

**Paying for Postsecondary Education: An Issue Brief on College
Costs and Financial Aid**

Amanda Sharkey
Research Associate

The Center for American Progress

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INTRODUCTION

In a twenty-first century economy that values critical thinking, problem-solving and communications skills, a college diploma represents an increasingly vital passport to individual economic self-sufficiency. Compared to high school graduates, the average college-educated worker earns about 73 percent¹ more over a working lifetime and faces a 40 percent² lower risk of unemployment. In addition, higher education is associated with better health and higher levels of civic engagement. In short, a college education opens up windows of opportunity, while leaving school before earning a postsecondary credential closes doors.

Yet, despite the high-stakes consequences of earning (or not earning) a college diploma, higher education remains a vague dream rather than a concrete reality for far too many young people. This is particularly true for low-income Americans for whom the price of higher education may make a college degree seem hopelessly out of reach. College enrollment rates show disturbing disparities by family income level. For example, in 2001, 80 percent of high-income high-school graduates aged 16-24 had enrolled in college by the October after graduation, as compared to only 44 percent of those graduates from low-income families.³ Similarly, 64 percent of white graduates aged 16-24 had enrolled in college by the October after graduation, while only 55 percent of black graduates and 52 percent of Hispanic graduates had done so.⁴ Not surprisingly, just as students from wealthier families were more likely to enroll in college, they were also more likely to graduate. For example, of those students who entered four-year institutions in 1995-96 with the goal of earning a bachelor's degree, 77 percent of those with family income greater than \$70,000 had done so within six years, compared to only 54 percent of those whose family income was below \$25,000.⁵

Although the gap in enrollment rates between low-income and high-income groups is distressing, there is also a growing sense that paying for college has become a serious challenge even for middle-income students and their families. An explanation for this lies in several converging trends. First, tuition and fees are rapidly increasing. This is partly attributable to financial difficulties at the state level, which have prevented states from contributing as large a percentage of their revenues to the funding of colleges and universities as they had previously. Faced with a relative loss of government funds, university administrators have turned to tuition hikes to make up the shortfall. Secondly, while tuition increases have outpaced income growth for many low- and middle-income families,⁶ the growth in costs would be less troubling if it was accompanied by

¹ Sandy Baum and Kathleen Payea, *Education Pays 2004: The Benefits of Higher Education for Individuals and Society* (Washington, DC: College Board, 2004).

² Bureau of Labor Statistics, "More education: Lower unemployment, higher pay," *Occupational Outlook Quarterly* 48, no. 3 (Fall 2004). Available at <http://www.bls.gov/opub/ooq/oochart.htm>.

³ Institute for Higher Education Policy and Scholarship America, *Investing in America's Future: Why Student Aid Pays Off for Society and Individuals* (Washington, DC and St. Peter, MN: Author, 2004).

⁴ *Ibid.*

⁵ Baum and Payea, *Education Pays 2004*.

⁶ Thomas R. Wolanin, ed., *Reauthorizing the Higher Education Act: Issues and Options* (Washington, DC: Institute for Higher Education Policy, 2003); and

commensurate increases in grants. However, federal grants and loans have not kept pace with tuition growth. For example, the Pell Grant maximum, or the amount received by the neediest students, represented 36 percent⁷ of the average charges at a four-year public university in 2004-05, down from 50 percent⁸ twenty years ago. In addition, federally guaranteed student loan limits have not been raised in more than a decade.

The failure to ensure that low- and middle-income students complete higher education at the same rate as their more affluent peers may divide America into a nation of haves and have-nots. In addition, as other countries make significant gains in college-going rates, America's ability to compete internationally may be endangered. The United States, which once led the world in higher education attainment, is now second (at 38 percent) behind Canada (at 43 percent) among all Organization for Economic Cooperation and Development (OECD) nations in terms of the percentage of the 25- to 64-year-old population that has attained either a two-year or four-year postsecondary credential.⁹ In addition, Australia, Finland, Iceland, Poland and Sweden now boast higher postsecondary entry rates than the U.S.¹⁰ Although overall undergraduate enrollment has nearly doubled since 1970¹¹ to reach an estimated total of more than 15 million¹² full- and part-time students in 2005, America's edge in higher education appears to be slipping.

Providing financial access to higher education for all citizens represents an increasingly critical challenge on a number of levels. First, the economic repercussions of not earning some sort of postsecondary credential are often stark, and are only likely to become more so as the economy bifurcates between high-level and low-level service jobs. Secondly, this challenge is apt to become more prevalent as those groups that have historically been less able to afford a college education (e.g., immigrants and some minority groups) represent an increasingly large proportion of the overall U.S. population.

Given this context, this paper provides an overview of trends in college pricing and federal financial aid, outlines the programs which the federal government uses to meet students' education-related funding needs, explores issues/proposals for ensuring that financial aid adequately meets the needs of the student population, and recommends three areas for immediate action. Review of these issues is particularly timely in light of the overdue reauthorization of the Higher Education Act of 1965, which is due to come

National Center for Public Policy and Higher Education, *Losing Ground: A National Status Report on the Affordability of Higher Education* (Washington, DC: Author, 2002).

⁷ Sandy Baum and Kathleen Payea, *Trends in College Pricing 2004* (Washington, DC: College Board, 2004).

⁸ Jacqueline King, *2000 Status Report on the Pell Grant Program* (Washington, DC: American Council on Education, 2000).

⁹ Organization for Economic Cooperation and Development, *Education at a Glance 2004, US Country Report* (OECD, 2004). Available at <http://www.oecd.org/dataoecd/34/55/33714494.pdf>.

¹⁰ Ibid.

¹¹ National Center for Education Statistics, "Past and Projected Undergraduate Enrollments" (Washington, DC: Author, 2004). Available at <http://nces.ed.gov/programs/coe/2004/section1/table.asp?tableID=101>.

¹² National Center for Education Statistics, *Enrollment in Postsecondary Institutions, Fall 2002 and Financial Statistics, Fiscal Year 2002* (Washington, DC: Author, Jan. 2005). Available at <http://nces.ed.gov/pubs2005/2005168.pdf>.

before Congress this year, as well as President Bush's recent budget proposals regarding student aid.

FEDERAL AND STATE ROLES IN FUNDING HIGHER EDUCATION

The myriad public and private benefits conferred by higher education have prompted both the federal government and the states to take a prominent role in ensuring that citizens have access to higher education. However, they pursue this goal using very different strategies. Federal spending on higher education tends to focus on providing financial aid in the form of grants, loan guarantees and tax credits, which help ensure that low- and middle-income students have the same opportunity to earn a postsecondary credential as do their more affluent peers. This commitment to direct student aid is reflected in the fact that approximately 73 percent of the \$111 billion in student financial aid in 2003-04 stemmed from the federal government.¹³ Federal funding to universities themselves, rather than to students, comprised only 12 percent of current fund revenues at colleges and universities.¹⁴

States, on the other hand, support higher education primarily through funding for colleges and universities themselves, rather than providing student financial aid. Currently, state funding of about \$60 billion annually comprises approximately 24 percent of current fund revenues at colleges and universities.¹⁵ On the other hand, only about 6 percent of all student financial aid came from the states.¹⁶

THE RISING COST OF A COLLEGE EDUCATION

The rising cost of college represents one of the major factors contributing to the gap in enrollment rates among different income groups. While tuition has risen dramatically over the last several years, it is important to note that it still remains less than the average cost of educating students due to state subsidies in the case of public institutions and to private gifts and endowments in the case of private universities. Historically, states funded public universities out of tax revenues and maintained low tuition levels so that individual citizens and the state as a whole could reap the benefits of postsecondary education. In times when states have faced budgetary shortfalls, however, they have reduced their relative contributions to postsecondary institutions. Over time, state appropriations have represented a declining share of college revenues. For example, the portion of state funds directed toward higher education fell from 44 percent in 1980 to 32 percent in 2003.¹⁷ This trend appears to be one driver of tuition increases, as universities have resorted to such measures in order to sustain themselves financially.

¹³College Board, *Trends in Student Aid 2004* (Washington, DC: Author, 2004). **Note: these figures do not include private loans. This definition of financial aid includes federally sponsored grant programs (i.e., Pell, SEOG, LEAP, Veterans and Military), Federal Work-Study, federally guaranteed loans (i.e., Perkins, subsidized and unsubsidized Stafford, PLUS), state grant programs, state-sponsored loans, and institutional grants. It does not include private loans that lack a federal guarantee.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid. **Note: these figures do not include private loans.

¹⁷ Stephen Burd, "Public Colleges Are at Odds Over Raising Limits on Student Loans," *Chronicle of Higher Education*, 18 July 2003.

The early 1990s, as well as the first few years of the 21st century, illustrate such sour economic times during which colleges have raised tuition significantly; during each of these periods, tuition and fee charges at public four-year institutions increased by at least 7 percent annually, or at least 5 percent after accounting for inflation.¹⁸ (Tuition in the intervening years continued to increase but did so at a pace closer to that of inflation.) Last year alone, the average annual tuition and fees for in-state students at public four-year colleges and universities grew 10.5 percent (\$487), to bring the total to \$5,132 for the 2004-05 school year.¹⁹ Total charges, which include room and board, at four-year public colleges and universities reached an average of \$11,354 in 2004-05, an increase of 7.8 percent (\$824) from the previous year²⁰. While annual tuition and fees at two-year public colleges remain significantly lower than at four-year institutions, students at these schools have also experienced relatively large increases in price over the last few years. Tuition and fees at these institutions averaged \$2,076 in 2004-05, an 8.7 percent (\$167) increase over the previous year.²¹ Finally, at private four-year colleges, tuition and fees averaged \$20,082 in 2004-05, up 6 percent (\$1,132) from a year earlier.²² Including room and board, the average annual cost of a private four-year college education totaled \$27,516 in 2004-05, in increase of 5.6 percent (\$1,459) from the previous year.²³

Last year's tuition growth came after a decade of price increases. Average tuition and fees rose \$2,427 (90 percent) at public four-year institutions, \$766 (58 percent) at public two-year institutions and \$8,363 (71 percent) at private four-year institutions over the ten years ending in 2004-05.²⁴ Even after adjusting for inflation, the average tuition and fees rose 51 percent (\$1,725) in constant 2004 dollar terms over the decade at public four-year colleges and universities, 26 percent (\$426) at two-year public colleges, and 36 percent (\$5,321) at private, four-year institutions.²⁵ When room and board is included as well, the cost of a year of college in inflation-adjusted terms over the decade increased 36 percent at public four-year universities and 32 percent at private, four-year schools.²⁶

It should be noted that the cost of a college education varies considerably by region, with average in-state tuition and fees at four-year public institutions ranging from a high of \$6,839 in New England to a low of \$4,130 in the West.²⁷

While many have bemoaned the large price increases at colleges, proposals to keep tuition in check have not been met with much success. Rep. Howard McKeon (R-CA) in 2003 introduced a bill that would have imposed penalties on colleges and universities that increased their costs of attendance by at least twice the rate of inflation for two years in a

¹⁸ Baum and Payea, *Trends in College Pricing 2004*.

¹⁹ Ibid.

²⁰ Ibid.

²¹ Ibid.

²² Ibid.

²³ Ibid.

²⁴ Ibid.

²⁵ Ibid.

²⁶ Ibid.

²⁷ Ibid.

row.²⁸ Those penalties included loss of eligibility to participate in the federal student aid programs, including Pell Grants, federally guaranteed student loans, and campus-based programs, such as work-study. The plan was dropped amidst opposition from Democrats, who argued that the rescission of student aid would hurt the very students that the law was intended to help, and from some Republicans, who expressed opposition to the idea of price controls.²⁹ An alternative proposal put forth by Sen. John Kerry during the 2004 presidential campaign would have allowed states to access new federal grants from a \$5 billion pool for higher education if they kept tuition increases at state universities in line with inflation.

MAJOR FEDERAL STUDENT AID PROGRAMS

Given the rising price of higher education, financial aid has become increasingly critical to enabling academically qualified students to earn a postsecondary degree. About 40 percent of all students receive some form of federal financial aid³⁰ and about 73 percent of all full-time students receive some sort of financial aid,³¹ including state aid and institutional aid from colleges. The federal government provides financial support to college students and their families through a number of vehicles, including student loans, grants, tax incentives and the federal work-study program. In 2003-04, the \$56.8 billion in federally guaranteed student loans represented the largest component of federal financial aid to college students, followed by \$17.2 billion in grants, an estimated \$6.3 billion in tax benefits and \$1.2 billion for the federal work-study program.³² While this report focuses on federal aid, it should be noted that students also received approximately \$23 billion in institutional grant aid (i.e., funds from a public or private university's endowment or tuition revenue that are distributed directly to students) in 2003-04, an increasing portion of which was merit-based rather than need-based, and \$6 billion in state grants.³³

Loans

The federal government entered the student loan business in 1958 with the establishment of National Defense Student Loans (NDSL), now known as the Perkins Loan Program. Today, the federal guaranteeing of student loans through this and other programs represents the federal government's most substantial role in making a college degree financially attainable for all students, regardless of income level. Federally guaranteed student loan volume totaled more than three times all federal grant aid in 2003-04.³⁴ With

²⁸ Stephen Burd, "Bill Would Penalize Colleges That Increase Tuition Sharply," *Chronicle of Higher Education*, 14 March 2003.

²⁹ Stephen Burd, "Plan to Punish Big Increases in Tuition is Dropped," *Chronicle of Higher Education*, 12 March 2004.

³⁰ Wolanin, *Reauthorizing the Higher Education Act*.

³¹ National Center for Education Statistics, *Enrollment in Postsecondary Institutions*.

³² College Board, *Trends in Student Aid 2004*. **Note: Loan totals provided here do not include consolidation loans, which allow students to combine their outstanding educational loans into a single loan. Consolidation loans were estimated to total \$44 billion in 2004, according to the president's FY 2006 Budget Summary and Background Information. (See <http://www.ed.gov/about/overview/budget/budget06/summary/06summary.pdf>)

³³ Ibid.

³⁴ Ibid.

their provision of a government guarantee in the event of default and the lack of stipulations on borrower creditworthiness, these loans represent a major form of assistance to young people, who typically lack both the cash to pay directly for their education and the collateral normally required to borrow from banks. In addition, federal loans almost always allow students to borrow at a much lower interest rate than offered by private lenders.

The federal government offers an array of student loans, which are administered by three different programs. The four major types of federally guaranteed loans for higher education include the following:

- *Subsidized Stafford loans* are need-based educational loans made to both undergraduate and graduate students without any conditions on their creditworthiness. The federal government pays the interest on these loans while students are attending school full-time and during a grace period following graduation. Lending volume in 2003-04 totaled \$25.3 billion.³⁵
- *Unsubsidized Stafford loans* allow graduate and undergraduate students to borrow funds for the cost of their education without any conditions on their creditworthiness. They are not need-based, and interest that accrues on these loans while students are attending school remains the responsibility of the borrower. Lending volume in 2003-04 totaled \$23.1 billion.³⁶ Interest rates on both subsidized and unsubsidized Stafford loans vary annually and are capped at 8.25 percent. The rate for borrowers in repayment was set at 3.33 percent for 2004-05.
- *Perkins loans* are need-based loans that help low-income undergraduates and graduate students pay for higher education. Perkins loan volume reached \$1.2 billion in 2003-04.³⁷
- The *Parent Loan to Undergraduate Students (PLUS)* enables parents to borrow funds for their dependent children's educational expenses. These are not need-based, and interest is not subsidized. In 2003-04, loan volume totaled \$7.1 billion.³⁸ Interest rates vary annually and are capped at 9 percent. This year, the rate is 4.17 percent.

In addition to these major federally guaranteed student loan programs, students may borrow from private lenders or through a small number of other federal or state loan programs targeted at specific populations.

The four major loan categories outlined above fall under the auspices of three different programs for administration purposes. All three of these programs are governed by Title IV of the Higher Education Act of 1965.

³⁵ College Board, *Trends in Student Aid 2004*.

³⁶ Ibid.

³⁷ Ibid.

³⁸ Ibid.

- The *Federal Family Educational Loan Program (FFELP)*, established in 1965 as the Guaranteed Student Loan Program, helps students afford college by administering both subsidized and unsubsidized Stafford loans, as well as the Parent Loan to Undergraduate Students (PLUS). Private banks and other lenders both provide the capital and originate loans under FFELP. Loans are guaranteed against default by guarantee agencies, which in turn are reinsured by the federal government. Lenders in this program are assured of a certain rate of return set by the government and are protected from default risk by the guarantees previously mentioned. FFELP dominates the federal market for student loans, capturing \$42.5 billion, or 75 percent of the \$56.8 billion in federal student loans in 2003-04.³⁹
- The *William D. Ford Direct Loan Program (FDLP)* was established in 1992 as a demonstration program and was offered as a lending choice in which all schools could choose to participate in 1993. FDLP provides the same loans as FFELP, with identical interest rates for students and very similar repayment options.⁴⁰ However, unlike FFELP, private lenders are not involved in the administration of the program. Instead, postsecondary educational institutions originate the loans, with the federal government supplying loan capital and, in effect, guaranteeing itself against default. Schools then turn the loans over to the government for servicing. Direct loan volume totaled nearly \$13 billion in 2003-04, or 23 percent of the federal student loan market.
- The *Perkins Loan Program* is the oldest and smallest of the federal student loan programs. Under the Perkins Loan Program, colleges and universities use capital provided by the federal government to originate loans to low-income students. For every dollar in federal Perkins loans provided to an institution, the institution must match it with \$0.33. Partly because of this match requirement, school-level financial-aid administrators exercise more discretion in selecting recipients of Perkins loans than they do for other federal loans. Schools are responsible for servicing these loans, unlike those from the FDLP or FFELP. Perkins loan volume reached \$1.2 billion, or 2 percent of all federal student loans in 2003-04.⁴¹

Loan Issues

Many issues related to student loans have been debated and are likely to be reviewed as part of the budget process and the pending reauthorization of the Higher Education Act. These issues include the elimination of the Perkins program, rising debt levels, loan limits, and the merits of the FDLP relative to FFELP.

Elimination of Perkins

³⁹ College Board, *Trends in Student Aid 2004*.

⁴⁰ Both offer consolidation programs, but FFELP offers them only to students who have left school. Borrowers through the Direct Loan Program can consolidate their loans while in school.

⁴¹ College Board, *Trends in Student Aid 2004*.

The need-based Perkins Loan Program provided an average loan of \$1,875 to approximately 673,000 recipients last year.⁴² In order to fund an increase in the Pell Grant program, President Bush proposed the elimination of the Perkins Loan Program in his 2006 budget.

Rising Debt Levels

The inadequate funding for need-based grants, coupled with tuition increases that outpace many families' incomes, have translated into students' increasing reliance upon loans to finance their college education. Sixty-five percent of students who graduated with bachelor's degrees in 2000 took out loans to pay for educational expenses, compared to 49 percent in 1993.⁴³ In addition, students are borrowing larger amounts. The median amount borrowed by 2000 graduates was \$16,500, an inflation-adjusted increase of 73 percent (\$7,000) since 1993.⁴⁴

Loan Limits

Some have argued that federally guaranteed student loan limits should be increased. The current limits for federal Stafford loans total \$2,625 for first-year dependent undergraduates, \$3,500 for second-year students, and \$5,500 each for third-, fourth- and fifth-year students.⁴⁵ Graduate students may borrow up to \$18,500 annually in Stafford loans.⁴⁶ PLUS loans may not exceed the student's estimated cost-of-attendance minus other financial aid. Perkins loans are constrained annually at \$4,000 for undergraduates and \$6,000 for graduates.⁴⁷

In addition, all these programs have aggregate limits which students may not exceed. Dependent undergraduates may not borrow more than \$23,000 in Stafford loans and \$20,000 in Perkins loans over the course of their undergraduate careers. Graduate students may borrow no more than \$138,500 in Stafford loans, no more than \$65,000 of which may be in subsidized amounts, and no more than \$40,000 in Perkins loans. Graduate loan limits include any outstanding federal loans of the same type from a student's undergraduate years.

The loan limits for Stafford – the most widely used of the guaranteed student loan programs – have not been increased for first-year students since 1986⁴⁸ and for all other

⁴² Stephen Burd, "Bush Seeks Bigger Pell Grants and Elimination of Some Programs for Low-Income Students," *Chronicle of Higher Education*, 8 February 2005.

⁴³ Melanie Corrigan, "Debt Burden: Repaying Student Debt" (Washington, DC: American Council on Education, 2004). Available at <http://www.acenet.edu/resources/HigherEdFacts/issue-briefs/2004DebtBurden.pdf>.

⁴⁴ *Ibid.*

⁴⁵ Federal Student Aid, "Types of Federal Student Aid – Stafford," *The Student Guide 2004-2005*. At http://studentaid.ed.gov/students/publications/student_guide/2004_2005/english/types-stafford.htm.

⁴⁶ Federal Student Aid Handbook 2003-4.

⁴⁷ Federal Student Aid, "Types of Federal Student Aid – Perkins," *The Student Guide 2004-2005*. At http://studentaid.ed.gov/students/publications/student_guide/2004_2005/english/types-fedperkinsloan.htm

⁴⁸ Wolanin, *Reauthorizing the Higher Education Act*.

students since 1993.⁴⁹ Given the inadequacy of grant aid and federal loans relative to growing tuition costs, some students have resorted to obtaining private loans, frequently on terms much less favorable than those offered by the federal government. Students took out \$10.6 billion in non-federal loans from private-sector institutions in 2003-04, an increase of 182 percent from three years earlier.⁵⁰ Some have cited the growth in private lending to students as evidence that the current federal limits do not adequately meet the financing needs of students.

On the other hand, while raising loan limits might help students meet their short-term cash flow demands, it would likely result in a burgeoning debt burden for students upon graduation. In addition, raising loan limits may reduce the pressure on Congress, states and colleges to increase grant aid. A compromise proposal, put forth by the American Association of State Colleges and Universities, asked Congress to raise the loan limits for first- and second-year undergraduates to \$5,500 annually, provided they remained within the aggregate loan limits over their academic careers.⁵¹ Because the aggregate limits represent the total of the individual loan limits for five years of undergraduate coursework, those who complete their studies in four years could take out increased loans in their earlier years under this proposal while still remaining within the aggregate limits.

In his 2006 budget proposal, the president proposed raising annual Stafford loan limits to \$3,500 for first-year students, \$4,500 for second-year students and \$12,000 for graduate and professional students.

FFELP Versus FDLP

Institutions of higher learning can choose to participate in FFELP, FDLP or both. While the terms offered to students on loans originated through these programs are nearly identical, FFELP loans are significantly more expensive to the government. The cost savings associated with the FDLP stem from the fact that the government can borrow at a lower cost than private banks can, and since the government provides the capital for FDLP loans, it also receives the interest payments. The cost savings have led many to call for the shifting of loan volume from FFELP to FDLP. In his FY2005 budget, President Bush himself admitted that the “significantly lower Direct Loan subsidy rates call into question the cost effectiveness of the FFELP structure.”⁵²

The Congressional Budget Office has estimated that if the FDLP increased its share of federally guaranteed loan volume to 40 percent, it would save taxpayers \$12.3 billion over 10 years.⁵³ If all federally guaranteed student loan volume were moved to the FDLP,

⁴⁹ Thomas J. DeLoughy, “The Higher Education Amendments of 1992: What They Mean for Colleges and Students,” *Chronicle of Higher Education*, 5 August 1992. Available at <http://chronicle.com/prm/che-data/articles.dir/articles-38.dir/issue-48.dir/48a02001.htm>.

⁵⁰ College Board, *Trends in Student Aid 2004*.

⁵¹ Stephen Burd, “Public Colleges Are at Odds Over Raising Limits on Student Loans,” *Chronicle of Higher Education*, 18 July 2003.

⁵² Department of Education PART Assessments (Washington, DC: 2004), 34. Available at <http://www.whitehouse.gov/omb/budget/fy2005/pma/education.pdf>.

⁵³ Committee on Education and the Workforce, “Bipartisan Student Loan Bill Would Boost Funding For College Scholarships by \$12 Billion Without Costing Taxpayers a Dime, Says CBO,” 12 January 2005.

the projected savings would amount to \$60 billion over 10 years.⁵⁴ This would be enough to allow the government to give each Pell Grant recipient an additional \$1,000 a year.⁵⁵

Rep. Thomas Petri (R-WI) and Rep. George Miller (D-CA) have introduced the Direct Loan Reward Act, which would establish incentives for colleges to switch to the Direct Loan program by offering to let them keep half of the savings for their use in financial aid programs. The bipartisan Student Aid Reward Act, introduced by Rep. Petri, Rep. Miller, Sen. Edward Kennedy (D-MA) and Sen. Gordon Smith (R-OR), asks the Secretary of Education to determine which student loan program is less expensive, and then provides additional scholarship money to schools that adopt the cheaper loan program. As might be expected, the banking industry opposes the migration of loan volume away from FFELP, and some have claimed that students benefit from the improved customer service stemming from competitive effects of having multiple loan programs rather than consolidating them into one.

Grants

If loans represent one piece of the financial aid puzzle, grants represent another piece – one which some would argue is more effective at raising student enrollment and graduation rates. Because grants do not have to be repaid, they represent a direct reduction in the cost of college. The government operates three major grant programs, which are described below. All are covered by Title IV of the Higher Education Act of 1965.

- The *Pell Grant*, established in 1972 as the Basic Educational Opportunity Grant (BEOG), is often considered the foundation of all federal student aid. The largest federal grant program, Pell is a portable grant (i.e., students can use it in any state at any accredited institution) aimed at providing a minimum level of resources to ensure access to higher education. The program is administered directly to students by the federal government. Undergraduate students can currently receive between \$400 and \$4,050 in Pell Grant funds annually, depending on their financial situation. Pell Grants are need-based, and 90 percent of Pell Grant recipient families earn \$35,000 or less annually.⁵⁶ The average Pell grant totals \$2,400.⁵⁷ In 2003-04, the program distributed \$12.7 billion⁵⁸ to 5.5 million students.
- The *Supplemental Educational Opportunity Grant (SEOG)*, created in 1965 as the first federal grant program to students, provides needy undergraduates with a supplement to the Pell Grant. Unlike the federally-administered Pell program, SEOG grants are administered by participating universities, which must match federal program allocations with a contribution of at least \$0.25 for every federal dollar

Available at <http://edworkforce.house.gov/democrats/releases/re111205b.html>.

⁵⁴ Committee on Education and the Workforce, “Bipartisan Student Loan Bill Would Boost Funding For College Scholarships by \$12 Billion Without Costing Taxpayers a Dime, Says CBO.”

⁵⁵ Ibid.

⁵⁶ Michael A. Fletcher, “Bush Proposes \$500 Boost for Student Aid,” *Washington Post*, 14 January 2005.

⁵⁷ Dan Morgan, “Change Means Fewer Students Will be Eligible for Pell Grants,” *Washington Post*, 24 December 2004.

⁵⁸ College Board, *Trends in Student Aid 2004*.

received.⁵⁹ College administrators have discretion to determine recipient eligibility and award size, in accordance with the law's mandate that priority be given to Pell Grant recipients who have exceptional need. Ranging from a federally mandated minimum of \$100 to a maximum of \$4,000,⁶⁰ the average federal SEOG award totaled \$615 in 2003-04.⁶¹ That same year, the program distributed \$760 million in federal funds to 1.24 million recipients.⁶² The total amount distributed in SEOG and the average award are likely to be at least 25 percent higher than the above figures, due to the institutional match requirement.

- The *Leveraging Educational Assistance Partnership (LEAP)* program, originally established in 1972 as the State Student Incentive Grant program, is a federal-state partnership aimed at encouraging states to build or expand their student aid programs. Participating states must match each dollar of LEAP allocations received with a dollar of state matching funds. If the total federal appropriation is at least \$30 million, the states must match the amount in excess of \$30 million with \$2 for every federal dollar they receive.⁶³ LEAP provides grants to undergraduate and graduate students on the basis of financial need. Unlike Pell Grants, LEAP funds in most states are not portable, although some states do have reciprocal agreements that allow students from one state to use their grant in another state. The majority of states restrict LEAP awards to undergraduates attending at least half-time. However, states may choose to allow graduate or part-time students to participate. Students may receive a maximum of \$5,000 in LEAP funds annually.⁶⁴ LEAP provided \$64 million in federal funds, plus at least that much in state matching funds, to students in 2003-04.⁶⁵

Grant Issues

A number of topics related to grants are likely to be hotly debated in the budget process and the reauthorization of the Higher Education Act. The majority of these relate to issues around the funding of Pell Grants.

Adequacy of the Pell Grant Maximum

The diminishing purchasing power of the Pell Grant has been cited as a major barrier to college access. Twenty years ago, during the 1984-85 school year, the Pell maximum (\$1,900) covered about 50 percent of the average tuition, fees, room and board at a four-year public university.⁶⁶ In 2001-02, when President Bush took office, the Pell maximum

⁵⁹ Federal Student Aid, "Participation, Fiscal Procedures and Records," in *FSA Handbook Vol. 7: FSEOG 2003-2004*. Available at <http://ifap.ed.gov/sfahandbooks/attachments/0304Vol7Ch1.pdf>.

⁶⁰ Federal Student Aid, "Payments to Students," in *FSA Handbook Vol. 7: FSEOG 2003-2004*. Available at <http://ifap.ed.gov/sfahandbooks/attachments/0304Vol7Ch3.pdf>

⁶¹ College Board, *Trends in Student Aid 2004*.

⁶² Ibid.

⁶³ Federal Student Aid, "Leveraging Educational Assistance Partnership (LEAP) Program," in *FSA Handbook Vol. 9: State Grant Programs, 2003-2004*. Available at <http://ifap.ed.gov/sfahandbooks/attachments/0304Vol9Ch1leapprog.pdf>

⁶⁴ Federal Student Aid, Introduction through Chapter 2, in *FSA Handbook Vol. 9: State Grant Programs, 2003-2004*. Available at <http://ifap.ed.gov/sfahandbooks/attachments/0304Vol9Masterfile.pdf>.

⁶⁵ College Board, *Trends in Student Aid 2004*.

⁶⁶ Jacqueline King, *2000 Status Report on the Pell Grant Program*.

(\$3,750) totaled 42 percent of the average charges at a four-year public university.⁶⁷ Today, the Pell maximum of \$4,050 represents 36 percent of such charges.⁶⁸

The current maximum Pell Grant, which is the amount the neediest students receive, has been frozen at \$4,050 since 2003. In January 2005, Bush proposed increasing the maximum Pell award by \$500 in total over five years, from \$4,050 currently to \$4,550 by FY 2010, as well as the creation of enhanced Pell Grants for approximately 36,000 low-income students who participated in the State Scholars Program in high school.⁶⁹ The enhanced Pell Grant program would give these students an additional \$1,000 in their first and second years of college.⁷⁰ Under the Presidential Math and Science Scholars Fund, the president would also provide up to \$5,000 in additional Pell grants for an estimated 20,000 low-income students studying math or science. However, because the president has yet to make good on his 2000 campaign promise to raise the Pell Grant maximum to \$5,100 and because the current proposal still falls short of that mark, many are skeptical about the likelihood that these plans will become reality.

Pending legislation regarding the adequacy of the Pell Grant includes the following:

- H.R. 133, the Pell Grant Increase Act of 2005, introduced by Rep. Ric Keller (FL) on 1/4/05. This bill would increase the Pell maximum to \$6,000 for 2005-06 through 2010-11. It was referred to committee.
- S. 2462, the 21st Century Federal Pell Grant Plus Act, introduced by Sen. John Warner (VA) on 5/20/04, would provide additional assistance to recipients of federal Pell Grants who are pursuing programs of study in engineering, mathematics, science, or foreign languages, and double the amount of a Pell Grant for a recipient who is pursuing a degree in a subject area related to national, homeland or economic security. It was read twice and referred to the Committee on Health, Education, Labor, and Pensions.
- S. 2360, the Nontraditional Student Success Act, introduced by Sen. Hillary Clinton (NY) on 4/29/04, would increase the maximum authorized Pell Grant to \$11,600 by 2010, and makes other recommendations focused on non-traditional students. It was read twice and referred to the Committee on Finance.
- H.R. 3894, the Pell Grants Plus Act, introduced by Rep. Max Burns (GA) on 3/29/04, awards an additional \$1,000 Pell Grant to recipients who have graduated from high school with a college preparatory diploma. It was referred to the Subcommittee on 21st Century Competitiveness.

⁶⁷ Calculated from College Board, *Trends in Student Aid 2004* and Baum and Payea, *Trends in College Pricing 2004*.

⁶⁸ Ibid.

⁶⁹ White House, "Strengthening Higher Education for a Successful Workforce Fact Sheet," 14 January 2005. Available at <http://www.whitehouse.gov/news/releases/2005/01/20050114-2.html#>

⁷⁰ Ibid.

Raising the Pell maximum might entail adjusting the minimum award as well. Increasing the minimum would allow the program to remain targeted on low-income students, rather than spreading smaller awards among a larger group of students. Finally, in addition to the above issues regarding the overall Pell maximum, proposals have also been put forth for front-loading the Pell Grant for first- and second-year students, who are more likely to drop out of college. While these proposals are admirable, without sufficient increases in overall funding, they are likely to result in reduced awards for third- and fourth-year students.

Pell Budgeting Process

The Pell program is not an entitlement, but it behaves like one in some ways. Congress annually appropriates discretionary funds for Pell Grants and sets a maximum award level based on projections of the number of recipients for the upcoming year. However, the actual number of recipients often deviates from the projections. Since eligible students must be awarded the maximum, there is often a shortfall or surplus relative to the amount appropriated. Currently, a \$4.3 billion shortfall exists.⁷¹ In addition, the amount appropriated for Pell is consistently less than the amount authorized.

Some have called for Pell to be made an entitlement, so that funds authorized must be appropriated. Others have argued that it should at least be advance funded for several years so that students know what to expect in terms of grant aid. Bush recently proposed treating the program as mandatory spending over the next five years.⁷²

Eligibility

Certain groups are ineligible to receive Pell Grants, and some groups receive reduced eligibility. For example, prisoners and drug offenders are currently ineligible to receive Pell Grants. There are questions around the fairness and economic sensibility of denying financial support for higher education to those who have committed criminal offenses but are trying to turn around their lives.

In another issue related to eligibility, changes were made to the Higher Education Act in 1992 to allow part-time students to obtain prorated Pell Grants, reflecting the growth in the number of non-traditional students. There are questions about whether this provision sufficiently serves those “very part-time students” who, due to family constraints or preferences, cannot maintain even official part-time status to qualify themselves for Pell Grants. These students often take one class, then stop school to save up for the next course. They are extremely unlikely to receive Pell Grants, because prorating the award by their attendance often reduces the award below its minimum level of \$400.

The question of eligibility raises many of the same issues discussed above regarding the targeting of aid to low-income students. Expanding eligibility to these additional

⁷¹ David Stout, “Bush Seeks More Aid for Low-Income College Students,” *New York Times*, 14 January 2005.

⁷² Public Policy Institute, “21st Century Schools Project Bulletin,” 25 January 2005. Available at http://www.ppionline.org/ppi_ci.cfm?knlgAreaID=110&subsecid=900001&contentid=253133

populations might be helpful for them, but without sufficient overall increases in funding for Pell, it is likely to result in reductions for other students.

Lack of Support for the LEAP Program

The LEAP program represents an opportunity for states and the federal government to partner in providing financial support for needy students, but current funding levels barely make a dent in addressing student need. Over the last decade, federal funding for LEAP has ranged from a high of \$72 million in 1994-95 to a low of \$25 million from 1998-2000.⁷³ In Bush's last two budget proposals, he recommended no funding for LEAP.⁷⁴ Last year, after negotiations, the program received \$66 million in federal funding.⁷⁵

Tax Incentives

In 1997, two major tax credits – the HOPE and Lifetime Learning tax credits – were established for educational expenses. Taxpayers could claim these for the first time in 1998.

- The *HOPE credit* provides taxpayers with a credit equal to 100 percent of the first \$1,000 and 50 percent of the next \$1,000 of qualifying educational expenses (i.e., a maximum credit of \$1,500) annually for the first two years of postsecondary education. Taxpayers can claim multiple HOPE credits on a single return, provided they, their spouse or their dependents have qualified educational expenses.
- The *Lifetime Learning tax credit* offers taxpayers a credit of 20 percent of the first \$10,000 (i.e., a maximum credit of \$2,000) in qualified postsecondary educational expenses each year. Taxpayers can only claim one Lifetime Learning credit per tax return, but the credit may include the combined educational expenses of all dependents. Unlike the HOPE credit, the Lifetime Learning credit can be claimed for educational expenses incurred at any time, rather than just during the first two years of undergraduate education. Taxpayers may not claim both a HOPE credit and a Lifetime Learning credit for the same educational expenses.

In addition to the above, Congress in 2001 established a temporary deduction of \$3,000 each year for 2002 and 2003, and \$4,000 each for 2004 and 2005 for educational expenses. This deduction was available in 2002-03 to those single taxpayers with adjusted gross incomes (AGI) of up to \$65,000 and to married couples with AGI up to \$130,000. The maximum deduction increased to \$4,000 in 2004-05, and eligibility expanded to include single taxpayers who earn between \$65,000-80,000 and married

⁷³ College Board, *Trends in Student Aid 2004*.

⁷⁴ Department of Education, "Fiscal Year 2005 Budget Summary," 2 February 2004. Available at <http://www.ed.gov/about/overview/budget/budget05/summary/edlite-section2d.html>. And "Fiscal Year 2006 Budget Summary," 7 February 2005. Available at <http://www.ed.gov/about/overview/budget/budget06/summary/edlite-section2d.html>

⁷⁵ Department of Education, "Fiscal Year 2005 Budget Summary."

couples who earn \$130,000-\$160,000. This credit will require reauthorization if it is to continue.

Finally, taxpayers who give more than \$11,000 to another person for educational expenses do not have to pay the 18-35 percent gift tax to which they would normally be subject. Similarly, tuition benefits of up to \$5,250 from employers are tax-free. In addition, taxpayers who meet certain income requirements can deduct up to \$2,500 annually in student loan interest payments.

Because families must show some level of tax liability in order to take advantage of these and because the HOPE and Lifetime Learning tax credits are not refundable (i.e., taxpayers do not receive a refund if their tax credit exceeds their total tax liability), tax benefits largely represent a form of financial aid targeted at middle-income students and their families. In 2002, for example, 42 percent of those who claimed education tax credits earned more than \$50,000 in AGI, while only 29 percent of claimants earned less than \$30,000.⁷⁶

It should also be noted that tax credits in some ways offset student aid, as taxes are factored into the government's determination of a student's Expected Family Contribution (EFC). For example, since tax credits like the Lifetime Learning Credit and the HOPE credit reduce one's tax liability, they make it appear as if one has more income left with which to pay for college in the following year. So, students' EFC may increase as a result of taking the tax credit, which would in turn decrease their eligibility for need-based aid such as Pell Grants. This interaction has prompted some to call for the minimum Pell Grant to be raised, thus excluding some current recipients. Those recipients, some say, should be encouraged instead to apply for tax credits. The downside of this, however, is that while tax credits and Pell Grants, over the long run, both have the effect of reducing the cost of college, only Pell Grants represent immediate and direct aid. Without a Pell Grant, students must find the funds to cover tuition at the time of enrollment and will only receive the tax benefit months later.

In addition to the above issues, there are a number of other tax-related issues around educational expenses and savings. These include the growth of college savings plans such as 529s and Coverdell Education Savings Accounts. These are not discussed here because they relate more to a family's planning to pay for college than financial aid provided by the government.

Federal Work-Study

The Federal Work-Study (FWS) program helps undergraduate and graduate students earn money to help pay for college by working part-time. A campus-based program, FWS provides colleges and universities with 75 percent of the cost of employing students in (mostly) campus jobs. Colleges and universities contribute matching funds to pay the remainder for work-study students and must ensure that their hourly wages remain at or above the federal minimum wage. The majority of work-study students are employed in on-campus positions, but they also may take off-campus jobs with either local non-

⁷⁶ College Board, *Trends in Student Aid 2004*.

profits, public agencies, or private, for-profit corporations in which the work is related to a student's academic plans and work-study students do not replace regular employees. Work-study jobs are awarded to students with a demonstrated financial need (i.e., the student's cost of attendance is greater than his or her expected family contribution), but unlike the other campus-based programs, students do not need to show exceptional financial need in order to participate.

Federal funds for work-study totaled \$1.2 billion in 2003-04 and reached more than 800,000 students.

Community Service Requirement

Postsecondary institutions that participate in this program are required to use at least 7 percent of their FWS funds to compensate students for performing community service activities. These positions can be funded 100 percent with FWS money and do not require matching funds from colleges. At least one of the participating students must be working as a reading tutor for children or performing family literacy activities. Although schools may petition to receive a waiver from these requirements, some argue that the community service requirement is unfair to rural schools, which may not have many community service options available in the area, and that it inconveniences both students, who are faced with job that is likely a greater distance from their school, and universities, which have to deal with additional administrative bureaucracy. Those on the other side argue that the community service requirement is an important component of work-study and that universities only complain because it taps into their pool of potential low-cost student workers.

In his 2006 budget request, President Bush proposed eliminating this requirement and replacing it with a new set-aside program for community service, which would be paid for with 20 percent of the money that Congress provides to the work-study program each year. Institutions would apply for these community service funds separately, and those universities that do not want to take part in the community service activities would no longer be required to do so.

Issues Spanning Loans, Grants, Tax Incentives, and/or Federal Work-Study

“Base Guarantees” for Campus-Based Programs⁷⁷

Supplemental Educational Opportunity Grants (SEOG), Perkins loans and Federal Work-Study are collectively known as “campus-based” programs because they require institutional matching funds and are administered directly to students by universities and colleges. Funds from these programs are supposed to be allocated on the basis of student need. However, some schools benefit disproportionately from these programs because the pot of federal funds for such programs is distributed using “base guarantee” formulas set in the 1970s. The base guarantee formulas give schools that were participating in the program at the time – largely private colleges and flagship state universities – the same share of federal allocations now that they received then. Additional money appropriated

⁷⁷ Stephen Burd, “Unfair Advantage?: Elite Private Colleges Say They Will Fight to Protect Federal Aid That Other Institutions Want for Needy Students,” *Chronicle of Higher Education*, 15 August 2003.

for campus-based programs is available to other schools on the basis of need. Because appropriations for campus-based programs have not kept pace with student need, newer institutions receive far less than those schools that are covered by base guarantees. Proposals to change the base formulas are popular with the Bush administration and the newer schools that would benefit from them, but many leading higher-education institutions and some high profile education advocates have voiced their opposition to the proposed changes.

The Student-Work Penalty

The federal need analysis process involves reviewing student and family earnings and assets to determine a student's eligibility for financial aid. In this analysis, dependent students receive an annual Income Protection Allowance (IPA) of \$2,420 and independent students receive an allowance of \$5,490. Income below these thresholds is not counted against students in the process of assessing their financial need. However, 50 percent of any earnings in excess of these levels is considered available for contribution to covering college expenses. Given that it may appear that these students have more resources available with which to pay for their education, students earning above these limits often face reduced eligibility for grant aid the following year. In light of rising college costs and the student-work penalty, young people in college face a perplexing catch-22. Many need to work more in order to fund their education and support themselves financially, but paradoxically, putting in more time on the job actually may reduce their eligibility for student aid. The Advisory Committee on Student Financial Assistance recently issued a report recommending that the IPA be raised by \$1,000 and that the assessment rate on earnings above the allowance should be reduced to 40 percent.⁷⁸ On the other hand, some have argued that working students are more likely to drop out of college, and that students would be better served by taking loans that allow them to spend time studying rather than working.⁷⁹

ISSUES FOR ACTION

A number of actions should be taken to ensure that a college education is within the reach of more young Americans. Some of these include addressing systemic challenges, such as the identification of the root causes of increases in higher education costs, as well as remedying some of the academic preparation issues that reduce college graduation rates. The following, however, are three areas which should be focused on more immediately.

Pell Grant Adequacy

The purchasing power of the Pell Grant has fallen significantly over the last several decades. Twenty years ago, during the 1984-85 school year, the Pell maximum covered about 50 percent of the average tuition, fees, room and board at a four-year public university, and today it covers only 36 percent of such charges.⁸⁰ Although President

⁷⁸ Advisory Committee on Student Financial Assistance, *The Student Aid Gauntlet: Making Access to College Simple and Certain* (Washington, DC: Author, 2005). Available at <http://www.ed.gov/about/bdscomm/list/acfsa/acsfathestudentaidgauntlet.doc>

⁷⁹ Stephen Burd, "Too Much Work?: Community Colleges Want Congress to Ease a Penalty That Cuts Aid to Working Students," *Chronicle of Higher Education*, 8 August 2003.

⁸⁰ Jacqueline King, *2000 Status Report on the Pell Grant Program*.

Bush has proposed to increase the Pell maximum by \$100 annually over the next five years, tuition costs are expected to increase even more, meaning the purchasing power is projected to further deteriorate over this timeframe. In fact, the president's proposed increase of \$500 over the next five years failed to keep pace with the \$824 average increase in costs at four-year public universities last year alone.

Given that the Pell Grant forms the foundation of all federal financial aid, it is imperative that Pell funding be increased such that the Pell maximum covers what it used to – at least 50 percent of the average cost of tuition, fees, room and board at four-year public universities. This would entail raising the Pell to nearly \$5,700 immediately. To maintain this level of purchasing power, the Pell maximum should increase at the same rate as average overall college costs do.

Revitalization of LEAP

Funding for the LEAP program, a federal-state partnership that provides grants to low-income students, has declined 31 percent in real terms between 1993 and 2003.⁸¹ In his last two budget requests, President Bush has proposed eliminating LEAP altogether, arguing that the program is duplicative of other federal financial aid programs and that it has served its intended purpose of encouraging states to establish need-based grant programs.

In an era when an increasing proportion of state aid to students is now distributed on the basis of merit rather than need⁸² and when federal grant aid alone fails to keep pace with tuition increases, eliminating the LEAP program would be a mistake. Because LEAP provides one dollar of federal funds for every dollar of need-based grants allocated by a state, the program effectively makes need-based aid cheaper for states than merit-based aid. By doing so, LEAP plays a valuable role in encouraging states to offer financial aid to those students least able to afford college instead of using it to attract the most talented students. Rather than eliminating funding for LEAP, the program should be revitalized to ensure that states are doing their part to guarantee that low-income students have access to a college education.

Moving Loan Volume from FFELP to FDLP

Despite the fact that the Federal Family Education Loan Program (FFELP) provides nearly identical lending options to students at a much lower cost to the government than the Federal Direct Loan Program (FDLP), the government continues to maintain both lending programs. Rather than providing banks and other lending institutions with excessive subsidies, incentives should be offered to encourage universities to move student loan volume to the much cheaper FDLP. As mentioned earlier, CBO estimates project that \$12.3 billion could be saved over 10 years if the FDLP increased its share of federally guaranteed loan volume to 40 percent.⁸³ If all federally guaranteed student loan volume were moved to the FDLP, the projected savings would amount to \$60 billion over

⁸¹ Sandy Baum, "Priming the Pump for Student Aid," *Chronicle of Higher Education*, 4 March 2005.

⁸² College Board, *Trends in Student Aid 2004*.

⁸³ Committee on Education and the Workforce, "Bipartisan Student Loan Bill Would Boost Funding For College Scholarships by \$12 Billion Without Costing Taxpayers a Dime, Says CBO."

10 years.⁸⁴ This would be enough to allow the government to give each Pell Grant recipient an additional \$1,000 a year.⁸⁵

At a time when budgetary constraints are forcing many tough decisions, switching to the FDLP is a viable option for funding some of the much-needed improvements to the student aid programs.

CONCLUSION

The cost of a college education has risen significantly over the last few decades, and federal financial aid has failed to keep pace. These trends are making it more difficult for students to earn a college degree at a time when the economic consequences of doing so – or failing to do so – are becoming more dramatic. In addition, the failure to provide adequate financial aid to ensure that all who have prepared academically for college can attend comes at a time when other nations are experiencing rapid growth in college enrollment and completion rates.

Providing sufficient financial aid is an important step in making college accessible for young adults. Three major actions – increasing Pell Grants, revitalizing the LEAP program, and switching loan volume from the FFELP to the FDLP – would assist young people and their families in bearing the financial burden of a college education and would provide evidence of our national commitment to supporting postsecondary attainment. While doing so may be expensive, the cost of academically prepared students cutting their educations short may be even higher – both for students and for the nation.

⁸⁴ Ibid.

⁸⁵ Ibid.