on measures that do not take student need into account (Heller 2012).

Loans

Loans make up the greatest share of federal financial aid to college students. Students often receive both subsidized loans—meaning that the government is responsible for paying interest while a student attends school—and unsubsidized loans, which may have lower rates than private loans but still accrue interest while students are enrolled. The Stafford loan is the most common federal loan, and students with unmet need after their grant aid can receive a limited amount of subsidized Stafford loans. Unsubsidized Stafford loans are available to students beyond this amount. Some institutions have a limited amount of Perkins loans to distribute to needy students; these loans have the greatest benefits, with subsidized interest, the lowest interest rate (5 percent), and the longest grace period (nine months). Unsubsidized Parent Loan for Undergraduate Students (PLUS) loans are available for graduate students and parents of dependent undergraduate students at a fixed interest rate.

Loans have increased as a share of individual student aid packages over the past several decades due in part to the introduction of unsubsidized loans, and this has coincided with the increase in overall cost of attendance. This shift in the cost burden to students is

important and may affect low-income households disproportionately (Long and Riley 2007). Some students may be more averse to borrowing than others, which increases their chance of dropping from full- to part-time enrollment or avoiding enrollment altogether. Other students may choose to work rather than take out loans, which may have an adverse effect on academic progress (Cunningham and Santiago 2008; Johnson, Montmarquette, and Eckel 2003).

Despite the proliferation of loans as a primary financing strategy, there is little evidence on their effect on college access and success, particularly for low-income households. Evidence suggests that increases in loan eligibility drive higher college enrollment rates, though effects are primarily seen for middle- and upper-income households (Dynarski 2003b; Long 2007). However, the increase in the availability of loans is not zero-sum; the availability of grants does not automatically decrease if loans increase. Indeed, both loans and grants have increased in recent years. Given this dynamic, more research is needed on the combined impact of both policies.

Tax Benefits and Savings

The federal government has instituted numerous tax policies in to ease the burden of college costs. For example, students are given the option of deducting tuition and fees from their income tax burden. However, this option has proven to be a highly regressive policy, with families in the top quintile of income often receiving more than five times more financial benefit of this tax deduction than low-income families (Maag, Mundel, Rice, and Rueben 2007). Students who attend college are also eligible for education-based tax credits that reduce their overall federal tax bill. In particular, the federal government created the Hope Credit (now known as the American Opportunity Tax Credit, or AOTC²) in the late 1990s, which was designed to help families offset the cost of tuition. The credit was claimed primarily by a small percentage of middle-income households, mainly because families without a tax

² In 2009, the Hope Credit was reformed and replaced with the AOTC. The maximum credit available was increased to \$2,500. The new credit is also partially refundable, meaning that students with no tax liability are eligible for up to \$1,000 of the total benefit. The net benefits of the AOTC above the Hope credit have not been subjected to rigorous research; some of the latter's inherent disadvantages (mainly timing) still exist in the new format.

FINANCIAL AID EFFECTIVENESS: WHAT DOES THE RESEARCH SAY?

Although more research is needed on the effectiveness of financial aid, we do know several things:

- **For low-income students, need-based grants are more likely to be effective in increasing access and completion than other forms of aid.** This is true provided that grants cover a meaningful percentage of students' cost of attendance.
- **The increase in the use of student loans as a financing strategy has had detrimental effects on low-income and underserved students.** Though loans may have been helpful for middle- and upper-income students, low-income students may be more averse to borrowing and also tend to have higher debt loads upon leaving school.
- **There is little proof that tax credits are effective for low-income students.** This is likely in part because they have been available to a small portion of the middle class, and because students do not receive them until after they are required to pay tuition.
- **Timing and delivery matter.** Although the design and dollar amounts of financial aid are important, students are more likely to utilize financial aid, and it is much more likely to be effective, when it is communicated clearly and early, provided through a simple enrollment and delivery process, and coupled with robust student counseling and support services.

liability were ineligible to receive it. Long (2004) and others have detailed that this and similar tax credits had virtually no impact on college access and attainment for low-income students in the years following its introduction, primarily because these credits were not readily available.

The federal government also provides tax-free growth and distributions to college savings plans (or 529 plans, named after the portion of the Internal Revenue Code to which they refer). These plans have been used primarily by middle- and upper-income families to subsidize future college bills (only 9 percent of those who invest in college savings plans report incomes below \$50,000 annually), most likely because families with little or no tax liability do not benefit from them (Bearden 2009; Black and Huelsman 2012). However, an emerging body of behavioral research indicates that, when presented with financial products that are tailored to their needs, low-income families can and do save for future needs, including higher education, and that savings for higher education are linked with outcomes such as increased college expectations, academic performance, and college attendance (Elliot and Beverly 2011; Zhan 2006; Zhan and Sherraden 2011). Significantly, this finding holds true for low-income students who have money set aside for educational and other future purposes, and some research has shown that savings in a child's name is a significant predictor of academic achievement in low-income children, but not in high-income children (Beverly and Sherraden 1999; Elliott, Jung, and Friedline 2010).

Federal Work-Study

Work-study is neither a grant nor a loan; instead, the recipient works for pay at a part-time job while in college, typically on campus. The federal government provides most of the pay, with the institution providing the remainder. Although the overall expenditure on federal work-study programs is minor compared with that of federal grants and loans, work-study programs are designed to provide additional financial opportunities for needy students.

It is nearly impossible to estimate the enrollment impact of work-study aid because it is packaged at the institutional level as a small part of the financial aid offered to students. Theory abounds about whether part-time work while in college has a net positive or negative effect. On the one hand, it reduces study time, but on the other hand it can improve integration into campus life, thereby increasing persistence. However, evidence suggests that work incentives produce mixed effects on grade point average and the likelihood of graduating within four years, and affects females more negatively than males (Scott-Clayton 2011). At best, it

has no known positive effects on academic outcomes or student persistence.

Timing and Delivery

To be effective, financial aid must be provided to students when it is likely to be most beneficial, and designed in a manner that ensures that students utilize it. Substantial research indicates that the process of applying for and receiving financial aid is cumbersome, and the complexity of the federal application process has a disproportionate effect on low-income students who may be on the margins of enrollment (Bettinger, Long, Oreopoulos, and Sanbonmatsu 2009; Dynarski and Scott-Clayton 2007). In addition, many students who otherwise would have been eligible for Pell grants or subsidized loans do not apply for them because they lack knowledge of the financial aid process or are put off by its complexity (Avery and Kane 2004; Long 2008). The effect of need-based aid overall is often maximized by simplifying the process, which can be done by pre-populating financial aid forms with requisite income and household wealth data. Simplifying the process seems to be more effective than providing families with more clear information on college costs and financial aid (Bettinger, Long, Oreopoulos, and Sanbonmatsu 2009). Research has also shown that many of the questions on the needs assessment for students are superfluous, and that a drastically simpler formula would yield nearly the same awards for students (Baum, Little, Ma, and Sturtevant 2012; Dynarski and Scott-Clayton 2007). Complexity and timing are also problematic with regard to tax credits. In the U.S. tax system, families do not receive tax refunds (the vehicle through which credits are delivered) until after they have filed taxes, which are due in April. In contrast, most college tuition bills are due at the beginning of a semester (often August or January), meaning that families must wait for several months after they have paid tuition before receiving financial relief (Long 2004). Because of this delay, as well as general confusion among eligible families, 14 percent of tax filers do not claim a higher education tax credit or tax deduction for which they are eligible, and an average of \$466 in tax savings goes unclaimed by families each year. Further, 250,000 families that did claim tax benefits in 2009 did not choose the most beneficial option, and lost out on approximately \$300 on average (Scott and White 2012).

Finally, student success is predicated on more than financial aid. Research clearly connects student engagement and campus supports to college outcomes, particularly among nontraditional students and those attending two-year institutions (College Board 2010; Engle and Tinto 2008; Kuh 2008). This finding indicates that financial aid may be necessary to support student success, but even well-designed programs require on-campus mechanisms to ensure that students are engaging beneficially with the financial aid system. While many institutions have limited dollars to spend on student support services, the efficacy of federal financial aid in particular may require a more integrated process in which financial aid is linked to on- or off-campus supports and benefits for students. In short, there are many ways to improve the current financial aid system, though policymakers would be wise to focus on what is working (or most likely to work) for students who most need financial and other support. This approach includes maintaining financial aid to keep pace with college costs, timing financial aid to enhance student expectations, and supplementing financial aid with campus and other supports to ensure that students take advantage of all available aid.

PART II. PRINCIPLES AND RECOMMENDATIONS FOR POLICY

Guiding Principles for Financial Aid Design and Delivery

The research on effectiveness is important in conceptualizing and designing a more effective financial aid system. However, the design of financial aid policies will inevitably be grounded in principles of equity and the proper role of stakeholders in the financial aid system, including students, families, institutions, states, employers, and the federal government. The following section offers a series of guiding principles on how to structure and deliver aid to ensure access and success for all students. These principles have been derived from both the research literature and our perspective on the most important goals of financial aid—increasing student access to postsecondary education, fostering student persistence to a degree or credential, and improving educational equity.

The primary targets of need-based financial aid should be low-income students, but given rising college costs, programs should be balanced to support reducing debt levels for middle-income populations as well. Low-income students are less likely to enroll and persist in higher education for many reasons, including real and perceived cost barriers as well as lack of academic and social supports. Therefore, the federal government should focus aid to students who may not otherwise attend and graduate. While a renewed effort to focus on low-income students would certainly increase equity and opportunity, it may also be an efficient use of public resources, given that relatively small investments in aid to underserved students may have greater effects on enrollment and persistence than the same investment in higher-income students, who would probably attend college regardless of whether they received need-based aid.

However, the rise in college costs has increased debt loads for middle-income students as well. It is therefore important to target some financial aid at middle-income students in order to ensure persistence, manageable debt loads upon completion, and consumer confidence.

Financial aid reform should focus first on crafting policies that can help students gain access to and succeed in college, and then focus on the availability of public resources. By definition, policies are debated and crafted in an environment of scarce public resources. This is particularly true in light of the recent recession, which has affected the ability of individuals, the federal government, and states to make new investments in higher education. Fiscal policy is a necessary piece of the debate over investments in education. However, it is important that financial aid proposals be evaluated first on how likely they are to ensure access, persistence, and completion for students—particularly those who could not attend without support. Likewise, any discussion of cuts to financial aid programs should begin by discussing which policies have proven ineffective or inadequate in helping students attend and complete college. Deep cuts to effective programs may provide temporary budget relief, but could cripple the long-term ability of the United States to increase higher education attainment rates.

There is room for simplification as well as increased efficiency within the financial aid system, and some reforms could be cost-effective. Not all new policies will require a substantial amount of public resources in order to be effective. Some current programs are ineffective because they are either overly complex, or communicated and delivered improperly. Simplifying the financial aid application and delivery processes, and ensuring that students clearly understand their awards and responsibilities, may go a long way in ensuring aid effectiveness without a large increase in government funding. In addition, many students who receive financial aid also often receive public benefits

“I am absolutely committed to making sure that here in America, nobody is denied a college education, nobody is denied a chance to pursue their dreams, nobody is denied a chance to make the most of their lives just because they can’t afford it. We are a better country than that, and we need to act like we’re a better country than that.”

—President Barack Obama, 2010

and services that, while not tied to higher education, may help them on the path to degree completion. Therefore, there should be better coordination among financial aid, existing public benefits, and campus support to maximize each benefit.

The earlier financial aid can be communicated or delivered, the more likely it is to benefit students.

The primary federal financial aid policy mechanisms target students at the time they decide to enter college, or by mitigating the costs of attendance once they have enrolled. However, most students form higher education expectations well before the application process for federal student aid begins. Research indicates that early and clear communication of financial aid and other information is likely to help students conceptualize and plan for the cost of higher education (Advisory Committee on Student Financial Assistance [ACSFA] 2008). Additionally, financial literacy and education is likely to be more effective if students receiving it also gain early access to actual financial services and products. Therefore, where possible, students should be given clear information about how much aid to expect well before college enrollment, and possibly provided with actual funding before college enrollment. There is a role for stakeholders in the K–12 system in ensuring that students are prepared and knowledgeable about the opportunities available to them after high school.

The financial aid system should better reflect the needs of nontraditional students. Much of the design of the current financial aid system is tailored to the needs of traditional students, typically described as students who enroll in postsecondary education immediately upon high school graduation. However, most students—perhaps up to 75 percent—who enroll in postsecondary education are nontraditional in some way (ACSFA 2012). There is a great deal of diversity in groups that are often defined as nontraditional—veterans, full-time workers, older students, General Educational Development (GED) recipients, student-parents, and students who are financially independent—and the financial aid system needs to recognize the specific circumstances facing these students in access to and persistence through college. This includes not only providing more flexibility, but also ensuring that aid is met with on-campus supports that

meet the needs of an increasingly diverse student population.

New federal financial aid programs should leverage, not replace, effective support from states, institutions, and the private sector. As state financial support of higher education has decreased, families and students have been required to finance postsecondary education out of current or future earnings. Meanwhile, the federal government has increased the total aid provided to students in recognition of high tuition and debt levels. However, the effectiveness of federal financial aid can be compromised by a decrease in state or institutional support. Therefore, new financial aid programs should not simply replace state or institutional aid programs, provided those programs are effective in helping underserved students. States and institutions should maintain their efforts to provide a net benefit to students.

Aid should be coordinated as a shared responsibility among students and families, states, institutions, the federal government, the K–12 education system, and other stakeholders. Higher education provides many benefits to students, including greater lifetime earnings, labor market opportunities, and quality-of-life outcomes. Higher education provides both economic and social benefits to society as well, including greater productivity and consumption, higher tax revenues, reduced crime, and better citizenship (IHEP 2012). Therefore, financial aid—which is intended to support higher education attainment—should be thought of as a system of shared responsibility among those who benefit. Each stakeholder should have “skin in the game,” because all parties stand to benefit from an effective financial aid system. This also encompasses efforts to better align K–12 and postsecondary education policies so that financial aid can best accomplish its goals.

These principles attempt to turn financial aid away from a series of isolated policies and into a coordinated system for students. Ideally, financial aid programs will work in concert, with investments being made by all who have a stake in its success and throughout a student’s career. Under a model financial aid system, students will be aware of the financing opportunities available to them, and these financing opportunities will

both be valuable as well as reflective of student needs. Most importantly, increasing college attainment for underserved student populations will require a system of smart and effective public investment. Defining such a system will require not only policy ideas, but clear discussions about the tradeoffs of each idea—for students as well as institutions. This will allow institutions in particular to spend scarce resources on supports for students that may preempt or mitigate the unintended or negative consequences of various policy choices.

The Pipeline of Financial Aid: Policy Recommendations

The financial aid system has been designed in silos, as a series of individual policy ideas rather than an integrated system that follows students throughout the educational pipeline. Some policies may be more suited to access, others will be required to ensure student progress, and still others will be needed to help alleviate excessive debt. These intentions, and thus programs, will overlap in many cases. Recognizing that financial aid can be delivered at many points along a student’s career, our four policy recommendations are organized into four areas of student outcomes:

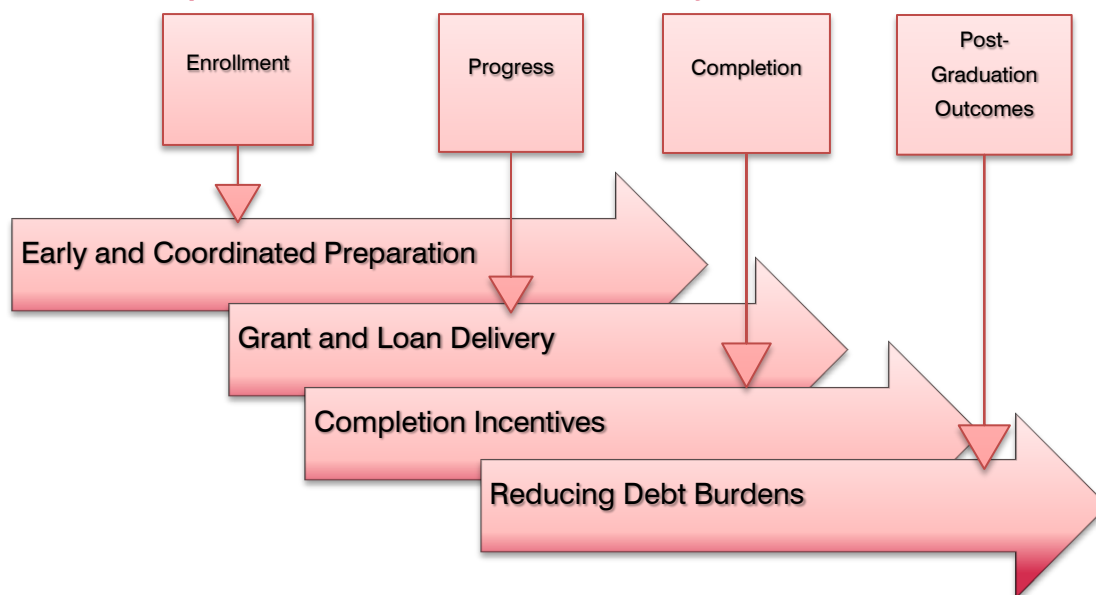
1. **Promote Early and Coordinated Preparation for College.**
2. **Restructure or Repurpose Grant and Loan Delivery Mechanisms.**

3. Provide Incentives for Completion.

4. Reduce the Burden of Debt Repayment for Students.

These ideas are informed by a thorough review of research on which types of financial aid are most likely to be effective in promoting student access and success. Additionally, these ideas are the result of discussions with higher education thought leaders, students, and researchers, as well as groups that currently reside outside traditional higher education discussions, such as students, civic groups, youth groups, and the business and workforce development community. Where possible, cost considerations have been mentioned, as well as relative feasibility in getting ideas off the ground. **FIGURE 1** displays these areas of policy reform along the educational pipeline. Policies may help students access (or enroll) in college, progress through college, complete college, and have meaningful postgraduate outcomes with manageable student debt. There also may be considerable overlap in the effects of these policy reforms—for example, a program to promote early preparation may affect both student progress and access. As such, this figure attempts to convey that financial aid is best designed as an overlapping system, where new financial aid programs build on the momentum of previous ones.

FIGURE 1. The Pipeline of the Student Financial Aid System



RECOMMENDATION #1: Promote Early and Coordinated Preparation for College

POLICY RECOMMENDATIONS

- Create a system of early financial aid “accounts” that can leverage family savings and public/private resources.
- Match family college savings for low-income households through public or employer dollars.
- Communicate potential financial aid awards in a statement based on IRS information that allows families to plan for the cost of college.
- Make the AOTC fully refundable so it may be utilized by low-income households, and create a pilot program for early delivery of the credit.

Given the research literature on the effectiveness of early financial preparation, the federal government should make an effort to coordinate financial aid as a means of increasing student expectations and providing resources for families to prepare for college costs. These efforts could include simplifying the aid system or providing new incentives for students to engage with the higher education system early. Ideas include the following:

- **Create a system of early financial aid “accounts” that can leverage family savings and public/private resources.** Several organizations and high-level commissions have recommended that a portion of need-based aid, possibly even a portion of the Pell Grant program, be provided to students several years before they access college, and even as early as birth (Black and Huelsman 2012; Cramer and Neville 2009; Rethinking Student Aid Study Group 2008). The structure of such a proposal could vary, and family income data could be used to determine eligibility and awards. New federal money would likely be needed to create the account infrastructure and delivery, though the amount required to seed the accounts would depend on the structure. For example, Pell-eligible students could simply receive a portion of their eventual award as a way to seed accounts, or new money could be appropriated. There is currently an Early Federal Pell Grant Demonstration Project in Title VIII, Part Y of the Higher Education Opportunity Act, based on several state grant programs and pilot projects that communicate and deliver financial aid to students as early as middle school (Heller 2012). This demonstration project should be funded and expanded to gain a better understanding of the effectiveness of providing tangible Pell money early in a student’s life.
- **Match family college savings for low-income households through public or employer dollars.** Several states, through the state 529 plan, match contributions by low-income families in recognition that early financial preparation may increase students’ ability to afford college. Additionally, tax benefits for college savings plans are currently regressive, with upper-income families receiving the greatest portion of the public benefit. Removing these barriers to saving by low-income families may increase financial preparation and, by extension, financial literacy among low-income households. A public savings match could be provided directly through federal dollars or through a federal grant program for states to match contributions by low- and middle-income families in their state 529 plan.
- **Communicate potential financial aid awards in a statement based on IRS information that allows families to plan for the cost of college.** In lieu of providing money to students earlier, the U.S. Department of Education and the IRS should coordinate to provide an annual update to families about the estimated aid they would receive, given financial circumstances and family characteristics. This update would be similar in concept to a Social Security statement. Students could use it as a guide to learn about the federal and state financial aid options that will be available to them upon enrollment in a postsecondary institution. This could promote financial literacy and combat the problem of family misinformation about the eventual net price of college, while requiring minimal investment on the part of the federal government.
- **Make the AOTC fully refundable so it may be utilized by low-income households, and create a pilot program for early delivery of the credit.** Current higher education tax credits are ineffective for low-income households because they are

inaccessible and ill-timed. Some stakeholders have called for tax credits to be scrapped completely, with tax savings being folded into increasing the average and maximum Pell grant awards. This should be explored, along with ideas to phase out the tax credits for wealthier families. However, tax credits are popular across the political spectrum despite their relative ineffectiveness at increasing college access, completion. Therefore, a more effective conversation may revolve around offering new ideas to the tax credit debate that improve the existing structure and make tax credits more valuable and reachable. Such new ideas include allowing the AOTC to be claimed fully by families without an income tax liability, allowing those families to offset the cost of higher education in a way similar to middle-class families. In addition, the federal government could set up a pilot program to examine the impact of letting families claim the tax credit before students enter postsecondary education, allowing the credits to be used only to pay tuition, fees, and other school expenses. The credit could have the same structure—students would be able to claim the credit for only four years—but such a program may fix the timing issues by allowing

TAX CREDITS: ELIMINATE OR IMPROVE?

The AOTC is one of several education benefits for which families can qualify through the tax code. In 2012, the Joint Committee on Taxation estimated that the AOTC cost the federal government \$8.3 billion, or nearly half of the cost of all education tax benefits (Joint Committee on Taxation 2012). This \$8.3 billion, if repurposed toward need-based aid, would constitute a 36 percent increase from the Obama administration's budget request for Pell Grants in 2012 (U.S. Department of Education 2012; author's calculations).

However, tax credits receive overwhelming support from across the political spectrum and are unlikely to be eliminated. Given this current political reality, we believe students could be better served in the short-term by introducing new ideas to improve the design and delivery of the AOTC without eliminating it entirely.

families to pay for college expenses when they are incurred, while also increasing expectations of college attendance among low- and middle-income families. Likewise, tax credits could be delivered to institutions, which would front the awards to students in financial aid packages and in doing so better communicate the availability of tax credits for students.

RECOMMENDATION #2: Restructure or Repurpose Grant and Loan Delivery Mechanisms

POLICY RECOMMENDATIONS

- Maintain the Pell Grant as the centerpiece of need-based aid, and make it an entitlement.
- Provide block grants to states to coordinate institutional student services and public benefits to financial aid.
- Reform the Supplemental Education Opportunity Grant (SEOG) to provide institutions with money for "emergency" aid to students.

Simplification and early delivery of financial aid may be beneficial, but the federal government could also reform existing grants to make them more valuable or efficient for low- and moderate-income students. Based on the research on the effectiveness of grants with respect to college access and completion, the federal government could do the following:

- **Maintain the Pell Grant program as the centerpiece of need-based aid, and make it an entitlement.** The primary concern about Pell Grant effectiveness has been the decrease in its purchasing power, as it has not kept pace with the rising cost of college. The Pell has been underfunded to meet the needs of students (Kantrowitz 2012). Some have suggested that the Pell Grant program should be reformed to better incentivize completion. However, policymakers would be wise to avoid compromising the core mission of the Pell Grant program: Access for needy students. In short, the Pell Grant program is well targeted and well-conceived as a program, and should be funded to reflect societal priorities of access for underserved students. Reimagining the Pell Grant as a tool to promote completion is likely to

have an adverse impact on access for underserved students, possibly shifting money to highly-selective institutions or to students who are already likely to graduate. Making the Pell Grant program an entitlement would remove uncertainty around funding for students, allowing students and their families to better understand the aid they may receive from year to year. In essence, making Pell an entitlement would be more of an accounting than an equity mechanism. Additionally, the maximum Pell Grant award should increase annually with inflation, using either the Consumer Price Index or state-level tuition inflation (which has been higher in recent years) as a guide. Some may argue that tying Pell to inflation would result in price increases on an institutional level, but there is little evidence that this would occur (Long 2006).

- **Provide block grants to states to coordinate institutional student services and public benefits to financial aid.** Federal financial aid that is provided directly to institutions should require institutions to provide students at public institutions with information and counseling about all benefits for which they may be eligible, including child care, food assistance, and other public benefits. This could help students maximize their benefits and reduce their risk of dropping out for financial reasons. The federal government could create a new block grant program that supplies money to states to support such efforts, or alternately require that institutions provide such services as a condition of receiving federal aid. This concept could apply to secondary education as well. The federal government could fund states to create programs in high schools that provide students with clear and useful information on the benefits—including financial aid—they are likely to receive upon matriculating to postsecondary education. There is an opportunity to provide an integrated academic and financial plan for college, not only while students are enrolled, but well before they reach postsecondary institutions.
- **Reform the Supplemental Education Opportunity Grant (SEOG) to provide institutions with money for “emergency” aid to students.** Many students face financial shocks at different points during the school year. In recognition of this, institutions should

be provided with funds to distribute to students for emergencies that might cause them to leave school for financial reasons. Institutions, particularly those that serve high numbers of low-income, non-traditional and adult students, should be allowed some flexibility in determining how to disburse emergency aid to students on a case-by-case basis. Reforming the campus-based SEOG to provide emergency aid to students would require very little, if any, new public expenditure. This idea is also based on several pilot projects, such as the Lumina Foundation’s Dreamkeepers program and the Angel Fund, which provide grant funds for financial flexibility for community college students in order to mitigate the impact of financial emergencies on enrollment and persistence (Geckeler 2008).

RECOMMENDATION #3: Provide Incentives for Completion

POLICY RECOMMENDATIONS

- Institute a system of loan forgiveness for on-time completion for Pell-eligible students.
- Tie campus-based aid to student debt repayment levels and degrees awarded in addition to cohort default rates.
- Create incentives for performance-based grants.
- Incentivize that spending be maintained on need-based aid for students.

Many financial aid programs are driven primarily by the desire to make college more affordable, and thus accessible, for students. However, given the stagnation in college completion rates, there has been a recent push to reform aid to incentivize college progress, rather than access. The role of the financial aid system in promoting completion could involve new grants for states, institutions, and students, but also could include new accountability measures to institutions to increase completion rates, as well as providing non-grant incentives for students. Ideas include the following:

- **Institute a system of loan forgiveness for on-time completion for Pell-eligible students.** Current debates about incentivizing completion through the Pell Grant program primarily revolve around limiting the number of semesters that students are eligible

for the grant, or creating performance measures for student or institutional eligibility. Currently, Pell grant recipients are more than twice as likely as non-recipients to take out student loans, and those who graduate have higher debt levels than non-Pell graduates (U.S. Department of Education 2012; author's calculations). The federal government currently provides loan forgiveness for students who enter certain professions; similarly, it could forgive a portion of loan balances for Pell-eligible students—or students just above the Pell-eligibility line—that complete degrees on time (i.e., four years for four-year degrees and two years for two-year degrees). This would serve as an incentive, rather than a penalty, for Pell-eligible students who may need to

take on loans to initially cover the cost of college, while increasing the likelihood that low-income students graduate and enter the workforce, rather than spending more years on campus and conceivably taking on more debt.

REFORM ON A BUDGET: INEXPENSIVE POLICY IDEAS

In the current fiscal climate, many are looking at reforms that will not require a great deal of spending by the federal government, or existing funding streams that may be repurposed to serve students more equitably and efficiently. To be certain, a more effective financial aid system will likely require new expenditures by the federal government and states, and a series of inexpensive measures is unlikely to have a broad impact on college access and completion. However, the following policy recommendations may require little or no additional funding while still improving the financial aid system.

- Communicate potential financial aid awards in a statement based on IRS information that allows families to plan for the cost of college.
- Reform the SEOG to provide institutions with money for “emergency” aid to students.
- Tie campus-based aid to student debt repayment levels and degrees awarded in addition to cohort default rates.
- Incentivize that institutional spending be maintained on need-based aid for students.
- Incentivize pre-tax employer matching for student debt repayment for the first five years after a student has completed college.

- **Tie campus-based aid to student debt repayment levels and degrees awarded in addition to cohort default rates.** Eligibility for institutional aid should be tied to measures other than the rate at which students default on loans. The federal government should create accountability measures for institutions that look at the overall borrowing of student populations relative to the likelihood that students will complete a degree (Carey and Dillon 2011). Such measures should be adjusted based on the type of institution—particularly for those institutions that seek to provide opportunity to those student populations with a higher likelihood of dropping out or defaulting—to safeguard against institutions simply rejecting at-risk students. Campus-based aid should be delivered to institutions that have proven more likely to graduate underserved and at-risk students.

- **Create incentives for performance-based grants.** Evidence suggests that providing increasing levels of aid to students as they progress through the higher education system, on top of existing federal and state aid, may increase the likelihood of on-time graduation (Scrivener and Coghlan 2011). Rather than reform the Pell Grant program to incentivize completion, the federal government should provide block grants to states that ensure maintenance of effort in order to create new aid programs that incentivize student progress. This in essence would protect the mission and funding of the Pell Grant program. Students would be eligible for grants for up to four years, and could receive larger grants once they reach a certain credit threshold. These new funding streams should be coupled with accountability measures—including potential loss of federal funding—that ensure states are sticking to and achieving agreed-upon completion goals.

- **Incentivize that institutional spending be maintained on need-based aid for students.** In recent years, institutions have been shifting resources away from need-based aid and toward

merit-based scholarships in order to attract and retain students who may enhance institutional prestige (Heller 2012). However, this aid disproportionately goes to high-income students who likely would have attended college anyway. To ensure that institutions—particularly those with public missions—provide aid to low-income and minority students, institutions should be rewarded for setting aside a certain percentage of their budgets for need-based aid. For universities with substantial endowments, rules could be created to ensure that a portion of those endowments is spent on need-based aid. These incentives could come in the form of providing increased campus-based aid, or possibly withholding campus-based aid for institutions that do not spend a certain percentage of their aid budgets on need-based aid.

RECOMMENDATION #4: Reduce Debt Burdens and Provide Better Repayment Options for Students

POLICY RECOMMENDATIONS

- **Make Income-Based Repayment (IBR) the default option for student loan repayment.**
- **Incentivize pre-tax employer matching for student debt repayment for the first five years after a student has completed college.**

The use of student loans has increased substantially over the past several decades, to the point that the nation's total outstanding student debt now exceeds credit card debt (Brown et al. 2012). Loans are part of a system of shared sacrifice, as students may receive substantial private benefits from higher education. However, relying on a strategy to finance college through debt has adverse effects on some students, to the point where many drop out without a credential or do not access the higher education system at all. Because loans are part of an overall college financing strategy, the federal government should develop strategies such as the following to ensure that debt loads are manageable, and that debt repayment is a straightforward process:

- **Make Income-Based Repayment (IBR) the default option for student loan repayment.** The purpose of income-based or income-contingent loan repayment

programs is to provide subsidized loans to risk-averse students who otherwise would be reluctant to borrow funds (or enroll in school in the first place) out of fear that they will not earn enough upon graduation to repay their loans. Evidence from Australia and New Zealand suggests that this type of program can dramatically expand access to higher education (Tulip 2007). Currently, students can qualify for IBR plans in which monthly payments are capped at an amount based on income and family size (calculated by federal poverty guidelines), and balances are forgiven after borrowers make payments on loans for 25 years. Rather than opting in and qualifying for such an option, we propose that students be automatically enrolled in an IBR plan and having the option of opting out of the program, thus automatically repaying loans based on income unless they choose to enroll in a different option. Payments should be calculated using available IRS data, and automatically adjusted if a borrower's salary or employment status changes. Students for whom IBR may not be as beneficial should be able to make larger payments, and the federal government should limit the number of payment plans available to students in order to avoid complexity. In addition, the federal government should create a series of mechanisms—or “triggers”—that would automatically enroll a student in the standard repayment plan once their financial circumstances would make that plan more beneficial. In short, students should be presented with the most favorable loan repayment option at all points of repayment, not just at the beginning of the loan.

- **Incentivize pre-tax employer matching for student debt repayment for the first five years after a student has completed college.** Pell-eligible students are more likely to graduate with debt, and higher levels of it, than non-Pell-eligible students. Even though higher education completion is likely to lead to better financial outcomes, many low- and middle-income students face financial hurdles upon completion of a degree, either through paying off debt or providing for family members. Currently, employers receive incentives for helping employees save for retirement and health care expenses, among other priorities. The same incentives should apply for employees who wish to pay off loans in a

timely fashion, with a particular emphasis on those who are just entering the workforce and may not have had the opportunity to save for debt repayment. The federal government should create a tax credit for employers to match employee contributions to student loan repayment, either directly to the federal government or to the employee's individual loan provider. These contributions should also be able to be deducted directly from employee paychecks in order to maximize simplicity and employee take-up. Rather than allowing an individual to deduct student loan interest from their annual tax liability, incentives for employer matching will offer individuals more opportunity to reduce their debt burdens more quickly.

These promising ideas are intended to speak to all aspects of financial aid reform, from grants to tax incentives to loans. They are derived from the belief that some aspects of the financial aid system effectively serve students but may need to be expanded or funded differently to better reach them, as well as the belief that some aspects need to be replaced with new, more equitable, and more efficient programs.

Many of these recommendations involve some federal government investment, such as creating new account infrastructure or block grants to states to coordinate student supports, repurposing tax credits, or instituting new systems of loan forgiveness. However, other suggestions, such as creating better information for students, providing new delivery mechanisms, reforming the SEOG to better serve students, or making IBR the default option, may not require substantial public dollars but rather reform in terms of accounting, delivery, or creating new efficiencies. In determining which policies to pursue, it is important to keep in mind the cost and potential offsets needed to carry out proposals, but also the potential impact on students, regardless of cost.

Furthermore, states or institutions could implement many of these ideas regardless of new federal mandates or supports. These ideas require shared sacrifice on the part of institutions and states, in order to ensure that all actors in the higher education system—students, institutions, and governments—have “skin in the game” of financial aid reform.

WHICH POLICIES ARE “READY FOR NOW?”

Several of these policy recommendations could be designed and implemented relatively quickly, given existing policy infrastructure. Rather than requiring substantial testing or pilot programs, these “ready for now” ideas require political will on the part of the U.S. Congress:

- Maintain the Pell Grant program as the centerpiece of need-based aid, and make it an entitlement.
- Communicate potential financial aid awards in a statement based on IRS information that allows families to plan for the cost of college.
- Make the AOTC fully refundable so it may be utilized by low-income households, and create a pilot program for early delivery of the credit.
- Provide block grants to states to coordinate institutional student services and public benefits to financial aid.
- Make IBR the default option for student loan repayment.

PART III. FRAMEWORK AND PRINCIPLES FOR ASSESSING TRADE-OFFS AND POLICY EFFECTIVENESS

Part II of this white paper included a number of principles and assumptions as well as policy reform ideas that were derived from reviews of the research literature and previous efforts to redesign financial aid, and undergirded by IHEP’s mission of promoting access and success for all students, especially those traditionally underserved in higher education. Any recommendations, however, should be examined to determine whether they support success without reducing access, or vice versa. In other words, it is important to clearly define, and where possible minimize, the trade-offs for students.

What do we know about how to accomplish this goal? And how do we evaluate whether the financial aid reform proposals described above will meet their goals and principles? Answering these questions is a crucial part of any financial aid reform effort.

Fortunately, there is ample evidence about the factors that make financial aid work well, including simplicity in the financial aid application and communication process, targeted aid toward students whose outcomes are most likely to be positively affected, and stakeholder “skin in the game”—in other words, a clear understanding of a financial aid program’s goals and a commitment to supporting its success and sustainability. The financial factors are not sufficient in

themselves; academic and social supports must be there so that the financial aid has maximum impact. These factors can be used to develop an analytical framework to evaluate financial aid proposals. The goal of such a framework is to give stakeholders a clear view of the likely effects of alternative ideas.

The following framework is modeled as a series of trade-offs that highlight the benefits, disadvantages, and unintended consequences of each financial aid proposal from multiple perspectives. **FIGURE 2** provides a policy checklist that can be used for each financial aid reform proposal. Within this framework, the primary factors that can help assess financial aid proposals include the following:

- Who is helped or hurt by the proposal?**
 It is important to have an idea of which students (and their families) would be affected by a new financial aid proposal. The change in financial aid might affect students differently based on income background, financial dependence, age, family structures, enrollment patterns, and other characteristics. In this regard, it is helpful to consider the eligibility criteria for a particular program, to see if certain groups of students are treated differently. In addition, the proposed changes might affect certain types of institutions or students differently. This is often an issue when it comes to campus-based aid programs, or institutions that have relatively high or low tuition levels. For example, the Pell Grant program is awarded primarily to students with

FIGURE 2. Financial Aid Policy Trade-Offs Checklist

Who is helped or hurt by the proposal?	Low-Income Nontraditional Universal
Whose behavior would change?	Students Institutions Governments
What is the impact on enrollment or completion goals?	Impacts on Enrollment vs. Completion Unintended Consequences
How much would it cost?	New Funding Stream Existing Funding Stream Repurposed Funding
What implementation issues may arise?	Complexity/Communications Delivery Mechanism Funding Source

incomes of \$30,000 or less, with only 1.9 percent of recipients having incomes above \$60,000 annually. Reforms to the Pell Grant program, either to make the grant more merit-based or incentivize completion, may change the scope of the program and result in higher or lower average grant amounts, or enable more or fewer—or different types of—students to become eligible (Congressional Research Service 2011).

- **Whose behavior would change?**

The behavior of students, institutions, or governments can change as a result of the financial aid proposal. It could affect students' choice of institution, field of study, geographical choice, attendance status, and other factors. It may have an effect on students' financial literacy or their willingness to borrow. Financial aid changes can also have an impact on institutions' recruiting of certain types of students, or accountability for default rates or other measures. Another key point is whether the new proposal would leverage or displace existing aid; some financial aid programs have an assumption of maintenance of effort, but others do not. For example, institutions may reallocate need-based aid once new sources of federal or private aid are introduced, which would not result in a net increase of aid to students.

- **What is the impact on enrollment or completion goals?**

Overall, a new financial aid proposal might incentivize enrollment and/or progress toward a degree. It could favor access over completion, or vice versa, and it could create unintended consequences for one or the other. The proposed change might affect time to completion or completion of certain types of degrees. It is also important to look at factors such as renewability and whether the financial aid is front-loaded, back-loaded, or similar by semester. For example, proposals to alter the minimum credit requirement for full-time enrollment may encourage some students to complete their degrees in less time, but students who take remedial courses or work to support a family may not fare well under such a proposal.

- **How much would it cost? What is the fiscal trade-off?**

Given current fiscal restraints, it is important to consider whether the proposed change is cost-effective and whether it can be funded with current resources. If not, how would the proposal identify new resources or reallocate funding? Funding the proposal might require defunding another program or consolidating programs. These issues are related to an idea's sustainability and short- and long-term funding flow patterns. For example, evidence of long-term benefits in the future can make up for short-term consequences up front. Essentially, cost-effectiveness is not simply a question of cost, but also a question of impact for students and taxpayers.

- **What issues arise in implementing the proposal?**

Implementation may raise issues such as communications, design, delivery, and other logistics, all of which may affect students and other stakeholders. Thus, it is important to consider whether the proposed idea is simple to understand and is communicated effectively. Also, does the proposal rely on institutional academic and social supports or a certain level of financial literacy? Financial aid proposals can be administered or funded by a range of sources; can go to students, states, or institutions; and can come in different forms. These design conditions can have different impacts on the above issues: Who is affected, what behaviors would change, and how much would the change cost?

Within each of these factors, it is important to drill down to a deeper level. For example, financial aid proposals may have positive or negative impacts on different stakeholders: Students and their families (and distributional effects on specific groups of students), higher education institutions (and specific types of institutions), and federal and state governments and the taxpayers they represent. Although this framework is based on principles that focus on students—especially underserved students—it is important to understand other effects on the system. In addition, it is useful to determine whether each financial aid proposal will lead to a minor or major impact, and whether the impact is short term or long term.

Examples of Policy Trade-Offs and Ideas

To illustrate how this framework could work, the following examples are taken from policy recommendations in this paper. While the trade-offs questions are not always easily answerable, they provide a guide for assessing each policy idea. Below, we run four ideas through the trade-offs framework, one from each section of the pipeline above: Creating a system of early financial aid accounts; providing block grants to states to coordinate institutional student services and public benefits to financial aid; incentivizing loan forgiveness for on-time completion; and making IBR the default option for student loan repayment.

IDEA #1: Create a System of Early Financial Aid “Accounts” that can Leverage Family Savings and Public/Private Resources

- **Who is helped or hurt by the proposal?**

Broadly, this proposal would involve providing some proportion of funds in a need-based aid program to students several years before college, while also allowing students to contribute a portion of their savings (as well as money from their families, the private sector, and academic scholarships).

Several studies have indicated a positive connection between family assets and savings and college outcomes, both from having the tangible resources to finance college and increasing expectations among families that do save (Conley 2009; Sherraden 2009).

- **Whose behavior would change?**

The point is to change student and family behavior through increased financial literacy, in addition to increased family resources. The federal government has authorized a demonstration project for providing Pell grants early, as a way of testing whether early commitment of financial aid will lead to positive outcomes.

The institutional response to such a program is unknown, though there may be an increase in published prices as students arrive on campus with larger amounts of aid. Evidence of such a strategy is limited, though different types of institutions—such as those in the for-profit sector—may be more likely

to increase prices under the system. This speaks to the need for broader accountability measures to ensure that financial aid retains its value for students.

- **How much would it cost? What are the fiscal trade-offs?**

The cost of such a program would vary considerably based on its design. For example, if accounts were simply seeded with a portion of the money that students would already receive from the Pell Grant program, the fiscal impact would be relatively low. Otherwise, the federal government would need to authorize a new investment to seed the accounts. Again, the cost would depend on the amount provided to students; as a gauge, a recent legislative proposal to provide accounts at birth (to be used for education, retirement, entrepreneurship, and homeownership)—seeded with \$500 and matched progressively—for all children in the United States has been scored at \$37.5 billion over 10 years (Cramer 2009).

- **What is the impact on enrollment or completion goals?**

This proposal is an attempt to increase college access by increasing college-going behaviors early in high school, though it is also conceivable that students with broad financing strategies would be more likely to complete a credential once enrolled.

- **What issues arise in implementing the proposal?**

Many of the trade-offs of this proposal would likely occur in the implementation stage. Questions that would need to be answered on the federal level include: How should assets in these accounts be treated with regard to expected family contribution? What would be the tax treatment of the accounts for individuals, and would this differ from current 529 plan rules? Should there be caps on the amount that individuals may save in such accounts and what should these caps be? How would money in the accounts be recouped if students do not attend postsecondary education? To what point in a student’s life should the funds be eligible for use? What accounting mechanisms would need to be in place to separate public money from private money? And what accountability measures should be implemented to ensure that the new financial aid

money is not simply overwhelmed by increases in published tuition?

IDEA #2: Provide Block Grants to States to Coordinate Institutional Student Services and Public Benefits to Financial Aid

- **Who is helped or hurt by the proposal?**

The federal government historically has provided block grants to states for a number of purposes, from Medicare to K–12 funding for Title I schools and other public benefits. Often, this approach offers states more flexibility in using funds for local needs, although it also can mean less federal oversight and an undermining of the program’s goals. A higher education example is the Leveraging Educational Assistance Program (LEAP, formerly known as the State Student Incentive Grant), through which the federal government used block grants to encourage the development and expansion of state need-based financial aid programs. As part of this program, federal allotments had to be matched with state funding, including maintenance of effort provisions. The program was defunded in 2010–11 because it was felt that it had accomplished its goal, as the overwhelming majority of states now have need-based grant programs.

- **Whose behavior would change?**

This proposal would take the same approach of allocating federal funds to states, with the requirement that public colleges and universities, and/or high schools, provide students with information and counseling. The behavior of students, as well as institutions, may vary across the public, private, and for-profit sector. In addition, it is important to note that the funding under this proposal would be going to institutions, not directly to students as in LEAP-funded grant programs, and therefore institutional behavior may be more likely to change than student behavior.

- **How much would it cost? What are the fiscal trade-offs?**

On a financial level, this proposal would require new federal funding or a reallocation of existing funding. One reason to shift more federal money to state block grants is to prevent disinvestment by states, or in this case, institutions. Federal investment can be

leveraged if states and/or institutions increase academic and social supports, but could displace funding for existing efforts if maintenance of effort is not required.

- **What is the impact on enrollment or completion goals?**

For students—especially first-generation, low-income, or less prepared students—the additional support would likely increase their persistence to a degree. On the other hand, the proposal would affect students differently depending on whether or not they were enrolled in public institutions.

- **What issues arise in implementing the proposal?**

In terms of implementation, the funds would likely be used differently by states/institutions, which could be positive in the sense of learning from those differences, but also raises the possibility that some interventions will be more successful than others. Despite the need for additional funding, it might be possible to implement the idea by resurrecting LEAP and changing the regulations toward a new set of goals.

IDEA #3: Institute a System of Loan Forgiveness for On-Time Completion for Pell-Eligible Students

- **Who is helped or hurt by the proposal?**

In general, loan forgiveness programs have had mixed results (Reilly 2005; Kirschstein et al 2004; Harnisch 2009), often because of issues such as program eligibility or students’ confusion about how the program works (especially when their loans were transferred to different servicers). Often, these types of programs have been targeted toward goals such as eliminating workforce shortages and keeping students in state; many have not taken financial need into account. Many loan forgiveness programs have had a low uptake—possibly because of confusion about the program—and may have a marginal impact on students’ post-graduation decisions.

The proposed idea would be quite different, in that it would focus on students enrolled in college and provide incentive to progress and obtain a credential. However, many details would need to be ironed out when thinking about potential impacts,

such as which loans would be forgiven, which students would be eligible for the program, how institutions could track student progress, and who would fund or administer the program. For example, the University of Texas has a new pilot program for needy freshmen, in which some students are offered loan forgiveness if they complete 15 hours of degree requirements by the end of each semester, and others if they complete 30 hours by the end of the year (University of Texas at Austin 2012).

- **Whose behavior would change?**

Students' willingness to participate could depend on the amount of student loans they initially take on, as well as the amount being forgiven. This factor, obviously, is also related to institutional prices. Many nontraditional students currently attend community colleges, where they tend not to borrow given the relatively low expenses that can often be covered by working and enrolling part time. This proposal might be irrelevant for them, or it might encourage them to enroll in a more expensive institution. In contrast, the proposal could be beneficial for students who graduate with a degree or credential from for-profits and private non-profit institutions, where students generally borrow at high rates.

- **How much would it cost? What are the fiscal trade-offs?**

In terms of fiscal trade-offs, the proposal would require federal funding (or decreased federal revenue) as it involves cancellation of federal loans, but may have an unpredictable effect on federal funds. In addition, previous experience with some loan forgiveness programs have seen high administrative costs, and possibly a marginal inducement for the money expended.

- **What is the impact on enrollment or completion goals?**

In theory, federal loan forgiveness would be most effective if it targeted students who would be less likely to complete in a timely manner and encouraged them to enroll full time or otherwise speed up their college progress. However, those students also have work, financial, or family obligations that may prevent them from enrolling full time. It is unclear whether the benefit of loan forgiveness would be enough to change behavior—

especially given that the borrowing occurs up front and any benefit is not seen until graduation. For this to be an incentive for students, it would have to be well marketed, with an easy-to-complete application. Importantly, for such a program to succeed, it should be communicated as a reward and not a penalty. In other words, students should not feel that aid is being taken off the table if they progress through school at a slower pace.

- **What issues arise in implementing the proposal?**

Many questions would arise in the implementation of such a program, including eligibility requirements (i.e., is it only for needy students, or students enrolled in certain types of institutions or programs?) and how progress is defined. On-time completion could mean the completion of a degree within a specific period of time, or it could use interim measures such as the completion of full course loads or retention from year to year. If interim measures are used, there are issues of whether the funds have an expiration date or whether students will need to refund the benefit if they do not complete their credential. Other important issues include how the program is administered (on federal and institutional levels) and whether institutional supports are in place. These complications may violate principles of aid simplicity. Therefore, there should be clear and simple benchmarks set, both for initial eligibility in the loan forgiveness program as well as the interim measures that are used.

IDEA #4: Make Income-Based Repayment (IBR) the Default Option for Student Loan Repayment

- **Who is helped or hurt by the proposal?**

An opt-out IBR system could lead to a reduction in delinquency and default for students who currently have trouble paying off student loan debt. Such a system could particularly be helpful to students who are more risk-averse in borrowing than other. Streamlining the loan options available to borrowers may bring peace of mind to low- and moderate-income borrowers who are currently disadvantaged by the complexity of the system. Finally, borrowers are likely to have more disposable income to use on household consumption, personal savings and asset building, or deleveraging from other forms of debt.

On the other hand, an opt-out IBR system may result in students paying larger balances over time when some could have afforded larger monthly payments. This is because, once automatically enrolled, most borrowers are unlikely to change their repayment options even if given the freedom to do so.

- **Whose behavior would change?**

Institutions may change their behavior by raising prices in response to such a system, given that more students would simply pay off student loans in proportion to income upon graduation. Not only could this increase have an adverse effect on students who opt out of income-based repayment and into a more standard repayment plan, but it could also cost substantially more to the federal government, which would be on the hook for forgiving the loans after the 20- or 25-year period.³ Such a system may also change students' behaviors around choosing institutions, since higher costs of attendance may be less of a hurdle if loans are likely to be forgiven. Institutional cost, in short, may be less of a factor when choosing schools.

- **How much would it cost? What are the fiscal trade-offs?**

It is difficult to estimate the cost of making IBR an opt-out program, in no small part because it is difficult to determine how many students would opt-out. However, a recent report suggests that the federal government has vastly underestimated the cost of changes to make IBR more accessible to borrowers, by as much as \$235 billion over the next 10 years (Delisle 2012). IBR in many instances is more expensive to the government than standard repayment plans, since some student loan balances will be forgiven, and high-income borrowers under IBR are often protected by maximum payment caps.

- **What is the impact on enrollment or completion goals?**

An opt-out IBR system could increase college-going expectations among risk-averse borrowers. Additionally, a near-universal IBR program could incentivize students to complete degrees in high-

need, low-paying fields that require postsecondary training, given that student loan debt would be less of a hurdle. From an equity perspective, a near-universal system of income-based repayment would better match investments in higher education with the return on those investments; it would not unduly penalize students when the costs of higher education outweigh the benefits.

- **What issues arise in implementing the proposal?**

Given that a system of IBR already exists, there would seem to be relatively few implementation issues arising from the design of this idea. Overall implementation issues may include the need to clearly communicate the personal benefits and trade-offs of IBR to students, including the fact that students may pay more over the life of a loan under IBR than under standard repayment (due to accrued interest). This awareness may require additional support structures in school once students enroll, and may require such information to be distributed in high schools as well. Additionally, an opt-out IBR system may need to be paired with new accountability measures as cohort default rates become a less meaningful measure of institutional effectiveness. As more students use IBR, there would also need to be more back-end tracking by the U.S. Department of Education, as well as the IRS, given that more students will need to provide income information over the life of their repayment.

³ Recent changes to the IBR program allows for loan forgiveness after 20 years, instead of the 25 years required by the previous IBR structure.

CONCLUSION: BALANCING STUDENT NEEDS AND PUBLIC RESOURCES

The policy ideas above are intended to spark a new conversation about reforming the financial aid system to meet the needs of the 21st-century student body. This student body is diverse and more nontraditional than ever before, and increasingly requires some postsecondary training in order to be successful in the global workforce. Higher education, and financial aid, must be responsive to these needs if it is going to provide a net benefit for all students.

The examples of policy trade-offs above are not meant to deter policymakers from planning and implementing this list of policy recommendations. Rather, they show that all policies involve a series of choices and trade-offs, and any comprehensive judgment of policy proposals should thoroughly examine the unintended consequences that may arise from a particular idea. This thought process will also determine, particularly on an institutional level, which additional supports may be necessary for students as grant, loan, and other programs are repurposed. For example, if financial aid is provided early, new supports may be needed at the K-12 level to maximize its effectiveness. Or, if loan and grant programs are repurposed, students may require additional levels of counseling once they are in school.

The financial aid reform conversation is occurring in an environment of increasingly tight budgets, in the midst of a national conversation about how best to invest public resources to meet society's needs and how best to pay for those investments. These political arguments must be considered, but the design of a financial aid system should not be entirely guided by what is politically possible in the current environment. Nor should it be hampered by the notion that re-committing to financial aid is unaffordable for society. Doing so may limit the opportunity to have a lasting impact on the lives of students.

This broader discussion is occurring under a new reality, that the postsecondary education system is more important than ever in creating a dynamic workforce and informed citizenry. Unfortunately, many of the current investments in that system have proven inadequate in meeting the needs of today's students. It is therefore paramount that those tasked with

reimagining financial aid design and delivery do so by balancing fiscal considerations with the need to properly invest in the 21st-century student.

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