Reforming Student Aid

How to Simplify Tax Aid and Use Performance Metrics to Improve College Choices and Completion

February 2013

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Executive Summary

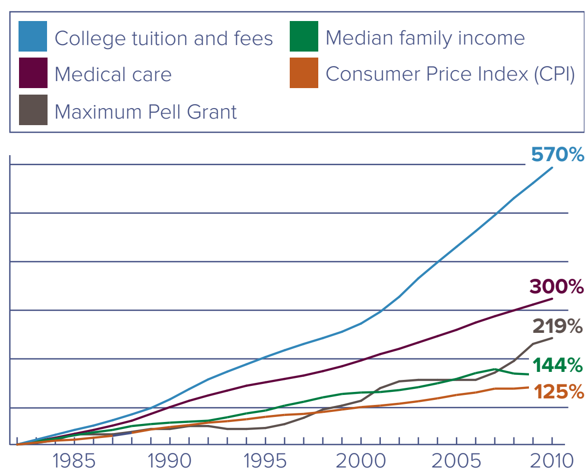
College costs are growing far faster than family incomes. Nearly half of students at public colleges have substantial unmet need.

Over the last three decades, college costs have increased nearly four times faster than median family income *(Figure A)*. Financial aid has not filled the growing gap, and "unmet financial need"—the share of college costs not covered by financial aid or what the family is expected to contribute—has risen sharply. Half of community college students had unmet financial need in 2007-08, averaging $4,500, as did 43 percent of students at public four-year colleges, with their unmet need averaging $6,400 (National Center for Education Statistics 2011).

As a result, students work more and borrow more, with debt now averaging more than $26,000 for recent four-year college graduates (Reed and Cochrane 2012). Rising costs and rising debt make college a riskier investment for students and families, who lack the information they need to shop around for colleges and programs of study that represent the best value in

Figure A: College Costs Rising Four Times Faster Than Income, Two and a Half Times Faster Than Pell Grants

Rate of cost growth in higher education and other goods compared to growth in Pell Grants, 1982-2011



Source: Darcie Harvey (National Center for Public Policy and Higher Education) and CLASP analysis based on data from the Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers. Median family income is from U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements and the American Community Survey. Maximum Pell Grant from Department of Education, Pell Grant End-of-Year Report (2010-2011). Adapted from figure in *Lifting the Fog on Inequitable Financial Aid Policies*, Lynch, Engle, and Cruz (2011).

terms of cost, completion rates, and employment and earnings (or further education) after graduation.

Financial pressures drive down college completion.

Lack of affordability not only limits access to college, it also affects the time it takes for students to earn a degree. For example, two-thirds of young community college students work more than 20 hours per week to cover college and family costs (Orozco and Cauthen 2009). This may explain in large part the widespread prevalence of part-time college attendance. A recent national study found that more than half of undergraduates (51 percent) attended a mix of full-time and part-time over a six-year period (Shapiro et al. 2012).

Beyond increasing time to degree, financial pressure to work more while in college—and consequently take fewer classes at a time—also affects whether students ultimately complete a certificate or degree program and earn a credential. A number of studies have found that working too many hours while in college negatively affects academic performance (Scott-Clayton 2012). A 2009 survey of young adults who had left college is consistent with this: 54 percent of students who had left school said the major reason was because they had to "go to work and make money" (Johnson and Rochkind 2009).

Reducing the pressure to work too many hours while in school might help explain why need-based grant aid not only increases college enrollment among low- and modest-income students but can also increase persistence and credits earned (Castleman and Long October 2012; Goldrick-Rab et al. 2012). But other factors can also stand in the way of student success, including logistical barriers (e.g., child care, transportation), poor high school academic preparation for college, and lack of knowledge about navigating complex college academic and financial processes (Bailey, Smith Jaggers and Jenkins 2011). Some financial aid programs have coupled grant

aid with other interventions (e.g., innovations in course delivery, curriculum, or instruction; learning communities; financial incentives; extra academic support and advising; emergency transportation or child care help) to address these obstacles. Early research suggests that such multifaceted approaches may be even more effective than grant aid alone (Scrivener, Weiss and Sommo 2012; Deming and Dynarski 2009; Washington State Board for Community and Technical Colleges 2011).

Federal student aid reform should be fair and increase educational and economic opportunity. Back proposed changes with evidence and model or pilot the consequences before adopting new policies.

CLASP recognizes that changes to federal student aid should not be proposed lightly, especially at a time when policymakers are focused on budget austerity rather than on the nation's linked college affordability and completion challenges. Accordingly, we have developed principles for guiding student aid reform choices.

First, the goal of federal higher education policy should be to increase educational and economic opportunity for all students, with a priority for low-income, underrepresented populations who cannot access and afford postsecondary education without federal assistance.

Second, federal student financial aid reforms should preserve—and even enhance—the original purpose of these programs: to increase access. Student success and completion are worthy additions but should be pursued in ways that do not undermine access. Reforms should be fair and recognize the diversity of today's students.

Third, any reforms should make federal student aid:

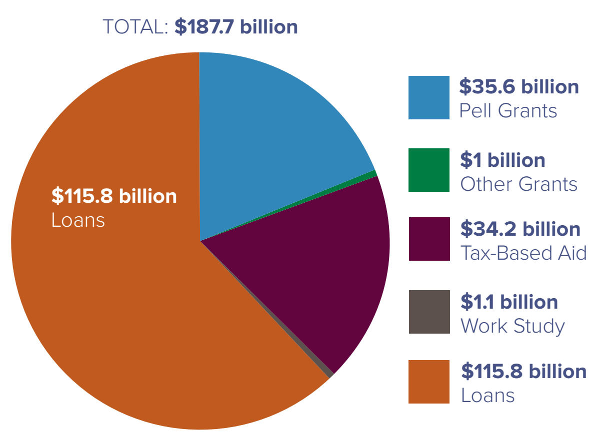
- *More effective*, in terms of increasing access to and completion of college by low-income underrepresented populations,
- *More efficient*, in terms of maximizing the impact of limited federal dollars, and
- *Simpler* for students and their families to understand and use.

Fourth, in looking forward, CLASP strongly believes that all policy reform proposals must pass a high bar before being moved forward for legislative or executive action. In our view, reform proposals should be *evidence-based*, with data backing the need for change and showing that proposed changes will help, not hurt, needy students; *modeled*, to show clearly any redistributive effects among students and families; and *piloted*, to understand the actual effects on students and institutions before major changes are scaled up.

Based on these considerations, CLASP has focused our work for the Bill & Melinda Gates Foundation project *Reimagining Aid Design and Delivery* on two federal policy areas that have received relatively little congressional attention and where we see considerable room for improvement: tax-based student aid and the use of performance metrics in student aid policy. We oppose any further cuts to the Pell Grant program as unnecessary and counterproductive to federal goals for increasing college access and completion. Not only are Pell Grants well targeted to the families that need help most, but growth in the program has leveled off. Students cannot afford any further Pell Grant reductions; next year's $5,635 maximum Pell Grant will cover less than one-third of the cost of college—the lowest since the start of the program.

The Pell Grant program does face a funding gap beginning in fiscal year 2015 (FY 2015), with the ending of an existing revenue source. Congress should look for savings elsewhere in student aid to fill that gap. Pell Grants represented less than one-fifth of all student aid provided to students in the last fiscal year *(Figure B)*. As Figure C indicates, a substantial portion of tax-based student aid flows to upper-income households whose college

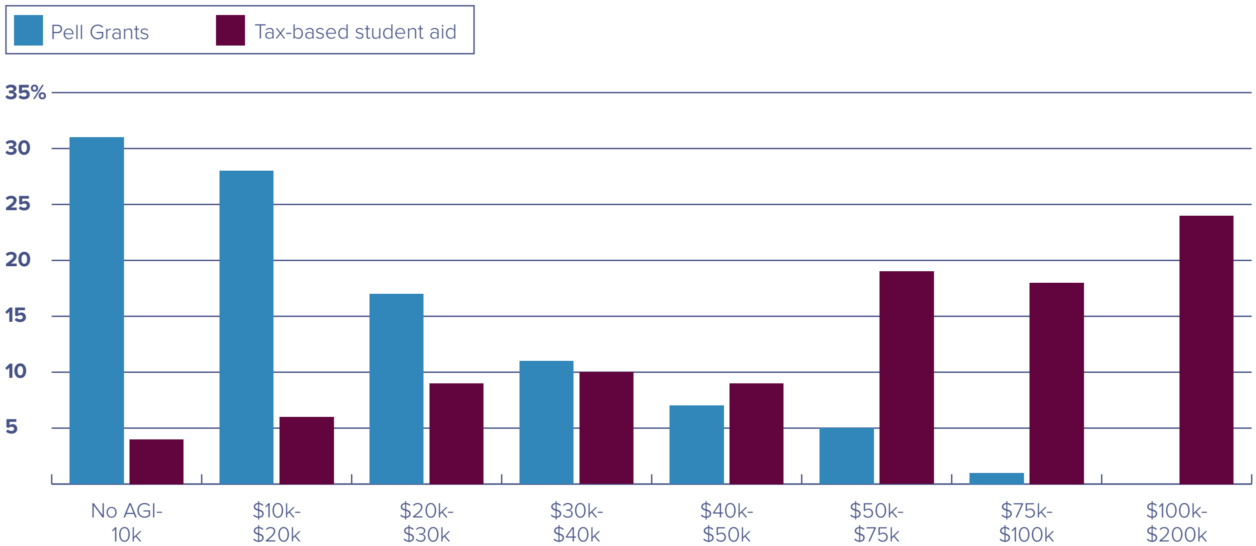
FIGURE B: Pell Grants Represent Less Than One-Fifth of All Federal Student Aid, FY 2012



Source: CLASP, based on estimates from the President's FY 2013 Budget and the Department of Education.

FIGURE C: Tax-Based Student Aid Provides Substantial Benefit to High-Income Households

Percent distribution of student aid by type and income category in 2013



Notes: "Tax-based student aid" here includes the American Opportunity Tax Credit, the Lifetime Learning Credit, the student loan interest deduction, and the tuition and fees deduction.

Source: CLASP, based on data from the Tax Policy Center.

decisions are unlikely to depend on receiving a tax deduction or credit.

Make tax-based student aid simpler and more effective.

There are three main criticisms of tax-based student aid: it provides little benefit to low-income students, it has little effect on college access or completion, and it is too complex and difficult to use. Our exploration of various reform options makes it clear that it is possible to address these problems by simplifying and better targeting federal tax-based student aid—and potentially redirecting some revenue savings to the Pell Grant program—within a budget neutral framework. While delivering student aid through the tax system is a "second best" strategy compared with grant aid, because Congress has chosen to deliver nearly half of all non-loan student aid in this way, it is essential to make it work better.

These options can be packaged in various ways to achieve different goals. CLASP has created three alternative proposals that provide a general framework for reform. All rely on improving the American Opportunity Tax Credit (AOTC) and simplifying the array of available tax benefits. These are:

Proposal One: Simplify aid to just the American Opportunity Tax Credit and front load refundability.

This proposal would refund 100 percent of the first $2,000 of the AOTC and index the AOTC for inflation. It would also lengthen the AOTC phase-out range to begin at $120,000 and end at $180,000 for joint filers and begin at $60,000 and end at $90,000 for single and head of household filers. In addition the proposal would eliminate the tuition and fees deduction, the Lifetime Learning Credit (LLC), and the student loan interest deduction. Compared with current policy, this reform package makes tax-based student aid much simpler for students and parents to understand and delivers significantly more of that aid to the most price sensitive households to increase its impact on access and completion. This proposal is essentially revenue neutral.

Proposal Two: Simplify aid but preserve both the American Opportunity Tax Credit and the Lifetime Learning Credit for undergraduates only. Front load refundability of the AOTC.

Proposal Two would preserve many of the benefits of Proposal One while addressing its potential shortcomings. This proposal would refund 100 percent of the first $1,500 of AOTC; index the AOTC for inflation; lengthen the AOTC phase-out range to begin at $120,000 and end at $180,000 for joint filers and $60,000 and $90,000 for single tax filers; eliminate the student loan interest deduction and the tuition and fees deduction; and eliminate the Lifetime Learning Credit for graduate students only. Proposal Two preserves tax-based aid to certain groups left worse off by full elimination of the Lifetime Learning Credit under Proposal One, such as undergraduates who are in their fifth year of studies, are attending less than half time, or are not seeking degrees. However, it provides significantly less aid to the lowest income households than does Proposal One. The package is modestly revenue positive, which would leave open the possibility of these revenues being redirected to help address the Pell Grant funding gap and to fund innovation aimed at increasing completion.

Proposal Three: Simplify aid but preserve both the American Opportunity Tax Credit and the student loan interest deduction. Front load refundability of the AOTC.

Proposal Three is similar to Proposal Two but with two major differences: it preserves the student loan interest deduction and eliminates the Lifetime Learning Credit. This alternative reflects that Congress' recent action to make permanent the expanded student loan interest deduction may signal a lack of interest in eliminating this benefit as part of tax simplification. Like the first two proposals, this package simplifies and better targets tax-based student aid but it provides slightly less aid to low- and modest-income families than Proposal Two and has the same negative effects on current undergraduate recipients of the Lifetime Learning Credit that Proposal One does. Proposal Three generates a modest amount of revenue that could be reinvested in the Pell Grant program and innovation.

The above proposals rely on the same general strategy to make the tax provisions more efficient, effective, and simple. Adjustments, such as altering the refundability rate or relying on an alternative set of eliminations, could be made to meet certain goals (e.g., securing more revenue for the Pell Grant program and for innovation).

In addition to these three proposals, we believe two other AOTC improvements should be adopted that would ensure nontraditional students can fully benefit from this important source of student aid. First, expand the definition of qualified expenses to include child care and transportation. Second, replace the four-year AOTC limit with a lifetime $10,000 limit. These two improvements are not included in the above proposals because it is not possible at this time for us to obtain revenue estimates for them. We are however able to evaluate the budgetary and distributional implications of expanding qualified expenses to align with the full Title IV cost of attendance definition (see Option 1 in Section II).

Whatever the package of tax-based aid improvements and simplifications that policymakers choose, we urge them also to consider reforms that would improve outreach and delivery of tax-based student aid to make it more useful to all households (see Options 9-12, Section II). Without such reforms, timing and information problems will always constrain the impact of tax-based student aid. In particular, we urge policymakers to:

- Require more aggressive outreach, including IRS-supported free tax-filing help, to increase receipt of the American Opportunity Tax Credit among eligible low-income students and parents.

- Test “real-time payment” of the AOTC to postsecondary institutions through a joint Treasury-Education pilot.
- Add the AOTC to the Department of Education “Financial Aid Shopping Sheet” and require all Title IV institutions to use the Shopping Sheet.

Provide students, policymakers, and colleges with the facts they need, and create federal incentives for students and colleges to partner on college completion.

Performance metrics have long been used in other public programs for diverse purposes, and they could be used in federal higher education policy to promote the goals described earlier. Current performance requirements for student eligibility for aid already strike a balance between the goals of access and student success. However, much less attention has been given to institutional performance metrics in federal policy. CLASP presents a framework of potential uses for institutional performance metrics in order to contribute to a thoughtful discussion about what might be most appropriate.

We also propose several reforms for producing more-relevant performance information for students, policymakers, and colleges and for incenting and supporting students and institutions to increase college completion. These proposals are:

Proposal One: Expand public reporting of institutional measures of affordability, student progress, and credential completion.

Expanded reporting should include key measures of *institutional access and affordability, interim measures of student progress*, and better reporting of *credential and degree attainment rates*. We also recommend a stronger role for the Department of Education and the National Center for Education Statistics (NCES) in developing common definitions and data elements, and we would modify Higher Education Act requirements to ensure that Pell Grant graduation rates, transfer policies, and key data on costs are reported publicly. We also recommend simplifying Title IV disclosure and reporting requirements.

Proposal Two: Require states to gather and disclose aggregate student employment and earnings for all programs of study.

This reporting should include results for those who complete and who do not complete a certificate, diploma, or degree. The aggregate results from these data at the institutional level should be available publically to improve student and parent college program choices. A key aspect of this option is to build on existing State Longitudinal Data System grants to require states to develop a common definition of postsecondary program enrollment and standardized collection of data on certificate and degree attainment. Similarly, Workforce Data Quality Initiative grants could be expanded to require inclusion of data on Unemployment Insurance earnings as part of longitudinal student records accessible through the SLDS. The aggregate results could be submitted to the U.S. Department of Education for use by NCES to expand institutional-level profile information to include employment and earnings results for all programs of study (not just occupational programs).

Proposal Three: Create a national, voluntary “Compact for College Completion” among the federal government, students, and colleges.

This Compact would provide financial incentives and national recognition to students and colleges that agree to partner with the federal government on college completion. “Compact Scholars” would receive rewards for staying enrolled continuously and making progress in programs of study. Colleges would receive rewards for helping Scholars persist and complete, tracking Scholar outcomes compared with other similar students, and adopting evidence-based strategies for increasing Scholar persistence and completion.

While our reform options rely on working within existing federal and state data infrastructure, the same goals could be reached through the establishment of a national student unit record system or, to some extent, through partnerships with a private intermediary, such as the National Student Clearinghouse.

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