A System in Need of Repair

An Examination of Federal Student Aid for Postsecondary Education

december 2012

ALLIANCE FOR EXCELLENT EDUCATION

Federal Student Aid

Three years after signing the Higher Education Act (HEA) of 1965—legislation that established the Basic Education Opportunity Grant (now called the Pell Grant)—President Lyndon Johnson declared that "every man, everywhere, should be free to develop his talents to their full potential—unhampered by arbitrary barriers of race or birth or income."[1] As it was originally designed, the federal student financial aid system was intended to increase access to higher education for students who would otherwise be unable to attend.

In the nearly five decades since the enactment of the HEA, however, there have been numerous legislative changes that have altered the structure and focus of the system. Today, many students and families find obtaining information about federal aid challenging and the process of applying for aid daunting. In fact, last year nearly 750,000 students initiated the financial aid application process but had their application returned because of insufficient data—and never resubmitted.

Many students and families find obtaining information about federal aid challenging.

The federal student aid system has grown into a complicated web of programs that are not clearly or purposefully coordinated to help students complete a degree or certificate. The system consists of grant, loan, and campus-based aid programs under Title IV of the HEA, as well as several federal tax credits and deductions. During School Year (SY) 2010–11, an estimated $169 billion in aid was awarded to students under Title IV HEA programs.[2] This represents 72 percent of the $235 billion in total financial aid awarded to college students during the same period, with the remaining amount coming from state and institutional aid and scholarships.[3] For comparison purposes, consider Title I of the Elementary and Secondary Education Act (ESEA), which is the largest single source of federal funds for K–12 education: in Fiscal Year (FY) 2012, the ESEA was funded at $14.5 billion[4]—less than 9 percent of the total amount of Title IV aid awarded, less than 50 percent of the amount awarded for Pell Grants, and less than 20 percent of the Stafford Loan amount for the same period.

In spite of this huge federal investment, students in the United States are completing postsecondary education at lower rates than their international peers. Once a world leader in postsecondary degree completion, in 2009 the United States ranked fifteenth in the number of degrees completed, far below the OECD average of 38.6 percent.[5] Failure to address this issue has consequences far greater than just the United States's international ranking. The nation's inability to increase the number of students completing postsecondary programs of study will have a negative impact on its economy. First, the country will face severe degree shortages: as Anthony Carnevale of Georgetown University and his colleagues write, "By 2018, we will need 22 million new college degrees—but will fall short of that number by at least 3 million postsecondary degrees, Associate's or better. In addition, we will need at least 4.7 million new workers with postsecondary certificates."[6] Second, research shows that individuals without some level of postsecondary education do not fare as well as their peers with degrees, and are hit particularly hard during tough economic times.[7]

Students who finish postsecondary education reap economic benefits for themselves and their communities. An increase in the education levels of citizens also benefits society by decreasing the costs of crime, social welfare programs, and health care. If the federal student aid system continues to focus only on increased postsecondary access and not on completion, individuals and the country as a whole will bear the economic and social impact.[8]

Students who finish postsecondary education reap economic benefits for themselves and their communities.

The Congressional Budget Office also recently suggested that the program might be unsustainable in the near future.

Pell Grants

The single largest federal grant is the Pell Grant (formerly the Basic Education Opportunity Grant), which is intended to provide low-income students access to postsecondary education. Pell Grants are awarded based on need and do not need to be repaid. In SY 2010–11, an estimated 9.3 million students received approximately $35 billion in Pell Grant assistance.[9] Further, 74 percent of Pell Grant aid went to recipients from families making $30,000 a year or less. The current maximum Pell Grant is $5,550; in SY 2010–11, approximately 30 percent of all recipients received the maximum award, indicating that they had the highest demonstrated need.[10]

The Pell Grant has never been more popular—or more expensive for the government—than it is right now. In SY 2010–11, 21.1 million students applied for a Pell Grant,[11] the highest number of applicants ever documented and 1.5 million more than SY 2009–10, the previous record year.[12] SY 2010–11 also set a record for program costs, with expenditures reaching nearly $35.7 million.[13] It is important to note that Pell functions as a "quasi-entitlement" program, because anyone who applies and is eligible receives a grant, irrespective of the amount of funding available. In some years there is a budget shortfall, with the Pell program costing more than the amount of funding available.

The Congressional Budget Office (CBO) also recently suggested that the program might be unsustainable in the near future. Beginning in FY 2014, the CBO projects shortfalls of more than $30 billion for the program through FY 2022 and beyond.[14] Although funding shortfalls have been solved in recent years through legislative changes—eliminating loan subsidies for graduate students, altering Pell Grant eligibility requirements, and providing funding from legislative savings mechanisms—much of the low-hanging legislative fruit to pay for these shortfalls has already been picked.[15]

Federal Student Loans

The federal student aid system also includes a number of loan programs (see Table 1). The largest of these is the Stafford Loan Program. Stafford Loans are broken down by whether the interest on the loan is subsidized by the federal government while a student is attending school or whether it is unsubsidized. In SY 2011–12, 10.4 million students received a Stafford Loan.[16] The total amount of all Stafford Loans awarded during this same period was $85.9 billion.[17]

The rising cost of college and limited federal and state assistance have resulted in increased borrowing for students and families. According to Brown et al., "As of Quarter 1 in 2012, the average student loan balance for all age groups is $24,301. About one-quarter of borrowers owe more than $28,000; 10% of borrowers owe more than $54,000; 3% owe more than $100,000; and less than 1%, or 167,000 people, owe more than $200,000."[18] The simple act of borrowing money to finance higher education costs is not new, of course; students and families have borrowed money for decades. But the amount borrowed annually to finance higher education in the U.S. has grown to record proportions. In March of 2012, the amount of student loan debt held in the United States exceeded $1 trillion—more than the total amount of credit card debt.[19] Further, even though the early 2000s saw the lowest student loan cohort default rates since 1989 (the first year the U.S. Department of Education collected data), the 2009 cohort produced the highest default rates since 1997. In fact, loan default rates have steadily increased every year since 2006.[20] This suggests that students and families are borrowing more to pay for college than what they can actually afford.

Table 1: Loan Programs

Loan Program	Recipients	Program Cost
Subsidized Stafford Loans*	9.4 million	$40 billion
Unsubsidized Stafford Loans*	8.8 million	$45.9 billion
Parent PLUS Loans**	884,000	$10.4 billion
Perkins Loans*	524,000	$970 million

*SY 2011–12 figures from College Board, *Trends in Student Aid 2012* (Washington, DC: Author, 2012), http://trends.collegeboard.org/sites/default/files/student-aid-2012-full-report.pdf (accessed November 1, 2012).
**SY 2010–11 figures from National Association of Student Financial Aid Administrators, *National Student Aid Profile: Overview of 2012 Federal Programs* (Washington, DC: Author, 2012), http://www.nasfaa.org/WorkArea/DownloadAsset.aspx?id=10463 (accessed October 17, 2012).

Campus-Based Programs

Title IV of the HEA also includes campus-based student aid programs, which allow participating institutions to determine the amount of aid each student receives.[21] These programs include Perkins Loans, the Federal Supplemental Educational Opportunity Grant Program (FSEOG), and Federal Work Study (FWS). Perkins Loans are low-interest loans provided to financially needy undergraduate, graduate, and professional students. In SY 2009–10, approximately 442,000 students received Perkins Loans.[22] The FSEOG Program provides grants to financially needy undergraduate students. Approximately 1.6 million students received an FSEOG award in SY 2009–10.[23] Federal Work Study provides jobs to undergraduate, graduate, and professional students at participating institutions. In SY 2009–10, approximately 733,000 students received FWS awards.[24]

Although all of these programs provide financial assistance to needy students, they are only available at slightly more than half of all Title IV–eligible postsecondary institutions, thereby excluding the majority of federal student aid recipients.

Although all of these programs provide financial assistance to needy students, they are only available at slightly more than half of all Title IV–eligible postsecondary institutions.

Tuition Tax Credits

In addition to Title IV programs, the federal student aid system includes aid in the form of tuition tax credits (the Hope Credit, the Lifetime Learner Credit, and the American Opportunity Tax Credit), tax deductions for parents with children enrolled full-time in an eligible post-secondary institution, and tax-advantaged education savings accounts (529 Plans and Coverdell Education Savings Accounts).

Between 1999 and 2009, tax credits and deductions for higher education expenses resulted in a loss of $70 billion in federal revenue.[25] Approximately 13 percent of these tax benefits ($9.4 billion) went to families making more than $100,000 a year, and 11 percent went to the neediest families, those making less than $25,000.[26] Middle-income families received the remaining 76 percent of the tax breaks.[27]

In the last five years, these kinds of tax breaks have increasingly subsidized postsecondary education for non-needy students and families—that is, those who would be able to pay for college expenses even without federal assistance. From 1999 to 2001, the first three years following the enactment of the Hope and Lifetime Learning Credit programs, families earning more than $100,000 did not receive these credits, because of income caps; from 2007 to 2009, however, the share of benefits for families making between $100,000 and $180,000 increased to 22 percent.[28]

The introduction of the American Opportunity Tax Credit (AOTC) in 2009 expanded benefits to include higher-income families. In 2009, families making between $100,000 and $180,000 received the largest amount ($3.88 billion) and share (26 percent) of the nearly $15 billion in tax credits; middle-income families' share was reduced to 56 percent.[29]

Research also suggests that tax credits may be an ineffective way to deliver aid to lower- and middle-income students, because students and families have to pay for expenses up front and then wait until they file their federal tax returns to have those expenses reimbursed.[30] These types of tax credits therefore fail to provide the necessary financial support to make postsecondary attendance a reality for lower-income students, and are disconnected from the more popular Title IV student aid programs. Additionally, they fail to incentivize postsecondary retention or completion.

These types of tax credits therefore fail to provide the necessary financial support to make postsecondary attendance a reality for lower-income students.

There are a number of problems with how federal policymakers have addressed student aid in the past.

Implications

This multifaceted, disjointed, and complicated federal student aid system is ineffective in supporting students from the point of matriculation through completion and is possibly contributing to the decline in postsecondary completion nationally. As Cohen et al. describe, "The highly fragmented and uncoordinated nature of financial aid makes it hard for students to navigate, and the process is particularly intimidating for first-generation college-goers. In fact, research has shown that uncertainty and complexity in the financial aid process can prevent low-income students from applying for and accessing available aid."[31] It is difficult for students—especially first-generation students—to prepare to attend an institution of higher education without knowing what aid they are eligible for or likely to receive. Clearer information provided earlier in the K–12 system and a streamlined and effective federal student aid system could help encourage students to both pursue and complete postsecondary education.

There are a number of problems with how federal policymakers have addressed student aid in the past. First, although policymakers have long focused on widening access to postsecondary education, there needs to be an emphasis on completion, as well—only when they finish a postsecondary program of study will students receive personal benefits and a full return on the government's investment. Second, policymakers currently deal with the aid programs in a highly siloed manner and make incremental changes to the components of the federal aid system that have minimal impact. It is shortsighted to address changes to individual programs; instead, policymakers should think holistically about how all of the pieces of the student aid system could combine to become larger than the sum of their parts.

It is difficult for students to prepare to attend an institution of higher education without knowing what aid they are eligible for or likely to receive.

Demand Changes

The federal student aid system is currently oriented around the admirable goal of increasing access to postsecondary education. Unfortunately, the system is not focused on helping these students cross the finish line once they start the race. Nationally, retention rates from the first to second year in both two- and four-year institutions are 67 percent or less. On-time completion rates are also disappointingly low, even for four-year private institutions, which graduate slightly more than 50 percent of students in four years (see Table 2).

Table 2: Retention and Completion Rates

Institution Type	Average Retention Rate	Average Completion Rate
2-year public	55.5%	25.4%
2-year private	55.5%	51.4%
4-year public	65.2%	36.6%
4-year private	67.3%	54.7%

ACT, "National Collegiate Retention and Persistence to Degree Rates" (Washington, DC: Author, 2012), http://www.act.org/research/policymakers/pdf/retain_2012.pdf (accessed October 10, 2012).

The federal student aid system can and must work better. Americans must demand a system that offers returns on the national investment in higher education and gives incentives and supports for students to complete postsecondary degrees. In an upcoming paper, the Alliance for Excellent Education will outline recommendations for reforming the federal student aid system to significantly increase the rates at which students enroll in and, most importantly, complete postsecondary programs.

Endnotes

[1] President Lyndon B. Johnson, "Fifth Freedom" speech, February 5, 1968.

[2] National Association of Student Financial Aid Administrators (NASFAA), *National Student Aid Profile: Overview of 2012 Federal Programs* (Washington, DC: Author, 2012), http://www.nasfaa.org/WorkArea/DownloadAsset.aspx?id=10463 (accessed October 17, 2012).

[3] Ibid.

[4] U.S. Department of Education, "Fiscal Year 2013 Congressional Action" (Washington, DC: Author, June 20, 2012), http://www2.ed.gov/about/overview/budget/budget13/13action.pdf (accessed October 10, 2012).

[5] OECD, *Education at a Glance 2011: OECD Indicators* (2011), OECD Publishing, http://dx.doi.org/10.1787/eag-2011-en (accessed October 11, 2012).

[6] A. P. Carnevale, N. Smith, and J. Strohl, *Help Wanted: Projections of Jobs and Education Requirements Through 2018* (Washington, DC: Georgetown University Center on Education and the Workforce, 2010), http://www9.georgetown.edu/grad/gppi/hpi/cew/pdfs/FullReport.pdf (accessed August 14, 2012).

[7] A. P. Carnevale, T. Jayasundera, and B. Cheah, *The College Advantage: Weathering the Economic Storm* (Washington, DC: Georgetown University Center on Education and the Workforce, 2010), http://www9.georgetown.edu/grad/gppi/hpi/cew/pdfs/CollegeAdvantage.FullReport.081512.pdf (accessed October 20, 2012).

[8] Alliance for Excellent Education, *Saving Futures, Saving Dollars* (Washington, DC: Author, 2006), http://www.all4ed.org/files/SavingFutures.pdf (accessed October 10, 2012); Alliance for Excellent Education, *Healthier and Wealthier* (Washington, DC: Author, 2006), http://www.all4ed.org/files/HandW.pdf (accessed October 10, 2012); Alliance for Excellent Education, *Education and the Economy: The Economic Benefits of Helping High School Dropouts Earn Both High School Diplomas and College Degrees* (Washington, DC: Author, 2011), http://www.all4ed.org/publication_material/EconStatesPostsecondary (accessed October 10, 2012).

[9] U.S. Department of Education, "Table 1: Federal Pell Grant Program: Summary of Statistics for Cross-Year Reference" (Washington, DC: Author, 2011), http://www2.ed.gov/finaid/prof/resources/data/pell-2010-11/pell-eoy-2010-11.html (accessed October 10, 2012).

[10] U.S. Department of Education, "Table 20: Distribution of Federal Pell Grant Recipients by Grant Level and Type and Control of Institution" (Washington, DC: Author, 2011), http://www2.ed.gov/finaid/prof/resources/data/pell-2010-11/pell-eoy-2010-11.html (accessed October 10, 2012).

[11] U.S. Department of Education, "Table 1: Federal Pell Grant Program."

[12] Ibid.

[13] Ibid.

[14] Congressional Budget Office, "CBO March 2012 Baseline Projections for the Student Loan and Pell Grant Programs" (Washington DC: Author, 2012), http://www.cbo.gov/sites/default/files/cbofiles/attachments/43054_StudentLoanPellGrantPrograms.pdf (accessed October 10, 2012).

[15] J. Delisle, "CBO Releases 2013 Pell Grant Funding Target" (Washington, DC: New America Foundation, 2012), http://edmoney.newamerica.net/blogposts/2012/cbo_releases_2013_pell_grant_funding_target-65244 (accessed October 10, 2012).

[16] College Board, *Trends in Student Aid 2012* (Washington, DC: Author, 2012), http://trends.collegeboard.org/sites/default/files/student-aid-2012-full-report.pdf (accessed November 1, 2012).

[17] Ibid.

[18] M. Brown, A. Haughwout, D. Lee, M. Mabutas, and W. van der Klaauw, "Grading Student Loans" (New York, NY: Liberty Street Economics via the Federal Reserve Bank of New York, 2012), http://libertystreeteconomics.newyorkfed.org/2012/03/grading-student-loans.html (accessed October 10, 2012); American Student Assistance, "Loan Debt Statistics," http://www.asa.org/policy/resources/stats/default.aspx (accessed October 12, 2012).

[19] J. Lorin, "Student-Loan Debt Reaches Record $1 Trillion, Report Says," Bloomberg News, March 22, 2012, http://www.bloomberg.com/news/2012-03-22/student-loan-debt-reaches-record-1-trillion-u-s-report-says.html (accessed October 12, 2012).

[20] U.S. Department of Education, "FY 2010 2-Year Official National Student Loan Default Rates," http://www2.ed.gov/offices/OSFAP/defaultmanagement/defaultrates.html (accessed October 12, 2012).

[21] NASFAA, *National Student Aid Profile.*

[22] Ibid.

[23] Ibid.

[24] Ibid.

[25] S. Burd, *Moving on Up: How Tuition Tax Breaks Increasingly Favor the Upper-Middle Class* (Washington, DC: Education Sector, 2012).

[26] Ibid.

[27] Ibid.

[28] Ibid.

[29] Ibid.

[30] S. Baum, M. McPherson, and P. Steel, eds., *The Effectiveness of Student Aid Policies: What the Research Tells Us* (New York, NY: College Board, 2008).

[31] J. Cohen, F. Hanleybrown, M. Pandit, and K. Tallant, *Keeping the Promise of Opportunity: Redesigning Financial Aid to Support Post-Secondary Completion Among Low-Income Young Adults* (Boston, MA: FSG), http://www.fsg.org/tabid/191/ArticleId/713/Default.aspx?srpush=true Footnote 17 (accessed October 14, 2012).

The Alliance for Excellent Education is a Washington, DC–based national policy and advocacy organization that works to improve national and federal policy so that all students can achieve at high academic levels and graduate from high school ready for success in college, work, and citizenship in the twenty-first century.

This document was written by Martens Roc and Bill DeBaun. Mr. Roc and Mr. DeBaun are members of the policy and advocacy team at the Alliance for Excellent Education.

Support for this paper was provided by the Bill & Melinda Gates Foundation. Opinions expressed are those of the authors and do not necessarily reflect the views of the Bill & Melinda Gates Foundation.

Alliance for Excellent Education
1201 Connecticut Avenue, NW, Suite 901
Washington, DC 20036
p 202 828 0828 f 202 828 0821
www.all4ed.org