

## CHAPTER 8

# INVESTING IN NEED-BASED FINANCIAL AID

For students who do gain admission to a selective college, figuring out how to pay for their education can pose substantial challenges to their enrollment and success.<sup>1</sup> Given the high costs of higher education today, need-based financial aid—from the federal government, states, and institutions—is a critical factor as students determine whether and where to pursue higher education. This is especially true for students with limited financial means. Along with rising costs, the declining purchasing power of the federal Pell Grant,<sup>2</sup> and falling per-student state appropriations for higher education,<sup>3</sup> the financial challenges students face today are greater than ever.<sup>4</sup> Institutional aid programs are a key lever for ensuring low-income and low-wealth students are not priced out of the education provided by selective, well-resourced institutions.<sup>5</sup>

**"I wish that there was another way in which the university took the time to educate students on how financial aid works, what grants are, what scholarships are, how to obtain them."**

**—A student from a low-income background attending a public four-year college**



**Research consistently shows that financial aid awards influence student decisions about which college is right for them, both through the direct effect it has on putting an institution within reach financially, and because these awards signal to students how much a particular institution values them.**<sup>6</sup> A significant body of evidence indicates that financial aid is an important recruitment tool,<sup>7</sup> consistently showing that financial aid awards increase the likelihood of a student enrolling at a particular school, especially for students from low-income backgrounds<sup>8</sup> and for Black<sup>9</sup> and Latinx students.<sup>10</sup> While research examining this relationship among Indigenous and underrepresented Asian American and Pacific Islander (AAPI) populations is harder to come by, presumably the enrollment decisions of these groups are similarly impacted by the availability of grant aid.<sup>11</sup>

Indeed, the availability of financial support can affect whether students attend college at all,<sup>12</sup> whether they attend their first-choice institution,<sup>13</sup> and their academic outcomes during and after enrollment.<sup>14</sup> Given these realities, and because many selective four-year institutions have significant yet limited financial aid funding, prioritizing need-based scholarships ensures support for the students who need it the most.

Unfortunately, as discussed in [Chapter 1](#), many selective institutions choose to recruit and financially support out-of-state students, those with high test-scores, and those from high-wealth families, a misallocation of limited financial aid dollars that has the effect of sacrificing access and diversity.<sup>15</sup> This institutional choice leaves Black, Latinx, Indigenous, and underrepresented AAPI students, and students from low-income backgrounds, with a gap between what their family can afford and what they must pay. This gap, often referred to as “unmet need,” can lead to dire situations for these students, including difficulty paying for basic needs like housing and food, working more hours than are conducive to keeping up with studies, and taking on unreasonable debt to finance college expenses.<sup>16</sup> In fact, material hardship generated by high levels of unmet need can cause students to leave higher education altogether.<sup>17</sup>

The research clearly shows that students’ awareness of financial aid and perceptions of their own eligibility for grants can influence their application and enrollment decisions.<sup>18</sup> Without this information, students from low-income backgrounds and students of color are disproportionately likely to choose less selective education options or forgo higher education altogether.<sup>19</sup> Targeted outreach, streamlined aid eligibility, and support in financial aid application processes have been proven to increase the likelihood that students from low-income backgrounds will apply to and enroll in selective institutions with generous financial aid programs.<sup>20</sup> Therefore, to encourage socioeconomic and racial diversity on their campuses, institutions should effectively convey financial aid availability and criteria and provide support in completing the application process.



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## How will COVID-19 affect institutional need-based aid?

The March 2020 onset of the COVID-19 pandemic will have far-reaching implications for society at large, and higher education is no exception. Colleges and universities continue to wrestle with economic pressures, even as institutions move toward resuming in-person instruction. For public institutions, the adverse impact of the pandemic on state budgets has also generated fears of future cuts in higher education appropriations and spurred some institutions to compete with others to meet their revenue goals. For students, the financial implications of COVID-19 have been even more devastating, with a lagging economy exacerbating their financial needs at a time when institutions are relatively ill-suited to provide support.

At the same time, many institutions and states historically have awarded financial aid based in part on standardized test scores. In the face of pandemic-induced ACT and SAT cancellations, many schools have announced test-optional admissions policies (see [Chapter 5](#)), either on a temporary or permanent basis.<sup>21</sup> If institutions and states do not adapt their financial aid policies to follow suit, students from low-income backgrounds and students of color may miss out on critical financial aid. Institutions should take advantage of this moment to revisit institutional aid allocations, emphasize student need in the distribution of resources, and pivot toward more equitable financial aid policies.

## Institutions typically allocate financial aid dollars using a combination of factors, including financial need and academic criteria.

**Need-based aid** provides money to students who demonstrate financial need. Institutional need-based aid programs typically determine need as the difference between a student's cost of attendance (COA) and their Expected Family Contribution (EFC).<sup>22</sup> COA is an assessment of the total cost of enrollment, including tuition and required fees as well as an estimate of living expenses, books and other necessary materials, and transportation.<sup>23</sup> EFC is an assessment of a family's financial strength based on income, assets, benefits, family size, and number of family members who will attend college that year, as reported on the Free Application for Federal Student Aid (FAFSA).<sup>a,24</sup> Because COA is included in the definition of need, applicants at more expensive institutions, such as highly selective colleges that charge more in tuition and fees, are more likely to have need and to show higher amounts of need than those applying to low-cost institutions.

**Non-need-based aid**—or so-called “merit-based” aid—is typically awarded to students based on academic factors, such as high school GPA, SAT or ACT scores, or high school class ranking.<sup>25</sup> Given the well-documented racial<sup>26</sup> and socioeconomic biases<sup>27</sup> in standardized testing, and the unequal distribution of resources across K-12 schools,<sup>28</sup> the measures of “merit” used by many of these aid programs disproportionately benefit wealthy and White students<sup>29</sup> (see [Chapter 5](#)). Some aid programs include both need-based and non-need-based criteria, while others can include eligibility criteria unrelated to academics, such as athletic ability, military status, or plans to select a specific major or profession, among other factors.<sup>30</sup>

- a. The Consolidated Appropriations Act, 2021 made changes to federal needs analysis, replacing the Expected Family Contribution (EFC) with a new calculation, called the Student Aid Index (SAI). Like EFC, SAI assesses a family's financial strength based on a variety of factors to determine eligibility for federal need-based aid and to serve as a financial indicator for state and institutional need-based aid. SAI will not consider how many family members attend college at the same time. These changes are set to take place for the 2023-24 Free Application for Federal Student Aid (FAFSA) and academic year. See the text of this act at <https://www.congress.gov/116/bills/hr133/BILLS-116hr133enr.pdf>.

## NON-NEED-BASED AID PROGRAMS DISPROPORTIONATELY BENEFIT WHITE AND AFFLUENT STUDENTS

Research on financial aid's impact on enrollment is robust and reveals a clear relationship between grant aid and higher education enrollment. In fact, enrollment rates increase by about four percentage points for every \$1,000 in additional grant aid available,<sup>31</sup> and students from low-income backgrounds are even more responsive to additional grant aid.

**Institutional aid, especially need-based aid, is vital for students from low-income backgrounds and students of color to enroll in postsecondary education. An additional \$1,000 in grant aid has the potential to increase college going rates by three to four percentage points.<sup>32</sup>**

Non-need-based aid programs, particularly those using academic criteria to allocate aid, disproportionately benefit students from wealthy or White families, who typically have access to better funded schools and other benefits like test preparation services (see Chapter 5).<sup>33</sup> For example, a recent study found that a high-income student from a household earning more than \$167,000 per year would receive state or institutional grants to attend 34 of the nation's 50 public flagships.<sup>34</sup> At one-third of these flagships, this high-income student would receive \$5,000 or more in aid—a substantial amount of funding that could be re-directed toward students from low-income backgrounds for whom aid is the deciding factor in whether they can attend college.<sup>35</sup>

Not surprisingly, research also shows that when institutions award aid using non-need-based factors, they enroll fewer students from low-income backgrounds. After statistically adjusting for other factors, selective private nonprofit institutions that adopted non-need-based aid policies between 1987 and 2005 had lower percentages of both Pell recipients and Black students than those that did not.<sup>36</sup> Indeed, Black and Latinx students are disproportionately represented in the ranks of students who receive need-based aid, while non-need-based aid dollars primarily support White students.<sup>37</sup> **Since institutional financial aid dollars are limited, devoting significant resources to non-need-based aid programs means fewer dollars are allocated for need-based programs.<sup>38</sup>**

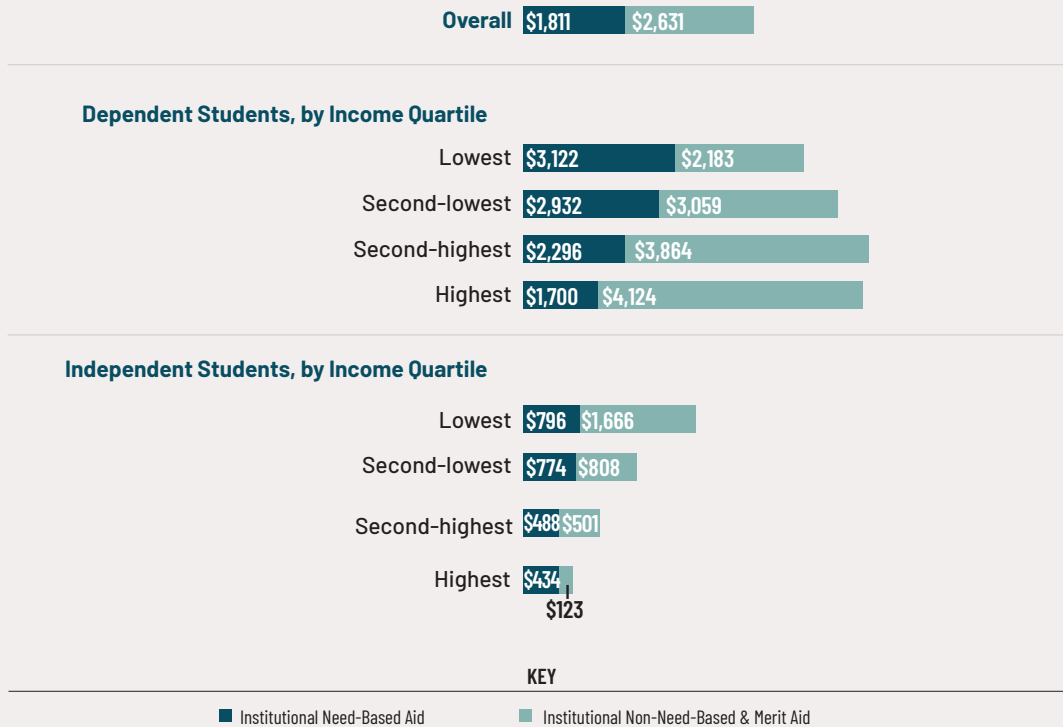
Despite this, as Figure 8.1 illustrates, four-year institutions that are at least minimally selective award substantial amounts of need- and non-need-based aid to high-income students. In fact, dependent students<sup>b</sup> from the second-highest income quartile receive the most institutional aid, with a majority of that funding coming from non-need-based sources. And despite receiving larger need-based grants than other students, low-income dependent students receive *less overall* in institutional grant aid on a per-student basis than students in any other income bracket. Independent students—those who do not rely on their parents for financial support and, as a result, tend to have fewer resources for college—receive even smaller amounts of institutional grant aid, need-based or otherwise, significantly limiting their ability to afford selective four-year schools.

Low-income dependent students receive less overall in institutional grant aid on a per-student basis than students in any other income bracket.

- b. Financial aid determinations for dependent students are determined based on financial information of students and their parent(s) or guardian(s), while awards are made to independent students are based solely on the students' financial profile. Independent students include those who are at least 24 years old, legally married, enrolled in a graduate program, supporting children or other dependents, active-duty military or veterans, in foster care or designated wards of the court, emancipated minors, and those who are experiencing homelessness or at risk of homelessness.

**FIGURE 8.1**

**Average Institutional Need and Non-Need-Based Grants, Among Selective Four-Year Institutions**



*Note: Includes public and private non-profit four-year institutions designated as minimally selective or higher. Source: Institute for Higher Education Policy analysis of data from the 2016 National Postsecondary Student Aid Study, a product of the National Center for Education Statistics, U.S. Department of Education. Computation by NCES PowerStats. See [technical appendix](#) for detailed methodology.*

**Aggregate spending confirms these inequitable patterns of aid distribution.** A recent analysis of institutional aid at 339 public four-year universities found that from 2001–2017, these universities spent \$32 billion on financial aid programs that did not consider student need.<sup>39</sup> In fact, more than half of these universities doubled the amount they spent on non-need-based aid in that time period, with regional universities allocating more toward non-need-based aid programs than public flagships. One egregious example is the University of Alabama, which spent approximately \$136 million, the largest amount of any university in this study, on non-need-based aid.<sup>40</sup>

The University of Alabama is not alone. In the face of mounting budgetary pressures, many public institutions provide large grants to students who can already afford college.<sup>41</sup> As state appropriations remain stagnant, tuition revenue from wealthier and out-of-state students bolster an institution’s bottom line.<sup>42</sup> Some public universities therefore prioritize recruiting wealthier students, many from outside the state, because of their ability to pay more in tuition.<sup>43</sup> In order to convince many of these wealthy, out-of-state students to enroll, institutions offer them modest non-need-based aid awards, which limits the aid available to in-state students with financial need. (See discussion of out-of-state student recruitment in [Chapter 1](#).)

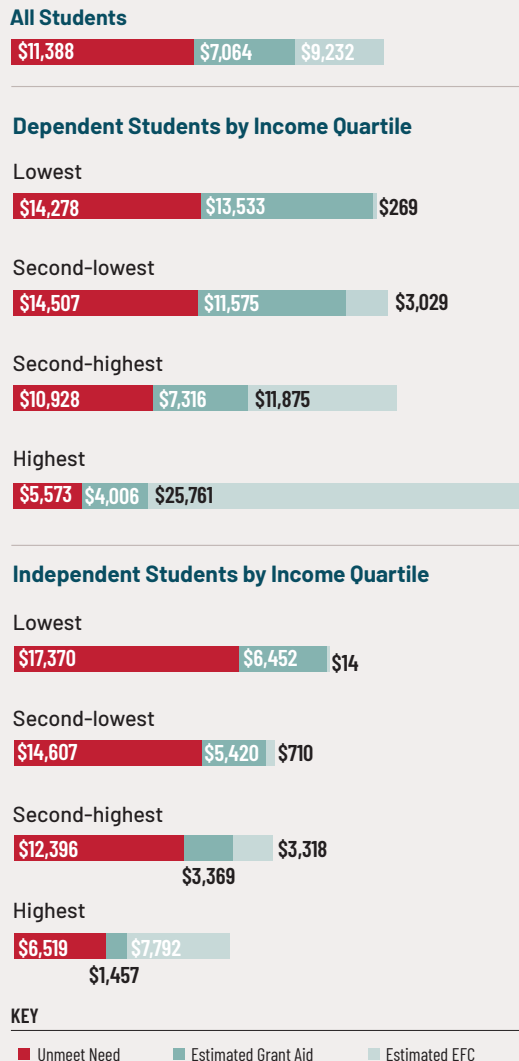
**While institutions spend large sums of money on non-need-based aid to recruit wealthy or high-scoring students, others—particularly Black, Indigenous, Latinx, underrepresented AAPI, and students from low-income backgrounds, all of whom have high levels of unmet need—are left with insufficient funding.** In 2015–16, more than three-quarters of students received financial aid insufficient to fully meet their need, with Black and Latinx students experiencing unmet need at even higher rates. That year, Black, Latinx, and Indigenous students were the most likely to have unmet need, while Asian American students had the highest dollar amount of need.<sup>44</sup> Nationally, despite low-income and independent students selecting lower-cost schools, they still face, on average, substantially higher levels of unmet need than their higher income peers (Figure 8.2).

Furthermore, while annual figures are troubling, these costs add up over time. Students from economically disadvantaged backgrounds at some flagship institutions may need to cover as much as \$80,000 more than what they can afford over four years—assuming they attend full time and complete their degree within four years.<sup>45</sup> In light of these affordability challenges, some universities have committed to awarding their aid dollars primarily based on need. The University of Kentucky, for example, announced in 2017 that it planned to significantly scale back its use of merit-based aid and award aid predominantly based on need.<sup>46</sup>

### State Aid Programs Often Exacerbate Financial Aid Inequity Found in Institutional Aid Programs

States also play a key role in higher education affordability, both through providing direct appropriations to schools and through state-based financial aid programs. Unfortunately, 24 states spend more on non-need- than need-based aid, and many others have increased funding for scholarships based on test scores or high school GPA instead of need. One highly studied state non-need-based aid program is Georgia’s Helping Outstanding Pupils Educationally (HOPE) Scholarship. Studies have found that the HOPE scholarship provides students an average of approximately \$1,600 (in 2020 dollars) in additional aid and increases college attendance rates by 3.7 to 4.2 percentage points.<sup>47</sup> However, research also shows that the HOPE program disproportionately benefits higher-income families and White students<sup>48</sup> and widens the college attendance gap between high- and low-income students and between White and Black students.<sup>49</sup>

**FIGURE 8.2**  
Student Unmet Need by Dependency, Among Selective Four-Year Institutions and Income



Note: The full height of the bar represents a student’s Cost of Attendance. Includes public and private nonprofit four-year institutions designated as minimally selective or higher. Source: Institute for Higher Education Policy analysis of data from the 2016 National Postsecondary Student Aid Study, a product of the National Center for Education Statistics, U.S. Department of Education. Computation by NCES PowerStats. See technical appendix for detailed methodology.

## INSTITUTIONS MUST TAKE RESPONSIBILITY FOR INFORMING STUDENTS FROM LOW-INCOME BACKGROUNDS AND STUDENTS OF COLOR ABOUT THEIR FINANCIAL AID ELIGIBILITY

Some selective institutions have already demonstrated that effective financial aid strategies can create affordable degree pathways for students from low-income backgrounds. For instance, the University of Michigan,<sup>50</sup> the University of North Carolina–Chapel Hill,<sup>51</sup> and the University of Wisconsin–Madison<sup>52</sup> have all committed to providing sufficient grants and work-study opportunities to put their schools within reach for students from low-income backgrounds. However, these well-resourced institutions enroll relatively few such students. In 2017–18, less than 15 percent of students at the University of Wisconsin–Madison received Pell Grants, while 16 percent of students at the University of Michigan and 23 percent of students at the University of North Carolina–Chapel Hill did.<sup>53</sup>

Many other institutions have implemented “no-loan” policies for some or all of their students, effectively promising students that they do not need to take out loans because their full need will be met through grants, scholarships, or work-study awards. School-wide no-loan policies are most common among highly selective, wealthy liberal arts colleges like Amherst and Pomona Colleges and Ivy League schools. However, several highly selective public institutions—including Michigan State University, among others—have also adopted no-loan policies for low-income and low-wealth students.<sup>54</sup>

In such a landscape, selective institutions that *do* meet the financial need of applicants from low-income backgrounds, via generous need-based aid programs or by guaranteeing students will not need to borrow, must also ensure that they actively provide information about admissions, financial aid availability, and eligibility to prospective students. Doing so has been proven empirically to dramatically increase application and enrollment rates among underrepresented students.<sup>55</sup> For example, research shows that the complexity of the federal financial aid system imposes cognitive and time costs on all applicants, and that these costs disproportionately

burden students with fewer resources.<sup>56</sup> At the same time, uncertainty in aid eligibility—driven in part by large differences in aid packages from one school to the next and the fact that students do not receive aid notices until well into the application cycle—can deter students who are the most sensitive to financial factors from ever applying.<sup>57</sup>

Simple and transparent processes are most effective in ensuring that students from all backgrounds can access higher education and successfully earn a degree.<sup>58</sup> The extensive research supporting this conclusion includes one study that found students from low-income backgrounds often do not consider applying to selective institutions due in part to poor information on financial aid eligibility and cumbersome financial aid application processes, even when generous financial aid programs would make these options less expensive than others.<sup>59</sup> A similar study finds that when given information about financial aid eligibility as well as financial aid application support, students from low-income families are much more likely to apply and enroll in college.<sup>60</sup> Another study demonstrates that direct outreach to high-achieving students from low-income backgrounds, along with a promise of free tuition, *doubled* their application and enrollment rates.<sup>61</sup>

### Designing Inclusive Financial Aid Programs

Institutions should ensure that their financial aid policies and eligibility standards do not exclude students who could benefit most. For instance, age limits can exclude older students from aid programs. Credit load requirements can pose challenges for working adults, student parents, or near-completers. Criminal history policies (see [Chapter 6](#)) can disproportionately disadvantage students of color.<sup>62</sup>

Taken together, these findings show that generous need-based aid programs are critical supports for historically underserved students. However, these programs alone are insufficient to radically improve access and success for students from low-income backgrounds and students of color at selective institutions. Instead, the evidence suggests that institutions’ responsibility is threefold: (1) prioritize need-based aid programs; (2) invest in targeted recruitment of students from low-income backgrounds and students of color; and (3) offer adequate support throughout the application and financial aid processes.





## OPENING THE DOOR TO OPPORTUNITY: INVEST IN NEED-BASED FINANCIAL AID

Even as institutions face intensifying budget pressures amidst the COVID-19 pandemic, they should work to prioritize equity in tough financial aid decisions. Need-based financial aid improves access for students from low-income backgrounds and helps them afford, persist, and complete their education.<sup>65</sup> The available evidence confirms that need-based aid has an especially large effect on Black<sup>64</sup> and Latinx<sup>65</sup> student enrollment, findings that are likely to extend to other underrepresented groups, including Indigenous and underrepresented AAPI students. It follows that these programs are important tools for reducing racial inequities in higher education.

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### **IT IS THEREFORE VITALLY IMPORTANT THAT INSTITUTIONS— PARTICULARLY WELL-RESOURCED INSTITUTIONS—DO THE FOLLOWING:**

#### **AWARD FINANCIAL AID DOLLARS BASED ON STUDENT NEED:**

The allocation of financial aid dollars can make or break students' decisions about enrolling in selective institutions, and in earning a degree. High levels of unmet need put students from low-income backgrounds and students of color in precarious situations, often forcing them to choose between working more to meet their basic needs at the expense of their academic performance or dedicating time to academic studies and borrowing significant amounts to do so.<sup>66</sup> The best way to allocate limited institutional aid is to target aid to students with the most financial need and increase the likelihood that all students have a chance at a postsecondary education. Doing so will require difficult conversations about institutional priorities, in which equitable access and success should be centered. Prioritizing equity may also require difficult conversations with donors, who should be encouraged to give flexible funds that can support students from low-income backgrounds. While some institutions have shown leadership in directing aid toward students with the most need, financial aid remains poorly targeted at far too many institutions.

#### **ADEQUATELY FUND TRANSFER AND PART-TIME STUDENTS:**

Four-year institutions, particularly well-resourced selective four-year institutions, should ensure that part-time students and students who transfer from two-year institutions are eligible for and receive institutional financial aid. These students are disproportionately likely to be Black, Latinx, Indigenous, and

underrepresented AAPI students or students from low-income backgrounds. Providing them with adequate financial aid is necessary for them to persist and complete their degree.<sup>67</sup>

### **CLEARLY INFORM PROSPECTIVE STUDENTS ABOUT FINANCIAL AID AVAILABILITY, ELIGIBILITY, AND APPLICATION REQUIREMENTS:**

For institutions that already provide generous need-based financial aid, or those seeking to adopt such policies, recruitment of students from low-income backgrounds and students of color must include clear, targeted information about aid availability and eligibility. General guidance on aid availability may be insufficient if students do not perceive financial aid programs as applicable to their specific situations. Tailored outreach is the most effective in promoting application and enrollment of students from low-income backgrounds and of students of color.<sup>68</sup> Institutions should avoid cumbersome aid application processes and should provide support to students throughout the application process. Institutions should ensure that their financial aid award letters use plain language, list grant aid and loans separately, and calculate students' net costs and estimated bill.

## **OPPORTUNITIES FOR FEDERAL AND STATE AID POLICIES**

Federal and state policies also can improve access to need-based aid, supplementing institutional efforts to improve affordability for low-income and low-wealth students.

### **FEDERAL POLICYMAKERS SHOULD:**

#### **DOUBLE THE MAXIMUM PELL GRANT,**

the cornerstone of federal need-based financial aid, and index it to inflation so the program catches up to and keeps pace with the rising costs of college.

#### **PURSUE A FEDERAL-STATE PARTNERSHIP**

in order to provide financial support to states in exchange for improvements in affordability.

### **STATE POLICYMAKERS SHOULD:**

#### **PROTECT AND INCREASE FUNDING**

for state need-based aid programs, and award state grants on the basis of financial need.

#### **REQUIRE PUBLIC INSTITUTIONS TO AWARD A HIGHER PROPORTION OF INSTITUTIONAL FUNDS**

to students based on financial need.

#### **PROVIDE SUFFICIENT SUPPORT FOR PUBLIC INSTITUTIONS**

to alleviate the pressure on institutions to turn to high-income and out-of-state students for revenue.

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