



# The Case for Federal Higher Education Affordability Standards

Lessons from Other Sectors

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By Ben Miller and Antoinette Flores

May 2016



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# Introduction and summary

In 2010, Congress enacted two major expansions to the social safety net. First, it passed the Patient Protection and Affordable Care Act, more commonly known as the ACA.<sup>1</sup> This bill brought sweeping changes to the American system of health care. In particular, it provided new money for states to expand health care coverage to extremely low-income people and tax credits to help individuals purchase insurance plans. A week later, President Barack Obama signed the Health Care and Education Reconciliation Act of 2010.<sup>2</sup> That legislation included more than \$36 billion in new money for the federal Pell Grant program, which helps low-income students afford college.<sup>3</sup> It also indexed the maximum Pell Grant award to inflation, guaranteeing benefits would increase each year.

The ultimate goals of both the health care and education expansions were similar: make an important set of benefits—health insurance in one case, college in the other—affordable for vulnerable populations. More than five years later, the effects of both changes are clear.

Thanks to the ACA, the share of Americans who lack health insurance has dropped by about one-third and is now at a historic low.<sup>4</sup> This includes decreases in the uninsured rate in every state in the country and the District of Columbia.<sup>5</sup> Millions more still need coverage, but the numbers appear to be headed in the right direction.

The legislation accomplished this by setting clear expectations that Americans should have health insurance and that it should be affordable. It set a goal for states to expand Medicaid—the program that provides coverage for low-income families—to everyone at or below a set threshold tied to the poverty level. It also created a new set of tax credits that established clear benchmarks for both how much people should have to pay out of pocket for health care coverage and what type of insurance they should be able to afford. These benefit structures provided a degree of certainty for families in what had previously been a chaotic market.

Meanwhile, the investments made in Pell Grants significantly raised the maximum award and number of recipients. This year, students can receive up to \$5,775 through the program, an increase from \$4,731 in 2008.<sup>6</sup> Similarly, the number of recipients grew from slightly more than 6 million to more than 8 million.<sup>7</sup>

While the Pell Grant increases have meant a lot for students, they have only held the line on college affordability for low-income individuals, not made it better. Today, the Pell Grant covers 30 percent of the total cost of attending a four-year public college.<sup>8</sup> In 2008, it covered 32 percent.<sup>9</sup> Similarly, the borrowing rate of Pell Grant recipients stayed unchanged at 70 percent from 2008 to 2012.<sup>10</sup>

The differing federal approaches to affordability partially explain why the expansion of Pell Grants was less successful in helping low-income students than the ACA was in raising the share of Americans with health care. Unlike with the ACA, the increase in Pell Grants did not come with guarantees that recipients would not pay more than a set percentage of their income or borrow no more than a set amount of money. The increased Pell Grant benefits boosted the maximum possible award by about \$1,000, giving students more money to spend on college expenses.

The result of an expectation-light approach to college affordability is that the ability of federal postsecondary benefits to achieve their desired aims is completely dependent upon the choices made by schools, governors, and legislatures across the country. In California community colleges, for example, where prices are low or nonexistent for most attendees, the federal benefits are more than enough to cover tuition and can also put a dent in living expenses. But in a more expensive state such as New Hampshire, federal grants and loans combined may not be enough to even pay for direct academic costs. And there is no guarantee the places where federal aid currently is sufficient will stay that way—a few lean years could easily result in California community colleges becoming much less affordable.

Such a situation is simply unsustainable. The federal government is making too large an investment in postsecondary education to see its dollars not guarantee affordability, simplicity, and certainty for students. To combat this, we need to flip the concept of federal postsecondary assistance to focus on what it buys, not how much it pays.

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As this report shows, changing federal financial aid benefits to guarantee recipients can purchase a specific set of goods, not just receive a set amount of money, will better conform these programs to the rest of the U.S. social safety net.

Drawing on examples from the health care and housing sectors, this report analyzes how the federal government addresses the question of affordability through the benefits provided to consumers. In particular, it focuses on two programs within each area: Medicaid and the ACA in health care and rental housing assistance and federally insured mortgages in housing. Importantly, this emphasis on the benefits to consumers intentionally excludes other questions about how the federal government could contain costs, such as through innovation. That is an important area for future research.

Examining how the federal government addresses affordability in other key policy areas shows five lessons for how the government could rethink its higher education benefits to better meet its goals. The most important of these findings is that benefits should be tied to specific purchasing goals for consumers. By benchmarking benefits to a stated end goal—such as affording a postsecondary education—federal assistance would provide greater assurance that those who are getting help will be able to afford at least a basic level of education.

Other lessons from health care and housing provide important information for restructuring federal aid for postsecondary education. These include:

- Minimizing expenses for the lowest-income individuals
- Setting limits for what level of goods the federal government will make affordable
- Creating separate affordability standards for debt
- Sharing the cost of achieving affordability beyond the federal government

While there is much to be learned about college affordability from other sectors, these health care and housing programs are not perfect. They may not serve enough eligible individuals; they may use a benchmark that does not feel sufficiently affordable to consumers; or they may have other challenges. To that end, these programs highlight four other lessons about the challenges in addressing affordability:

- Unavailability undermines affordability
- Affordability must tackle all cost elements
- Benchmarks must have face validity
- Providers that meet affordability standards may change

Based on these lessons, this report suggests a new framework for postsecondary affordability. It starts with guaranteeing a low- to no-cost education for the most vulnerable individuals. As students move higher up the income spectrum, the guarantee shifts to ensure they can afford at least an in-state public option without paying more than a reasonable share of their income. To make the math work, states and institutions would have to provide enough assistance to fill in any gaps that exist between family contributions and federal funds. Recognizing that such clear-cut affordability aims may not be feasible at private institutions, these schools would instead have to keep students' debts below certain levels that are tied to postgraduate earnings.

Setting explicit goals and guarantees for federal student aid recipients highlights that these investments are the most credible tools for addressing affordability. As the largest single funder of college education in the country, the federal government could and should use its aid to demand that the beneficiaries of its assistance are guaranteed access to affordable educations. This vision of a student aid program actively engaged in requiring affordability is also an explicit rejection of the theory first articulated by former U.S. Secretary of Education William J. Bennett that these programs are to blame for never-ending price increases.<sup>11</sup> Rather than enabling colleges to raise prices to capture more money, as the Bennett Hypothesis articulates, this vision allows the federal government to exert its leverage to keep prices affordable and in check.

While this paper represents its own vision for achieving postsecondary affordability through federal action, it builds upon other thinking about the need for greater clarity about what families should pay for college. In particular, it draws on concepts first discussed by the Lumina Foundation—a funder of the Center for American Progress Postsecondary Education team—in its 2015 benchmark for higher education affordability.<sup>12</sup> Though nonbinding, the benchmark argues that families should be able to afford college through contributions from savings, income, and student work. This paper takes such a concept even further by proposing how the federal government could create a binding affordability requirement.

The need for a new approach to higher education benefits is clear. Today, more than 41 million Americans currently hold a combined \$1.2 trillion in federal student debt, including 7.5 million borrowers in default.<sup>13</sup> States continue to reduce spending on their public institutions of higher education, driving up tuition and debt. Additionally, family incomes simply cannot keep up with prices that grow faster than inflation year after year. And this does not even begin to address the persistent access and completion gaps by race and income. Only by taking a new approach to these benefits—one that builds on lessons learned from other policy areas—can the federal government hope to guarantee that all students, regardless of background, can access and afford postsecondary education.

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# The goal and structure of federal financial aid

Federal financial aid is a long-term investment that, if effective, should help students move up the socioeconomic ladder over time. This time frame for success is slightly different from other federal benefits, such as housing assistance or health insurance, which are designed to immediately improve or stabilize the lives of families. This difference also explains why federal financial aid benefits differ somewhat from those provided for health insurance and housing. With the exception of mortgage assistance, the other major benefit programs provide just-in-time cash transfers or other types of assistance that do not have to be repaid. Federal college aid includes grants but also relies heavily on student loans. The idea behind these debts is that students borrow against the future increases in income they will receive from earning a degree.

But even if the investment horizons and structures are different, the federal government's college aid programs still have the same ultimate goals as funds spent in other sectors such as health care and housing. The government wants its support for postsecondary education to allow recipients to afford a college education. These funds should supplement gaps in the financing landscape that would otherwise prevent students from going to college. And for the lowest-income students, federal grant aid should minimize or obviate the need to borrow.

To accomplish these goals, Congress sets a maximum level of grants and loans that a student can receive each year. These amounts are not small—this year, the largest Pell Grant for low-income students is \$5,775, and Stafford Loans for first-year students range from \$5,500 to \$9,500. The exact funds students are eligible to receive vary depending on a number of factors, including students' economic situation, the number of credits they attempt, their year in college, and the cost of their institution.

Notably, the major federal financial aid programs operate as vouchers for students. Dollars are disbursed to colleges on behalf of students, meaning that the amount of federal support an institution receives is directly related to the number of enrolled students who are receiving this aid. Pell Grants and Stafford Loans contain no matching requirements and no additional funds for enrolling large numbers of

students who receive these forms of aid. The other effect of the voucher distribution model is that state governments never receive any money from the aid programs. State governments are not expected to play any formal operational role in the system beyond approving institutions to operate within their borders.

Despite their size, the federal financial aid programs' purchasing power is decreasing over time. Today, the maximum Pell Grant covers just 30 percent of the total cost of attending a public four-year college versus 77 percent in 1980.<sup>14</sup> While some of this drop is due to years when the maximum Pell Grant did not increase, even indexing the award to inflation from its inception in the 1970s would not be enough to overcome the relentless increase in college prices.<sup>15</sup> As a result of this decline in purchasing power in the 2011-12 academic year, 70 percent of Pell Grant students at public four-year colleges also had to borrow to pay for their education.<sup>16</sup>

The reason behind the decline in federal purchasing power also matters for understanding what can be done to address it. Federal benefits' values fall not because institutions are raising prices just to capture more federal money. Instead, states are intentionally reducing their support for postsecondary education. According to a Center for American Progress analysis, 38 states cut their funding per student by at least 5 percent from 2008 to 2012.<sup>17</sup> When faced with budgetary holes from state cuts, institutions are forced to raise prices for students. The result is that educational costs that used to be borne by states are now being passed on to students who then turn to federal student aid to pay them. Absent the presence of federal benefits, students and families would find themselves with completely unattainable tuition bills.

States supplanting their own funding for student and federal support is not a good outcome. This is particularly true because a lot of the federal benefits come as loans that must be repaid by the students—raising their long-term costs and resulting in bad financial conditions if they cannot make their loan payments.

Reversing the decline in the purchasing power of federal postsecondary benefits and improving affordability cannot be done with simple tweaks to the programs. Nor will increasing benefits alone be enough—the rate at which tuition rises is simply too great. Instead, if the federal government wants to ensure that its higher education programs truly improve affordability, it needs to look to the lessons learned from other sectors about how to address these problems. Investigating how major federal programs in areas such as health care and housing tackle the challenges of affordability can highlight other practices that would be good to adopt in higher education. It can also show the challenges of different approaches and give a sense of potential pitfalls.

# Affordability lessons from other sectors

Reviewing how the federal government approaches affordability in other sectors reveals five positive lessons that could be applied to higher education financing:

- Many other programs tie benefit amounts to defined benchmarks so recipients know they will receive enough aid to purchase the goods they need.
- Areas such as health care set distinct affordability policies for the most vulnerable individuals that result in minimal to no expectations for out-of-pocket spending.
- The federal government also limits which products within a market it will make affordable, refusing to subsidize the priciest options.
- Related to this sense of limits, the federal government also creates affordability standards—specifically, when it deals with debt in areas related to housing—to protect consumers from unaffordable payments.
- Finally, the federal government does not always pursue affordability on its own. For crucial items such as health insurance, it enlists the help of states and employers to achieve its aims.

Not all the lessons learned about approaching affordability are positive. Many of the programs profiled here have their own challenges that make them less effective at promoting affordability. In acknowledging these limitations, this report identifies four problems in other sectors that any efforts to change federal student aid benefits must recognize:

- Available resources must be sufficient to avoid rationing support or tying goals to outdated standards that do not reflect the amount of help needed in today's world.
- Affordability often matters on multiple dimensions in a given sector that must be addressed. For example, making monthly premiums affordable in health insurance may not be enough if the copays are too expensive for people to visit the doctor.
- Expectations for out-of-pocket spending must feel reasonable to recipients.
- One challenge in attaching benefits to specific levels of quality is the options that meet this standard might change over time. For instance, the ACA provides tax credits for health insurance plans that meet certain cost conditions. But the plans that qualify for this benefit may change over time.

The next sections describe each of these nine lessons—five positive and four negative—in greater detail, with specific examples from health care and housing and an explanation of how they might relate to higher education benefits.

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## Lesson #1: Tying federal benefits to specific affordability benchmarks helps guarantee purchasing power

In higher education, federal benefits are calculated in terms of dollars with no consideration for what those funds can buy. By contrast, federal programs for health care and housing focus on providing enough assistance to bridge the gap families face between the price of the product and what the families can afford to pay. This approach ensures that federal support theoretically gives families enough purchasing power to buy what they need.

### How federal financial aid calculates benefits

Here is how the aid awarding process works in higher education: When students complete the Free Application for Federal Student Aid, or FAFSA, they are presented with a figure, known as an Expected Family Contribution, or EFC. Theoretically, the EFC is a ballpark estimation of what a family can be reasonably expected to pay for college. This number can range anywhere from \$0 to tens of thousands of dollars, depending on a family's income and assets.

The EFC also drives how much federal aid students receive. For instance, the maximum Pell Grant students can receive in a given year is equal to the difference between the maximum award and their EFC. In other words, if the maximum award is \$5,915, then a student with an EFC of \$0 can receive up to \$5,915, while someone with an EFC of \$1,250 would qualify for up to \$4,665. The EFC also matters for receiving Subsidized Stafford Loans. It is not, however, relevant for Unsubsidized Stafford Loans, which are available to anyone regardless of EFC or income.

The use of the EFC in the aid awarding process suggests that affordability can be accomplished by combining family contributions and any necessary grant or loan aid. In fact, the Higher Education Act itself establishes this idea, noting in Section 401 that the combination of a reasonable family contribution, the Pell Grant, and other small federal assistance programs should cover 75 percent of the cost of a higher education.<sup>18</sup>

In practice, the sum of EFC and other aid rarely adds up to affordability for lower-income students. The problem is that the EFC is a nonbinding number. Institutions of higher education are under no obligation to honor that figure and charge students anything close to it. A student with a \$0 expected contribution could end up still paying tens of thousands of dollars per year for college. In fact, 27 percent of these individuals who attend full time pay \$5,000 or more just for their tuition and fees, including 13 percent at public four-year colleges.<sup>19</sup> Including living expenses, 86 percent of full-time students with a \$0 EFC are paying at least \$5,000 for college—including 89 percent at public four-year institutions.<sup>20</sup>

Without a binding EFC figure, federal education benefits only ensure recipients will get a specific dollar level of support. For instance, maximum Pell Grant recipients in their first year of college know that they will receive up to \$5,915, and they can get a loan of up to \$5,500 if they are still supported by their family.<sup>21</sup> But what recipients lack is any guarantee that those dollars will be sufficient to actually purchase the postsecondary education they are supposed to afford.

Thus, how far students' federal dollars stretch depends on where they live and what type of school they attend. For students who live in states such as Florida or California, which traditionally have reasonably priced higher education, federal support may cover all or most of their costs. By contrast, someone with the exact same financial situation in New Hampshire or other states that typically have very high college prices may have a much harder time affording college.<sup>22</sup> And in both cases, the federal government allows states and institutions to choose whether to offer affordable postsecondary options.

This approach to benefits, solely in dollar terms and without considering what the funds should actually buy, is distinct from how other federal programs consider affordability. In other programs, such as the health care tax credits authorized under the ACA or federal rental assistance, benefits are attached to specific prices consumers face, ensuring that dollars will be sufficient to meet their intended aims. Doing so provides certainty for the recipients—who know they will be able to actually buy health insurance or rent an apartment with the aid. It also helps the federal government—which knows its aid can actually achieve its desired goals.

How the ACA calculates benefits

The health insurance tax credits created by the ACA illustrate a way of thinking about benefits in terms of being enough to specifically afford a product instead of just being a set dollar amount. The goal of these credits is to provide subsidies for low- and moderate-income individuals who receive either no or insufficient employer coverage to purchase health insurance on the individual market.<sup>23</sup> But to work, subsidies have to be large enough to bring the level of plans on the market down to a price people can actually afford. To accomplish this goal, the federal government sets the credit amount at the difference between the cost of a specific type of insurance plan and a set percentage of an individual’s income.<sup>24</sup> It varies this percentage based upon where a family’s income falls between 100 and 400 percent of the poverty line. As families make more money, their expected contribution to health insurance increases. The result is that the lowest-income individuals do not pay more than 2 percent of their income, while those at 400 percent of the poverty line do not pay more than 9.5 percent of their income.

The table below shows the premium tax credit’s expectations for family income based upon their earnings relative to the federal poverty level.

TABLE 1  
Share of family income for ACA tax credits  
By percentage of the federal poverty level

Family income as a percentage of the federal poverty level		Percentage of family income paid for health care premiums (For the second-cheapest silver-level plan)	
Starting income	Ending income	Starting premium	Ending premium
0%	133%	2.01%	2.01%
133%	150%	3.02%	4.02%
150%	200%	4.02%	6.34%
200%	250%	6.34%	8.10%
250%	300%	8.10%	9.56%
300%	400%	9.56%	9.56%

Note: Tax credit calculations use a family’s modified adjusted gross income, a measure of annual earnings minus some deductions.  
Source: Bernadette Fernandez, “Health Insurance Premium Credits in the Patient Protection and Affordable Care Act (ACA) in 2015” (Washington: Congressional Research Service, 2015), p. 10, available at <https://www.fas.org/sgp/crs/misc/R43945.pdf>.

The use of income in the premium tax credits is similar to the idea behind the EFC in federal aid calculations, only it is binding. The amount of the subsidy still declines as income increases, just as Pell Grants phase out. But the difference is people who qualify for the credit know that as long as they can afford the out-of-pocket percentage of their income, they will be able to buy a plan. By contrast, even individuals who can afford their EFC have no guarantee that they can afford to pay for college.

The premium tax credits also set goals for what a family's contribution is supposed to buy. The ACA created a classification system that grades health insurance plans as bronze, silver, gold, or platinum.<sup>25</sup> A plan's level is based upon its actuarial value—a measure of the share of health insurance expenses that are paid by the plan versus the participant on average.<sup>26</sup> For example, a bronze plan is one with an actuarial value of 60 percent, meaning that participants are expected to cover about 40 percent of costs; the plan covers the rest. The other classifications represent increasingly generous options in which the participant pays a smaller share of costs. Silver, on average, covers 70 percent of a patient's costs; gold covers 80 percent; and platinum covers 90 percent.<sup>27</sup>

While families receiving premium tax credits choose their plan level, the federal government guarantees affordability only to a certain level of coverage. The premium tax credit is attached to the cost of the second-cheapest silver plan available to the recipient. This means that a family that chooses that plan receives a tax credit equal to the difference between their family contribution and the cost of the premium. So if the monthly premium is \$100 and their contribution is \$30, then the premium credit will be \$70.

This connection of the tax credit to a good of a specific type is another key lesson for higher education. By stating exactly what the credit must be able to buy, it guarantees everyone can buy a silver plan, while letting the amount a person actually gets from the federal government vary. In contrast, higher education benefits fix the amount a student can obtain—so people who are in identical circumstances receive the same amount of money—but float the value of what those funds can buy. In other words, two full-time maximum Pell Grant recipients would likely receive the same amount of money, but those dollars buy them very different percentages of their total education costs if one goes to a community college in California and the other goes to a public four-year institution in Vermont.

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Thinking about the tax credits in terms of the value of the good also allows plans to develop benefit structures in different ways. For example, one plan could get to a 70 percent actuarial value through low coinsurance but high deductibles, while another could take the opposite approach. Nor are these values determined on an individual basis—they represent the general estimate of what a typical person would pay.<sup>28</sup> This provides insurers with flexibility for how to manage toward a specific end value.

In some ways, the actuarial value concept mirrors what states and institutions already do on college pricing. Some states aim for affordability through a so-called high cost, high aid model. In these cases, colleges charge a high sticker price but then provide generous grant aid to subsidize the price for lower-income students. In other places, the state may provide a lot of operating support to a college, allowing it to charge a low upfront price. The end price paid by students could very well be the same; it is the path to that number that differs.

### How federal housing assistance calculates benefits

The concept of a strong connection between the benefit amounts and specific purchasing goals is also a key element of the federal rental assistance programs. These programs use a set of benchmarks that are based upon a family's income and the price of housing in a given area. The local rental market sets the maximum subsidy a family can receive, ensuring that benefits are sufficient to afford housing but are not too high. Families' incomes dictates their chances of qualifying for support and what they are expected to pay out of pocket. The number of people in the household entitles them to structures of a certain size. These straightforward rules help families clearly understand the level of support they are entitled to receive if they are able to get into the program while still allowing choice up to a reasonable point of affordability.

The federal government administers several rental assistance programs that provide affordable housing to more than 5 million households in the United States.<sup>29</sup> The two largest of these programs are Section 8 Project-Based Rental Assistance and Section 8 Housing Choice Vouchers, or HCVs, which were created in 1974.<sup>30</sup> Combined, these two programs serve approximately 70 percent of all federal rental assistance recipients.<sup>31</sup>

Both Section 8 programs operate as voucher models in which the government provides financial support for individuals to rent privately owned and operated apartments. The big difference between the two is that project-based rental assistance programs subsidize specific rental apartments and buildings, while HCVs cover properties of the recipients' choosing. Over time, tenant-based vouchers have become the preferred method of providing rental assistance and currently serve 2.1 million families—almost double the 1.2 million served by project-based rental assistance.<sup>32</sup>

At the most basic level, HCVs provide support for families so they will be able to pay no more than 30 percent of their income toward rent. This benchmark is supposed to guarantee that paying for a place to live does not overwhelm a family's budget so they also can afford food, clothing, and other necessities. This serves the same purpose as the income percentage for the health care tax credits. It is also the same concept absent in the federal aid programs.

The amount of a recipient's HCV is based upon the actual costs of housing in a given area. Section 8 HCVs are capped at the fair market rent, or FMR—the typical average rent in the local housing market.<sup>33</sup> In other words, the federal government will not provide a voucher for an amount above the typical rent in an area. Tying benefits to rent in an area controls costs while providing a clear definition of what families pay. The vouchers also have standards for how large a structure a family can rent based upon its size and the ages of its members.<sup>34</sup>

Though health care and housing are two very different markets, they both show the benefits of taking a more intentional approach to the benchmarks and levels set for federal assistance. By setting standards for the income percentage a family should pay for a product or service and guaranteeing that level of payment to be enough to afford a minimum product, these programs ensure that participants receive support that actually helps them buy what they need. This is distinct from the federal student aid programs, which appear to set affordability goals based upon income but simply distribute set amounts of dollars with no consideration for what those dollars can buy.

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## Lesson #2: The most vulnerable individuals have minimal to no out-of-pocket costs

Improving affordability for everyone is a laudable goal. But keeping expenses reasonable is even more important for the most at-risk individuals. Lower-income people have fewer resources to cope with high prices. Shocks such as sudden cost increases may be more likely to cause them to stop using a service. For example, they may drop out of college or go without health insurance. It is for these reasons that any affordability system must pay particular attention to how it serves the most vulnerable of its beneficiaries.

### Federal health benefits

One notable feature of the health insurance tax credits is that individuals must make at least 100 percent of the federal poverty level to receive assistance. This is not some conspiracy to exclude the poorest individuals. Rather, it reflects a theory of affordability that recognizes that some people are so low income that demanding any kind of out-of-pocket contribution is infeasible. Instead, the expectation of the ACA is that the poorest people who fall below the poverty level will get a different form of coverage that is less expensive for them through the Medicaid program.

The Medicaid program provides a different way to think about how to serve the lowest-income individuals. In higher education, the federal government supports the poorest students by giving them the largest amount of grant aid. It then hopes that states and institutions will support these individuals but does not actually require them to do so. Medicaid sets much more explicit assistance goals for who must be covered and what types of services they must receive. It then splits the costs of meeting these aims with the states. This creates a sense of shared responsibility for helping the most at-risk individuals.

Medicaid provides health care coverage to more than 71 million Americans.<sup>35</sup> It was signed into law in July 1965, predating the Higher Education Act's November signing by a few months.<sup>36</sup> Medicaid operates as a federal-state partnership, in which the federal government reimburses states for a portion of funds spent. All states and the District of Columbia participate in Medicaid. In exchange for this federal assistance, states must provide at least a defined set of health care benefits to some specific populations. Beyond these parameters, states have significant flexibility both in terms of other benefits offered, groups covered, and even how to finance their share of expenses. As a result, Medicaid varies a great deal from state to state.

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The federal government requires that states use Medicaid at a minimum to provide health care coverage to all individuals who meet certain qualifications. These groups have very specific definitions that are based on financial tests—such as being extremely low income—or individuals’ characteristics—such as being pregnant or disabled. At a significantly simplified level, Medicaid must cover individuals in several main categories: extremely low-income households, pregnant women and children age 18 and under living in low-income households, elderly people who are low-income, or those with significant long-term disabilities. The ACA, meanwhile, allowed states to expand coverage to everyone up to 138 percent of the federal poverty level. Beyond those groups, states have discretion to provide services to other individuals, though in many cases they need a waiver from the federal government to do so.<sup>37</sup> For example, states can choose to cover pregnant women with slightly higher incomes with a waiver.<sup>38</sup>

Medicaid’s notion of extending benefits to the most vulnerable is not that dissimilar from the Pell Grant. Both are targeted programs that direct support to people who have very minimal resources. In the case of Pell Grants, 72 percent of recipients come from households making \$30,000 or less per year.<sup>39</sup> For Medicaid, families qualify for the program if they are at or below 138 percent of the poverty level, which is equal to an annual income of about \$33,465 for a family of four.<sup>40</sup>

But Pell Grants and Medicaid also have several differences. For one, the Pell Grant program sets consistent benefit eligibility across the country—no state can be more or less generous with recipients because the rules for who can receive support are set by federal law. By contrast, states may choose to extend Medicaid eligibility to additional individuals because they are sharing in the cost of the program. While this benefit expansion is a good thing, states may also choose to be less generous. This is particularly a problem in states that did not accept the Medicaid expansion, where coverage of adults without children is extremely low.<sup>41</sup>

Once individuals are eligible for Medicaid, they are guaranteed to receive certain benefits. For example, an individual participating in Medicaid must receive certain services, such as lab, X-ray, or inpatient hospital care.<sup>42</sup> States can, however, choose the exact scope and duration of benefits as long as they do not limit the benefits so much that they would no longer be able to serve their intended purpose.<sup>43</sup> States can also choose to cover certain optional benefits at their discretion if they wish to be more generous.<sup>44</sup>

The guaranteed benefits that come with Medicaid eligibility provide consumers with much more certainty than the federal student aid programs. Students who are eligible for a Pell Grant are not actually entitled to funding beyond the set dollar sum they receive. They are not guaranteed that they will be able to access or afford a college of a certain type or level of quality.

### Federal housing benefits

Federal rental assistance programs also build in concepts of greater generosity for the lowest-income individuals through their eligibility terms. For starters, a family must not earn more than 80 percent of the median income in their city or county to qualify for aid. Income limits are determined for metropolitan areas and counties and are adjusted for family size.<sup>45</sup> But because these programs are not entitlements—a low-income family is not guaranteed to receive support—they also target benefits further. For instance, project-based rental assistance requires that at least 40 percent of units in each development go to families who are extremely low-income—meaning they make no more than 30 percent of the local median income.<sup>46</sup> Tenant-based HCVs are even more targeted—extremely low-income families must receive 75 percent of all new vouchers each year.<sup>47</sup> While this need for greater targeting is mostly a reflection of the disappointing fact that not enough support is available for rental assistance, it does also show a similar commitment to providing as much generosity as possible to the lowest-income individuals.

Overall, both the health care and housing approaches to the most vulnerable populations send a message that there are some levels of income so low that recipients cannot be expected to pay much, if anything.

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### Lesson #3: There are limits to what the federal government will support for affordability

While the federal government has a vested interest in making certain goods and benefits affordable, it does not need to meet this goal for every type of a given product or service. Ensuring affordability for every type of insurance plan, housing structure, or institution of higher education would discourage efforts at cost containment and likely result in the federal government spending more money on expensive options with identical outcomes to cheaper alternatives.

Currently, the federal government does not really consider the question of what should be affordable or where it should limit assistance in its higher education assistance programs. On the first issue, the government uses the same formulas to determine students' benefits regardless of whether they attend a higher- or lower-priced institution. It is, thus, equally willing to subsidize the country's most expensive school as it is the cheapest. In fact, the aid awarding formulas are set so students cannot receive benefits above their level of expenses. This means someone who goes to an expensive college will receive more federal assistance, even though the dollar amounts may be able to purchase a smaller share of a college education.<sup>48</sup>

By contrast, other sectors have very different approaches to affordability limits. In the case of health insurance tax credits, this means attaching benefits only to coverage of a certain level and not increasing support beyond that point. In the housing space, the federal government addresses this issue by setting limits on how much of its income a family can spend and still receive a subsidy.

In the health care sector, the federal government sets its affordability limits in terms of how generous a plan it will guarantee someone can afford. To do this, it attaches the amount of the tax credit to the difference between the second-least expensive silver plan and a set percentage of a family's income. Only for plans of this type and below does the federal government ensure that a set percentage of income will purchase a defined level of benefits. A family can, however, choose a more expensive gold or platinum plan, paying a larger share of their income for premiums because their subsidy does not increase to reflect the higher plan's cost. The credit by no means prevents such a choice, but it does provide a clear understanding that the government is not expected to guarantee affordability for those options.

Similar to health insurance tax credits, federal rental assistance programs attach their benefits to the median rent in an area to ensure housing options will be affordable. This too allows families to choose more expensive housing. But regulations allow them to do this only to a point—families cannot pay more than a certain percentage of their income and still receive assistance.

Federal rental assistance benefits provide families the difference between the fair market rent in their area for the size of house for which they qualify minus 30 percent of their income. Families have the option to choose housing that costs more than the FMR, but then they pay the difference between the amount over the benchmark plus 30 percent of their income.<sup>49</sup> For example, the FMR in Washington, D.C., for a family of four in a three-bedroom home is \$1,951. That

is the maximum subsidy a family in the region could receive toward the cost of housing. If the family chooses housing that costs more than \$1,951, the family would pay more toward rent.

Families cannot, however, use vouchers for any housing above the FMR where they would pay more than 40 percent of their income in their first year of renting.<sup>50</sup> This ensures families choose a home that is affordable for their income and that subsidies do not cover overly expensive homes.

The concepts described above could apply to higher education in several ways. For instance, Congress could require that benefits be sufficient to afford a set percentage of the price of a public four-year college in each state. This would allow students who attend a community college to cover a larger percentage of their costs, while those who choose private colleges would not have any guarantees or expectations that their education would be affordable. Alternatively, affordability limitations could be applied to the debt levels so that institutions cannot load students with loans beyond a certain point of indebtedness relative to their future income. As the next lesson shows, this is just one way to tackle the question of affordability in a debt-based financing mechanism.

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## Lesson #4: There are affordability standards for debt

The federal government often helps individuals afford products and services with debt financing. In the case of higher education, it provides students with low-cost loans that are repaid to the government. For housing, the government provides insurance to encourage companies to issue mortgages and sets standards to protect borrowers from some of the unscrupulous behavior observed during the Great Recession.

The federal government must be very careful when it provides access to debt. While leverage can help individuals access a home or an education that they might not otherwise be able to afford, it also adds risks. This is not a problem if these individuals easily repay their loans, but it matters a lot if they fall behind or default, which can have disastrous financial consequences.

## Federal higher education debt

In higher education, the government limits access to loans strictly in dollar terms. For undergraduate borrowers, it sets annual and lifetime loan limits based on a student's year in school. These cumulative limits are \$31,000 for dependent students and \$57,500 for independent students.<sup>51</sup> Meanwhile, both graduate and parent borrowers have largely unlimited access to debt. As long as they can pass a minimal consideration of past credit history, they are allowed to borrow any amount up to an institution's cost of attendance.

## How federally guaranteed mortgages approach indebtedness

The housing sector takes a much different approach to debt. While it too has dollar-based limits, the housing sector also sets affordability standards in terms of debt relative to income in order to protect borrowers from ending up with mortgages they are unlikely to repay. Neither of these steps prevents someone from finding a loan that appears unaffordable, but it limits how much the federal government will become involved in mortgages that appear to be overly risky.

The Federal Housing Administration, or FHA, is the best example of how the federal government approaches affordability in other debt programs. Congress created the FHA in 1934 after the Great Depression. Its goal is to improve housing standards, provide an adequate home financing system through insured home mortgage loans, and stabilize the housing market.<sup>52</sup> When FHA was created, only 40 percent of households could afford to own their home.<sup>53</sup> The majority of families could not meet the strict mortgage loan terms: down payments equal to 50 percent of the property's market value and repayment schedules of only three to five years ending with a balloon payment.<sup>54</sup>

The FHA attempts to increase homeownership by providing insurance for private lenders to issue mortgages. The insurance provides private lenders with full protection against losses if a buyer defaults on a loan. In most cases, if a borrower defaults, the FHA pays the lender the remaining principal owed. Because the government provides insurance and lessens the risk to private lenders, lenders can offer loans with more accessible terms to buyers who would not otherwise qualify. Since its start, the program has insured more than 34 million homes, allowing the United States to achieve a homeownership rate of 68 percent—one of the highest rates in the world.<sup>55</sup> Today, approximately 4.8 million single-family mortgages are FHA insured.<sup>56</sup>

What makes FHA mortgages interesting from an affordability standpoint is they are capped in absolute terms and relative to a buyer's income. The exact amount that can be lent varies by locality but has a national ceiling that cannot be surpassed. For high-cost areas such as Washington, D.C., the cap is at the national maximum of \$625,500; for the lowest-cost areas, the cap is \$271,050.<sup>57</sup> In addition to these maximum limits, the FHA also limits mortgage sizes based upon the family's debt-to-income ratio. This test looks at all debt—not only the mortgage amount. In general, FHA will not allow a mortgage in which payments exceed 31 percent of a family's income or where the combination of the mortgage and other debt exceeds 43 percent of income.<sup>58</sup>

The higher education market recently incorporated a similar concept of debt-to-earnings rates for loan eligibility through a regulation known as gainful employment. Issued by the U.S. Department of Education in 2014, it requires career-oriented programs to ensure that graduates who received federal aid have debt payments that are equal to or less than 8 percent of their annual income. Programs that cannot maintain this threshold risk losing access to federal student aid. The difference between gainful employment and the FHA's mortgage process, however, is that gainful employment looks at the results after the fact to ensure debts were not too high, while the FHA simply would not have insured the loan at the outset.

Even outside of the gainful employment context, the upfront affordability requirements considered by the FHA could be implemented in two other ways in the student loan programs. First, affordability benchmarks could be used to establish risk-sharing requirements, in which colleges would be on the hook for a larger share of unaffordable debt burdens that become delinquent, default, or are not repaid. Second, for parents who take out federal loans, affordability requirements could be similar to those used for housing—parents would be unable to borrow amounts for which their monthly payments would be greater than a certain share of their income. Regardless of structure, adding these requirements would allow students and parents to acquire some debt, while preventing colleges from burdening them with too much debt without sharing the risk.

Importantly, limitations on debt based upon the student would not work in higher education. The undergraduate loan limits already serve as a good check on preventing egregious debt levels in absolute terms. In addition, most students lack the credit or income history to gauge proper limits. Unlike a mortgage, where the purchaser's income is likely to stay constant or grow at a relatively stable rate, someone who gets a good college education should expect to see fairly steep income increases in the years after graduation. The result is that the maximum amount of reasonable debt upfront may end up being easily repaid after a few years in the workplace.

## Mortgage affordability after the financial crisis

Additional new rules relating to mortgages provide another way to add affordability protections to student loans. These rules establish a qualified mortgage, which encourages lenders to offer loans with certain protections and reasonable terms. The idea arose from the mortgage crisis, when it became clear lenders did not bear enough responsibility for offering unaffordable loans to homebuyers. To address this issue, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2008. The bill required all creditors to make a reasonable, good-faith determination of a consumer's ability to repay a homeowners' mortgage.

In 2013, the Consumer Financial Protection Bureau issued a rule further implementing ability-to-repay requirements and established the concept of a qualified mortgage.<sup>59</sup> The basic idea is to create greater legal protections for lenders that offer affordable products without undesirable features, while raising the risk for companies whose loans do not meet these terms.

The most important requirement for a loan to be a qualified mortgage is that it takes into consideration a buyer's ability to repay the loan.<sup>60</sup> This analysis must consider not only the cost of the mortgage but also other debts a buyer holds. To be a qualified mortgage, the payments on the loan plus other debts cannot exceed 43 percent of the buyer's pretax income.<sup>61</sup> This provision discourages lenders from offering excessive amounts of debt to people who likely cannot afford them. In addition, the loan itself cannot have risky features associated with deceptive practices, such as temporarily low interest rates that will rise over time, hidden fees, or mandatory arbitration clauses.<sup>62</sup>

Whether a lender offers a qualifying mortgage matters for how a court assesses a company's compliance with ability-to-pay standards. Offering a qualified mortgage gives a lender some protection against consumer lawsuits that allege the lender violated ability-to-repay requirements. Lenders that offer low-cost qualified mortgages have a safe harbor. This means that in the case of a lawsuit, the court presumes the lender has complied with ability-to-repay requirements, providing the lender with greater leverage in the case.<sup>63</sup> This does not mean that lenders cannot issue nonqualified mortgages, but it does provide an encouragement for offering these debts.

Applying the concept of qualified mortgages to student loans has interesting implications for higher education affordability. In 2013, the Center for American Progress discussed this issue in the context of private student loans.<sup>64</sup> But the idea could work for colleges, as well. For example, the federal government could establish rules that affect how much risk an institution has to bear based upon the amount of debt it offers certain students or the ratio of student debt to postcollege income. Schools that stay below a set threshold would have to share in little to no risk, while those above the benchmark would bear more risk. The basic idea would be the same—institutions that do well by students on specific clear metrics would have greater protections than those for whom excessive debt is the norm.

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## Lesson #5: Make affordability a shared goal

The federal student aid programs are unilateral investments. The federal government covers the entire cost of the benefits it provides to students via institutions. Operationally, this makes the programs easier to administer because they do not require relationships in every single state. It also ensures that students receive equitable benefits regardless of where they live.

A unilateral approach to higher education affordability also has significant drawbacks for the federal government. In particular, it means the federal government cannot leverage partnerships with states and institutions to make them do their part in keeping costs down. Instead, when states and institutions cut their own funding, the federal government steps in as a safety net for students. The additional grants and loans the government provided when states aggressively slashed funding during the Great Recession helped millions of students afford education that would otherwise likely have been too costly. Unfortunately, by placing no requirements on the states and institutions that also benefit from federal aid, the government puts itself in a position in which its programs can be taken advantage of, allowing states and schools to supplant their own funding. When this occurs, the costs of subsidizing higher education directly transfer from the state and institution to the student and the federal government.

To be clear, the issue at stake here is distinct from the argument that some make about how federal student aid directly leads to tuition increases. That theory, known as the Bennett Hypothesis, alleges that institutions intentionally raise prices as a way of capturing increases in financial aid revenue.<sup>65</sup> This formulation is a misunderstanding of the dynamics behind higher education funding. For one, federal

student aid has not risen nearly as much as tuition. Undergraduate federal student loan limits have not increased since 2008. And before that, they had not changed since 1994 for anyone other than first-year students.<sup>66</sup> The Pell Grant does increase each year by a few dozen dollars, but this is far below the annual rise in tuition and is not available for all students. While higher education tax benefits also increased by about \$700 since 2008, this is still well below the rise in tuitions.<sup>67</sup>

Rather, the issue at play is a question of who should be responsible for subsidizing public higher education. For decades, the answer to this question was the states, with the federal government providing some support for the lowest-income students, and everyone else paid out of pocket. While state subsidies still exist today, they are significantly diminished. In many ways, this is the same pattern that repeats itself elsewhere in the social safety net, where states have decimated funding for goods and services such as support for low-income families.<sup>68</sup> In the case of higher education, however, the federal government has done more to assist students and fill the gap created by declines in state funding. The end result of this is a cost shift away from states and toward students and the federal government. Thus, rather than being the engine of state cuts, federal student aid has become the safety net that so many other parts of the social benefit structure lack.

While having the federal government fill in the funding gaps left by state cuts is not ideal, it is particularly problematic in higher education because much of the backfilling is done with debt. Paying for college with loans raises the long-term price of college for students since they must repay what they borrow plus interest. Debt also increases the risk to attempt college. If students do not complete college or attend a poor-quality program, they may not receive the income gains necessary to make the loan proposition work. For these people, debt can become unmanageable, leading to default and dire financial consequences such as wage garnishment.

Fortunately, the significant size of the federal investments in postsecondary education presents an opportunity to change these dynamics. Moving away from federal financial aid as a unilateral investment and toward a system that creates shared requirements between states, institutions, and the federal government presents the best opportunity for guaranteeing postsecondary affordability. Rather than treating financial aid as a price driver, policymakers need to recognize its place as the nation's single best tool for keeping costs reasonable.

There are several ways the federal government could use its financial aid programs to play a more active role in affordability. In particular, two examples from the health care coverage and insurance space stand out: Medicaid and the employer mandate from the ACA.

Rather than treating financial aid as a price driver, policymakers need to recognize its place as the nation's single best tool for keeping costs reasonable.

## Shared affordability through Medicaid

As noted earlier, states that participate in Medicaid are required to cover certain populations and share in the expense of coverage. The way this cost sharing actually works is as an open-ended reimbursement program. The state spends money on allowable Medicaid expenses, and then the federal government reimburses part of the cost. Importantly, there is no hard cap on spending. States that are willing to expand their eligibility and thus provide better benefits to more people receive additional federal support to make it workable.

A state's reimbursement rate under Medicaid is dictated primarily by the Federal Medical Assistance Percentage, or FMAP, rate, though additional formulas may apply under certain exceptions.<sup>69</sup> The FMAP formula takes into account the relationship between a given state's per-capita income and national per-capita income.<sup>70</sup> By law, the FMAP cannot be lower than 50 percent—meaning that the federal government evenly shares the cost of every expense with a state—or higher than 83 percent—meaning that for every \$1 the state spends, it gets all but 17 cents back.<sup>71</sup> Mississippi had the highest FMAP rate in 2015 at 73.58 percent, while 13 states had a rate of 50 percent.<sup>72</sup>

The FMAP structure shows a way to share the costs of affordability across states that have radically different levels of affluence. Rather than holding every state to identical standards, the varying reimbursement rate allows the federal government to pick up a larger share of the costs for states that cannot afford to pay, while providing less assistance to those with more wealth. This is essentially the same way the federal government approaches benefits for individuals, with the amount of help declining as wealth rises.

The payment structures for Medicaid and federal higher education benefits create very different incentives. By reimbursing states for costs incurred, Medicaid encourages states to be more generous, but it also makes them share the burden of additional costs as a way of discouraging overly profligate spending. This type of funding model could be one way to get states to reinvest in higher education. It bears some similarity to an idea suggested by the American Association of State Colleges and Universities, which would create a new federal funding stream that rewards states with additional dollars, depending on how much they spend on a per-student basis.<sup>73</sup> As states spend more, they would receive additional dollars, creating a similar incentive for greater generosity.

It is possible to incorporate similar principles from the Medicaid program into federal student aid even without a new funding stream. Congress could change the programs to introduce a more formal role and set of expectations for states. Under this structure, states would have to commit to making higher education affordable for Pell Grant recipients and share in the cost of doing so. Similar to Medicaid, this structure would require states to focus efforts on supporting the lowest-income recipients through a shared funding model.

While the Medicaid model represents a collaborative approach to tackling affordability through increased funding, other health care examples suggest ways to address the same challenge with accountability. This would be particularly effective for thinking of ways to make institutions play a greater role in offering affordable products. Recognizing that not all schools have their own aid to use or set their own tuition, starting accountability with colleges could also be a way to spur state action.

### ACA's employer mandate

The ACA's employer requirements for health insurance coverage provide an example of how accountability can create shared affordability. Basically, the ACA requires employers bigger than a certain size to offer employees coverage of a minimum benefit and cost level. These conditions apply only to companies that employ the equivalent of 50 or more full-time employees.<sup>74</sup>

The shared responsibility provisions serve as a way to hold larger employers monetarily accountable for not offering acceptable health care coverage. To avoid these penalties, an employer's plan must provide minimum essential coverage, at least 60 percent of benefit costs.<sup>75</sup> Employers must also offer coverage to at least 95 percent of their full-time employees and ensure the premiums do not exceed 9.5 percent of an employee's annual income.<sup>76</sup> Meeting these conditions is important—the penalties are triggered if even one full-time employee receives a premium tax credit.<sup>77</sup>

This framework establishes a strong message that employers have a responsibility to keep their coverage affordable and their employees off the individual market. Failure to do so can have significant financial consequences. Employers that do not offer coverage to enough employees are assessed a penalty equal to \$2,000 multiplied by their number of full-time employees. Additionally, if an employer offers unaffordable coverage that results in an employee receiving a premium tax credit, the fine increases to \$3,000 per person. These fines are not based on the number of employees getting a credit or not getting coverage; rather, a single unacceptable instance results in a cost based upon all full-time employees.<sup>78</sup>

The requirements for employers to provide insurance coverage can be applied to accountability for colleges. Institutions that lead students into unaffordable levels of debt are failing in their responsibilities the same way employers with unacceptable insurance coverage do. But instead of fining colleges, institutions with unaffordable debt levels could be prohibited from participating in the federal aid programs or required to share in more of the risk when borrowers with excessive loan balances struggle. The former case would be similar to expanding the existing gainful employment regulation that holds career training programs accountable for the debts of graduates versus their earnings. In the latter, it would mean that the more unaffordable the debt levels become, the more an institution would pay to the federal government each time a borrower struggles.

The benefit of the risk-sharing approach is that institutions would have to contribute funds only if elevated debt levels became problematic. This protects institutions with good outcomes from facing sanctions while sending a strong signal about the connection between debt and performance. An initial focus on performance also means penalties could be intensified over time.

In establishing a risk-sharing system, the federal government should consider the choices about differentiated accountability that are present in the ACA. For instance, a risk-sharing system should draw distinctions in requirements based upon the size of the institution, including the number of borrowers and amount of debt received. This protects the smallest institutions because it may not be feasible to expect from them the same results as large universities.

Regardless of whether through a reimbursement-style reward or risk-sharing accountability, the lessons from health care demonstrate one strong lesson: Affordability is too complex a problem to rely solely on solutions from the federal government. It will be impossible to lower prices, increase value, and keep debt levels in check without creating incentives for everyone involved in affecting those results.

Affordability is too complex a problem to rely solely on solutions from the federal government.

# Potential downsides of affordability

The lessons illustrate five useful strategies for tackling higher education affordability. This includes relying on clear benchmarks for determining how much assistance to provide and creating shared responsibility for keeping benefits in reach. This does not, however, mean every social support program from other sectors has a perfect structure that should be adopted in federal aid programs. In fact, looking closely at other programs raises several concerns that must be thought through before making changes in the student programs: ensuring benefit levels and funding are sufficient to avoid rationing, addressing all costs that might be barriers to affordability, requiring family contributions that recipients believe are manageable, and acknowledging that supporting only products and services that meet certain requirements can be difficult if they change over time.

Achieving  
affordability  
requires providing  
sufficient support  
for everyone who  
needs it.

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## Concern #1: Unavailability undermines affordability

Achieving affordability is not just about providing sufficient benefits for an individual—it requires providing sufficient support for everyone who needs it. Not assisting enough qualified individuals can undermine the goals of a program because it means recipients will not be certain of getting the help they need.

The Pell Grant fares extremely well in terms of availability. Any student who applies for aid and meets the eligibility terms is guaranteed to receive support. This is true whether the student is the first or the 8,000,000th person to apply. This dependability is crucial for building trust in the program and convincing young families they will receive help paying for college.

This concern of availability within affordability also relates to where recipients can actually use their benefits. For instance, a program that covers all eligible individuals but lets them participate only at sites that are geographically distant is not really an affordable program. After all, lower-income individuals may not be able to afford the time and money needed to get to the places where their benefits are accepted.

The issue of local availability is a particular concern in the Medicaid program. While Medicaid requires states to provide recipients some freedom to choose among different health care providers, beneficiaries can have trouble finding a doctor or dentist willing to serve them.<sup>79</sup> Being unable to actually use Medicaid benefits can weaken its goal of keeping individuals and families healthy.

The federal aid programs, however, excel at having options for students. Financial aid can be used at any of the more than 7,000 participating colleges, as long as the institution accepts the student.<sup>80</sup> Recipients can use their benefits to attend colleges in other states, whereas Medicaid covers costs in other states only under certain circumstances.<sup>81</sup>

That said, the actual ability of students to choose among many institutions may be overstated. In general, poorer students are much more likely to choose higher education institutions close to their home, especially if they attend a community college.<sup>82</sup> Similarly, adult or working students who already have established professional or family lives are unlikely to pursue postsecondary options that are far away. And even setting aside geographic concerns, institutions that cost more than the available benefits may be so out of reach that they are not actually a viable college choice.

In other cases, federal benefit programs may not be funded well enough that they are guaranteed to be available for everyone who needs them. This is particularly an issue in the federal rental assistance programs. It is not uncommon for a family to spend months and even years on a waitlist before receiving help through these programs. While federal rental assistance subsidies currently help more than 5 million households, it is estimated that figure represents only 25 percent of those who could be eligible for such help.<sup>83</sup> Once families get off the waitlist, the housing where they can use their benefits may not be in neighborhoods that are best for children.<sup>84</sup>

Problems with rental assistance availability will likely continue to get worse as demand for low-income housing has grown while funding for these programs has stalled in recent years.<sup>85</sup> Budget cuts stemming from sequestration in 2013 resulted in millions of fewer dollars available for low-income housing programs and a reduction in the number of families assisted by the program. While Congress restored some of the funding in 2014, the program still does not have enough money to provide for all families that need affordable housing.<sup>86</sup>

All of this suggests that any rethinking of affordability benefits needs to strike a balance between robust choice for the beneficiary and sufficiency to achieve its intended aims. The rental assistance programs have clear goals to make sure benefits are sufficient but do not pay enough attention to choice and widespread availability. Medicaid falls in the middle, with some thought paid to choice but gaps that need to be filled. In the case of federal student aid, there is, arguably, too large a focus entirely on choice with no consideration of sufficiency. While there is not necessarily a perfect answer to these challenges, they need greater consideration in the federal aid programs.

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## Concern #2: Affordability has multiple elements

Most discussions about college affordability are actually focused on the price students must pay an institution to attend. But looking at only these direct costs misses a big portion of the affordability challenge. Consider, for example, California community colleges: These institutions are essentially free for most students.<sup>87</sup> But the students who go there still must find ways to cover their housing, transportation, food, and possibly child care to attend. These are thousands of dollars in costs and cannot be ignored. After all, students who cannot pay to fix the broken car on which they rely to get to school may be at just as high a risk of dropping out as students who struggle academically.

The federal student aid programs partially consider the additional costs that must be covered to make college affordable. On the positive side, federal benefits can be used to pay for nondirect expenses, such as living costs. This allows students who attend a less expensive college to potentially receive more assistance covering these necessities. At the same time, because federal college benefits are not connected to any affordability metric, there is no guarantee a student's institution will be cheap enough to have money left over for living. As a result, students' ability to afford all expenses associated with an educational program varies a great deal by where they happen to live and study.

## The costs of using health insurance

The challenge of addressing affordability beyond the direct cost of the item purchased is particularly present in the health care context. In this area, the issue is that the monthly premiums are just one health-related cost consumers must manage.

In the case of federal student aid, there is, arguably, too large a focus entirely on choice with no consideration of sufficiency.

Out-of-pocket spending for prescriptions or copays for doctor visits also need to be affordable because any plan for which someone can afford the premiums but not the per-visit costs proves to be insufficient for care except catastrophic incidents.

The ACA tried to address these additional affordability challenges through two provisions. First, it capped the out-of-pocket cost to consumers on the ACA exchange to \$6,450 per year for services covered by their plan; the family cap is \$12,900.<sup>88</sup> Families that make between 100 percent and 250 percent of the poverty level have an even lower cap of \$2,250 to \$5,200.<sup>89</sup>

The second provision gave additional subsidies to increase the actuarial value of silver plans for low-income people. It does this by increasing the actuarial value so that the lowest-income individuals will, on average, pay even less than 30 percent of costs. Someone between 100 and 150 percent of the poverty level cannot be charged an actuarial value for a silver plan below 94 percent—meaning the individual is responsible for 6 percent of costs. Families with incomes between 150 percent and 200 percent of the poverty level are guaranteed an actuarial value of 87 percent, while those between 200 percent and 250 percent are promised 73 percent.<sup>90</sup> These requirements provide a way to further decrease other health care costs, such as deductibles, coinsurance, or other payments.

These cost-sharing requirements also have implications for choice. They nudge families to pick silver plans because those who choose less generous options—such as a bronze plan—or top-tier options—such as a platinum plan—do not get the increase in actuarial value. This change does not restrict choice, but it provides greater guidance for individuals who may be unsure which plan to choose. This setup also involves danger. A family that does not understand the nudge may end up making a significant mistake, choosing to pay a bit less each month for a bronze plan even though the reduced cost sharing of a silver plan more than offsets the difference in premiums.

In Medicaid, the process of dealing with additional costs is more straightforward. Under program rules, only higher-income Medicaid participants can be charged monthly premiums.<sup>91</sup> And while states can charge participants when they access health care in the form of copayments, deductibles, etc., these amounts must be kept small, with poorer individuals charged less. Overall, the participants' share of costs must generally stay below 5 percent of their income.<sup>92</sup>

Making nonacademic costs affordable in higher education is one of the most vexing problems facing the sector today. It is increasingly suggested that living costs cannot be ignored when trying to address college affordability and completion. But living costs are also quite high, and expanding benefits to cover all of these expenses would be unaffordable. Greater standardization or consistency in estimating the size of these costs would be a good first step. Currently, colleges can set their own estimates of living expenses, resulting in a lot of inconsistency: Colleges located near each other have come up with radically different numbers.<sup>93</sup> Taking a more rational and consistent approach to these costs would at least start the process of understanding what kind of gaps need to be filled and the possible strategies for addressing them.

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### Concern #3: Spending requirements for families must feel affordable

Establishing affordability benchmarks is important for giving families a sense of certainty about what they will have to pay. If, however, these thresholds are set too high, they seem so unaffordable that the certainty value is lost.

A potential example of this problem already exists in the federal student loan programs. Right now, struggling borrowers are able to reduce their loan payments to no more than 10 percent of their discretionary income. As a percentage of their overall income, this proportion is much lower. This is because discretionary earnings represent an individual's income minus estimates of necessary expenses such as housing and food. But if borrowers do not understand the concept of discretionary income, then 10 percent may feel far too high as a repayment expectation.

Similarly, if the amount of money a family is expected to pay out of pocket is too high, then a guarantee may not feel generous enough to be meaningful. Consider, for example, a family that makes 300 percent of the poverty level and receives an ACA tax credit. Paying a little more than 9.5 percent of the family income may seem affordable in the abstract, but if that family has a lot of additional debt, then it may not be a low enough figure to be workable.

The challenge of setting thresholds that seem affordable is further complicated by the fact that many of the numbers chosen are the result of political calculations of what Congress can afford based on available funds. This means a given benchmark may be less a reflection of an objectively determined number and more a reality of the lowest that could be agreed upon.

If the amount of money a family is expected to pay out of pocket is too high, then a guarantee may not feel generous enough to be meaningful.

All of this means that any approach to threshold setting in higher education must strive to find clear numbers based upon objective assessments of what families can pay. Missing the mark can weaken the effectiveness of any new benchmarks.

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#### Concern #4: What meets affordability standards can change

Setting affordability goals through benchmarks and subsidizing options that meet certain conditions is one way to ensure that federal programs meet their intended goals. But one challenge with such an approach is that options are not static—a provider that meets the benchmarks today might change and no longer meet the benchmark tomorrow. For instance, a college that was affordable may raise its prices, or a high-quality program may get a new owner and not perform as well.

Making it possible for the options that qualify under certain affordability standards to change can be good for products and services that need to be bought every year, such as health insurance. In health care, because plan premiums generally change annually, there is no guarantee the previous year's second-lowest-cost silver plan will hold the same position the following year. The positive result is that consumers are encouraged to continue shopping for affordable coverage, which encourages greater competition and—it is hoped—better products for consumers. On the downside, switching plans could be inconvenient if the plans have different networks of doctors and hospitals.

Efforts at higher education affordability would do well to avoid this problem of changing eligibility if at all possible. Students attend college only for a few years, and transferring can result in lost academic credits or other adjustments that make it difficult to graduate on time. Given these considerations, the benefits of comparison shopping that come from changing what is eligible are more than outweighed by the costs of transferring. Because of this, the best way to handle changes in eligibility over time is by applying them only to new students. Doing so allows students to stick with their chosen school until they finish their education.

# Recommendations

The federal investment in higher education is designed to correct a failure in the market. Without government support, millions of low- and middle-income families across the country would be unable to access and afford a postsecondary education. The result would be lower levels of educational attainment, a less-skilled workforce, and depressed economic growth.

At the same time, the government cannot ignore the return on its investments. As stewards of taxpayer dollars, it has a fiduciary responsibility to make sure money is well spent and achieves its desired aims. It cannot simply spend an infinite amount of money to fix the market failure in higher education.

Unfortunately, the current construction of the federal aid system is insufficiently concerned with what its dollars buy and how states and institutions use them. As a result, it becomes far too easy for the purchasing power of federal grants and loans to be diminished by unabated tuition increases brought on by reductions in state funding.

To fix these problems, the federal government should build upon the strategies already developed to tackle these same challenges in other key areas. In particular, it should do the following:

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## Create a guarantee of no- or low-cost public education for Pell Grant recipients

Pell Grant recipients are the lowest-income individuals in higher education. They simply cannot afford to be charged thousands of dollars for college and shoulder massive debt burdens. Yet the current Pell Grant program contains no protections to ensure that even the absolute poorest individuals—those receiving the maximum award—have an expectation that the colleges enrolling them will charge a reasonable price. That needs to change. Much like the federal health

care benefits system sets standards for what low-income recipients can pay out of pocket, the Pell Grant program should establish similar requirements. This should start with guaranteeing Pell Grant recipients can use their funds to purchase a public in-state education for an amount that is equal or close to free.

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### Create purchasing guarantees for middle-income students

Just because someone is not a Pell Grant recipient does not mean they should lose any sort of guarantee about affordability. For these individuals, their guarantee should be framed in terms of knowing that a reasonable family contribution coupled with small loans will be sufficient to cover the entire cost of an in-state public education. Such a system mirrors the structure of the ACA tax credits—middle-income individuals are still expected to contribute out of pocket, but they know that contribution will be enough to buy what they need.

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### Require states to meet affordability targets

The two recommendations above will work only if states do their part to keep the gaps that federal aid fills at a reasonable size. Doing so means setting expectations that are tied, not to per-pupil spending amounts, but to the back-end price faced by students after subtracting other forms of nonfederal financial aid and the family contribution. This approach gives states many paths to meeting the goal. They could increase operating support to keep tuition low; raise financial aid to target subsidies to lower-income students; pursue innovative strategies that reduce the expense of providing an education; or some combination of these approaches. These requirements would be conceptually similar to the state relationship in Medicaid, in which participating states would have to meet minimum expectations for which students receive what kinds of assistance, with flexibility for states to be more generous if they desire.

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### Hold colleges accountable for excessive loan burdens

Both the health care and housing sectors recognize the risk of high prices and/or debt and take steps to mitigate those challenges. In health care, this means establishing penalties for large employers that provide insufficient coverage. In housing, it means not providing subsidies for properties that would be too expensive relative to a recipient's income or holding lenders accountable for offering unaffordable loans.

Higher education would benefit from embracing similar concepts. Colleges that regularly ask their students to take on unreasonable debt burdens—as measured relative to some expectation of economic return—should no longer continue to do so with impunity. Rather, those whose debt is out of control should face greater risks for their actions. This could take the form of making colleges with higher debt burdens be accountable for a larger portion of loans that perform poorly or revoking the right to offer loans for some or all programs at a school where debt gets too high.

# Conclusion

Federal higher education benefits are crucial investments for securing the country's future economic competitiveness. But for far too many students, the financial aid programs fail to meet their goal of making college more affordable.

An in-depth review of other federal benefit programs in health care and housing provides valuable lessons for rethinking higher education benefits. These programs are structured in a way that guarantees that money provided to individuals will be enough to meet costs. But they also hold other parties accountable to ensure recipients are not being charged more than they can actually afford.

As detailed in this report, there are several options policymakers could take to ensure that investments guarantee affordability, simplicity, and certainty for students and families. To accomplish this goal, an affordability guarantee must create clear expectations that financial aid dollars will cover the cost of college, that states cannot continue to pull money away from public colleges, and that institutions will be held accountable for high tuition and burdening students with too much debt.

In order to achieve their true aim and full potential, it is time for federal higher education benefits to not just be denominated in dollars but instead guarantee affordability and access for the most vulnerable individuals.

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